



Essential pensions news

Updater

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Introduction

Essential Pensions News covers the latest pensions developments each month.

DWP publishes consultation on new powers and sanctions regime to build a stronger Pensions Regulator

On *June 26, 2018*, the Department for Work and Pensions (DWP) published “Protecting Defined Benefit Pension Schemes – A Stronger Pensions Regulator”, a consultation on proposals outlined in the pensions White Paper, published in March 2018. The consultation closes on *August 21, 2018*.

The White Paper, published on *March 19, 2018*, included a wide range of reforms to support defined benefit (DB) pension schemes, among which were suggested measures to strengthen the powers of the Pensions Regulator (TPR), including

- Changes to the voluntary clearance regime.
- A power for TPR to issue punitive fines against targets of a contribution notice.
- A new criminal offence to punish “wilful or grossly reckless behaviour” of directors in relation to a DB scheme.

A requirement for sponsoring employers to make a statement of intent before any relevant business transaction, to confirm that they had considered the impact of the transaction on their DB scheme.

Outline of the consultation

The DWP's current consultation paper on proposals to "strengthen" TPR outlines three main areas of change

- Improving TPR's powers allowing it to be more proactive where changes are proposed which could affect DB schemes.
- A new system of sanctions to "deter wrongdoing and punish it when necessary".
- Improving TPR's existing powers to issue contribution notices (CNs) and financial support directions (FSDs).

The consultation proposes several major changes enabling TPR to be more closely involved in transactions and restructurings that involve companies with DB pension schemes. This would be implemented by changes to the current notifiable events framework, including the introduction of a requirement to produce a "declaration of intent" prior to signing contracts on the transaction.

New notifiable events requirements

The proposed changes affect the current notifiable events regime in respect of both the range of events that will trigger a reporting requirement, and the timing for making a notification to TPR. The new regime will require notification only where a certain "risk threshold" is exceeded, for example, where the scheme is underfunded on a pre-determined basis. This basis is to be set out in regulations later, and supported by a revised DB Code of Practice.

The new events will be employer-related and include

- Sale of a "material proportion" of the business or assets of a scheme employer which has funding responsibility for at least 20 per cent of the scheme's liabilities. The DWP sees these transactions as significant because they frequently indicate a change in covenant support for the scheme.
- Granting of security on a debt to give it priority over debt to the scheme.
- Significant restructuring of the employer's board of directors and certain senior management appointments.

The DWP proposes removing the existing notifiable event relating to wrongful trading of the sponsoring employer and to extend the current notifiable event for a breach of a banking covenant to include covenant deferral, amendment or waiver.

The payment of dividends will not be a trigger for notification at this stage, pending the results of the Department for Business, Energy and Industrial Strategy (BEIS) consultation into corporate governance, which closed on June 11, 2018. The consultation sought views on new proposals to improve the governance of companies by strengthening the responsibilities of directors of companies either in or approaching insolvency, "while [maintaining] a fair balance of interests for all shareholders". In particular, the consultation considered: the sale of businesses in distress; the reversal of value extraction schemes (asset-stripping); investigating the actions of directors of dissolved companies; and strengthening governance in pre-insolvency situations.

The timing of the notification requirement to TPR is to be at an earlier stage, as the current requirement for notification as soon as “reasonably practicable” after they have occurred, this has sometimes been after the transaction has completed.

The consultation states that TPR made aware of the relevant transaction no later than when negotiations have led to agreement in principle of its main terms, to coincide with the point at which scheme trustees being made aware of the transaction. The DWP proposes that notification of these particular notifiable events should occur when a Heads of Terms agreement is first put in place, but the trustees are expected to be involved earlier in the negotiations.

Failure to comply with the new notifiable events framework

Among the new sanctions proposed in the consultation is the introduction of a new criminal offence to punish several breaches. These include failure to comply with the notifiable events framework, although the consultation states that any criminal penalties would be reserved for “the most serious cases of wrongdoing”. Alternatively, TPR may levy a fine of up to £1 million.

Declaration of intent

The consultation sets out how the DWP envisages that a “declaration of intent” will operate in conjunction with the notifiable events regime. It will be required at a stage when “there is greater certainty as to whether the transaction is going ahead, its nature and the implications for the scheme”.

