STEPHENSON HARWOOD
pensions law group

Snapshot

January 2024

Overview

- **HMRC's LTA guidance newsletter**

  HMRC have published an updated newsletter providing further guidance on the abolition of the Lifetime Allowance (**LTA**). Alongside the abolition of the LTA is the introduction of two new lump sum allowances. Trustees and employers should be considering, ahead of the 6 April 2024 deadline, whether their trust deed and rules will need amending and what information they will include in member communications and booklets regarding the change.

- **Pensions Regulator sets out expectations of trustees considering capital backed journey plans**

  The Pensions Regulator (**Regulator**) has set out its expectations of trustees who are considering capital backed journey plans (**CBJP**). In particular, trustees must engage early with the employer and Regulator (and PPF in distressed situations). The Regulator will then assess the arrangement before it is entered into and trustees should therefore build this into their timelines.

- **The Regulator's expectations during M&A transactions**

  The Regulator has published a speech it gave regarding how it expects to engage with schemes and businesses involved in M&A transactions. Key themes were that the Regulator expects to be involved early on in the process and, where defined benefit (**DB**) schemes are involved, it expects these to be treated equitably alongside other creditors.

- **The Regulator's guidance on cyber security**

  On 11 December 2023, the Regulator updated its guidance on cyber security principles for pension schemes. The guidance includes requirements that trustees should keep detailed records that illustrate their understanding of the scheme's cyber risk. The revised guidance also includes a new section that requests that schemes, advisers and providers report "significant" cyber incidents, as soon as reasonably practicable and on a voluntary basis, to the Regulator.

- **LDI – government responds to recommendations**

  In November, the government released its response to 10 recommendations contained in the Work and Pensions Committee's seventh report on Liability Driven Investments (**LDI**) in DB schemes. The government indicates that the Regulator will be taking a more active approach to monitoring adherence to its guidance on 'Using Leveraged Liability Driven Investment'. If compliance with the guidance on this issue is found to be unsatisfactory, the government has indicated its willingness to legislate to place this guidance on a statutory footing. The government is also considering expanding reporting requirements surrounding LDI.

In more detail

HMRC's LTA guidance newsletter

In January 2024, HMRC published an updated newsletter providing further guidance on the abolition of the LTA which will take full effect from 6 April 2024. Key to these changes is the introduction of two new lump sum allowances: the "**lump sum allowance**" and the "**lump sum and death benefit allowance**", together referred to in this Snapshot as the "**Lump Sum Allowances**". The purpose of the Lump Sum Allowances is to control the level of tax-free cash that an individual can receive from registered pension scheme arrangements.

The standard lump sum allowance will be 25% of the current LTA, which is £268,275. Anyone with LTA protection or lump sum protection will, however, benefit from an increased lump sum allowance. For example, a member with Fixed Protection 2014 and a personalised LTA of £1.5m, will have a lump sum allowance of £375,000 (25% of £1.5m).

The standard lump sum and death benefit allowance will be the current LTA, which is £1,073,100. Again, though, anyone with LTA protection will have a lump sum and death benefit allowance that reflects this personalised protection.

Any lump sum paid in excess of an individual's Lump Sum Allowance will be subject to income tax at his or her marginal rate. This reflects the LTA regime under which benefits paid in excess of the LTA were subject to a tax charge.

There are some key differences between the old and new regimes, though, including the fact that under the LTA regime, lump sums paid in excess of the LTA were subject to a 55% LTA charge, whereas payments in excess of the Lump Sum Allowances are subject to marginal rate income tax. Importantly too, the Lump Sum Allowances are relevant only to the payment of lump sums; a payment of pension income will not (unlike under the LTA regime) "use up" a member's Lump Sum Allowances. Further, tax charges by reference to the Lump Sum Allowances will arise only when a lump sum is paid and not on the occurrence of events such as reaching age 75 or death.

In terms of what scheme trustees and employers need to think about in advance of 6 April 2024, the key action points are as follows:

1. Check that the scheme administrator is fully prepared for the changes, in particular with regards reporting to HMRC, operating the new PAYE rules, and providing statements to members.

2. Check the scheme trust deed and rules for explicit references to the LTA and to determine whether any changes need to be made.

3. Consider member communications (including member booklets and employment handbooks), which may need updating to reflect the changes. It may also be necessary to consider how any alternative to pension accrual (such as cash in lieu) offered in connection with the LTA may be impacted by the abolition of the LTA.

The Regulator sets out its expectations of trustees considering capital backed journey plans

The Regulator has set out its expectations of trustees whose pension schemes are considering CBJPs. CBJPs generally involve scheme assets being invested in assets that provide a higher-than-expected return. A third-party funder then provides additional capital to support the additional risks in the scheme.

The Regulator has noted that it is supportive of the industry developing innovative ways of offering trustee's choice without compromising on member benefits. The Regulator has promised guidance early this year to help trustees and employers navigate alternative arrangements. In the meantime, if a CBJP is being considered, trustees must:

- Engage early with the employer, the Regulator and the PPF in distressed situations. The Regulator will assess the arrangement, which is likely to take between two to six months.
- Additional investment risk to be taken must be balanced against the additional capital put in place. Trustees should have the final say over the level of risk taken.
- Trustee boards must have sufficient skill and understanding to appreciate the benefits and drawbacks of such arrangements for their scheme.

