SLAUGHTER AND MAY/

PENSIONS ESSENTIALS

January 2024

QUICK LINKS

General Code: Pensions Regulator issues final version

Abolition of lifetime allowance and introduction of new allowances: update

Collective defined contribution schemes: technical amendments to the legislation

Updated guidance on cyber security

Pensions Ombudsman's guidance on recoupment of overpayments

Pension Regulator's approach to merger and acquisition transactions

Pension Protection Fund levy 2024/25

Pension legislation and regulation watch list

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GENERAL CODE: THE PENSIONS REGULATOR ISSUES FINAL VERSION

The Pensions Regulator (TPR) has issued the final version of its General Code of Practice; it is expected to come into force on 27 March 2024. The Code is a consolidation of TPR's expectations of trustees in relation to governance of their schemes and of the trustee body itself. Some of the guidance is new - notably the requirements to have, and to review, an "effective system of governance". Parts of the Code have been modified since the 2021 draft and some review of trustee policies may be required.

The General Code, which was first consulted on back in 2021, amalgamates 10 of the Regulator's 16 codes of practice, so much of the content will be familiar. It does not include the existing codes on funding (which is due to be re-issued in revised form later this year), modification of subsisting rights, notifiable events, material detriment or the specialist codes of practice for master trusts and collective defined contribution schemes.

Section 249A Pensions Act 2004 requires trustees to "*establish and operate an effective system of governance including internal controls… [which is] proportionate to the size, nature, scale and complexity of the activities of the… scheme*". This applies regardless of scheme size, although certain types of scheme are exempt, such as authorised master trusts and collective defined contribution schemes. The General Code sets out the Regulator's views on the policies and processes that trustees should have in place to comply with this statutory duty and on the frequency with which trustees should review those processes to ensure that they remain appropriate. It identifies specific areas of governance, including policies and processes, that should be part of an effective system of governance and says that trustees should have a policy for the review of each element of their governance processes at least every three years.

The Code also says that trustees of schemes with 100 or more members should carry out an assessment of how well their effective system of governance is working, and the way potential risks are managed. This is referred to as an own risk assessment or "ORA". The ORA needs to be in writing and signed off by the chair of trustees. The first ORA should be completed within 12 months of the end of the first scheme year starting after the General Code comes into force or, if later, either 15 months from the date on which the next actuarial valuation is due or the due date for the next chair's statement. Subsequent ORAs should be carried out at least every three years, but not all elements of the system of governance need to be assessed at the same time. The General Code sets out specific matters that should be addressed by the ORA.

For a more detailed analysis of the content of the General Code, please see our separate client briefing.

Next steps

Watch out for the Code coming into force and consider what additional policies and processes will be required. Start to put together a timetable for reviewing governance policies by the required deadline (which will vary depending on whether a scheme has more than 100 members).

ABOLITION OF LIFETIME ALLOWANCE AND INTRODUCTION OF NEW ALLOWANCES: UPDATE

There are just a few weeks to go until the pensions lifetime allowance is due to be removed from tax legislation on 6 April 2024, with two new tax-free lump sum allowances introduced in its place. HMRC has issued a Lifetime Allowance Newsletter, explaining its approach and changes from the earlier draft of the legislation, with some helpful confirmations.

In our Pensions Essentials November 2023, we reported on the policy paper summarising the proposed changes to the pensions tax legislation, building on draft legislation published in July last year. The Finance Bill, currently going through Parliament, abolishes the lifetime allowance (LTA) from 6 April 2024, having removed the LTA charge in April last year. This will result in a number of consequential changes, including new limits in relation to existing tax-free lump sums and lump sum death benefits. There will also be new reporting requirements for trustees.

HMRC has issued a Lifetime Allowance Newsletter. This is largely an explanation of their approach and changes from the July draft of the legislation. However, it confirms the following points:

- There is an error in the current draft of the Finance Bill, which appears to require all lump sums that are tested against the new allowances to be reported to HMRC. Schemes will only have to report taxable lump sums above the new allowances, and lump sums where the member's allowance is not exceeded due to reliance on a protection or enhancement factor. HMRC says the legislation will be amended at the earliest opportunity.
- HMRC has provided welcome confirmation that the current processes for taxing lump sum death benefits will be continued from 6 April 2024, with HMRC collecting the tax due from the recipients of lump sums. Schemes will not have to collect the tax under PAYE for death lump sums.
- The Finance Bill introduces a new authorised lump sum — the pension commencement excess lump sum (PCELS), for members who are permitted, by scheme rules, to take a lump sum in excess of their lump sum allowance on commencement of their pension. The whole of the PCELS is liable to income tax, charged at the member's marginal rate. As currently drafted, the PCELS is only payable where a member has used up all of their lump sum allowance, a pension is being paid and the total of the lump sum for payment on commencement of their pension exceeds the available lump sum death benefit allowance (see here for an explanation of these allowances). Any payment made in excess of the maximum limits for payment of a pension commencement lump sum, that does not meet the criteria for a PCELS, will be an unauthorised payment.

