TRUSTEE QUARTERLY UPDATE

TRUSTEE QUARTERLY UPDATE – 1 MARCH 2018

Cases

High Court ruling in BT Pension Scheme RPI/CPI case

The High Court has held, in the case of British Telecommunications plc v BT Pension Scheme Trustees Limited, that the scheme's employer was not allowed to substitute a different cost of living index for RPI where the pension increase rule allowed this if RPI "ceases to be published or becomes inappropriate". The employer plans to appeal. For more detail, click here.

Court holds amendment power reference to "rights of any Member" means rights already earned

In the case of Wedgwood Pension Plan Trustees v Salt, the court had to rule on the meaning of an amendment power which prohibited any amendment which "shall prejudice or adversely affect any pension or annuity then payable or the rights of any Member". This raised the issue of whether the amendment power restriction applied to rights which a member might earn in future or only rights already accrued to the member in respect of past service. The judge held that the reference to "the rights of any Member" only covered rights accrued in respect of past service. An important factor in the judge's decision was the principle that pension scheme rules should be construed so as to give reasonable and practical effect to the scheme, bearing in mind the need to operate it against a constantly changing commercial background.

On the basis that the amendment power protected the members' right to have their accrued rights increased with future salary increases ("final salary link"), the judge held that an amendment which introduced a new rule broadening the circumstances in which employers could cease to participate in the scheme breached the restriction in the amendment power. This was because the amendment had broadened the circumstances in which the final salary link could be broken. The judge therefore needed to decide whether the new rule was invalid altogether or partially valid, ie valid to the extent that it did not breach the amendment power restriction. The judge's decision on this point was crucial, as the new cessation of participation rule had been used to close the scheme to future accrual in 2006. If the new rule had not been validly introduced, that raised the question whether the 2006 closure had been legally valid.

The judge held that in order for the amendment to be partially valid, two tests had to be satisfied:

- it must be possible to distinguish clearly the boundary between the valid and invalid elements of the amendment: and
- it must be possible to show that the trustees would still have exercised their power to make the more limited amendment had they understood the effect of the amendment power limitation.

Applying these tests to the facts of the case, the judge held that the tests were satisfied, so that the introduction of the new rule was valid to the extent that it did not go further than the old rule allowing employers to cease to participate. As the old rule had allowed employers to cease to participate and break the final salary link where continued participation was "impracticable or inexpedient", the new rule should be read as allowing employers to cease to participate in the scheme in those circumstances. The judge held that at the time when the employers had ceased to participate, the requirements of the old rule were met and that the closure was therefore valid.

Comment

This case illustrates the importance of considering the terms of a scheme's amendment power before making an amendment. In this case, the closure of the scheme in 2006 was held to be valid, but the uncertainty which arose regarding the validity of the amendment meant that the position could only be established with certainty by going to court.

Pensions Regulator obtains court order for restitution against trustees who misused scheme assets

In the case of The Pensions Regulator v Payae Limited, the Regulator has for the first time obtained a court order under section 16 of the Pensions Act 2004 which allows the Regulator to apply to court for an order requiring a person involved in the misuse or misappropriation of pension scheme assets to take such steps as the court may direct for restoring the parties to the position in which they were before the misuse or misappropriation.

The Regulator brought the case against a number of individuals involved in an alleged pensions liberation scheme. Members were induced to transfer out of their existing schemes through the payment of cash sums paid directly to them from their transfer values. Once transferred, funds were unlawfully transferred out of the receiving scheme's bank account or invested in high risk illiquid investments. The court made orders against four individuals requiring them to repay a total of over £13 million.

Employment Appeal Tribunal judgment in firefighters' and judges' age discrimination claims

In our March 2017 Update we reported on two Employment Tribunal decisions relating to age discrimination claims, one relating to the judges' pension scheme and one relating to the firefighters' pension scheme. Both cases involved a change in pension arrangements to a less generous scheme, and in both cases the claimant had alleged that transitional arrangements that benefited those closest to retirement age amounted to unlawful age discrimination. The government's defence was that the age discrimination was objectively justified. For an "objective justification" defence to succeed, it must be shown that the discrimination is a "proportionate means of achieving a legitimate aim".

