STEPHENSON HARWOOD

*May 2025*

# PENSIONS SNAPSHOT

## SUMMARY

It has been another busy month! We cover a lot in this Snapshot, including:

- Considerations for trustees in response to **Trump's tariffs**, whether relating to volatility in investment markets, potential impacts on employer covenant, and considerations for member communications;
- The **Mansion House Compact II** and how it differs from the original Compact;
- The latest announcement regarding **Collective Defined Contribution** schemes;
- An update on **pensions dashboards** and considerations for sectionalised schemes;
- The April 2025 **Supreme Court case on the definition of "woman"**, and potential implications for pension schemes and the calculation of benefits;
- A trustee-favourable Court decision on the availability of **recission** where a mistake as to the tax consequences of actions has been discovered; and
- Short observations on the **Pensions Regulator's speech** at Professional Pensions Live and on expectations for **DB surplus** provisions in the Pension Schemes Bill.

Look out later this month for our Client Briefings on the Pensions Investment Review and the government's response to the Options for Defined Benefit schemes consultation launched in February 2024 by the previous administration.

As always, if you want to talk to us about anything covered in this Snapshot do reach out to Stephen, Estella, or Philip, or to your usual Stephenson Harwood contact.

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## TARIFFS - CONSIDERATIONS FOR TRUSTEES

President Trump's shock announcement in April of substantial tariffs on the USA's trading partners has presented a significant challenge to the assumptions underpinning the global financial system. The tariffs initially imposed were so high as to threaten the continued economic viability of trade, threatening a decoupling of global trading patterns.

This, combined with increased uncertainty regarding the course of USA trade policy and how other nations may respond has led to substantial volatility in global financial markets. This negative impact will likely be felt widely for the foreseeable future.

Trustees face several challenges as a result. Given currently high funding levels, the fluctuations in both liability matching and return seeking investments may have relatively limited effect across the DB industry as a whole. However, trustees may see a weakening of the employer covenant where sponsoring employers have significant exposure to global trading patterns. Trustees will need to monitor this carefully, as always.

Members of DC schemes have likely observed downturns in the investment performance of their pension pots. We suggest trustees consider reminding members of the risks of making substantial investment changes during periods of market volatility, and of the risks of pension scams which often seek to prey on member concerns at times of economic uncertainty.

The impact on pensioner members will vary depending on their retirement choices. Members who have secured an annuity will be largely protected from current market fluctuations, while those who have opted for flexible drawdown may be exposed to significant downside risk.

Trustees should review the suitability of investments offered and may want to review default investment strategies for members choosing flexible drawdown.

The Pensions Regulator has published a useful and comprehensive guide for trustees looking for more guidance on key considerations and steps to take.

## MANSION HOUSE COMPACT II

The original Mansion House Compact, announced in 2023 by the then Chancellor, is a voluntary agreement under which eleven of the largest DC pension providers in the UK agreed to allocate 5% of assets in their default funds to unlisted equities by 2030. A year later, it had been reported by the Association of British Insurers that the signatories to the Compact held nearly £800m of unlisted equities in their DC default funds (equating to only 0.36% of their total DC default funds).

The current Chancellor, Rachel Reeves, has spearheaded a new Compact under which signatories commit to invest 10% of their default funds in unlisted assets by 2030, half of which should be going to UK private markets. As of 13 May 2025, at least seventeen pension funds had signed up including Aviva, M&G and Royal.

The Chancellor has stated the aim of the new Compact is to "*back British businesses and British workers*" and that Compact II will "*unlock billions for major infrastructure, clean energy and exciting startups – delivering growth, boosting pension pots, and giving working people greater security in retirement*". The Compact has been made "*assuming a sufficient supply of suitable investable assets*".

Compact II remains subject to Consumer Duty and fiduciary duty rules, meaning trustees and providers of "subscribed" pension schemes nonetheless must consider their fiduciary duties and good outcomes for beneficiaries when making investments.

The Treasury has not indicated it will take punitive action against pension schemes for failure to comply with the agreement but has noted that commitments will be monitored and has also referred to a set of measures to be introduced to protect the aims of the Compact. We expect the impending raft of pensions legislation in Autumn 2025 may be too early to contain any such protective measures.

In terms of next steps, some pension funds have already indicated that they will go beyond the targets agreed through Compact II. Furthermore, the British Business Bank has been approved by the FCA to deliver the British Growth Partnership, which will provide UK pension funds and other institutional investors with access to the Bank's portfolio of UK venture capital opportunities.

## COLLECTIVE DEFINED CONTRIBUTION

The government has announced that it plans to introduce legislation in Autumn 2025 to permit the formation of multi-employer CDC schemes, and that it "*intends to bring the legislation and an updated Regulator's Code into force as soon as is practicable*". It is expected that the Pensions Regulator will provide updated codes of practice to support this new framework.