Voluntary clearance

The current clearance guidance was last updated in March 2010, and will be reviewed to make clearer TPR’s expectations of trustees and employers. The consultation proposes changes to the current clearance regime in three respects

- The “material detriment” definition will be reviewed and clarification will be given on how applicants and trustees should approach this test.
- A revised definition of event types will be produced, including the circumstances in which clearance is given in relation to FSDs.
- Further detail on the clearance process, including expectations around timing of an application, expressed as “as early as possible” in the consultation.

New civil and criminal penalties

One of the biggest changes to the current regulatory regime which permit a civil fine of up to £5,000 for individuals and £50,000 for corporate entities for non-compliance, the consultation proposes an extension of the civil and criminal sanctions that TPR may impose. In addition to the existing civil penalty regime, there is to be a new layer of civil fines up to £1 million for “serious breaches” in order to “deter behaviours which ... have resulted in actual harm to the pension scheme or have the potential to do so if left unchallenged”.

In addition, new criminal offences are included to punish “wilful or grossly reckless behaviour” in relation to DB schemes, non-compliance with a CN and failure to comply with the notifiable events framework. It will also give the criminal courts the power to impose further penalties.

The possible targets of these sanctions will depend on the offence in question, but could include directors, sponsoring employers, any associated or connected persons and, in some circumstances, trustees.

Changes to the moral hazard regime

The consultation outlines changes to the current CN and FSD regime to strengthen both procedures with proposals.

For CNs proposals include

- Changing the “reasonableness” test to focus more closely on the loss or risk caused to a scheme by the “act” when assessing the amount to be demanded under a CN. Scope would also be given for the employer’s justification for the “act” as a determining factor.
- Introducing a means to reflect the impact of the delay in payment in the amount of the CN.
- Changing the date on which the cap on the level of a CN is calculated to a date closer to the final determination.
- Creating an additional limb to the “material detriment” test, assessed by reference to the weakening of the employer.

For FSDs proposals, several features of the CN process are incorporated including

- Creating a single-stage process, under which the FSD would create a specific and enforceable obligation on the target (rather than this occurring at some later stage as in the current regime).
- Tightening up the forms of financial support the target is required to make to the scheme, so that FSDs will either require a cash payment or impose a form of statutory guarantee in relation to some or all of the sponsoring employer’s liabilities.
- Reviewing whether the “insufficiently resourced” requirements should be amended or replaced to make the criteria for imposing a FSD clearer and more certain.
- Allowing FSDs to be issued to a broader range of individuals, where they are associated with or connected to the sponsoring employer.
- Amending the reasonableness test to make clear that the actions of a target in creating or increasing risk are a relevant (but not necessary) factor.
- Providing TPR with a power to impose a CN on any person associated or connected with the recipient of the FSD.
- Exploring whether the FSD “lookback” period could be increased beyond two years.
- Allowing TPR to issue an FSD after the scheme has entered the Pension Protection Fund (PPF).

Next steps

The consultation closes on *August 21, 2018*. Further proposals in the DB White Paper will be addressed over the coming months, and TPR intends to engage with interested stakeholders on the design of clearer funding standards, culminating in a formal consultation on a revised Defined Benefits Funding Code of Practice in 2019.

The DWP will also be consulting on the design of the legislative framework and authorisation regime for the commercial consolidation of DB pension schemes “later this year”.

Comment

There are some major changes proposed here but it is doubtful whether any of them would have prevented the recent failures of BHS and Carillion. However, the consultation offers scant detail, so it is difficult to comment at this stage in any depth. The next Queen’s Speech will be in 2020 and the fines and criminal proceedings changes will require primary legislation. Therefore, it may not be until late in that year that new legislation comes into force. Even the provisions that require clarifying regulations and TPR guidance are unlikely to be finalised in the near future.

Of particular concern are the proposals to make failure to report a notifiable event a criminal offence and the extension of the look-back period – is this to be retrospective? If so, it is possible that current transactions could be under scrutiny before the final shape of the reforms is known.

We will be responding to the consultation and producing an in-depth briefing on this topic in the near future.

View the [consultation paper](#).

DWP consults on proposed expansion of schemes’ Statements of Investment Principles

The DWP is consulting on changes to regulations governing investment and disclosure of information by pension trustees to better reflect environmental, social and governance issues (ESG) and stewardship concerns. Consultation on the draft amending regulations closes on *July 16, 2018*.

