SLAUGHTER AND MAY/

CLIENT BRIEFING

JUNE 2025

EVERYTHING, EVERYWHERE ALL AT ONCE - PROPOSALS FOR PENSIONS REFORM

After months of relative quiet on the pensions front, last week saw a flurry of activity from the Government with long awaited responses to consultation being published in relation to both DB and DC schemes. The consistent theme is how pension scheme assets can be effectively used to bolster the UK economy whilst ensuring that members are adequately protected and receive value from their pension schemes.

The key developments the Government says are coming soon in relation to surplus, default funds, investment and transfers from group personal pension schemes are explored in below.

DB surpluses: The Government had been trailing for some time that the upcoming Pension Schemes Bill would include provisions intended to facilitate the refund of surplus in ongoing schemes. The Pensions Minister promised that the Bill "*will allow Pension trustees and the sponsoring employers to safely release some surplus to invest back into their businesses and unlock more money for pension scheme members*".

The Government's response to consultation on options for DB schemes provides more information about what the Bill and any necessary regulations are likely to say in relation to surplus refunds:

- Surplus resolutions: DB schemes are generally unable to refund surplus to the employer outside a wind-up unless the trustees passed a resolution prior to 6 April 2016. Whilst in our experience most larger schemes did this, it would seem many smaller schemes did not and therefore, this restriction will be repealed.

- Power to amend: There will be a new statutory power for trustees to modify scheme rules to provide for "*surplus sharing*" where rules do not currently allow this. The power will need to be exercised in a manner consistent with trustees' "*duties to scheme beneficiaries*". No indication is given as to what trustees should do where scheme rules contain a prohibition on refunding monies to an employer but as the language of the response talks about "*surplus sharing*", it may be, for example, that an amendment benefiting both members and employers might be possible.

  The Government also notes that some responses to the consultation (including ours) observed that a power to amend scheme rules "*would not necessarily encourage surplus sharing in isolation and that other changes would need to be made to unblock this*". Our concern was the potential difficulties in releasing surplus when liabilities are uncertain because of Virgin Media issues - sadly there is no suggestion in the response that this is being addressed.

- Funding levels: The Government is "*minded*" to amend the threshold at which trustees are entitled to share surplus with an employer from buy-out to full funding on the low dependency funding basis. Low dependency funding is broadly defined in the Funding and Investment Strategy Regulations 2024 as where the ratio of assets to liabilities is 1:1, no further contributions are expected from the employers and it is assumed that the assets are invested in a manner that "*is highly resilient to short-term adverse changes in market conditions*". This will clearly allow for larger refunds of surplus than would currently be the case and may act as an incentive for some schemes to run on rather than buy-out.

- Conditions: Current legislation imposes conditions on ongoing surplus refunds, including a requirement that they are in members' interests. This will be amended to "*clarify for trustees that they must act in accordance with their overarching duties to scheme beneficiaries, which will remain unchanged*". This reflects recent case law that there is no standalone duty to act in the best interests of members, it is simply an expression of the duty for trustees to exercise their powers for the purposes of the trust.

  The Government is clear that the "*potential for members to benefit from any surplus shared with the sponsoring employer must remain a key consideration for trustees*" and trustees "*will remain responsible for negotiating* *with sponsoring employers regarding possible benefits to members". from surplus extraction*". The Government intends to work with TPR to develop guidance which will set out options open to trustees to bring benefits to members from surplus sharing.

- Tax: No tax changes will currently be made in relation to refunds, although the Government has said it is continuing to consider the position. This means that refunds will continue to be taxed at 25% and one off increases to pensions to share surplus with members will still potentially trigger an unauthorised payments charge.
- PPF alternative: The possibility for schemes to pay an additional PPF levy to ensure PPF protection for 100% of scheme liabilities has been rejected on the basis of concerns that this "*would be unaffordable for most schemes… [and might] create moral hazard in the DB universe*".

Default funds in master trusts and GPPs: Proposals in relation to DC schemes are set out in two separate documents (although there is a lot of overlap between them), the final report of the Investment Review and the response to consultation on unlocking the UK pensions market for growth.

Because of the perception that scale leads to better value for members, the Government will legislate in the Pension Schemes Bill to require GPPs and multi-employer master trusts used for auto-enrolment to have at least one "main default arrangement" with assets of £25 billion by 2030. Regulations will define what is meant by a main default fund and will not rely on the existing statutory definitions – which is to be welcomed as they are not always easy to follow.

In addition, there will be a "transition pathway" for schemes with smaller default funds under which a provider or master trust will need to satisfy a number of conditions including demonstrating that they will have at least £10 billion in their main default arrangement by 2030 and that they have a credible plan to have £25 billion by 2035 – an application must be made to join this pathway in 2029. New entrants to the market will also need to have a credible plan to achieve.

