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UK PENSIONS UPDATE – DECEMBER 2023

In this edition, we take a look at the raft of pensions announcements arising from the Chancellor's Autumn Statement. We also cover a recent Court of Appeal ruling on the Pensions Ombudsman's status, key recent determinations by the Pensions Ombudsman and updates on a number of other recent developments.

Content

1. Autumn Statement 2023
2. Court of Appeal rules Pensions Ombudsman not a "competent court"
3. Ombudsman dismisses surplus complaint
4. Ombudsman determination on meaning of "overseas investments"
5. Taskforce on Social Factors publishes guide for consultation
6. Retained EU law regulations made to codify principles established under case law
7. Pensions Regulator publishes updated guidance on regulated apportionment arrangements
8. Pension Protection Fund consults on levy rules for 2024/2025
9. Progress on UK-US data bridge
10. HM Treasury publishes call for evidence on pension fund clearing exemption

1. AUTUMN STATEMENT 2023

The Chancellor made a number of key pensions announcements in the 2023 Autumn Statement, and a raft of documents were published following his speech setting out further details. Key highlights were:

- confirmation the government will legislate to abolish the lifetime allowance ("**LTA**") from 6 April 2024.
- publication of a response to the Department for Work and Pensions' ("**DWP**") call for evidence on trustees' investment duties.
- confirmation of an intention to establish a public sector consolidator by 2026, with a consultation this Winter on the details.
- confirmation that the authorised surplus repayment charge will be reduced to 25% from 6 April 2024.
- publication of a response to the DWP's consultation on dealing with deferred small pots, which confirms an intention to proceed with a multiple default consolidator model.
- publication of a new call for evidence proposing a lifetime provider model to allow pension savers to have contributions paid into their existing pension scheme when they change employer.
- confirmation that the Financial Conduct Authority ("**FCA**") intends to consult on rules for a value for money framework for contract-based schemes in the Spring.
- publication of a response to the consultation on helping savers understand their pension choices at retirement.
- publication of a new call for evidence to explore the development of collective defined contribution ("**CDC**") schemes.
- publication of a consultation response regarding the investments of the Local Government Pension Scheme ("**LGPS**").

Please see below for an overview of these key announcements. While there is a lot to absorb, the more significant proposals are still in consultation/draft form at this stage.

A. ABOLITION OF THE LTA

Though not mentioned in the speech itself, documents published afterwards (including an HMRC policy paper) confirmed the intention to abolish the LTA from 6 April 2024.

The Autumn Finance Bill was then published on 29 November 2023, containing the draft provisions to implement the changes. Close scrutiny will be required to confirm whether the issues identified with the previous draft legislation have now been resolved (please see our September edition of the UK: Pensions Update for more details on the background).

The HMRC policy paper notes that in order to facilitate the transition from the LTA regime to the new allowances (designed to limit the pension tax-free lump sums individuals can receive in their lifetime and the tax-free lump sums they can pass onto beneficiaries on death), the Treasury will have the power, if needed, to make additional necessary primary legislative changes via statutory instruments. This power will only have effect until 5 April 2026.

B. TRUSTEES' INVESTMENT DUTIES

Following the Chancellor's Mansion House speech (as covered in our special edition briefing on the Mansion House Reforms), the DWP published a call for evidence to help improve the skills and capability of trustees and remove barriers to making effective investment decisions. The response has now been published, in which the DWP confirms a view that trustees would benefit from more support, guidance, and training. Areas for immediate action include:

- **Supporting the Pensions Regulator ("tPR") to put in place a trustee register**. The scope of this register is fairly unclear, but the response says the register will enable tPR to collect information to assess whether knowledge and understanding requirements are being met and can be used to target those trustees and schemes that require additional support to fulfil their obligations.

- **Accreditation of professional trustees**. The DWP strongly encourages all those acting as a professional trustee to gain accreditation through one of the existing frameworks and will continue to review whether legislative changes to mandate accreditation may be needed in future.