Following its December 2017 interim response to the Law Commission’s 2017 report on pension funds and social investment, the DWP is proposing the following changes

- Replacing the existing legislative requirement that trustees must set out in their statement of investment principles (SIP) their policies towards ESG considerations. In future, the DWP suggests trustees should be required to set out in their SIP their policies towards “financially material considerations”. These will be expressly defined as including (but not being limited to) “environmental social and governance considerations (including climate change)”. While the Law Commission had stopped short of recommending that climate change be singled out in the SIP, the DWP considers this is necessary given the importance of the issue and the consensus that exists on its significance for long-term investment.

- Requiring trustees of DC schemes that are obliged to produce a SIP to prepare a statement of members' views, setting out the extent to which trustees will take members' views about financial and non-financial matters into account in preparing or revising their SIP.
- Requiring trustees of DC schemes to publish their SIP and statement of members' views online, alongside an annual implementation report that will have to explain the extent to which the SIP has been followed in the previous year. These documents will also have to be referred to in members' annual benefit statements.

Subject to the outcome of the consultation, and assuming the amending regulations are laid before Parliament this autumn, the DWP intends that the new requirements concerning the contents of the SIP (and the requirement to publish it online) should come into effect on *October 1, 2019*. The requirement to publish an implementation report will not be brought into force until *October 1, 2020*.

Comment

In practical terms, the changes may lead to more frequent disagreements over the scale of funds' investment in areas such as fossil fuels, both among trustees and between trustees, employers and members. One of the areas of uncertainty will centre on how trustees should gauge members' views in the course of preparing their statement setting these out. The DWP suggests that some views should be easily evident to trustees. For example, they can fairly assume that members would not want their schemes' funds to be invested in the manufacture of cluster bombs, on the basis that the production of these materials is banned under international treaties, but this is largely uncontroversial.

There are some concerns that the requirements to publish the SIP and a statement concerning members' views online may cause some confusion for trustees as to whether members' views need be taken into account as a matter of law, which is not the case. It is important that new regulations do not blur the role and responsibilities of trustees, and that they do not place any unnecessary costs burden or constraints on schemes.

As the recent Court of Appeal decision in *R (Palestine Solidarity Campaign Ltd) v Secretary of State for Communities and Local Government* [2018] showed, (and on which we reported in our [June 2018 update](#)) many members are keen for their schemes to pursue other, more political, aims. In the long run, there could be a rise in litigation centred on how pension schemes are discharging their new ESG responsibilities.

View the [consultation paper](#).

DWP consults on amendments to PPF compensation regime to remedy issues caused by *Beaton v PPF*

The DWP is consulting on amendments to the PPF compensation rules to ensure that the PPF can continue to apply the compensation cap in line with its current practice in relation to fixed pensions that have been transferred into a scheme which then enters the PPF.

The PPF's practice is to treat benefits derived from a relevant fixed pension and those derived from pensionable service within the scheme alike, irrespective of whether they are based on actual pensionable service under the relevant scheme or have been the subject of a transfer-in. However, last year the High Court in *Beaton v The Board of the Pension Protection Fund* [2017] held that a member's transferred-in benefits were not attributable to pensionable service with the new employer and were not to be aggregated for compensation cap purposes when the new employer's pension scheme entered the PPF.

The DWP consider that this decision has resulted in PPF legislation being interpreted inconsistently with PPF practice and contrary to policy intent. It is therefore consulting on The Pension Protection Fund (Compensation) (Amendment) (No.2) Regulations 2018 which will amend the PPF compensation provisions to allow the PPF to apply the compensation cap in line with its current practice and ensure that it has the legal basis to pay compensation and inflation-related increases to compensation in respect of relevant fixed pensions.

The consultation closes on *July 24, 2018*.

Master trusts code of practice laid before Parliament

TPR has finalised its code of practice no. 15 on the authorisation and supervision of master trusts following a consultation earlier this year. The final code was laid before Parliament on *July 2, 2018*.

TPR received 28 responses to the consultation, the majority of which considered that the code was comprehensive and clear in setting out TPR's expectations in relation to the authorisation criteria. However, some changes to the code have been made in response to specific comments.

TPR's response confirms that it will consult on its policy on the supervision and enforcement of master trusts over the summer, with a view to publishing the policy ahead of the application window opening on *October 1, 2018*. It will then consider whether any further guidance is required.