At the Employment Tribunal, the claimant in relation to the judges' pension scheme was successful, but the claimant in relation to the firefighters' pension scheme was not. In both cases, there was an appeal to the Employment Appeal Tribunal (EAT) which considered the two cases together.

In the case of the judges, although the EAT held that the government had been pursuing a legitimate aim in adopting the transitional measures, the claimant was ultimately successful because the EAT agreed with the tribunal's finding that the measure adopted had not been a proportionate means of achieving the government's aim.

In the case of the firefighters, the EAT agreed with the tribunal's conclusion that the government had been pursuing a legitimate aim in adopting the transitional provisions, but found that the tribunal had taken a wrong approach to the question of whether the transitional provisions were a proportionate means of pursuing that legitimate aim. The EAT remitted that question back to the tribunal, so it remains to be seen whether the firefighters will ultimately be successful before the tribunal.

Given the amounts at stake, it is likely that both cases will end up before the Court of Appeal.

Legislation

Final form regulations published on DC transfers without member consent

In our previous Update, we reported on the Government's plans to change the law on transferring benefits between DC schemes without member consent. The final form regulations to make the changes have now been published and will come into force on 6 April 2018. There have been some changes to the regulations compared with the draft previously published. In particular:

- the definition of "independent" for the purposes of what constitutes an adviser independent of the receiving scheme has been relaxed;
- there will be an exemption from the requirement for independent advice in certain circumstances where the receiving and transferring scheme are closely related; and
- from 1 October 2019, the existing legal route of making a transfer without consent having obtained an actuarial certificate will only be available to DB schemes. 1 October 2019 has been chosen as the effective date for this change in the expectation that this will allow any current DC transfer exercises proceeding on the basis of the existing law to be completed.

Changes to Employer Debt Regulations published

We previously reported on the Government's proposals to introduce a new way to avoid triggering a "section 75 debt" on an employer that ceases to employ any active members of a multi-employer scheme. The final form regulations have now been published and will come into force on 6 April 2018. The Government has made some changes to the detail in response to the consultation responses. The Regulations will allow an employer to enter into a "deferred debt arrangement" under which no immediate debt will be triggered on it ceasing to employ any active members, with the employer instead remaining liable to fund the scheme on an ongoing basis. The proposed changes have been particularly welcomed by participants in schemes for non-associated employers, where existing methods for addressing section 75 debts are often not workable.

A deferred debt arrangement does not remove the possibility of the employer being liable for a section 75 debt in future, so existing ways of addressing section 75 debts are likely to remain the preferred option where a company is being sold out of a group and the buyer wants to be sure it is taking the company free of any pension liability.

Regulations on bulk transfers without consent to schemes that have never been contracted-out

The government has published regulations coming into force on 6 April 2018, to allow contracted-out benefits to be transferred without consent to a scheme that has never been contracted-out provided certain conditions are satisfied. The current prohibition on such transfers can hinder restructurings where it may be desirable to transfer members into a new scheme, but obtaining the consent of every member is not a viable option.

Before the abolition of contracting-out, where the parties wished to transfer contracted-out rights without consent to a newly established scheme with no ongoing accrual, a "workaround" was available of putting one member into the newly established scheme to accrue contracted-out benefits for a short period so that the scheme would become a formerly contracted-out scheme. With the abolition of contracting-out, that workaround ceased to be available.

In order for a transfer without consent to take place the transferring scheme actuary will have to certify that the transfer credits to be awarded in the receiving scheme are broadly no less favourable than the rights being transferred.

Regulations on disclosure of costs and charges

In our previous Update, we reported on the Government's consultation on new regulations which will require trustees of schemes providing DC benefits (other than schemes where the only DC benefits are AVCs) to publish online more detailed information about costs and charges and include in members' annual benefit statements details of the website on which the information can be viewed. The final form regulations have now been published.

