SLAUGHTER AND MAY/

NEWSLETTER

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PENSIONS BULLETIN

QUICK LINKS

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In this month's Pensions Bulletin, we cover:

1. New draft legislation to abolish the pensions lifetime allowance (LTA) and set out the tax treatment of lump sums and lump sum death benefits in place of the LTA.
2. A High Court decision that a restriction on an amendment power operated to protect future service benefits for active members, rather than past service benefits alone.
3. A decision of the Upper Tribunal on the anti-avoidance powers of the Pensions Regulator (TPR) to issue Contribution Notices, including confirmation that the amount need not be limited to the financial loss to the scheme.
4. Updated interim TPR guidance on DB superfunds, relaxing some aspects of the "gateway" tests for prospective ceding trustees and employers.
5. Guidance from TPR on trustees' duties in relation to pensions dashboards, following the removal of the connection timeline and replacement by a single deadline with staging to be set out in guidance.

We include our regular watch list of current and future developments.

ABOLITION OF LIFETIME ALLOWANCE AND INTRODUCTION OF NEW TAX-FREE CASH ALLOWANCES

As part of the package of measures outlined in the Budget 2023 and subsequent Finance (No. 2) Act 2023, the pensions lifetime allowance (LTA) charge was removed from 6 April 2023 but the LTA framework remained in place for the tax year 2023/24. New draft legislation published by HMRC will abolish the LTA and set out the tax treatment of lump sums and lump sum death benefits in place of the LTA.

HMRC has published the draft legislation abolishing the LTA, for inclusion in the 2023/24 Finance Bill. Technical consultation on this will end on 12 September 2023 and HMRC says the changes will take effect on 6 April 2024. The main provisions in the draft legislation are two new individual "tax-free lump sum allowances", applied per person and not per scheme, from 6 April 2024, being:

- **"Lump sum allowance":** a fixed limit of £268,275 (25% of the current LTA) on the tax-free cash that can be taken from certain lump sums in life. This includes tax-free cash from pension commencement lump sums (PCLS) and uncrystallised funds pension lump sums, which were previously tested against the LTA, but also from trivial commutation, small lump sums and winding-up lump sums with uncrystallised rights – these were not previously tested against the LTA, and did not have to be reported.
- **"Lump sum and death benefit allowance":** a fixed limit of £1,073,100 (the current LTA) on the tax-free cash that can be paid in life and death.

Only lump sums will use up these new allowances, not regular pensions. This is a key difference from the LTA where crystallised pensions and lump sums were all tested. There will be no age-related tests.

To the extent that payment of a lump sum takes the total over an allowance, individual recipients are taxed on the excess at their marginal rate of income tax. (Under the LTA regime, a 55% charge was payable.) For both allowances, those with valid LTA protection and/or lump sum protections will retain their rights to the higher protected amounts. Eligible individuals will be given until 5 April 2025 to apply for Fixed Protection 2016 and Individual Protection 2016.

One source of confusion for DB schemes is that the current drafting suggests that there is no limit on the monetary amount of PCLS that can be an authorised payment. Only a maximum of 25% of the total value of the pension and lump sum can be paid tax free; an additional PCLS can be paid but would be subject to income tax. This would appear to give scope for members of DB schemes to take most of their benefit as lump sum. However, a subsequent HMRC newsletter states that "*it is not the government's intention to significantly expand pension freedoms*", which suggests that this aspect may be further amended.

In a change for members with DC benefits, the policy paper suggests that pensions from uncrystallised funds on death before age 75 will no longer be excluded from marginal rate income tax. Also, lump sum death benefits that relate to already crystallised pensions (e.g. flexi-access drawdown fund lump sum death benefits) on death before age 75, where paid within the two year period, will be tested against the new limit. Income tax will be payable on any excess, where there would have been no income tax or LTA charge payable under the LTA regime.

Further draft legislation is expected in due course covering transitional issues, international elements and some aspects of taxation of survivor pensions in DC arrangements.

Next steps for employers and trustees: Trustees should check with the administrator that they are starting to plan for the changes, although there is still considerable uncertainty, in particular how the old LTA system will fit with the new lump sum allowances. It is expected that this will be complex, not least because different data will be required going forward. Trustees should consider what information about the changes should be included in member communications. Trust deeds and rules should be reviewed for the potential impact of the changes. For example, in circumstances where the employer and the trustees are open to benefit accrual recommencing, there may be provisions that restrict members with certain tax protections from recommencing benefit accrual.

