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PENSIONS BULLETIN

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One Bunhill Row
London EC1Y 8YY
United Kingdom
T: +44 (0)20 7600 1200

In this month's Pensions Bulletin, we cover details of the new "notifiable events" regime, under which employers with defined benefit (DB) pension schemes will have to give the Pensions Regulator (TPR) early warning of certain kinds of corporate and financing activity. We recap briefly on the significant changes taking effect from 1 October. We then report on the interim response from TPR to consultation on its draft consolidated Code of Practice and further details from the Government on the increase in normal minimum pension age to 57. Next we look at two determinations – confirmation from the Court of Appeal that the cap on compensation from the Pension Protection Fund is age discriminatory and a Pensions Ombudsman's decision that a member could rely on a change of position defence to avoid repayment of overpaid benefits. We conclude with our monthly watch list.

We should like also to recommend a "back to basics" article, first published in the Tax Journal, where Emma Game from our Tax group considers the principles under which tax relief can be obtained for employer contributions to UK registered and non-registered pension schemes.

STOP PRESS: NEW GUIDANCE FROM THE PENSIONS REGULATOR

The Pensions Regulator (TPR) has just published a number of documents relating to its new powers under the Pension Schemes Act 2021 (PSA). Although many of the powers take effect at the end of this week (see the item below on Changes taking effect on 1 October 2021), TPR does not explain in detail all the changes to the previous drafts. The documents are:

- Finalised draft of TPR's criminal offences policy, setting out its approach to the investigation and prosecution of new criminal offences. TPR consulted on a first draft earlier this year and its response to consultation confirms that the new measures will only be used to target the most serious intentional or reckless conduct that was already within the scope its power to issue Contribution Notices (CNs), or would be if the person was connected with the scheme employer. TPR does not intend to prosecute "ordinary commercial activity". The policy now includes a new Appendix 2, which sets out some clear cases in which TPR would expect a person to have a reasonable excuse, with the result that no offence would be committed (debt or liability management arrangements under the Employer Debt Regulations, for example). There is also a detailed case study, at Appendix 3, illustrating TPR's approach to a restructuring scenario.

The new criminal offences do not have retrospective effect – TPR can only prosecute for acts that take place on or after 1 October 2021. However, as in the previous draft, the policy states that evidence pre-dating the 1 October commencement date may be relevant to investigation or prosecution after that date, for example if it indicates intention. Equally, it would be appropriate for targets of TPR action to refer to decisions taken before 1 October to show that they had a reasonable excuse.

- In response to calls for its policy on the new criminal powers to be given more context, TPR has issued a draft policy on TPR's proposed approach to its enforcement policies, covering overlapping powers (providing more detail on TPR's approach when investigating situations in which it could potentially use both its criminal and regulatory powers), an update to its monetary penalties policy on its power to impose high fines and a draft policy on information gathering powers in enforcement cases. TPR is consulting on these documents until 22 December 2021, with a view to having the policies finalised early in 2022.
- A response to consultation on TPR's revised Code of Practice on the circumstances in which it will exercise its CN powers, reflecting the introduction of the new tests (see below), together with a revised draft Code and guidance. TPR has rejected a call for more detailed examples or guidance on how the tests will be used. TPR justifies this by explaining that the decision to impose a CN also depends on a reasonableness assessment, which is not covered by the Code. However, it has "updated" its clearance guidance to take account of the new tests (without explaining what changes have been made to the guidance).

NEW NOTIFICATION REQUIREMENTS FOR EMPLOYERS IN RELATION TO CORPORATE AND FINANCING ACTIVITY

New notification requirements, expected to be in force from April 2022, require corporates with DB pension schemes to plan carefully for future disposals, acquisitions and the introduction of new secured debt. Notification to the Pensions Regulator (TPR) will be required at an early stage of a transaction and more detailed disclosures - which will necessitate disclosure to and interaction with trustees - on the impact of the transaction on the pension scheme will also be required before the transaction completes. The Government consultation and draft regulations raise a number of details questions on timing.