There are some key immediate actions for trustees and employers:

- Check that scheme administrators will be ready to operate the new regime, particularly the new reporting requirements, from 6 April 2024. For example, all taxable lump sums paid in excess of the new allowances will need to be reported on the Event Report, along with lump sums where the member's allowance is not exceeded due to reliance on a protection or enhancement factor.
- Consider how to deal with the tax changes in member communications, particularly in member retirement packs where the retirement may occur after 5 April 2024. For members with significant pension savings, as the legislation is currently drafted there will potentially be changes to the way that benefits can be taken.
- Consider the impact of the removal of the lifetime allowance on the trust deed and rules and on the eligibility requirements for top up life cover. The draft legislation does not contain any statutory overrides to assist schemes with these provisions.
- There are default provisions for working out how lifetime allowance used up under the old regime counts against the new tax-free lump sum allowances. Members or their personal representatives will be able to ask any pension scheme of which they are a member to certify a personalised transitional tax-free amount for them to use in the new regime, if they can provide "complete evidence" of previous lump sum benefits across all schemes. Trustees should check that scheme administrators are ready to do this.
- Check with sponsoring employers whether there are any top-up pension promises outside the scheme where removal of the lifetime allowance might impact the pension benefit provided by the scheme.

- Watch out for further Newsletters from HMRC, as these may contain further clarifications of how the legislation is expected to operate in practice.

You can find more information on the abolition of the lifetime allowance and introduction of the new tax-free lump sum allowances in our Finance Bill briefing, which pre-dates HMRC's LTA newsletter.

Next steps

The timescale for the introduction of significant tax changes is challenging, particularly for trustees and their administrators. Although there have been some helpful clarifications following the publication of the draft Finance Bill, the detail of how the legislation is expected to work in practice is yet to be established. However, given the timeline, this should not delay preparations.

COLLECTIVE DEFINED CONTRIBUTION SCHEMES: TECHNICAL AMENDMENTS TO THE LEGISLATION

As announced in the Government's response to its consultation on extending collective defined contribution (CDC) schemes to multi-employer schemes and to decumulation-only schemes, draft amendments have been made to the authorisation and supervisory regime for single or connected employer CDC schemes.

As part of its Mansion House reforms, the Government announced that it is going ahead with its proposal to expand "whole-of-life" collective defined contribution (CDC) provision (i.e., arrangements which offer accumulation and decumulation in one vehicle) to multi-employer schemes where the employers are not associated with one another, which would allow for commercial providers to offer CDC schemes. We are expecting a consultation on the draft changes in the coming weeks. The Government also made clear that it wishes to explore the opportunities presented by decumulation-only CDC arrangements, but only after further consideration.

At the same time, the Government acknowledged that the regulatory architecture for individual and connected employer CDC (contained in the Pension Schemes Act 2021 and regulations), which will be used for multi-employer schemes, needed technical amendments to address some issues. These changes have now been made, in the *draft Occupational Pension Schemes (Collective Money Purchase Schemes) (Amendment) Regulations 2023*:

- Amendments make clear that, during the wind-up of a CDC scheme, the accrued rights of the dependants and survivors of members or survivors of dependants can be transferred to a flexi-access drawdown arrangement. This change takes effect from 1 October 2024.
- When an annual valuation shows that a decrease to benefits needs to be made, for example due to a fall in the value of the collective funds, schemes can smooth the impact of the reduction on members through the multi-annual reduction (MAR) process. The amendment implements a suggestion made in consultation responses that where a MAR is initiated following poor investment performance and there is a subsequent positive bounce back in investment, that increase should be offset against any planned reduction under the MAR. This change takes effect as soon as the amending regulations come into force.

Next steps

Keep an eye out for the upcoming consultation on the future expansion of the CDC regime which is likely to be of significant interest to employers and trustees.

UPDATED GUIDANCE ON CYBER SECURITY

In its updated guidance on cyber security, the Pensions Regulator is asking trustees to report significant cyber incidents, on a voluntary basis. The General Code of Practice, expected to be in force from 27 March 2024, says trustees should assess vulnerability to cyber risk and maintain a cyber incident response plan.