HIGH COURT GIVES WIDE MEANING TO RESTRICTION ON AMENDMENT POWER

In BBC v BBC Pension Trust Limited, the High Court found that a restriction on an amendment power, whereby no modification should take effect as regards active members "whose interests are certified by the Actuary to be affected", operated so as to protect future service benefits for active members, rather than past service benefits alone.

Facts: The employer asked the Court for clarification on the correct interpretation of the scheme amendment power, asking, in effect, how it could be used to change the benefits active members might receive for future service or to increase their contributions. The amendment power gave the trustee, provided it acted with the consent of the employer, power to "*alter or modify any of the trusts, powers or provisions of the Trust Deed or the Rules*". The amendment power was subject to fetters, including a proviso that no alteration or modification should take effect as regards active members "*whose interests are certified by the Actuary to be affected thereby*" unless certain criteria were fulfilled, which (broadly) were designed to ensure that the relevant interests were not substantially prejudiced.

Decision: The Court found that in context "interests" could encompass future service benefits. As a matter of ordinary language, the concept of interests did not suggest a division between benefits already earned by past service and those yet to be earned in the future. The focus should be on the position the active members had under the Deed and Rules as they stood prior to the proposed amendment, compared to their intended position if the proposed amendment came into effect. If their positions were different, then it was inescapable that their "interests" were "affected". Even if benefits earned were left entirely intact, the Deed and Rules might nonetheless be amended in a manner which put the active members in a different and potentially worse position for the future. If that happened, the Judge found it difficult to see on what basis it could be said that their interests were not affected.

The Court found that "interests" was sufficiently broad to include:

- the rights earned by past service up to the date of any amendment;
- any linkage of the value of those past service rights to final salary;
- the ability of members to accrue future service benefits under the scheme on the same terms as provided for under the scheme immediately before the amendment; and
- the ability of members to accrue future service benefits on any terms under the scheme. This included the scheme being closed to future accruals. Members' "interests" included the terms of the Deed and Rules not changing in a manner that affected the basis on which they accrued benefits in the future.

Next steps for employers and trustees: Whilst subtle differences in the wording of amendment powers in scheme rules can give rise to significant differences in their interpretation, trustees and employers with similar restrictions on the amendment power in their scheme rules to those in the BBC scheme will want to consider this judgment carefully.

THE PENSIONS REGULATOR'S DECISION TO ISSUE CONTRIBUTION NOTICE WAS REASONABLE

Shah v The Pensions Regulator is the first substantive decision of the Upper Tribunal concerning the powers under Section 38 of the Pensions Act 2004 for the Pensions Regulator (TPR) to issue a Contribution Notice (CN). The Tribunal decided that it was reasonable for TPR to issue a CN for £1.875m to an individual who had been the former owner of a business with a defined benefit pension scheme, notwithstanding his purported inability to pay. In terms of the decision's wider significance, the Tribunal also confirmed that the amount of a CN need not be limited to the financial loss to the scheme.

In broad terms, Section 38 of the Pensions Act 2004 permits TPR to issue a CN - a notice requiring an employer, or a person connected with or an associate of the employer, to pay money into a pension scheme - where TPR is of the opinion that the target was a party to an act, or failure to act, which (following the Pension Schemes Act 2021) meets one of four tests, including a "material detriment" test. Various conditions must be met, including that TPR considers that it is reasonable to impose liability, taking into account all the circumstances and a non-exhaustive list of specific matters set out in Section 38(7), one of which is the target's financial circumstances. A CN can be up to the amount of the Section 75 buy-out deficit in the scheme.

Facts: The case concerned the diversion of the sale proceeds from a joint venture (JV) subsidiary in 2014. Instead of the proceeds being paid to the parent, the sponsor of the group pension scheme, they were paid, under an agreement made in

May 2012, to a Jersey based nominee company connected to a Liechtenstein trust of which of the target individual was a beneficiary, allegedly relying on an informal agreement of 2004 between the JV parties. The target individual was connected to the sponsor by virtue of being a director.