With immediate effect from 1 October 2021, the current, relatively minor, fines for breaching existing notification requirements are replaced by financial penalties of up to £1million and, where false or misleading information is provided, commission of a criminal offence.

Section 69 of the Pension Schemes Act 2004 sets out the current "notifiable events" regime, under which TPR has to be given advance warning of certain events (broadly, those that might be harmful to the scheme). Section 109 of the Pension Schemes Act 2021 changed the notifiable events regime, adding a new Section 69(A) with two new notifiable events and a revamped two-stage notification procedure.

The DWP has now published further details in a consultation: *Strengthening TPR's powers: Notifiable Events (Amendments) Regulations 2021*. The consultation closes on 27 October. There is no confirmation in the consultation as to when the new requirements will take effect but the draft regulations have a commencement date of 6 April 2022.

There will be two new notifiable events:

1. The intended sale by an employer of a **"material proportion"** of its business or assets (excluding money), in respect of which a "**decision in principle**" has been reached.

   A "**material proportion**" of (i) a business is one that accounts for more than 25% of its annual revenue and (ii) an employer's assets is one that accounts for more than 25% of the gross value of that employer's assets. Any other sales of employer businesses or assets decided upon or completed within the last 12 months are to be included in calculating whether the thresholds are reached. This is wider than the Government's initial proposal, which would have required notification only where an employer had funding responsibility for at least 20% of the scheme's liabilities.

   "**Decision in principle**" is "*a decision prior to any negotiations or agreements being entered into with another party*": the consultation says this is intended to be the point at which the employer has made the decision to go ahead (the example given is a decision to sell the asset) and will then start to negotiate the specific terms and draw up the contract. There is no indication of what qualifies as a “decision” or who might qualify as a decision-maker.

2. A “**decision in principle**” by the employer to grant or extend a **relevant security** over its assets, such that, should the employer become insolvent, the secured creditor would be ranked above the scheme in order of priority for debt recovery.

   A “**relevant security**” includes both fixed and floating charges over the assets or the wider employer group, and an all assets floating charge which gives the charge holder the right to appoint an administrator. It does not include the refinancing of an existing debt, security for specific chattels or financing for company vehicles. TPR will provide more information in its code of practice and accompanying guidance.

The existing notifiable event of where a controlling company decides to relinquish control of the employer company will be amended – see below.

There will be a new, two-stage, process for notification:

- Initial notification of the event to TPR and the trustees - notice to be given at the “decision in principle” stage i.e. much earlier than under the current notifiable events framework (where the requirement is to notify “as soon as reasonably practicable” after the event).
- Further notification (notice and statement) at a later stage to include implications for the scheme and how risks are to be mitigated. This notification will be required when “*the main terms of the relevant event have been proposed*” (or, in the case of the expanded change of control “bid” event referred to below, the relinquishment of control of the employer company). There is no further information on what “the main terms of the event” means.

The duty to notify will apply only to the new notifiable events 1 and 2 above and to the existing notifiable event of where a controlling company decides to relinquish control of the employer company. To reflect the new notification process, this event has been amended:

- to make it clear that the existing notifiable event notification regarding relinquishing control takes place when a “decision in principle” is made and is now therefore the first stage in a two-stage process (stage two is the notice and statement), and
- to include an offer to acquire control of the employer company, where the controlling company has not made a decision in principle to relinquish such control.

The draft regulations set out what the accompanying statement must contain:

- the event, including, where relevant, the main terms proposed,
- any adverse effects of the event on the eligible scheme,
- any adverse effects of the event on the employer’s ability to meet its legal obligations to support the scheme,
- any steps taken to mitigate those adverse effects, and
- any communication with the trustees or managers of the eligible scheme about the event.

There is a requirement in Section 69A to notify TPR “as soon as is reasonably practicable” of a material change in the event or mitigation. “Material change” is defined in the draft regulations as a change in the terms of the intended sale, the intended granting or extension of security or the relinquishing control, or a change in the steps taken to mitigate any adverse effects of the event.