TPR is obliged to issue a new code (or codes) of practice covering

- The process for applying for a master trust scheme to be authorised.
- The matters TPR must take into account in deciding whether the authorisation criteria are met.

In our [April 2018 update](#), we reported that TPR had published the draft code of practice for consultation on *March 27, 2018*, which sets out details on the authorisation process, the matters TPR will take into account in deciding whether a master trust should be authorised and the legal requirements that apply once authorisation has been achieved.

Consultation response

TPR received 28 consultation responses. The key points to note are

Fit and proper assessment

A "significant minority" of respondents queried whether the requirements for trustee competence as part of the fit and proper assessment were set at the right level for both individuals and the board. Some felt that the expectations for individual trustees should be higher, others thought than an expectation that each individual trustee should have a basic level of knowledge on appointment would deter new trustees.

TPR did not agree that the requirement for all trustees to demonstrate at least a basic level of knowledge created a barrier for member-nominated or newly-appointed trustees. In addition, the fact that a trustee is on TPR's list of independent trustees is not, it considers, a suitable proxy for the fit and proper test. However, amendments have been made to the code in relation to how TPR assesses trustee competence at board level. Boards should be able to demonstrate that they have the right blend of skills and experience for their particular master trust;

Continuity strategy

Some respondents queried the description of the continuity strategy as "a high-level, flexible document" given that it needs to include specific information on a wide range of matters. TPR notes that the range of matters to be included in the continuity strategy are set out in legislation and that not including this information will result in a failure to submit an adequate continuity strategy. However, TPR does not expect the strategy to be "too exhaustive" in the level of detail it sets out;

Financial sustainability requirement

There were strongly argued responses in relation to elements of the "haircuts table" included in the draft code. When calculating the value of assets held in financial reserves in the scheme's costs assets and liquidity plan, a master trust must apply the discount rate directed by TPR (as a "haircut" to reflect the fact that it may be necessary for a master trust scheme to dispose of assets at a sub-optimal time). In response, TPR has reduced the haircuts applied to scheme revenue and scheme income and taken steps to make the haircuts table clearer. TPR has also acknowledged that the proposed minimum to be held by master trusts using the basic method to assess the scheme's financial reserves may not be sufficient for every scheme. It has decided to increase the amount to £150,000 (from £75,000), which it believes "is a more prudential estimate of costs incurred by master trusts with less than 2,000 members".

Next steps

TPR will consult on its policy on the supervision and enforcement of master trusts in next couple of months with a view to publishing this before *October 1, 2018*. It will then consider the need for any additional guidance. TPR will also publish checklists for the business plan and continuity strategy, together with a process map of the application procedure.

Assuming no issues are raised in Parliament, schemes hoping to achieve authorisation will have a busy summer putting together a detailed application. Some master trusts have submitted a draft application to TPR as part of "readiness reviews". TPR aims to provide feedback on these draft applications by the end of August 2018 to help master trusts prepare their formal application for authorisation.

TPR will submit formal applications for authorisation to the DP in batches in the order they are received. Further information on publication of the authorised list of master trusts will be provided ahead of the application window opening in October 2018.

View the [consultation response](#) (21 pages).

View the [code of practice](#) (102 pages).

PPF publishes new guidance on its approach to company voluntary arrangements

The PPF has published new guidance setting out the approach that employers and their advisors should take when presenting a proposal for a company voluntary arrangement (CVA) to the PPF.

When an employer lodges a CVA proposal, the PPF takes over the trustees' creditor rights. The PPF has specific restructuring principles which it applies in situations where the pension scheme is compromised and is likely to enter the PPF. However, it has now set out its approach to situations where the pension scheme is to be rescued and remains whole.

The guidance, published on June 12, 2018, includes a list of issues that the PPF expects employers and their advisors to address in order for it to vote in favour of a CVA proposal. These include

- What risk to the deficit reduction contributions (DRCs) is posed by the CVA and how will these be mitigated? Should the trustees seek a new valuation and agree a new schedule of contributions? The employer covenant is likely to be weaker (at least in the short term) and therefore DRCs may be too low.
- Are any dividends forecast to be paid in the foreseeable future and what steps are proposed to ensure that the scheme receives comparable amounts?
- What is the quantum of PPF drift (the PPF's exposure during the period of the CVA) and what mitigation is being provided in addition to DRCs to protect against this?