In 2020, TPR's Determinations Panel decided that the material detriment test was met. Entering the 2004 informal agreement and the 2012 formal agreement constituted a series of acts that had detrimentally affected in a material way the likelihood of accrued scheme benefits being received: a non-binding loose agreement had been changed into a legally binding agreement the effect of which was that the sponsor was no longer entitled to the JV sale proceeds. The Panel rejected the target's claim that, as he had not the financial resources to pay the CN (on the basis he had not benefited personally from the acts in question), it had not been reasonable for TPR to issue the CN.

The target referred the Determination to the Tribunal to assess whether it was reasonable for TPR to issue the CN.

Decision: The Tribunal agreed with the Panel's decision:

- Although the target accepted that his only argument on reasonableness was his financial circumstances, the Tribunal went through the factors in Section 38(7) in detail, finding that in this case each factor pointed strongly in favour of issue of a CN. The Tribunal's view was that not all the factors carried equal weight; the degree of involvement of the target in the actions which caused material detriment, as well as the target's connection with the scheme and the employer, ought to be given strong weight. Financial circumstances should not outweigh the other factors, particularly in the most serious cases, where the deterrent effect of the penalty should not be diluted. The Tribunal pointed out that the issue of a CN is not analogous to the imposition of a financial penalty, where financial circumstances are a very important factor. One of the factors against the target was the fact that both the 2012 agreement and the 2014 payment were notifiable events under Section 69 of the Pensions Act 2004 but no notification had been made, nor had the target taken pensions advice.
- On quantum, the Tribunal rejected an argument that, where recovery of only part of the shortfall has been prevented by the target's actions, it would not be reasonable to impose a liability for the whole sum. Under the wording of the legislation, there was no basis to imply a further constraint on reasonableness beyond the factors set out in the legislation.

Next steps for employers and trustees: Although TPR's decision, confirmed by the Upper Tribunal, was made prior to the extension of the tests for issuing a CN made by the Pension Schemes Act 2021, the aspects of the reasonableness test in Section 38(7) discussed in the case are unchanged by the Pension Schemes Act 2021. The issue of quantum is arguably the most significant aspect of the decision. Following obiter comment from Mr Justice Warren in *Re Bonas Group Pension Scheme* it had been thought that a CN should be confined to compensation for loss to the scheme. In other words, it was thought that if a scheme's Section 75/buy-out deficit was £100 million but the target's act caused £5m of detriment to the scheme, the quantum of the CN should be limited to £5m. The Upper Tribunal's decision suggests that there is no such limit and, in theory, TPR could impose a CN for £100m notwithstanding that the target of the CN did not cause £100m of detriment. Trustees and employers will need to bear this decision in mind in the context of material corporate events and discussions around mitigation for events which could detrimentally impact their scheme.

THE PENSIONS REGULATOR'S REVISED SUPERFUNDS GUIDANCE

The Pensions Regulator (TPR) has updated its 2020 interim guidance for DB superfunds: its Superfund guidance for prospective ceding trustees and employers and separate DB superfunds guidance for those setting up and running superfunds. This follows the Government's response to consultation on DB consolidation as part of the Mansion House proposals, in which it confirmed that it will go ahead with an authorisation and supervision regime for superfunds (see our Pensions Bulletin July 2023).

The Government has said that legislation on superfunds will be brought forward "*as soon as Parliamentary time allows*", with further details following in regulations. After a transition period, existing superfunds will be required to comply with the legislative framework (once in force) in order to continue to accept new transfers in. Pending the introduction of the legislation, TPR has made amendments to its interim guidance issued in 2020.

Before trustees and sponsoring employers enter into any transaction with a superfund, TPR expects them to demonstrate, in their clearance application, why they believe the transaction is in the best interest of members, and how the transaction meets three "**gateway principles**". As amended, those principles are now:

1. The scheme cannot "access" buy-out now.
2. There is no realistic prospect of buy-out "in the foreseeable future" given potential employer contributions and the employer's insolvency risk.
3. The transfer improves the likelihood of members receiving full benefits.

In relation to the first gateway test, the 2020 guidance referred to the scheme being unable to "afford" buy-out; the amendment to "access" reflects fears that there may be capacity issues within the insurance market due to the number of schemes that are now able to afford buyout because of improvements in their funding positions. The guidance says that the trustees' assessment of whether the scheme can access buy-out should be based on the response by an appropriate insurer (i.e. one indicated by professional advice to be potentially interested in taking on schemes with similar characteristics to the scheme). It now goes on to say that, if the insurer declines the scheme or advises that buy-out could not be completed "*within a reasonable period appropriate for the circumstances of the scheme*", then it would be reasonable to conclude that the scheme cannot currently access buy-out. TPR has declined to give more guidance on "a reasonable period", saying only that the circumstances are likely to include the outlook for the scheme's sponsoring employer/covenant and that schemes should use independent advice in relation to what is likely to be in the best interests of the members.