- **Updates to tPR's investment guidance and trustee understanding of alternative investments**. TPR is currently reviewing its toolkit to align it with pre-existing codes of practice and guidance. Additional guidance from tPR is expected to be published by the end of this year in relation to investment decisions and alternative assets.

- **Engaging with employers selecting a pension scheme**. Alongside the proposed value for money framework (see further below), the DWP thinks it would be helpful to provide some further information for employers on what factors should be assessed when they are selecting a pension scheme. The DWP will work with tPR to take this forward. The government will also consider how to shift employer incentives away from low fees towards long-term pension investment performance and better outcomes from their employees.

C. THE ROLE OF THE PPF AND THE PART DB SCHEMES PLAY IN PRODUCTIVE INVESTMENT

The DWP has published its response to the Mansion House call for evidence on options for defined benefit ("**DB**") schemes. In conclusion:

- the DWP says it is clear from the lack of consensus across the responses that there is scepticism across the industry with respect to surplus extraction and public sector consolidation, and that further work is required before workable proposals can be shared with key stakeholders.

- the DWP will introduce measures to make surplus extraction easier and establish a public sector consolidator by 2026. It will launch a public consultation this Winter to consider the detail of these measures, including design, eligibility, safeguards, and the viability of a 100% PPF underpin.

Separately, it was confirmed that the authorised surplus repayment charge will be reduced from 35% to 25% from 6 April 2024.

The government also made several announcements intended to facilitate a growth in the part that DB schemes play in productive investment:

- To support pension scheme investment into the UK's most innovative companies, the government will commit £250m to two successful bidders in the Long-term Investment for Technology and Science initiative, subject to final agreement. This will create new investment vehicles tailored to the needs of pension funds.
- The government has also confirmed its intention to establish a Growth Fund within the British Business Bank to give pension funds access to investment opportunities in the UK's most promising businesses.
- Alongside measures on pensions investment, the government is legislating to give effect to the Solvency II reforms to deliver a more tailored, clearer and simpler regulatory regime for the insurance sector. The reforms will boost economic growth by incentivising private investment for productive assets, such as infrastructure.

D. DEFINED CONTRIBUTION CONSOLIDATION

The DWP has now published a response to its July consultation on dealing with deferred small pots. This confirms the intention to go ahead with the multiple default consolidator model, whereby a small number of authorised schemes would act as consolidators for eligible deferred pension pots (deferred pension pots of £1,000 and below, which have not received contributions for 12 months and which were created since the introduction of auto-enrolment within charged-capped default funds). The DWP says it will develop an authorisation and supervisory regime for trust-based schemes to act as consolidators and investigate options with the FCA for a similar framework for contract-based schemes. The DWP says it will look to take forward legislation to implement a statutory framework as parliamentary time allows. In the meantime, it will look to form a delivery group with the pensions industry and other interested parties, to ensure that the outstanding design questions are tackled.

The Chancellor also announced that the government is going to consult on giving savers a legal right to require a new employer to pay contributions into their existing pension pot if they choose so they can have one pot for life and a call for evidence has been published on a lifetime provider model to achieve this. This closes on 24 January 2024.

E. DC VALUE FOR MONEY FRAMEWORK

The FCA has confirmed that it will consult on rules for a value for money framework for contract-based schemes in Spring 2024, working closely with the government and tPR.

In response to the Autumn Statement, tPR has also issued a statement on value for money which explains how it is looking at options to embed the disciplines of the joint value for money framework ahead of legislation.

F. DECUMULATION OPTIONS

The government has published its response to the July 2023 consultation on helping savers understand their pension choices at retirement. It proposes:

- placing duties on occupational pension scheme trustees at the earliest opportunity to offer decumulation services and products at an appropriate quality and price when savers access their pension assets, either themselves or through a partnership arrangement.
- to require schemes to devise a backstop default decumulation solution, based on the general profile of their members, that a member would be placed into if they access their pension assets without making an active choice on how to access their pension funds. Again, this could be achieved either directly or in partnership with other organisations.