Next steps for employers and trustees: Sponsors of DB schemes and their trustees will need to amend their planning and processes, including information sharing agreements between trustees and sponsors, to take account of the new notification requirements, noting that the first stage notice to TPR will apply much earlier in the timeline of a transaction than currently and in relation to a wider range of situations. Thought will need to be given to the content of this notice. Although the changes are not expected to come into force until April 2022, transactions happening now might be relevant to the new notifiable event of intended sale of a "material proportion" of business or assets – the 25% threshold is measured cumulatively over 12 months.

Whilst much of the detail reflects the Government's original proposals, some key wording in the draft regulations is open to interpretation, notably when a "decision in principle" is taken. The draft definition does not say who is regarded as the decision-maker or at what point "negotiations" are regarded as having started (the "decision in principle" has to be "prior to" those negotiations).

CHANGES TAKING EFFECT ON 1 OCTOBER 2021

A number of significant legislative and regulatory changes come into force on 1 October 2021:

- **Extended powers for the Pensions Regulator** (TPR), under the Pension Schemes Act 2021 (PSA):
    - Two new tests for TPR's use of Contribution Notices (in addition to the long-standing general "material detriment" test) - the "employer insolvency" test and the "employer resources" test - with a controversial "normalised profits before tax" test being used to value a material reduction on employer resources. On this, please see our *Pensions Bulletin July 2021*.
    - Criminal offences (with up to seven years' imprisonment) and civil penalties of up to £1million for avoidance of employer debt to a DB scheme and conduct that detrimentally affects accrued scheme benefits in a material way, as well as failure to pay a Contribution Notice. For more detail, please see our *client bulletin* on the PSA.
    - Potentially more severe consequences of a breach of the notifiable events regime (see the first item in this Bulletin). The current penalty regime (under Section 10 of the Pensions Act 1995) for breach (with a maximum £50,000 fine) is replaced, with effect from 1 October 2021, with financial penalties of up to £1million. Knowingly or recklessly providing information to TPR that is false or misleading in a material particular will become a criminal offence, punishable by up to two years in prison.
    - Strengthened investigative powers - new powers to require those subject to TPR's information gathering powers to attend an interview, and in relation to inspection of premises.
- **Transfer restrictions** - to help guard against pension scams, trustees will be permitted to proceed with statutory transfers only if one of four conditions is satisfied, even if the member has taken regulated financial advice in relation to the transfer. Please see our *Pensions Bulletin May 2021*. Please note that the draft regulations are not yet in force.
- **Climate risk governance and reporting** - DB and DC schemes with £5billion or more in net assets on the first scheme year end date on or after 1 March 2020, as well as all authorised master trusts and all collective DC schemes, will be required to have governance for the scheme year underway from 1 October 2021 and to publish the first annual report within seven months of the end of the scheme year. Please see our *Pensions Bulletin July 2021* for the latest on this –TPR's guidance and enforcement policy.
- **Changes to DC scheme governance** – all DC schemes will be required to calculate and state the return on investments from their default and self-select funds, net of transaction costs and charges. This information must be recorded in the annual Chair's Statement for the first scheme year ending after 1 October 2021 and published on a publicly accessible website. From 5 October 2021, all DC schemes will be required to report to TPR, in their annual scheme return, the total value of assets held in the scheme for the purpose of providing benefits. For this and other changes to DC governance taking effect later in 2021 (notably the requirement for smaller schemes to publish a detailed "value for members" assessment, starting from the end of the year), please see our *Pensions Bulletin June 2021*.

THE PENSION REGULATOR'S DRAFT CODE OF PRACTICE: LATEST DEVELOPMENTS

The new TPR consolidated Code of Practice will not be in force before Summer 2022. TPR will not proceed with the proposed limit on assets not traded on regulated markets and will relax some of the timing requirements relating to the Own Risk Assessments schemes are required to carry out.