The guidance follows what the PPF describe as a "marked increase" in the use of CVAs, the majority of which are aimed exclusively at addressing property issues with the intention of leaving other creditors, including the pension scheme, untouched. However, the PPF's experience of such proposals has shown that a significant majority are not successful since the issues facing the business remain unaddressed and the employer goes on to fail.

View the [PPF's guidance](#) (four pages).

TPR updates its guidance to the Chair's Statement

Speaking at a recent conference, TPR Chief Executive Lesley Titcomb announced that TPR has published an updated version of its guidance setting out the legal requirements in relation to a chair's statement.

Ms Titcomb indicated that the guidance would be applied retrospectively meaning redress could be provided to some schemes. She said: "Some of our interventions in terms of fining have raised eyebrows. Today, we are publishing updated guidance to ensure we are being as clear as possible to what we expect in terms of chair's statements. We will be issuing revocations of penalties to be consistent. It is also important that, as a regulator, we act fairly."

Comment

The guidance makes clear that TPR expects detailed and clear explanations of how trustees are governing their schemes. This is an issue that TPR takes seriously, having already issued fines on trustee boards which do not comply, and trustees should take care to give proper consideration to their scheme's specific circumstances.

View the [updated guidance](#).

HMRC publishes Pension schemes newsletter no. 100

On *June 29, 2018*, HMRC published the latest edition of its Pension schemes newsletter. The contents include

- A reminder that the new Manage and Register Pension Schemes service was launched on *June 4, 2018*, with additional features being added on *June 11, 2018*. Feedback on the new service is welcomed.
- Notes for administrators on how to register and how to apply to register a scheme.
- Reminders for scheme administrators on how to request confirmation of registered schemes where transfer requests are received.
- A confirmation that the annual allowance and carry forward calculator, which has been unavailable since April 2018, will be ready for online use again from *July 6, 2018*.
- A reminder that the deadline for submitting the 2017/18 annual return of information is *July 5, 2018*. Details of the changes for the annual return of information 2018/19 are also highlighted.
- Notes on amendments to relief at source forms and templates.
- Changes to the employer guidance on the taxation of flexi access payments.
- Options to resolve the issue that some administrators have reported on reporting multiple small pots payments.

View the [newsletter](#).

HMRC publishes Countdown Bulletin no. 35

Of interest to all schemes formerly contracted-out on a DB basis is the latest issue of HMRC's Countdown Bulletin, which was published on *June 29, 2018*.

The Bulletin includes updates on the

- Scheme cessation guidance for Pension Scheme Administrators.
- New automated solution for 2R local authority schemes liability part period.
- New automated solution for change of responsible paying authority.
- Guaranteed Minimum Pension checker.

View the [Countdown Bulletin](#).

Draft Finance Bill 2019 legislation: taxation of employer contributions to life assurance and overseas pension schemes to be reformed

HMRC has published draft legislation to reform the tax relief of employer premiums paid into life assurance products from *April 6, 2019*.

Under the current tax regime, premiums and contributions are only tax exempt if the named beneficiary is the employee or a member of the employee's family or household. The draft legislation will amend section 307(2) of the Income Tax (Earnings and Pensions) Act 2003 to allow a beneficiary named by an employee to be any individual or registered charity. The amendment will also include contributions paid into qualifying recognised overseas pension schemes (QROPS) *within the exemption*.

The explanatory note, issued with the consultation, confirms that the change is intended to:

“... [modernise] the exemption to ensure the tax charge remains relevant and fair ... The exemption will also allow employees to nominate a registered charity, which is consistent with existing government policy of providing tax relief on charitable donations.”

***MB v Secretary of State for Work and Pensions*: ECJ rules on the age transgender people should receive their State pension benefits**

Summary

In the 2016 case of *MB v Secretary of State for Work and Pensions*, the Supreme Court considered the issue of State pension entitlement for a transsexual person with an acquired female gender.