The regulations will require additional information on costs and charges to be included in the chair's statement. This will apply from the first scheme year that ends on or after 6 April 2018. Certain information in the chair's statement, such as the default investment option and costs and charges associated with that, will need to be published on a publicly available website. Members' benefit statements will need to inform them that the additional information is available. Trustees will also be required to have due regard to new statutory guidance on reporting costs and charges.

The consultation also included plans to require trustees to provide information on request about investments underlying "pooled funds", to enable members to establish meaningful information about the underlying investments. The Government has decided to bring the pooled fund disclosure requirements into force from 6 April 2019.

New duty on trustees to recommend guidance or independent financial advice

A new clause inserted into the Financial Guidance and Claims Bill making its way through Parliament provides for the Government to make regulations requiring scheme trustees:

- to ask members who apply to transfer or receive their benefits whether they have received pensions guidance or independent financial advice; and

- if a member says no, to recommend that he/she does so and to ask whether he/she wishes to wait until after receiving such advice or guidance before proceeding with the application.

Lifetime Allowance £1,030,000 for tax year 2018/19

Regulations have been made increasing the lifetime allowance to £1,030,000 for the tax year 2018/19. Legislation provides for the lifetime allowance to increase annually in line with CPI inflation, and the increase for 2018/19 reflects this.

Regulations change relief at source deadlines

Regulations due to come into force on 6 April 2018 will bring forward reporting deadlines for pension schemes that provide member tax relief via relief at source rather than a net pay arrangement. The changes have been prompted by the introduction of a Scottish rate of income tax (covered in more detail below) which will mean HMRC will need to tell scheme administrators the correct rate of income tax to apply to members' contributions, based on their residency status.

Regulations simplify valuation of benefits with GARs for purposes of advice requirement

New regulations coming into force on 6 April 2018 will make it more straightforward to value money purchase benefits with guaranteed annuity rates (GARs) to assess whether their value exceeds £30,000 and therefore triggers a requirement for trustees to check that a member has received "appropriate independent advice" before transferring his benefits out to another money purchase scheme. The principle behind the regulations is that the appropriate independent advice requirement will be triggered if the member's transfer value will exceed £30,000.

PPF compensation rules changed in relation to bridging pensions

New rules came into force on 22 January 2018 to allow the PPF to take account of bridging pensions when assessing the level of compensation payable. Previously, PPF compensation rules assessed pension based on the level of pension payable at the assessment date, and took no account of the fact that a member might be receiving a scheme pension that was due to decrease on the member reaching state pension age. This gave rise to the anomaly that over the long-term, a member in receipt of a bridging pension at the assessment date might receive PPF compensation that was higher than the pension the member would have received had the scheme not entered the PPF.

New requirement to notify HMRC if scheme becomes or ceases to be a master trust

A new requirement is being introduced from 6 April 2018 for a scheme's administrator (which for the purposes of the legislation will normally be the scheme trustees) to notify HMRC within 30 days if a scheme becomes or ceases to be a master trust as defined in the Pension Schemes Act 2017. Broadly, a master trust is an occupational pension scheme for unconnected employers that provides money purchase benefits.

Pensions Ombudsman

TPAS dispute resolution function to move to Pensions Ombudsman

It has been announced that the TPAS dispute resolution function will move to the Pensions Ombudsman. The transfer will be completed by 1 April 2018.

Member complaint dismissed where trustee relied on legal advice to interpret pension increase rule

In the case of Mr S (PO-17674), the Deputy Pensions Ombudsman (DPO) has dismissed a member complaint where the trustees relied on legal advice to interpret a pension increase rule. The pension increase rule of the scheme in question provided for pension increases in accordance with the retail price index (RPI) (capped at 5%) "as specified by order under Section 2 of Schedule 3 of the Pensions Schemes Act." From January 2011, the government decided that orders made under the Act would be made by reference to CPI rather than RPI. The scheme trustees therefore took legal advice on the correct interpretation of the rule.