Collective Defined Contribution (**CDC**) schemes are a relatively new form of pension scheme where both employer and employee contribute to a collective fund, and which aim to provide a regular pension income for life in a manner similar to defined benefit schemes, but without risking significant unanticipated liabilities for employers. Schemes pool investments and owing to the scale of the funds, and the way risk is pooled, the expectation is that they can provide a target pension income for life.

In October 2024 Royal Mail launched the UK's first CDC scheme for its employees with over 100,000 members, offering a combination of cash lump sum and an income for life in retirement.

Minister for Pensions, Torsten Bell, has said that CDC will deliver value for money as pooling some of the risks that individuals face "*will drive higher incomes for pensioners and greater investments in productive assets across the economy*".

From a value for money perspective, there are three main benefits to CDC schemes:

1. **Greater average replacement rate**: PPI modelling suggests that single employer CDCs could deliver a significantly greater average replacement rate than currently delivered through annuities.
2. **More effective support for economic growth**: As evidenced by similar collective funds in jurisdictions such as Canada and Australia, CDCs can be a more effective way of supporting economic growth, by allowing access to investment in a wider range of industries.
3. **Ability to invest in illiquid and productive investments over long term**: Because of the collective nature of CDC schemes, they can invest in illiquid and productive investments over the long term. This includes investment in UK businesses and infrastructure.

## PENSIONS DASHBOARDS - SECTIONALISED SCHEMES

PASA has released a dashboards AVC toolkit with some helpful commentary on the position for schemes with split administration. This may be the case where, for example, a scheme uses a different administrator for AVC benefits to main scheme benefits, or where a master trust with un-associated employers uses more than one administrator across the master trust.

The starting point is that a scheme must connect to the dashboard fully on the same date. It is recognised, however, that despite all best efforts this may not always be possible, resulting in a technical breach of the rules. PASA has liaised with the Pensions Regulator and the FCA to understand their approach in such situations, which can be summarised as follows:

- There is an expectation that schemes will fully connect on a single date;
- Where this is not possible, remaining sections should be connected at the earliest possible date;
- TPR and the FCA will take a pragmatic approach when considering potential member impact;
- Occupational schemes should consider whether they are obliged to report to TPR under the "breach of the law" reporting requirements, noting that TPR will not usually consider such a breach to be materially significant if prompt and effective action is taken to connect all sections by the longstop deadline of 31 October 2026; and
- FCA-regulated providers may want to consider using the FCA's modification by consent process.

## FOR WOMEN SCOTLAND LTD V THE SCOTTISH MINISTERS - TRANSGENDER CONSIDERATIONS

The Supreme Court has recently handed down judgment on the definition of "woman" for the purposes of the Equality Act 2010, in the widely publicised *For Women Scotland Ltd v The Scottish Ministers* case. The judgment provides that the legal definitions of "man", "woman", and "sex" in the Equality Act 2010 refer to a person's biological sex. This means that for the purposes of sex discrimination protections, a person's sex is determined by their sex at birth. This is the case even if a person holds a Gender Recognition Certificate (**GRC**) which recognises her gender as female.

This does not, however, change the fact that a transgender person will be protected under the Equality Act 2010 through the protected characteristic of gender reassignment.

### Calculating benefits for members who change gender

Historically, men and women's pension scheme benefits accrued on a different basis depending on the member's sex. Since 17 May 1990, trustees of occupational pension schemes have been required to ensure that schemes do not discriminate on grounds of sex. However, members may still have benefits within an occupational pension scheme which are determined by reference to gender, and these may still be unequal. These include rights to a state pension, deductions, actuarial factors, and accrued GMP benefits. As such, a member's gender may still be relevant for benefit calculation purposes.

The Gender Recognition Act 2004 (the **GRA 2004**) makes express pension provision for individuals who have changed gender. It provides that a member's current or future entitlement to benefits should be determined based on the person's acquired gender from the date the full GRC is issued.

This leaves various grey areas – the GRA 2004 does not say how schemes should treat pension benefits which were built up before a member gained a GRC, or what to do if a member has chosen not to apply for a GRC (which many transgender people do not do).

### The impact of the judgment

The Supreme Court ruling does not cut across the pension provisions in the GRA 2004. This means that the importance of a GRC for the purposes of any alteration to entitlement to benefits will still usually be required to change the member's benefits from the date of the GRC, as this is usually required as the evidential threshold for any alterations to state pension and GMP benefits.

It is also important to note that the ruling is limited to the definition of "woman" in the Equality Act in relation to sex discrimination protections. Pension trustees are still required to ensure they do not discriminate against members based on gender reassignment as well as biological sex.