The Pensions Regulator (TPR) has published updated guidance on cyber security principles for pension schemes, setting out the practical steps to meet the expectations set out in the recently issued General Code of Practice (at page 115 onwards). It covers the trustees' role, assessing the risk, controls, and responding to and reporting incidents. The accompanying Press Release explains that, for the first time, TPR is asking trustees and scheme providers to report "significant cyber incidents", on a voluntary basis, "in an open and cooperative way", as soon as reasonably practicable and possibly even

before a full investigation has been conducted. A significant cyber incident is one which is likely to result in a significant loss of member data, major disruption to member services, or a negative impact on a number of other schemes or providers.

The guidance also notes:

- Schemes should not assume that suppliers or system managers have implemented the right controls – trustees retain accountability. Trustees might want to consider having the effectiveness of their cyber risk management independently assessed by a cyber specialist.
- Trustees should ensure they know who is legally responsible for data following a change of third-party supplier. They should understand how long the former supplier will hold scheme data, where the data will be held and how it will be protected.
- Trustees should ensure adequate controls are in place - staff engagement and training, data security, technical controls, detection and incident response planning. TPR expects trustees to consider the incident response plans of third parties.

The guidance explains how cyber incidents can be reported and notes that making a report does not replace existing legal requirements such as reporting a personal data breach to the Information Commissioner's Office or the requirement to report to TPR breaches of pensions law if they are likely to be of material significance.

Next steps

Pension schemes have suffered a number of high profile cyber security incidents recently, so trustees should check that security arrangements are in place in line with the latest guidance and consider whether changes need to be made.

PENSIONS OMBUDSMAN'S GUIDANCE ON RECOUPMENT OF OVERPAYMENTS

The Pensions Ombudsman (TPO) has clarified how trustees can recover overpayments of pensions in the event that there is a dispute with the member (assuming the scheme rules allow this). TPO has also issued a determination which makes clear that, after the CMG Court of Appeal case, if recovery is disputed, trustees will be acting unlawfully if they start recoupment without a county court order; this is likely to be maladministration as well as a breach of trust.

The Court of Appeal, in *The Pensions Ombudsman v CMG Pension Trustees Limited*, confirmed that although determinations and directions of the Pensions Ombudsman (TPO) are binding, the Ombudsman is not a "competent court" for the purposes of the set-off provisions in the Pensions Act 1995. This means that if trustees wish to recover overpaid benefits by offsetting them against future benefit payments and there is a dispute, they will need an enforcement order from the county court. (See our Pensions Essentials November 2023 for discussion of the case.)

TPO has issued a statement about the ruling. After expressing its disappointment at the decision, TPO reports that there will be legislative changes to enable it to conclude overpayment disputes without the need for a county court order. In the meantime, a factsheet provides guidance on how, in accordance with Civil Procedure Rules, overpayment disputes should now be managed:

- The county court will not revisit the merits of the dispute but will authorise the scheme to deduct overpayments from the member's future pension payments in accordance with a schedule in TPO's determination which will set out the amount and rate of recoupment. When issuing its determination, TPO will also provide a certified copy for the county court.
- Court form N322A must be completed, with a fee, referencing Section 151 of the Pension Schemes Act 1993 (under which enforcement is sought).
- The appropriate county court is the one nearest to the member's address.

Meanwhile, TPO, in *Mr Y*, its first determination of a complaint relating to recoupment since the Court of Appeal's decision in *CMG*, decided that the trustee should not have started recovery of overpayments without a county court order. TPO had found that the trustee was entitled to recover the overpayment by recouping the excess from future pension increases, but because of the *CMG* decision, the trustee had acted in breach of trust in starting recoupment without a county court order.

The trustee was ordered to pay the increases withheld and to apply to the county court for an order, in accordance with the new factsheet, to allow it to recoup the overpayment in accordance with the schedule set out in TPO's determination. TPO accepted that there had been no maladministration because the trustee had received unqualified advice from its legal advisers that it could recoup overpayments. However, it noted that, going forward, the recoupment of disputed overpayments without a county court order would be likely to constitute maladministration.

Next steps

If there is a dispute, trustees will need a county court order to rubber stamp an Ombudsman's determination that has said they can recover overpaid benefits by recoupment. If there is no dispute, trustees do not need an order.

THE PENSION REGULATOR'S APPROACH TO MERGER AND ACQUISITION TRANSACTIONS

The Pensions Regulator has reiterated its expectations of employers and trustees in transactions involving DB schemes.

The Pensions Regulator (TPR) has published a speech from CEO Nausicaa Delfas covering TPR's supervisory expectations and approach relating to protecting DB schemes during M&A transactions. The speech repeats previous messages, referring to its criminal offences policy, and concludes with a summary of its expectations of management teams:

- They should provide trustees with direct access to the bidder at the earliest opportunity. This allows trustees to set out any liabilities and begin the negotiating process for the protection of members.
- Corporates should ensure that any M&A activity is backed with a well-thought-out business plan which considers the scheme's long-term funding objectives and how they will ensure the scheme remains protected.
- If the trustees and TPR agree an acceptable arrangement, it should not be "watered down" after the transaction has taken place. If that were to happen, TPR could take further action, including considering the use of powers again if required.