The trustees were advised by counsel that there were two possible interpretations of the rule. The first was that the trustees were required to use the index specified in the order under the Act **as it stood from time to time**, meaning that they should have provided increases calculated by reference to CPI for the year 2010/11 onwards. The second possible interpretation was that the rules required the trustees to use for all time the index that was specified in the order under the Act as at the date the rules were put in place, ie RPI. Counsel was strongly of the view that a court would consider the first interpretation to be the correct one. Following this advice, the trustees decided to suspend any further increases to pensions in payment until pensions equalled the level they ought to have been if increases based on CPI had been applied from 2011. (The trustees agreed with the employer that they would not seek to recover past overpayments.) The member complained about the trustees' approach.

The DPO concluded that the trustees could not be criticised for being unsure whether they needed to pay RPI or CPI increases and for seeking legal advice to clarify this. The DPO was satisfied that the trustees' interpretation of the rule was a reasonable one and that they had not made any error of law. She therefore dismissed the complaint.

Complaint not upheld where transferring scheme refused to provide equalisation information

In the case of Mr E (PO-17428), the Deputy Pensions Ombudsman (DPO) has dismissed a complaint by a member relating to a refusal by the member's existing scheme to provide confirmation that there was no equalisation issue in relation to his benefits (ie that has benefits had not accrued on a basis which unlawfully discriminated between men and women).

The member had originally accrued his benefits in a master trust, but his benefits were subsequently transferred to a "section 32 buy-out policy". The member took financial advice on transferring his benefits to a different scheme in order to take advantage of the "pension freedoms" introduced in April 2015. The scheme to which the member wished to transfer would not accept a transfer value without confirmation of equalisation and the member's financial advisers had an internal compliance policy of requiring confirmation that equalisation had taken place before proceeding with a transfer, so without confirmation the transfer did not proceed.

The DPO dismissed the member's complaint, holding that it was ultimately a commercial decision for the provider of the member's existing scheme to decide whether or not to provide confirmation on equalisation, and a commercial decision for the member's preferred receiving scheme to decide whether to accept a transfer.

Comment

It is legally possible for a pension scheme to assume liability for equalising benefits if it accepts a transfer value in respect of unequalised benefits which accrued on a basis which was not the same for men and women. However, in this case the evidence suggests that the member's benefits were derived from a money purchase scheme and may only have started to accrue in 2001, by which time the legal duty to provide equal benefits for men and women had already been long established. This may therefore have been a case where there was in reality no equalisation issue.

Overpayments recoverable despite being caused by scheme administrator's delay in implementing pension sharing order

In the case of Mr D (PO-16922), the Pensions Ombudsman has held that a scheme was entitled to recover overpayments of pension despite the fact that the overpayments were attributable to the scheme's delay in implementing a pension sharing order (PSO) on the member's divorce. The PSO had awarded 43.7% of Mr D's pension to his ex-wife. There was a delay of approximately 3 months in implementing the order, due to a delay by the scheme in informing the member that he needed to pay a charge for the order to be implemented, and a subsequent delay in giving effect to the order after the member paid the required charge. The scheme sought to recover the overpayments of pension made to the member during this period. The member objected on the grounds that the overpayments were the result of the scheme's delay in implementing the PSO.

The Ombudsman dismissed the member's complaint. The Ombudsman agreed that the scheme had unreasonably delayed in implementing the PSO, but found that the member was aware that he was being overpaid and that the delay in implementing the PSO was not a valid reason to uphold the complaint regarding the scheme's recovery of the overpayments.

Beneficiary required to repay overpayments where unaware spouse's pension ceased on remarriage

In the case of Dr N (PO-15719), the Deputy Pensions Ombudsman (DPO) rejected a beneficiary's complaint regarding the Teachers' Pension Scheme seeking repayment of a spouse's pension to which he ceased to be entitled following re-marriage. The beneficiary received a total overpayment of £7,000 over a period of six years. The evidence indicated that at the time the spouse's pension was put into payment, the beneficiary had not been informed that it would cease on re-marriage, though he had subsequently received annual newsletters which did ask beneficiaries in receipt of a spouse's pension to let the scheme administrator know if they re-married.