In the meantime, the DWP will encourage schemes to voluntarily develop a decumulation offer. To support this, tPR will bring forward interim guidance to show how the objectives of these policies can be met without legislation, and to encourage innovation.

G. COLLECTIVE DC FUNDS

The government has published its response to the consultation on helping savers understand their pension choices at retirement and a new call for evidence which also sets out the intention to further explore the development and wider use of CDC schemes as part of a long-term vision for pension saving in the UK.

The DWP specifically wants to explore whether there is any merit in going further and to understand what benefits encouraging the use of CDCs for auto-enrolment could bring to members. The DWP says it recognises that changing the auto-enrolment framework to require employers to enrol their employees into a scheme offering a CDC would be a significant regulatory and culture change and there are a range of issues to be considered in this regard.

H. LGPS CONSOLIDATION / INVESTMENTS

The consultation response on LGPS consolidation has been published, with the government confirming that LGPS guidance will be revised to implement a 10% allocation ambition for investments in private equity, which is estimated to unlock around £30 billion.

The government is also establishing a March 2025 deadline for the accelerated consolidation of LGPS assets into pools and setting a direction towards fewer pools exceeding £50 billion of assets under management.

2. COURT OF APPEAL RULES PENSIONS OMBUDSMAN NOT A "COMPETENT COURT"

The Court of Appeal recently dismissed an appeal by the Pensions Ombudsman, ruling that the Ombudsman is not a "competent court" for the purposes of section 91(6) of the Pensions Act 1995.[1]

The impact of the decision is that, where recoupment of an overpayment to a pension scheme member (i.e. recovery by making deductions from a member's future pension payments) is disputed by a member and the member complains to the Ombudsman, trustees would need: (i) an Ombudsman determination finding that the overpayment can be recouped; and (ii) a County Court order enforcing that determination, in order to actually make the deduction.

However, in practice, it seems that (ii) is purely an administrative task as the judgment was clear that the County Court is not to revisit the merits of the matter and make its own order (an Ombudsman determination can only be appealed to the High Court).

The Ombudsman has not provided any substantive comment on the decision yet – stating on its website that it has seen the judgment and is reviewing its position and will provide an update shortly.

3. OMBUDSMAN DISMISSES SURPLUS COMPLAINT

The Ombudsman recently dismissed a complaint by a pensioner member concerning a trustee's decision to return £12m surplus to the sponsor on wind-up of the scheme.

The scheme rules provided that once benefits were fully secured, on wind-up, any surplus assets may, following employer consultation, be used to augment member benefits if it was "just and equitable to do so" – any remaining surplus assets were then to be returned to the employer. The trustee decided the surplus should be returned to the employer and a pensioner member complained, contending that scheme funds were to be solely used for the benefit of the members and as, in his view, the surplus was derived from, *inter alia*, member contributions and investment returns, it was "morally indefensible" for the sponsor to benefit from this surplus.

The Ombudsman confirmed that he only had jurisdiction to consider whether the trustee had followed the correct process in reaching its decision. Ultimately, the Ombudsman dismissed the complaint, confirming that the trustee had acted properly and had made a reasonable decision. Key to reaching the decision were that (i) the trustee had followed the requirements of the scheme rules correctly; and (ii) trustee meeting minutes showed the trustee had considered all potentially relevant factors e.g. employer views, member views and expectations, source of the

[1] *The Pensions Ombudsman v CMG Pension Trustees Limited & Anor [2023] EWCA Civ 1258*

surplus, actuarial and legal advice given in respect of the surplus, the trustee's duties, the fact that members' benefits had been secured in full, that there had been past augmentations to members' benefits and the impact of historic significant additional employer contributions which had been made to allow the trustees to de-risk their investment strategy which was a significant factor in generating the surplus.