TPR has published an *interim response* to its March 2021 consultation on the new consolidated Code of Practice (please see our *Pensions Bulletin March 2021* for details of the draft Code). Key points are:

- **Timing**: TPR does not now expect the new Code to become effective before Summer 2022.
- **Limit on unregulated investments**: The expectation that, unless there are exceptional circumstances, no more than one fifth of scheme investments should be held in assets not traded on regulated markets caused some concern to trustees wanting to invest in illiquid assets. TPR has now confirmed that it will not be proceeding with the 20% limit: it says it will instead explore options for protecting poorly run, typically small, schemes from investment in poor quality or unregulated assets, whilst allowing schemes with liquidity risk management plans and prudent investment strategies to maintain exposure to unregulated assets.
- **Own Risk Assessments** (ORAs): As part of the Government's implementation of the 2019 Governance Regulations, the draft Code included the expectation that trustees of schemes with 100 or more members should carry out and document an annual ORA, assessing the effectiveness of, and risks from, a number of issues, such as risk management policies, investment governance, administration and payment of benefits. Schemes in scope were to be required to prepare and document their first ORA within one year of the Code coming into force, and then annually thereafter, and to review the ORA after a material change in the risks facing the scheme or to its governance processes. TPR has now said it will be having a rethink about the timing requirements, and frequency of review, following concerns about the amount of work involved in producing ORAs.

Next steps for trustees: Although trustees will have more time to implement the new Code requirements, trustees will still need to progress strategic governance and risk reviews to assess what new governance framework, procedures and policies are needed in the light of the extensive re-writing of existing TPR Codes of Practice.

INCREASING THE NORMAL MINIMUM PENSION AGE TO 57: MORE DETAILS ON THE NEW REGIME

Schemes will need to communicate the proposed 2028 change in Normal Minimum Pension Age (NMPA) to members. The changes will affect all new joiners after 5 April 2023.

The earliest age at which pension benefits can be taken in authorised form for tax purposes, Normal Minimum Pension Age (NMPA), will rise to 57 on 6 April 2028. HM Treasury's response to consultation sets out the proposed approach to legislating for the changes.

There are two additional features to the proposed scheme-specific grandfathering regime:

- There will be a window running up to 5 April 2023 in which individuals will have the opportunity to grandfather an earlier NMPA, by joining a pension scheme with rules that included an unqualified right to take a benefit before age 57 on 11 February 2021. This is consistent with the approach taken when NMPA rose from 50 to 55.
- It will be possible for a member with a protected NMPA in a scheme who cannot meet the block transfer test to take a transfer representing all or some of their benefits to another registered pension scheme and for the protected NMPA to be retained for that transfer on a ring-fenced basis.

Draft legislation has been published, and HMT will also provide further advice "in due course" on the proposed transitional arrangements, for example for members who do not have a protected NMPA and have reached age 55 but not age 57 by 6 April 2028. It is expected that this will require further transitional legislation, as was the case with the rise in NMPA to 55.

Now that an "application window" has been included in the proposals, there will also be a need for transitional provisions to manage the position where there is a bulk transfer between the date on which the relevant rule had to be included in the scheme rules (11 February 2021) and the date by which the member has to have joined the scheme and benefitted from that right (5 April 2023).

There will be no changes to the existing grandfathering protection for individuals with a protected NMPA of less than 55. The new regime will only apply if the existing regime does not.

As a reminder, the proposed new scheme specific grandfathering regime is based on the existing grandfathering regime, but more flexible in some respects:

- A protected member will be able to keep an NMPA earlier than 57 (with a floor of age 55) in that scheme, for benefits built up both before and from the date of change. A right means an unqualified right where no consent of another person (e.g. trustee, employer) is required. As the legislative drafting follows the existing regime, HMRC can be expected to take the same view that relevant rights include an unqualified right to take benefits if a contingency arises e.g. redundancy, or a minimum service period.

- Helpfully, there will not be a retirement from employment or full crystallisation condition (unlike the current grandfathering regime).

- Non-block transfers will result in some protection (see above). However, on a non-block transfer, unlike on a block transfer, only the transferred assets will be protected, so the individual will not be able to build up new benefits with a protected NMPA in the new scheme. This may mean that "buddy transfers" are still attractive in the new regime, where a member is transferring all of their benefits (not just partial benefits).