The DPO accepted that the beneficiary had only become aware of the rules on re-marriage six years after he had re-married. She concluded that the beneficiary could not have been expected to check the scheme's website for a condition of which he was unaware, and that it was maladministration for the scheme not to have informed him at the outset that his pension would cease on re-marriage. Nevertheless, she rejected the beneficiary's claim that he should not have to re-pay the sum in full. (The beneficiary had not put forward any "change of position" defence to repayment.)

The DPO did say that she would expect the repayment terms to extend over at least the period of the original overpayment, and to take into account the beneficiary's financial circumstances. The DPO did not make any award for non-financial injustice on the basis that the beneficiary had had the use of the overpayment, "in effect an interest free loan".

Comment

Scheme rules which provide for a spouse's pension to cease on re-marriage are relatively rare, but where scheme rules do contain such a provision, this should be drawn to the spouse's attention at the point of bringing the benefit into payment.

No financial loss award for misquoted spouse's pension, but total of £1,000 for non-financial loss

In the case of Mr E (PO-16971), the Pensions Ombudsman rejected a member's claim for financial loss where the member claimed he gave a greater sum to his daughter than he otherwise would have done, having been repeatedly quoted incorrect figures regarding the spouse's pension that would be payable on his death. However, the Ombudsman awarded the member £500 for non-financial injustice in addition to the sum of £500 already offered by the scheme administrator.

Over a period of several years, the member was repeatedly quoted incorrect figures regarding the pension which would be payable on his death to his spouse, who was nine years younger than him. The member and his wife gave a gift of £93,200 to their daughter to help her with buying an investment property. When the member became aware that he had been quoted incorrect figures for the spouse's pension, he calculated that if his wife outlived him for 15 years, she would receive a total of £13,500 less than he had been led to believe. He made a claim for £13,500 on the grounds that he would have reduced the gift to his daughter by this amount had he been quoted the correct figure.

The Ombudsman rejected the member's claim for £13,500, holding that the alleged loss of £13,500 was not an actual loss as the figure was based on a scenario which might or might not materialise (ie the member's wife outliving him by 15 years). However, taking into account the number of occasions on which the member had been quoted incorrect figures, the Ombudsman ordered the trustees to pay £500 for maladministration in addition to the £500 which the member had already received from the scheme administrator. The Ombudsman said that in setting the level of award, he had taken into account that the misstatements related to a contingent benefit which might never be relied upon. It is implicit from this that the award for maladministration might have been higher had the misstatements related to the level of the member's pension rather than a spouse's pension contingent on the spouse outliving the member.

Pensions Regulator

Regulator statement on management of service providers by trustees

The Pensions Regulator has published a statement summarising its expectations of good practice by trustees on the management of service providers, and planning for events which could have major consequences for the scheme, including the failure of service providers.

Regulator fines trustees for failure to get accounts audited on time

The Pensions Regulator has for the first time fined scheme trustees for a failure to obtain audited scheme accounts within the statutory deadline. The deadline was missed for the scheme year ending 5 April 2015 and 5 April 2016. The Regulator imposed penalties of £500 each on four individual trustees.

Dominic Chappell ordered to pay £87,000 following conviction for failure to provide information to Regulator

Dominic Chappell, the director and majority shareholder of the company that bought BHS for £1, has been fined £50,000 and ordered to pay £37,000 in costs after being convicted of failing to provide information to the Pensions Regulator without a reasonable excuse.

HMRC

HMRC extends to 5 March deadline for registering with Trusts Registration Service

In previous updates we have reported on the new money laundering regulations which came into force in 2017 and which may require a scheme to register with HMRC's Trusts Registration Service (TRS) if liabilities to certain taxes have been incurred. The deadline for registering with the TRS if a relevant tax liability had been incurred in tax year 2016/17 was due to be 31 January 2018, but HMRC has extended the deadline to 5 March 2018.