This latest case ultimately highlights the importance of trustees following a proper decision-making process and keeping sufficient records of such process; in reaching his decision, the Ombudsman frequently pointed to the legal and actuarial advice sought by the trustee and the trustee meeting minutes which demonstrated they had been through a proper process.

4. OMBUDSMAN DETERMINATION ON MEANING OF "OVERSEAS INVESTMENTS"

The Ombudsman has published a determination in a case involving a trustee's interpretation of the *Occupational and Personal Pension Schemes (Conditions for Transfers) Regulations 2021* (the "**Transfer Regulations**").

The case involved a member who had complained that the trustee had incorrectly interpreted the "amber flag" in the Transfer Regulations which applies where there are overseas investments in the receiving scheme and as a result, had required the member to obtain MoneyHelper guidance before implementing the transfer. This delayed the transfer process and the member's transfer value fell by c.£20k.

There has been debate in the pensions industry about the scope of this amber flag for some time – namely, that it is much broader than intended as it would catch any receiving scheme which includes **any** overseas investments, meaning that a very large number of members would be required to take scams guidance before a transfer can proceed. It has been noted that this was not the DWP's intention and the DWP most recently commented in June that further work would be done to see if changes could be made to the regulations, but no draft legislation has been forthcoming to date.

This Ombudsman determination provides some useful insight to the Ombudsman's thinking on this – the Ombudsman ultimately dismissed the member's complaint, noting that while the drafting of the regulations and their intended practical application may not be aligned, the trustee was entitled to adopt a literal interpretation of the Transfer Regulations and that this was not unreasonable. The Ombudsman also noted that it is not necessary that the *transferring member's* funds will be invested in any overseas investments in the receiving scheme for the amber flag to be present, and that while the member was aggrieved that his transfer value had fallen in value, transfer values do fluctuate over time.

5. TASKFORCE ON SOCIAL FACTORS PUBLISHES GUIDE FOR CONSULTATION

The DWP's Taskforce on Social Factors recently published a draft guide for consultation on considering social factors in pension scheme investments (the consultation closed on 1 December 2023). The Taskforce was established following a 2021 DWP consultation on the consideration of social risks and opportunities by occupational schemes.

The draft guide is intended to help trustees to identify and monitor social risks and opportunities and develop a consensus as to how these should be approached in pension investment. The guide covers three main areas:

- **Social factors and pension funds:** this looks at why material social factors are important from an investment perspective and how taking these into consideration aligns with pension trustees' fiduciary duties.

- **Social factor data:** this discusses data trustees can use to manage social factors in investment, along with a materiality assessment framework to help prioritise areas for action. The guide recognises that trustees are unlikely to need to understand social data in depth, but says a basic understanding is fundamental to ensure trustees can engage with and hold to account their investment managers and advisers.

- **Addressing social factors in pension portfolios:** this sets out a recommended framework for including social factors in trustees' investment policies and practices.

The guide concludes by making recommendations for action that should be taken in this area, though it notes that the DWP does not have the power to enforce some of these recommendations. We would note that it is important for trustees to remember that their overarching duty is very broadly to invest in beneficiaries' best financial interests and, as such, social factors should be taken into account if they are *financially material*.

6. RETAINED EU LAW REGULATIONS MADE TO CODIFY PRINCIPLES ESTABLISHED UNDER CASE LAW

Two sets of regulations have now been made under the restatement powers in the Retained EU Law Act ("**REUL Act**") relating to pensions. These are needed to maintain the status quo from 1 January 2024 (as a result of the REUL Act which will revoke retained EU law rights preserved by the Withdrawal Act 2018, unless specifically preserved).