Trustees and employers should keep an eye out for the imminent guidance the Regulator has promised in this area. Continued investment innovation in the pensions space is likely throughout 2024.

The Regulator's expectations during M&A transactions

In December 2023, the Regulator published a speech given by Nausicaa Delfas, Chief Executive of the Regulator, to the UK Finance Corporate Finance Committee dinner. The speech specifically addressed how the Regulator engages with schemes and businesses during M&A transactions. It noted its priorities are to "protect, enhance and innovate in savers' interests". Some of the key messages of the speech included that there should be early engagement between the corporate, trustees and Regulators. This can assist with ensuring that transactions proceed smoothly. The Regulator emphasised that it was not there to prevent mergers and acquisitions, but to ensure savers' interests are protected. Further, the Regulator's is keen to ensure that DB schemes are treated equitably alongside other creditors.

The Regulator's guidance on cyber security

In December 2023, the Regulator updated its guidance on cyber security principles for pension schemes. The guidance sets out practical steps that schemes can take to meet the Regulator's expectations on cyber security.

The guidance defines cyber security broadly, in the context of pension schemes, as the risk of loss, disruption, or damage to a scheme or its members associated with using information technology. There is a clear emphasis throughout on how trustees and scheme managers are accountable for the security of scheme information and assets, and are responsible for ensuring that the scheme is administered and managed in accordance with legal requirements. It is noted that this will inevitably entail working together with other parties involved in the scheme, such as advisers. The guidance further states that trustees and scheme managers should keep detailed records that illustrate their understanding of the scheme's cyber risk, of what controls have been implemented to safeguard against incidents, and of any incidents that have arisen. Trustees and

scheme managers are encouraged to refer to those with the required skills and expertise in cyber security, where necessary, to assist their understanding of cyber security.

The revised guidance now includes a new section that requests that schemes, advisers and providers report "significant" cyber incidents, as soon as reasonably practicable and on a voluntary basis, to the Regulator. Significant cyber incidents are detailed to be those that are likely to result in a significant loss of member data, a major disruption to member services, or a negative impact on other pension schemes or service providers. This is in addition to existing legal requirements on reporting cyber incidents, including the requirement to report cyber incidents to the Information Commissioner's Office and, in some cases, to the National Cyber Security Centre, and to report breaches of pensions law likely to be of material significance to the Regulator under section 70 of the Pensions Act 2004.

LDI – government responds to recommendations

In November, the government released its response to 10 recommendations contained in the Work and Pensions Committee's seventh report on LDI in DB schemes, following the LDI crisis in September 2022.

The government's response highlights a number of areas of proposed regulatory reform. Firstly, the government accepted the proposals of the committee that, in light of concerns that they are not providing scheme specific advice, investment consultants should be brought within the regulatory scope of the FCA, subject to the outcomes of ongoing DWP and HMT calls for evidence in relation to pension trustee skills, capability and culture.

The government also indicates that the Regulator will be taking a more active approach to monitoring adherence to their guidance on 'Using Leveraged Liability Driven Investment'. If compliance with the Regulator's guidance on this issue is found to be unsatisfactory, the government has indicated its willingness to legislate to place this guidance on a statutory footing.

The government is considering expanding reporting requirements surrounding LDI, and the Regulator is in the process of expanding its data and digital capabilities as well as improving its coordination with the FCA and BoE, in order to monitor scheme controls surrounding LDI more effectively. The Regulator is already introducing new questions to the annual scheme return to improve oversight of asset liquidity outside LDI mandates in order to gain confidence that scheme buffers can be replenished in the event of a market shock. The government has also indicated that, on the conclusion of the Regulator's existing programme of work to improve data collection surrounding LDI issues, it will consider whether the implementation of further disclosure requirements are appropriate.

Finally, the committee had recommended that the government delay its existing plans for a new DB funding regime in light of concerns raised by the committee that the proposals would impact the ability of open schemes to thrive, and would encourage 'herding' in investment decisions. The government reaffirmed that it will press ahead with its plans to lay the draft Occupational Pension Scheme (Funding and Investment Strategy and Amendment) Regulations 2023 before Parliament, and that this legislation would address the concerns raised by the committee.

Contacts

Philip Goodchild

Partner, Pensions

T: +44 20 7809 2166
E: philip.goodchild@shlegal.com

Stephen Richards

Partner, Pensions

T: +44 20 7809 2350
E: stephen.richards@shlegal.com

Estella Bogira

Managing Associate, Pensions

T: +44 20 7809 2298
E: estella.bogira@shlegal.com

Julia Ward

Senior knowledge lawyer, Pensions

T: +44 20 7809 2028
E: julia.ward@shlegal.com

This note does not constitute legal advice. Information contained in this document should not be applied to any particular set of facts without seeking legal advice. Please contact your usual Stephenson Harwood pensions law group member for more information.

© Stephenson Harwood LLP 2024. Any reference to Stephenson Harwood in this document means Stephenson Harwood LLP and its affiliated undertakings. The term partner is used to refer to a member of Stephenson Harwood LLP or a partner, employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Stephenson Harwood LLP's affiliated undertakings. LONLIVE/109720061

STEPHENSON HARWOOD