Pension Protection Fund

PPF Levy Determination and new requirements for contingent assets published

The PPF has published its Levy Determination for 2018/19 and related documents. These include new standard form contingent asset agreements. Some key changes to the levy rules this year are:

- if trustees are seeking recognition for a "Type A" contingent asset (guarantee) which will result in a levy saving of £100,000 or more, they will need to submit a "guarantor strength report" prepared by a professional adviser. PPF guidance sets out detailed requirements that the report must meet. The report must be submitted in hard copy by 5pm on 29 March 2018;and

- the PPF has changed the rules for multiple guarantors so that it will be possible to certify a different "realisable recovery" for each guarantor rather than having to certify a single figure which all certified guarantors are able to meet.

Miscellaneous

Relief at source for Scottish income tax

From tax year 2018/19, different rates of income tax will apply to Scottish taxpayers (broadly, individuals resident in Scotland). For occupational pension schemes which operate a "net pay arrangement" whereby member contributions are taken from pay before tax is deducted, members effectively automatically get tax relief at their marginal rate of income tax. However, the impact of Scottish rates of income tax for schemes operating relief at source was less clear. HMRC has now published a newsletter to address this.

For schemes operating relief at source in tax year 2018/19, scheme administrators will continue to give tax relief at the basic rate of 20% for all taxpayers. HMRC will not attempt to claw back tax to reflect the fact that the starter rate for Scottish taxpayers will be 19%. However, no adjustment will be made by scheme administrators to reflect the fact that Scottish taxpayers will pay income tax at the "intermediate" rate of 21% on income between £24,001 and £43,430. It appears that Scottish taxpayers who do not complete a tax return will need to contact HMRC to request an adjustment to their tax code if they want to get tax relief at the intermediate rate of 21%. HMRC indicates that it has not yet decided whether to adopt the 2018/19 approach long-term or make changes for subsequent tax years.

Announcement of 6 month grace period for obtaining LEIs

In our previous Update, we reported on the need for schemes to obtain a "legal entity identifier" (LEI) by 3 January 2018 to comply with the Markets in Financial Instruments Directive (MiFID II). On 20 December 2017 the European Securities and Markets Authority announced a 6 month grace period, but that is subject to the investment manager obtaining from the client the necessary documentation to apply for an LEI on the client's behalf. The FCA says it still expects firms to make every effort to secure a client's LEI before trading on the client's behalf.

Government plans amendment to law on statement of investment principles

On 18 December 2017, the Government published an interim response to the Law Commission's report on pension funds and social investment. The current law requires a statement of investment principles to include details of the extent, if at all, to which social, environmental or ethical considerations are taken into account in the scheme's investment policy. The Law Commission report considered that this is confusing as the law conflates such factors being taken into account (a) because of their potential impact on financial performance, and (b) for non-financial reasons such as ethical concerns. The Law Commission recommended a change to the law to require the statement to address these two issues separately. The Government has said it is minded to make this change, subject to consultation which it plans to undertake in 2018.

Government announces long-term plan to reduce lower age limit for auto-enrolment and remove lower earnings limit

In its Automatic Enrolment Review 2017 the Government announced that it is its "ambition" to have changed the auto-enrolment regime by the mid-2020s to:

- reduce the lower age limit for auto-enrolment from 22 to 18; and
- abolish the lower limit for the earnings band on which contributions are paid, so that if a worker is auto-enrolled, contributions will be payable on his first £1 of earnings.

The report also confirmed that for 2018/19 the "earnings trigger" for auto-enrolment will stay at £10,000.

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Addleshaw Goddard Pensions Team

Addleshaw Goddard's Pensions Group is acknowledged by independent commentators as one of the leading practices in the UK, renowned for its ability to deliver commercial and practical advice, designing and delivering training for trustees and pensions managers and providing timely and accurate advice services. Headed by Rachel Rawnsley, the Group operates across offices in Leeds, London and Manchester.

For further information about our Pensions team, click here.

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