- The same conditions apply for block transfers as for the current regime, including a requirement that the transfer must represent all of the members' benefits. This can be problematic on e.g. a DC transfer to a master trust from a "hybrid" pension scheme providing both DB and DC benefits, if the transferring member retains DB benefits or life cover in the transferring scheme. If a transfer fails the block transfer test, the non-block transfer alternative is available, but new benefits cannot be built up in the receiving scheme with the protected NMPA.

- The protection will be automatic (there is no need to apply for it), which is the same position as under the current grandfathering regime.

- The protection regime will apply to all types of registered pension schemes, including personal pension schemes (which are excluded from the existing grandfathering regime).

Next steps for employers and trustees: Schemes should review member communications, and add flags reflecting this proposed change in NMPA. As well as communicating the proposed change to members, schemes will also need to check whether their rules, as they stood at 11 February 2021, provided for an unqualified right to take benefits prior to age 57 in any circumstance, and so whether grandfathering is likely to be relevant to members who have joined the scheme before 6 April 2023. Schemes that are considering bulk transfers (such as master trust transfers) will need to consider how the proposed change might affect members.

COURT OF APPEAL CONFIRMS PPF COMPENSATION CAP IS UNLAWFUL AGE DISCRIMINATION

Although the Pension Protection Fund (PPF) has estimated that the removal of the compensation cap would increase liabilities by only about 1%, there may be an impact (albeit minimal, in most cases) on schemes' Section 179 valuations and the level of benefits on entry into the PPF.

The Court of Appeal, in *Secretary of State for Work and Pensions v Hughes*, confirmed that the PPF compensation cap constitutes unlawful age discrimination. (In broad terms, PPF compensation is assessed as 90% of the benefits fixed by the scheme for those members below normal pension age. In addition, for these members, there is a statutory cap on the compensation payable.) The Court of Appeal agreed that the High Court had been entitled to conclude that the cap was not an appropriate means of achieving the legitimate aim of protecting pension entitlements.

The Court of Appeal confirmed the PPF's approach to increasing payments to members following the decision in *Hampshire v PPF*. (The European Court of Justice held in *Hampshire* that Article 8 of the Insolvency Directive was to be interpreted as meaning that Member States had to guarantee benefits corresponding to at least 50% of the value of their accrued pension entitlement in the event of the employer's insolvency.) The PPF was not required to provide at least 50% of the actual value over time of the benefits; it was entitled to conduct a one-off actuarial valuation of members' benefits. However, the Court of Appeal added a caveat that, as there was no challenge to the actuarial assumptions used in the PPF methodology, the assumptions were not "immune from challenge" in terms of whether they would achieve the 50% one-off value requirement.

The Court also approved the PPF's approach to survivors' rights. Article 8 does not require payment to the survivor of an amount no less than 50% of the benefits which the survivor would have received under the scheme. It was open to a Member State to value survivors' benefits on the assessment date in a way that factored in the actual benefits conferred on a survivor by the scheme rules, as part of the actuarial assessment of the overall value of the member's rights.

The PPF has responded by saying that its approach will be to offer the option of a tax-free lump sum to pensioners affected by the cap, as well as increasing and paying arrears on monthly compensation. The PPF is assessing whether to implement a six-year time limit on the payments.

MEMBER COULD RELY ON CHANGE OF POSITION IN OVERPAYMENTS CASE

The Pensions Ombudsman determination in Mrs E is an example of the difficulties schemes can face in trying to recover pensions overpaid in error.

Facts: In 1980, Mrs E left the scheme and received a refund of contributions as her benefits had not vested. She re-joined the scheme in 1983 and again accrued pensionable service. The scheme failed to update its records to show the refund in 1980. Accordingly, Mrs E started to receive her benefits in 2014 taking into account the period of pensionable service for which she had received a refund of contributions. When the error was discovered in 2019, the scheme administrator sought to recover income overpayments of £7,838 caused by the incorrect pensionable service record. Mrs E argued that she had spent the overpayments irreversibly on expenditure she would not otherwise have incurred, including expensive gifts and long-haul trips. She provided information showing her otherwise low level of disposable income over the period. The administrator argued that Mrs E had no defence to the claim for repayment, as she had been given enough information to spot the error herself.