In addition, there will be restrictions on creating and operating new default arrangements and master trusts and providers will need to apply for regulatory approval. The precise nature of the conditions will be subject to further consultation, but it is anticipated they will require an arrangement to be necessary to meet certain member needs, manage conflicts of interest or possibly to meet a genuine employer need or drive innovation.

CDC schemes will be exempt from the scale requirements as will "*DC/defined benefit hybrid schemes which are only available to a closed group of employers related through their industry or profession, or to default arrangements that serve protected characteristics, such as religion*".

The Government had considered limiting the number of default funds a scheme could have but is not moving forward with this proposal as "*there could be circumstances where it will be in savers' best interests to remain in their existing default arrangement. However, [it is] setting a clear expectation… that providers and trustees proactively consider consolidation into their main default arrangement, only not doing so where it would not be in savers' interests…*"

There will also be no requirement for the market to implement a single pricing structure.

Investment: The final report of the Investment Review says that the Government has been "*strongly encouraged by the recently launched Mansion House Accord…, a voluntary commitment by seventeen of the largest defined contribution pension providers to invest 10% of their main default funds in private markets including 5% in the UK specifically*". As a result, it has "*concluded it is not necessary currently to mandate investment… Instead, the Pension Schemes Bill will include a reserve power which would, if necessary, enable the government to set quantitative baseline targets for pension schemes to invest in a broader range of private assets, including in the UK, for the benefit of savers and for the economy.*"

It is not anticipated that this power will be used unless "*the industry has not delivered the change on its own*" and any intervention would require a thorough assessment of the potential impacts of any proposed quantitative targets on members and economic growth and "*be consistent with the principles of fiduciary duty*". To ensure compliance with fiduciary duties (in occupational pension schemes at least) any targets would need to be fairly soft as trustees' key duty in an investment context is to act in the best financial interest of their members, not the UK economy!

To provide the Government with the data to determine whether to exercise its reserve power, TPR and FCA will launch a joint market-wide data collection exercise later this year which will include asset allocation information in workplace DC schemes. It is envisaged that this will run annually until the data under the new Value for Money framework becomes available.

The Report also sets out various things that the Government is planning to do to ensure that there are new mechanisms for schemes to invest in private markets within the UK.

Bulk transfers from GPPs: Where a personal pension arrangement does not provide value for members or is an old legacy arrangement, there is currently no mechanism to transfer members to an arrangement which might be more appropriate for them without obtaining their consent.

The Government therefore proposes to allow transfers without consent from personal pension schemes used for auto-enrolment where various conditions, including the transfer being in the members' best interests, are met. Providers will be required to obtain an assessment of the proposal from an independent third party with sufficient expertise. The Government does not propose to specify who can be an independent expert but will set out criteria that must be met.

Active employers will need to be notified of any proposed changes but will not play a specific role as part of the process. However, the Government expects that an active employer will be consulted by the provider where appropriate.

The costs of the transfer will be borne by the pension provider and where a transfer is to another provider, these costs could be split across the two providers.

Detailed rules around such transfers will be developed by the FCA.

What next?

It is anticipated that the Pension Schemes Bill will be issued before parliament goes into recess on 22 July. However, the Bill will not contain all the details around the new proposals. As has become increasingly common in recent years much of that will be left to regulation.

The DC proposals will certainly push forward the agenda of market consolidation as figures currently suggest that only 5 of the existing master trusts have assets of £25 billion or more in one default fund. Whether the others can achieve sufficient scale within the Government's proposed timeframe remains to be seen.

It is also difficult to determine what the impact of the proposals on surplus release will be. Where schemes are currently on a pathway to buy-out, the impact is likely to be minimal. For other schemes, it may well depend on the certainty with which trustees are able to determine their liabilities and the outcome of the Verity Trustees case (dealing with evidential issues on actuarial confirmations following Virgin Media).

The most uncertain area though is the so called "reserve power" in relation to investment targets and how that will interact with other legal duties that trustees and providers have to scheme members. It is difficult to see how any mandatory requirements around investment allocations could be put in place without modifying existing legal obligations to members.

Watch this space to see what comes next!

CONTACT

- CHARLES CAMERON
- PARTNER
- T: +44 (0)20 7090 5086
- E:Charles.Cameron@SlaughterandMay.com

- DANIEL SCHAFFER
- PARTNER
- T: +44 (0)20 7090 5090
- E:Daniel.Schaffer@SlaughterandMay.com

- CHRIS SHARPE
- PARTNER
- T: +44 (0)20 7090 4261
- E:Chris.Sharpe@SlaughterandMay.com

- KAREN MUMGAARD
- KNOWLEDGE COUNSEL
- T: +44 (0)20 7090 3752
- E:Karen.Mumgaard@SlaughterandMay.com

- CATRIN YOUNG
- SENIOR KNOWLEDGE LAWYER
- T: +44 (0)20 7090 3750
- E:Catrin.Young@SlaughterandMay.com