The 2020 guidance required the ceding trustees' assessment of whether buy-out was affordable to be based on the scheme actuary's estimated buy-out funding level at a date no more than one month before the date of the clearance application. This has now been changed to nine months, TPR recognising that, as gateway tests are undertaken early on in any transaction, the one-month period does not provide enough time to conclude negotiations and prepare for clearance. A longer period could also help superfunds enter exclusivity deals with schemes, meaning the transaction is much more likely to go ahead. TPR notes that there is a risk that the markets move during the nine-month period, which may have an impact on the scheme's funding position and any subsequent assessment of the gateway test, and it therefore emphasises that trustees will still need to ensure the transaction is in their members' best interests before completion. TPR believes that in most cases the three phases (preparing a clearance application, submitting the application form and completing the transaction after clearance) should take no longer than nine months.

In its guidance for **setting up superfunds**, TPR has introduced a similar nine-month period for demonstrating that the capital buffer requirements for the superfund have been met. TPR expects the capital requirements to be "highly likely" to be met at the date of transfer if reassessed at that date and the agreement between the parties to the transfer should reflect this expectation. TPR's intention is that this change should make it easier for the parties to agree in advance the amounts they will contribute when the transfer takes place. Other changes to the guidance for setting up superfunds include:

- **Funding expectations:** the discount rate used for assessing the superfund's funding position is increased from gilts plus 0.5% per annum to gilts plus 0.75%, reflecting changes in the market. TPR is satisfied that the higher discount rate is consistent with the principles in the draft Funding Code for low dependency and sees no conflict with the proposed low dependency discount rate for Fast Track, given the different objectives.
- **Fitness and propriety:** Superfunds are expected to provide evidence of the collective competence and experience of their corporate and trustee boards.
- **Profit extraction:** The Government's consultation response envisaged allowing for profits to be extracted. However, as this is a complex area, TPR intends to engage further with industry to establish a profit trigger mechanism. TPR's blog states that it will issue an update "in due course".

Next steps for employers and trustees: Trustees and employers who have been considering a transition to a DB superfund, possibly because the prospects of achieving full funding on a buy-out basis in the near-to-medium term are low, are likely to be interested in the changes to the gateway tests in the interim regime. In our view, the change from "afford" to "access" in the first gateway principle may well be of practical assistance for relatively well-funded schemes looking to access the superfund market. That said, the second and third gateway principles are likely to remain significant hurdles; in many circumstances the judgment about the relative strengths of the sponsor versus superfund covenant and implications for the security of member benefits will not be a straightforward one. Moreover, there is no indication as to when the permanent legislative regime will be in place. To date, Clara-Pensions is the only superfund to pass TPR's assessment process and therefore able to transact, while trustees and employers have so far appeared unwilling to take advantage of a temporary regime which has been available since 2020.

PENSIONS DASHBOARDS: NEW GUIDANCE FROM THE PENSIONS REGULATOR

The Pensions Regulator (TPR) has updated its initial guidance on pensions dashboards, in particular the sections on trustees failing to comply with their duties, following the removal of the staging timeline from the Dashboards Regulations. The timeline has been replaced by a single connection deadline of 31 October 2026 for all schemes in scope (all registerable UK-based occupational pension schemes with 100 or more active and/or deferred members), with staging to be set out in DWP guidance.

In updating its initial guidance, TPR says not only that trustees "*must have regard*" to the DWP guidance but that failing to have regard to the guidance "*will also be a breach*", potentially attracting penalties of up to £5,000 for individuals and up to £50,000 in other cases for any instance of a single compliance breach. TPR says it will take action in cases of "*intentional or reckless non-compliance*". TPR's guidance goes on to say that trustees will be expected to demonstrate how they have had regard to the guidance, and that this means:

- Trustees should not make final decisions about connecting and whether to follow the connection date until they have engaged with the guidance.
- Trustees must be able to demonstrate that they have adequate governance and processes for making decisions about connection. The reasoning for those decisions, and how risks are identified, evaluated and managed, should be clearly considered and documented.
- Trustees should make sure that they have access to all the relevant information before making decisions and acting upon them and should keep clear and accurate audit trails to demonstrate the decisions made, the reasons for them and the actions taken.