Next steps

Employers should ensure that robust non-disclosure agreements are in place to smooth progress and the use of an information sharing protocol could also be considered. However, the severe delay in regulations on the new notification requirements for DB schemes in relation to corporate and financing activity means that TPR's guidance is an incomplete picture.

PENSION PROTECTION FUND LEVY 2024/25

The Pension Protection Fund has confirmed its final levy rules for 2024/25, with a 50% reduction in its target levy collection.

The Pension Protection Fund (PPF) has announced its final levy rules for 2024/25 and confirmed a 50% reduction in its target levy collection to £100m, down from £200m in 2023/24. As a result, almost all PPF-eligible DB schemes in the UK are expected to see a further reduction in their levy. As supported by respondents to the consultation, and set out in its Policy Statement, the PPF will proceed with minimal changes to its levy methodology for the next levy year.

The majority of respondents to the PPF's consultation understood and supported the PPF's approach, in light of the legislative constraints, to maintaining a levy at this level in future years. However, almost all felt strongly that legislation should be changed as soon as possible to allow the PPF to move to a much lower or even a zero levy. The PPF has shared these responses with DWP who will consider the points raised and "*expect to legislate as soon as parliamentary time allows*". Changes could result in larger well-funded schemes paying higher levies in future if the levy calculation focuses on schemes that pose the greatest risk to the PPF.

The PPF has also confirmed that the Pensions Regulator expects to publish updated guidance on asset class reporting shortly. The proposed changes would clarify the preference for schemes to report their exposure primarily via the asset mix, only using the more detailed risk factor stress impact methodology for particularly complex arrangements that cannot be adequately described in the asset mix.

Some key dates to note in relation to the levy are:

- Submission dates:
    - Scheme returns and electronic contingent asset certificates to TPR by 31 March 2024.
    - ABC certificates and special category applications to the PPF by 31 March 2024.
    - Contingent asset documents to the PPF by 5pm on 2 April 2024.
    - Deficit Reduction Contributions certificates to TPR by 5pm on 30 April 2024.
- Mean scores will be published in July 2024; invoicing starts Autumn 2024.

Next steps

Note the deadlines for submitting key levy documents for the 2024/25 levy year and ensure they are submitted on time. Watch out for more developments on the future of the levy.

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	Later in 2024.	DC schemes only. Consultation expected in first half of 2024 on phased introduction of new Value for Money framework for all DC schemes (excepting some small schemes). Draft regulations to extend CDC to multi-employer schemes expected early 2024. Proposals on multiple consolidator for small DC deferred pots expected late 2024.
2	DB consolidation	Legislation "as soon as Parliamentary time allows", for new compulsory framework for superfunds. Public consolidator to be established by 2026.	TPR updated interim guidance issued August 2023.
3	Changes to pensions tax allowances	Finance (No 2) Act 2023: removal of lifetime allowance charge from 6 April 2023. Removal of lifetime allowance expected on 6 April 2024 together with introduction of new tax-free cash allowances.	Abolition of lifetime allowance and introduction of new tax-free cash allowances from 6 April 2024, through Finance Bill 2023-24.
4	Reduction of tax on repayment of surplus	6 April 2024	Tax charge on repaying surplus to be reduced from 35% to 25%. Consultation on further measures in Winter 2023/24.

No	Topic	Effective date or expected effective date	Further information/action
5	Draft DB Funding Code of Practice	Final Regulations expected Q1 2024; Code of Practice expected to be in force Q2 2024 but to apply to valuation effective dates from Autumn 2024.	DWP regulations issued for consultation July 2022. Part 2 of TPR consultation and draft Code issued December 2022. Consultation on covenant guidance was expected in 2023.
6	New notification requirements for DB schemes in relation to corporate and financing activity and change to the notification process	Significant uncertainty about publication of Government response to consultation on draft Notifiable Events (Amendment) Regulations.	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 all schemes with 100 or more active and/or deferred members at scheme year end between 1 April 2023 and 31 March 2024; staging timetable to be set out in DWP guidance. Application for deferral (in limited circumstances existing at 9 August 2023) must be made by 8 August 2024.	All registerable UK-based schemes with active and/or deferred members.
8	Corporate transparency	Regulations under the Economic Crime and Corporate Transparency Act 2023, expected to come into force in early 2024, will introduce requirements on identity verification, corporate directors and limited partnerships.	All corporate trustees and schemes using Scottish Limited Partnerships.

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