The Gender Recognition Act 2004 (GRA 2004) came into force on April 4, 2005, and provides for the issue of a gender recognition certificate to those who have undergone gender reassignment surgery. Once the certificate has been issued, the individual's new gender is legally recognised for most purposes but it does not have retrospective effect. Arguably, this means that pension accrued before the date of the gender recognition certificate must be treated as having accrued in the person's original sex. This, together with the requirement that a transgender person must be unmarried in order to obtain a gender recognition certificate, were the potentially discriminatory issues considered by the European Court of Justice (ECJ).

The ECJ handed down its judgment on *June 26, 2018*.

Facts of the case

MB was born in 1948 and registered at birth as male and had been married to a woman since 1974. However, since 1991 MB had lived as a woman and underwent gender reassignment surgery in 1995.

Upon reaching age 60 (the State pension age for women in the UK at that time), MB applied to receive her State pension. Her application was rejected on the ground that she did not have a full gender recognition certificate, which was required under UK law in order to be treated as a woman for the purpose of receiving State pension benefits. Without it, MB would have to wait until reaching age 65 (the State pension age for men) to receive her pension.

One of the requirements for obtaining such a certificate was that the applicant had to be unmarried (due to the UK not permitting same-sex marriage at that time). Therefore, unless MB obtained an annulment of her marriage, it was not possible for her to obtain a full gender recognition certificate. However, for religious reasons, MB and her wife wished to remain married.

MB brought a challenge in the UK courts against the UK government in respect of the decision not to pay her State pension from age 60. Her challenge was brought on the basis that the requirement to be unmarried was discriminatory and contrary to EU law. The decision to withhold her State pension was upheld in the lower courts and the Court of Appeal. However, the Supreme Court referred this point to the ECJ.

The Advocate General's opinion and his reasoning

The Advocate General (AG) found that previous ECJ case law established that prohibited discrimination on the grounds of sex also covers discrimination on the basis of gender reassignment. The requirement to be unmarried for the purposes of accessing the State pension applied only to transgender persons, and this contravened the Equal Treatment Directive.

The AG decided that the correct comparator for establishing sex discrimination in the context of gender reassignment depends on the circumstances of each case and, as MB sought to receive her State pension from the same age as an individual who had been registered at birth as a woman – a cisgender woman – this was the correct comparator in MB's case. The requirement to be unmarried to receive State pension benefits does not apply to a cisgender woman.

The AG noted that discrimination on the basis of sex cannot be objectively justified unless it falls within specific circumstances set out in EU law, and the requirement for transgender persons to be unmarried did not fall within any of them. He therefore concluded that such a requirement could not be objectively justified.

The ECJ's decision

The ECJ held that the Equal Treatment Directive must be interpreted as precluding any national legislation which requires a transgender person not only to fulfil physical, social and psychological criteria but also to satisfy the condition of not being married to a person of the acquired gender, in order to be able to claim a State retirement pension from the State pension age which applies to those of his or her acquired gender.

Comment

With the ECJ having followed the AG's opinion, this will be good news for married transgender persons such as MB who wish to receive their State pension from age 60. Despite this, the number of people who stand to benefit from such a decision in future is limited. The requirements for issuing full gender recognition certificates have changed now that same-sex marriages are recognised in the UK, and the requirement for a transgender person to be unmarried no longer applies. Furthermore, UK State pension ages for men and women are being harmonised, so the number of transgender persons potentially affected by this issue will diminish over time.

***R (Palestine Solidarity Campaign Limited and another) v Secretary of State for Communities and Local Government* [2018] – Court of Appeal allows Secretary of State’s appeal and rules guidance on LGPS statutory investment guidance held to be lawful**

In our [monthly update for July 2017](#), we reported on the case of *R (Palestine Solidarity Campaign Ltd and another) v Secretary of State for Communities and Local Government* [2017]. In this case, the High Court upheld a challenge relating to the statutory guidance governing the investment strategy for the Local Government Pension Scheme (LGPS), and agreed with the claimants that the guidance was outside the minister’s statutory powers in stating that administering authorities under the LGPS must not

- Use pension policies to pursue boycotts, divestment and sanctions against foreign nations and UK defence industries except where the Government has put in place formal legal sanctions, embargoes and restrictions.
- Pursue policies that are contrary to UK foreign policy or UK defence policy.

The Secretary of State appealed to the Court of Appeal (CA).