We do not therefore consider that there is much for trustees to do, although trustees may want to consider updating their scheme rules where death benefit rules are based on defined terms such as "wife" and "woman" given that those definitions no longer include transgender partners.

## RECISSION DUE TO UNINTENDED TAX CONSEQUENCES

### *JTC Employer Solutions Trustee v Garnett* [2024] EWHC 3128 (Ch)

This case relates to an employer who created an employer financed retirement benefits scheme (**EFRBS**) for some high-paid employees. The EFRBS provided income tax benefits but also had inheritance tax (**IHT**) advantages. It provides an interesting example of a successful application for recission (i.e. unwinding acts taken so that the scheme and members are in the position they would be in had the rescinded acts not occurred).

The EFRBS were set up to benefit from a provision under the Inheritance Tax Act 1984 (the **1984 Act**) which provides that property held in trust which is applied only for the benefit of a defined class of persons by reference to employment (and those married or in a civil partnership with those persons) will be outside the outside the scope of IHT. Importantly, the defined class must comprise "*all or most of the persons employed by or holding office with the body concerned*".

To give each member an identifiable sub-fund within the EFRBS various deeds of appointment were entered into to appoint funds for the benefit of a specific member and his or her family. The issue was that by creating sub-funds in this way the requirements of the 1984 Act ceased to be met as the funds were no longer held for the benefit of all or most of the employees at that time. As a result, the funds became subject to IHT charges. By the time the issue was identified, IHT charges of £7m were outstanding and there were insufficient funds in the EFRBS to pay the tax due.

After closely examining the facts, the Court used its equitable jurisdiction to set aside the appointments to the sub-funds based on recission so eliminating the tax charges. The Court found the key requirements for recission were present: there was a distinct mistake (as opposed to mere ignorance or inadvertence) as to the fiscal effect of the deeds, the gravity of the mistake was sufficiently grave because the outstanding tax liability would fall on the trustees given the shortage of funds in the trust and it would be unconscionable to leave that injustice uncorrected.

HMRC submitted written objections to the parties' application but for now, the case affirms the findings in *Pitt v Holt* that a mistake as to the tax consequences of a disposition is sufficient grounds for recission, and recission can be granted where relief from tax is the principal, or only, effect of the setting aside of the transaction. It follows the trend of generous judicial decisions on recission and will be welcome news to professional indemnity insurers. It remains to be seen however whether HMRC will want to join as a party to a future claim to make more substantive submissions in support of its objections to try and turn the tide of this trend.

## THE PENSIONS REGULATOR - DC PRIORITIES

On 21 May 2025, the Chief Executive of TPR, Nausicaa Delfas gave a speech at Professional Pensions Live, setting out TPR's priorities as a regulator. A key concern for TPR is that millions of people with DC pension schemes will not have enough to support themselves in later life. Ms Delfas highlighted two key themes that will inform how TPR seeks to meet the pensions challenge: firstly, for the pensions system to deliver value; and secondly, for savers to be able to take informed decisions at retirement. Ms Delfas commented that the upcoming Pension Schemes Bill will have an "*enormous impact*" on the market.

## THE PENSION SCHEMES BILL AND DB SURPLUS

In a press release on the same day as the Regulator's speech, the DWP confirmed that the new Pension Schemes Bill will include changes to DB surplus rules to provide more flexibility for surplus release. We do not have much detail yet, but the press release provides that the Bill will allow trustees and sponsoring employers "*to safely release some surplus to invest back into their businesses and unlock more money for pension scheme members. The upcoming changes will focus on member protection, and trustees will continue to be required to fulfil their duties towards scheme beneficiaries*."

As with all surplus commentary from the government, the focus is on increasing investment in the UK economy. It is not clear whether and how the Bill might mandate the use of some or all surplus funds. Interestingly, one of the questions asked of Ms Delfas at Professional Pensions Live was the level of surplus needed to trigger surplus release from pension funds under the future laws. Ms Delfas responded that it would be self-sufficiency funding rather than insurance buy out level funding that would meet the threshold. This may be indicative of what to expect in the new Bill, which we hope to see in draft form before the summer.

## CONTACT US


### STEPHEN RICHARDS
*Partner, Head of Pensions Advisory*
+ 44 20 7809 2350
stephen.richards
@stephensonharwood.com

### ESTELLA BOGIRA
*Partner*
+ 44 20 7809 2298
estella.bogira
@stephensonharwood.com

### PHILIP GOODCHILD
*Partner*
+ 44 20 7809 2166
philip.goodchild
@stephensonharwood.com

### HARRIET FLETCHER
*Senior Knowledge Development Lawyer*
+ 44 20 7809 2036
harriet.fletcher
@stephensonharwood.com