The two sets of regulations[2] are designed to:

- enshrine the principle established in the case of *Hampshire*[3] that, in the event of employer insolvency, every former employee should receive no less than 50% of their accrued old age benefits and PPF protection should never fall below this minimum level. The regulations also remove the PPF compensation cap in light of the *Hughes*[4] judgment.
- enshrine the position established in *Walker v Innospec*[5] by removing the 5 December 2005 service limitation when paying survivor benefits in respect of same sex legal relationships. They also enshrine a requirement to equalise GMPs without the need for a comparator – as the DWP takes the view that this principle was established in the case of *Allonby*[6].

Both sets of regulations provide for the amendments to come into force immediately before the end of 2023.

7. TPR PUBLISHES UPDATED GUIDANCE ON REGULATED APPORTIONMENT ARRANGEMENTS

Last month, tPR published updated guidance on regulated apportionment arrangements ("**RAAs**"), replacing its 2010 guidance and 2017 quick guide. The updated guidance is more detailed; setting out the principles tPR will consider on an RAA application and detail around the application process itself.

The principles tPR expects to be met in respect of any RAA application are:

1. **The employer's insolvency is inevitable within the next 12 months** – the application should describe all other options that have been considered/implemented to avoid the employer's insolvency.

2. **The upfront cash consideration proposed is significantly greater than the recovery expected for the scheme in the case of the employer's insolvency** – tPR expects evidence of this in the form of analysis estimating what each creditor of the employer would receive on insolvency, together with justification of each assumption used.

3. **A better outcome could not be attained for the scheme by other means, including through the use of tPR's powers** – when considering whether a better outcome could be achieved, trustees should check whether tPR's powers could be engaged and whether there are unpaid debts which should be collected.

4. **It would not be reasonable for the wider employer group or any entity within it to support the scheme or its employer in the future**: tPR says this is a wider consideration than under (3) above and expects the

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[2] *The Pensions Act 2004 (Amendment) (Pension Protection Fund Compensation) Regulations 2023 and The Pensions Act 2004 and the Equality Act 2010 (Amendment) (Equal Treatment by Occupational Pension Schemes) Regulations 2023*
[3] *Grenville Hampshire v Board of the Pension Protection Fund [2018] (Case C-17/17)*
[4] *Secretary of State for Work and Pensions v Hughes [2021] EWCA Civ 1093*
[5] *Walker v Innospec Limited & Anors [2017] UKSC 47*
[6] *Allonby v Accrington and Rossendale College [2004] (Case C-256/01)*

application to describe the position of the wider group and provide evidence that it has not disproportionately benefited or derived value from the employer, leading to its current distress.

5. **The scheme is receiving equitable treatment in comparison to the employer's other creditors, shareholders and other stakeholders:** tPR says this means 'fair treatment' in the specific circumstances of a proposal. In the context of inevitable insolvency, the critical measure will be assessing what each financial stakeholder would be expected to receive in the event of insolvency.

6. **The scheme receives an appropriate portion of the equity in the employer departing the scheme under the RAA**: the guidance says the appropriate size of the equity to be provided to the scheme/PPF would be a minimum of 33% where the employer continues to be owned or controlled by the same persons who owned or controlled it before the RAA, or 10% where the employer is transferred to a new owner previously unconnected in any way to the employer, or any members of a group to which the employer is connected at the time of the RAA.

(NB: When considering these principles on a PPF+ compromise proposal, tPR says there would be an additional requirement to demonstrate that the level of mitigation offered will be more than sufficient to allow the scheme to buy out members' benefits in excess of PPF compensation levels. TPR also says that in respect of other agreements which produce a similar outcome to RAAs, they would expect the RAA principles to also be followed.)

The PPF also needs to be on board for a successful RAA application and has separately set out in its guidance on employer restructuring the principles it expects to be followed in respect of any restructuring or rescue proposal put to it, which would include RAAs.