The Court of Appeal decision

The CA decision was unanimous, with Sir Stephen Richards giving the lead judgment. The CA held that it was plainly within the scope of the relevant legislation for an authority’s investment strategy to make provision for non-financial considerations to be taken into account in making investment decisions, including the authority’s policy on how social, environmental and corporate government considerations are taken into account in the selection, non-selection, retention and realisation of investments.

The CA considered various decisions of the European Court of Justice which were useful in that they adopted an approach which distinguished between national rules which restricted basic freedoms (and in so doing were an infringement) and rules that laid down a technical framework (which were not). The CA held that the guidance was closer in character to the technical framework than to a set of rules prescribing the authority’s investment strategy. Therefore, the authority was left with the freedom to take those decisions and was not required to invest (or not invest) in any particular financial product.

The guidance did not infringe the prohibition on subjecting an institution’s investment decisions to any kind of prior approval or systematic notification requirements in the IORP (pensions) Directive.

Comment

Presumably, this decision will result in an “as you were” approach in relation to the strategy guidance for local authorities under which they make decisions before investing LGPS funds. The judgment was handed down on *June 6, 2018*, and the expected result is that the paragraph which was removed from the guidance pending appeal will be reinstated.

Local authorities will need to continue to ensure that their investments are made taking into account appropriate factors, both financial and non-financial. There is both legal precedent and DB investment guidance from TPR recognising that trustees may take non-financial considerations into account when making investment decisions. This decision may be reflected in the revision of the DB scheme funding Code of Practice when the revised version is published for consultation in 2019.

British Airways v Airways Pension Scheme Trustee Limited – Court of Appeal upholds employer’s appeal and holds trustees’ discretionary increase invalid

In a judgment handed down on *July 5, 2018*, the Court of Appeal (CA) overturned the High Court decision and held (by a majority of two to one) that the trustees had acted outside of their powers by granting the 0.2 per cent discretionary increase. The CA held that trustees should manage and administer the scheme rather than redesigning the benefits.

The trustees have been granted leave to appeal to the Supreme Court.

Facts

Historically, pensions had been increased in line with the Retail Prices Index (RPI). In 2010, after the Chancellor announced the change to the Consumer Prices Index (CPI) for the increase of public sector pensions, there was some concern that CPI would not provide the members with adequate protection against inflation. The Trustees therefore used their power of amendment to change the rules to give themselves a power to grant discretionary pension increases. In 2013, they used this power, giving a discretionary increase of 0.2 per cent (on the basis that this would bring the increase closer to the RPI level). BA challenged both the use of the power of amendment, and the exercise of the power to grant the increase.

High Court decision

The High Court considered two issues

- Did the trustees validly exercise the power of amendment when they conferred on themselves a power to review and increase pensions beyond what would have otherwise been permitted under the rules?
- If the above amendment was properly made, did the trustees exercise their new power validly when they used it to grant an increase of 0.2 per cent above CPI in 2013 (or was it a benevolent or compassionate payment)?

The High Court held that both powers had been validly exercised.

CA decision

The CA held that:

On the first point, by a majority, that the amendment went beyond the purpose of the power of amendment contained in the trust deed.

Although the (unusually) trustees were able to make any amendment without employer consent, the amendment in question went beyond the proper purpose of the power of amendment, which the CA said was to be determined by looking at the purpose of the scheme as a whole.

When considering at the scheme as a whole, there were several circumstances in which the employer could be required to pay more, but discretionary increases was not expressed to be one of these. Further, the trust provisions gave the employer a power to increase benefits, but did not grant such a power to the trustee. Both Lewison and Jackson LLJ thought that this omission was crucial. There was nothing in the deed to suggest that the trustees should

be able to “remodel the balance of powers between themselves and the employer” and that making the amendment had resulted in a scheme which had a different purpose, as the “trustees effectively added the role of paymaster to their existing responsibilities”. The function of trustees was to manage and administer the scheme; not to design it.

Patten LJ dissented on this point, and held that the amendment made was within the proper purpose of the scheme, as the overall purpose was defined as the provision of pension benefits, (which this was), and that the benefit conferred on members was the same in kind as that which they had always enjoyed - that is, an increase calculated with reference to RPI.

On the second point, the CA held that the payment was not benevolent or compassionate. However, this point was no longer relevant as it had been held that the amendment had been invalidly made.