Determination: The Pensions Ombudsman decided that the general principle that money paid in error can be recovered did not apply in this case because Mrs E had a “change of position” defence to the recovery. The Ombudsman was satisfied that she had received, and spent, the overpayments in good faith; she did not have actual knowledge of (nor had she “turned a blind eye” to) the overpayment when she incurred the expenditure. The Ombudsman pointed out that the test for good faith in a change of position defence is subjective, not objective. It was not enough for the administrator to show that she had been sent estimates of retirement benefits and statements that indicated that her benefits had been calculated based on an incorrect pensionable service record; it needed to be clear that, on balance, she had spotted the error and appreciated, or at least suspected, its implications.

Mrs E was a layperson whose understanding of pensions was “very basic at best”. There was no evidence she had fully reviewed, or appreciated, the information sent to her. She had assumed that the administrator had the correct details about her service record. The error was not easy to spot and the forecasted benefits were the most prominent information on the documents.

Mrs E was also awarded £1,000 for serious distress and inconvenience. Mrs E had been chased for payment within two weeks of being told about the overpayment for the first time - this was unreasonable.

PENSION LEGISLATION AND REGULATION WATCH LIST

No	Topic	Expected effective date	Further information/action
1	Statement of Investment Principles (SIP) annual implementation statement	Annual reports which are signed off on or after 1 October 2020	This applies to all pension schemes required to have a SIP.
2	Annual implementation statement on website	Annual reports which are signed off on or after 1 October 2020	For DC schemes only.

No	Topic	Expected effective date	Further information/action
3	Annual statement on compliance with policy on stewardship and engagement activities, and voting behaviour on website	1 October 2021	DB schemes only.
4	Climate risk governance and reporting requirements	1 October 2021	For all authorised master trusts and schemes with £5 billion or more in net assets on the first scheme year end date on or after 1 March 2020. Governance to be in place for the scheme year underway and the first annual report to be published within seven months of the end of the scheme year.
5	Changes to DC scheme governance and disclosure, including the annual Chair's statement and charge cap	First scheme year ending after 1 October 2021 (changes to Chair's statement); 5 October 2021 (changes to annual scheme return); first scheme year ending after 31 December 2021 (detailed value for money assessments for schemes with assets below £100m) April 2022: introduction of £100 de minimis pot size below which flat fees cannot be charged	DC schemes only. DWP to confirm whether look-through mechanism for charge cap compliance will be amended or removed. DWP to review whether fines for non-compliance with Chair's statement requirements should be mandatory (DWP review of Charges and Governance Regulations April 2021).
6	Restrictions on transfers of a member's cash equivalent transfer value by trustees/managers of occupational or personal pension schemes unless prescribed conditions are met	Autumn 2021	Awaiting final regulations.
7	Trustee oversight of fiduciary managers	Under the Investment Consultancy and Fiduciary	Consultation response and new DWP regulations have

No	Topic	Expected effective date	Further information/action
	and investment consultants	Management Market Investigation Order 2019, compliance statements, confirming the extent to which requirements have been met, had to be provided to CMA by 7 January 2021	been delayed until June 2022.
8	DB superfunds	Regulatory regime expected Autumn/Winter 2021	Interim regulatory regime in place from October 2020.
9	Refer members to guidance before processing application to access or transfer flexible benefits	April 2022	For DC schemes only. Consultation on draft regulations closed 3 September 2021.
10	Register certain trusts with the Trust Registration Service	Registration by 1 September 2022	Applies to some trusts relating to pension and life assurance benefits where no exemption applies (e.g. bare trusts set up on distribution of a lump sum).

London
T +44 (0)20 7600 1200
F +44 (0)20 7090 5000

Brussels
T +32 (0)2 737 94 00
F +32 (0)2 737 94 01

Hong Kong
T +852 2521 0551
F +852 2845 2125

Beijing
T +86 10 5965 0600
F +86 10 5965 0650