8. PPF CONSULTS ON LEVY RULES FOR 2024/2025

In September, the PPF published its consultation on the PPF levy rules for 2024/2025, which closed at the end of October. The PPF has only published a consultation document and not updated draft rules this year given the limited nature of the changes proposed. In summary, the consultation notes that:

- **In the short term:** the PPF proposes to reduce the total levy it collects from £200m (as in the current year) to £100m in 2024/2025. To achieve this, it will need to make some methodology changes – without making changes, some schemes could see their levy increase significantly as the pool of risk-based levy payers diminishes. It can achieve this for 2024/2025 by making only minimal changes.

- **In the longer term**: the consultation is looking at options for how to maintain a total annual levy of £100m for future years. More substantial changes are likely to be necessary to achieve this.

The PPF intends to publish its conclusions in December but notes that this will not cover conclusions on the longer-term issues.

9. PROGRESS ON UK-US DATA BRIDGE

The UK and US announced earlier this year that they were committed in principle to establishing a "data bridge" for a UK extension to the existing EU-US Data Privacy Framework (as discussed in the UK Pensions Update: June 2023). The intention was to allow personal data to be transferred more easily and more securely between UK entities and certified US entities without the need to rely on alternative mechanisms such as contractual clauses (which can be costly and time-consuming to agree).

There has been some further progress on this front, namely new regulations[7] came into force on 12 October 2023 which specify the US as a country which provides an adequate level of protection of personal data where the transfer

[7] *The Data Protection (Adequacy) (United States of America) Regulations 2023*

is to a certified US organisation[8]. This means that personal data may be transferred to these US certified organisations without the need for further safeguards or authorisation.

Though this development may not impact many UK pension schemes, it may reduce the burden on some schemes with a nexus to the US where this involves the transfer of personal data to the US. The nexus might arise from a scheme having a US sponsor/sponsors in its structure or for schemes (or their administrators) which use cloud service providers to host/otherwise process member data to the extent this includes US providers. As long as the receiving organisation has certified compliance with the EU-US Data Privacy Framework Principles, then personal data could be transferred without needing to put in place further safeguards (e.g. contractual clauses) to transfer such data.

If a UK scheme transfers personal data to a US organisation which has **not** self-certified, note that the new regime still lessens the burden slightly for transfers based on standard contractual clauses, because the adequacy decision made under these regulations effectively amounts to a positive “transfer risk assessment” for transfers to the US based on the standard clauses, meaning that no separate transfer risk assessment is necessary (which was previously required when making a transfer on this basis).

NB. It is possible that the EU-US Data Privacy Framework will be challenged in the EU courts in the future. If it is invalidated, attempts may be made to persuade the UK government to withdraw approval of the UK-US bridge and/or for the courts to hold it invalid. Therefore, the permanence of this new data bridge is questionable.

10. HM TREASURY PUBLISHES CALL FOR EVIDENCE ON PENSION FUND CLEARING EXEMPTION

In November, HM Treasury published a call for evidence seeking input on the current exemption for UK pension funds from clearing certain derivative contracts. This call for evidence follows regulations which came into force in June 2023 to extend the current expiry date of the exemption from 18 June 2023 to 18 June 2025 (as covered in the UK Pensions Update: June 2023), which means that pension funds based in the UK and the EEA will continue to be exempt from the UK clearing obligation.

At the time that the extension regulations came into force, the government recognised that it would be desirable to put in place a longer-term policy approach and to remove the need for future temporary extensions to this exemption. HM Treasury therefore committed to conduct a review of the pension fund exemption ahead of its new expiry date. This call for evidence represents that review.

The call for evidence requests input from industry stakeholders on the exemption. It asks questions around how pension funds currently hedge their risks and make use of the current exemption. Most pension schemes will invest in derivatives to some extent, so this is likely to be of interest to a broad spectrum of our clients.

The call for evidence closes on **5 January 2024**.

[8] Essentially, US organisations which self-certify annually to the US Department of Commerce, confirming that they agree to adhere to the EU-US Data Privacy Framework Principles.

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