Meanwhile, the DWP has amended its guidance on deferred connection. The ability for schemes to apply for a one-off deferral (for a maximum 12 months) of the 31 October 2026 connection deadline, subject to specific and limited conditions, has been retained in the Dashboards (Amendment) Regulations 2023. The application for deferral will need to be made by 8 August 2024. However, deferral is available only where the trustees can provide evidence to show that, before the Amendment Regulations came into force, i.e. 9 August 2023:

- they had embarked on a programme to transfer the data held by the pension scheme to a new administrator; and/or
- they had entered into a contract containing an obligation to retender the administration of the scheme and the timetable for this is reasonable and conflicts with the staging deadline for the scheme.

The trustees will additionally need to provide evidence to show that complying with the connection deadline would be disproportionately burdensome, or would put the personal data of members at risk.

The guidance adds that if a scheme has embarked on a programme to transfer data to a new administrator before 9 August 2023, the DWP "*would expect this to have been done in good faith*" and will not grant deferrals where it appears that trustees have sought to change their administrator or delayed the change deliberately to avoid needing to meet the connection requirements. Where applications for deferral were made before 9 August 2023, the DWP will contact applicants to clarify the status of their application.

Next steps for employers and trustees: The removal of staging deadlines from the Dashboards Regulations may have led schemes to assume that they did not need to prioritise connection until nearer the 2026 deadline. Clearly, this is not the case but, perhaps as a result, TPR has strengthened its guidance on trustees' duties, highlighting the need to keep an audit trail of decisions. Much of the administrative work will be delegated to third parties but trustees remain liable for compliance and will have important decisions to take, in particular on their approaches to matching members to their pensions and to providing the “view data” that will be sent to members. Some issues, such as how to capture the value of benefit underpins, are yet to be resolved.

In practice, given that deferral is available only where the scheme met the criteria before 9 August 2023, deferred connection will be available in limited circumstances and schemes that are contemplating winding-up following buy-out or transfer to a master trust will have to complete these actions by the 31 October 2026 deadline if they do not intend to connect.

PENSION LEGISLATION AND REGULATION WATCH LIST

No	Topic	Effective date or expected effective date	Further information/action
1	Changes to DC scheme governance and disclosure	From 1 October 2023: Inclusion of explanation of illiquid investment policies in default SIPs and disclosure of asset allocation data in Chair's Statement.	DC schemes only. Consultation expected on draft regulations for phased introduction of new Value for Money framework for all DC schemes (excepting some small schemes). Draft regulations to extend Collective Defined Contribution to multi-employer schemes expected Autumn 2023.
2	DB consolidation	Legislation, "as soon as Parliamentary time allows", for new compulsory framework for superfunds.	DB commercial consolidators. TPR updated interim guidance issued August 2023.
3	Changes to pensions tax allowances	Finance (No 2) Act 2023: removal of lifetime allowance charge (replaced with income tax charge on lump sums that could have triggered a charge) and changes to other allowances, from 6 April 2023.	Abolition of lifetime allowance and introduction of new tax-free cash allowances from 6 April 2024, through Finance Bill 2023-24.
4	DB Funding Code of Practice	Part 2 of TPR consultation and draft Code issued 16 December 2022; consultation closed 24 March 2023. Regulations and Code expected to be in force from April 2024 but may be delayed until October 2024.	Update on DWP regulations (issued for consultation July 2022) expected Autumn 2023. Once in force, the Code will apply to triennial valuations submitted thereafter. Consultation on covenant guidance in 2023.
5	TPR General Code of Practice	Revised Code expected shortly.	All schemes.
6	New notification requirements for DB schemes in relation to corporate and financing activity and change to the notification process	Response to consultation on draft Notifiable Events (Amendment) Regulations expected later in 2023.	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.

No	Topic	Effective date or expected effective date	Further information/action
7	Pensions dashboards	Compulsory connection deadline of 31 October 2026 for all schemes with 100 or more active and/or deferred members at the scheme year end between 1 April 2023 and 31 March 2024; staging timetable to be set out in DWP guidance.	All registerable UK-based schemes with active and/or deferred members.

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