The trust deed set out that: “The main object of the scheme is to provide pension benefits on retirement and a subsidiary object is to provide benefits in cases of injury or death for the staff of the Employers in accordance with the Rules. The scheme is not in any sense a benevolent scheme and no benevolent or compassionate payments can be made therefrom.”

Patten LJ held that the reference to not being a benevolent scheme was included merely to ensure the scheme obtained revenue approval, and could not be read to mean that any payment made could never be viewed as benevolent. He held that the purpose of this clause was to draw a distinction between the provision of benefits in accordance with the scheme, and the making of purely gratuitous payments of a benevolent or compassionate kind which are not pension payments. Although the additional 0.2 per cent was generous, it did not make the payment a benevolent one. Lewison LJ and Jackson LJ agreed on this point.

BA will not be required to pay the £12 million cost of the discretionary increase that the trustees awarded. The trustees have been granted leave to appeal to the Supreme Court.

Comment

The CA’s decision is an interesting reversal of the High Court’s position on the trustees’ amendment. However, the dissent of Patten LJ indicates that the matter was far from straightforward.

However, this decision relates very much to its facts, as trustees rarely have a unilateral power of amendment. The decision does raise some interesting points on how the exercise of any amendment power needs to be made with regard to the principle of proper purpose. Many schemes have other powers that rest solely with the trustees, and the power to choose an index for pension increases is often one of them. This decision may give such trustees, and their advisers, reason to consider carefully how they are exercised in future. For sponsoring employers, the decision will provide some comfort that, even where they are not a party to the decision-making process, there is the potential for challenging the exercise of discretionary powers where the result might be an increase in benefits and the associated costs of providing them.

It remains to be seen whether the trustees will appeal this decision.

High Court rules DB scheme closed to future accrual but with final salary link frozen for employer debt purposes

The High Court has given judgment in *G4S plc v G4S Trustees Ltd and another*, in which the employer brought Part 8 proceedings to clarify whether a multi-employer defined benefit (DB) scheme which was closed to future accrual of benefits, but in which the members retained a final salary link, had active members for the purposes of the employer debt regime such that an employment-cessation event (ECE) was capable of occurring. This in turn depended on whether such members were in “pensionable service”. If they were not in pensionable service, (and therefore not active members), the scheme would be a frozen scheme.

The High Court held that the scheme was a “frozen” scheme for the purposes of the employer debt regime. Mr Justice Nugee decided that, based on the proper interpretation of “pensionable service”, where a scheme has closed to future accrual but retained a final salary link, those members benefiting from the final salary link were not in pensionable service in respect of the scheme.

This, he held, was on the basis that they were no longer building up “units” of pension by virtue of their ongoing service - their continued service went only to the quantification of that pension. This meant that they were not active members and therefore that the scheme was a “frozen scheme” in respect of which an ECE could not occur automatically.

The decision will be welcomed by many employers and trustees, as it clarifies that in a DB scheme, service that qualifies the member for pension or other benefits must mean service that qualifies the member for units of accrual.

Lloyds GMP equalisation case reaches High Court

In our [update for June 2017](#), we reported on a case concerning three female members of Lloyds Banking Group Pension Scheme, who are bringing a discrimination claim related to the calculation of guaranteed minimum pensions (GMPs). The hearing began in the High Court on *July 5, 2018*.

Legal background

In November 2016, the DWP consulted on a re-worked proposed calculation basis for the equalisation of GMPs. Consultation respondents broadly welcomed the new method, which involves a one-off actuarial comparison with opposite sex comparators and conversion to ordinary scheme benefits.

Several technical changes to existing secondary legislation governing formerly contracted-out salary-related schemes (on which the DWP also consulted) have now been finalised in the Occupational Pension Schemes and Social Security (Schemes that were Contracted-out and Graduated Retirement Benefit) (Miscellaneous Amendments) Regulations 2017 (the Amending Regulations). Among other things, the Amending Regulations extend the period during which formerly contracted-out schemes may pay contributions equivalent premiums where they have used HMRC’s scheme reconciliation service to reconcile their GMP data. They also revise the rate of fixed-rate GMP revaluation for those leaving pensionable service after April 5, 2017. The new rate will be set at 3.5 per cent a year, a reduction from the current 4.75 per cent rate, and below the 4 per cent rate originally proposed by the DWP. The amending regulations came into force on *April 6, 2017*.

The Lloyds case

A legal bid was launched by female employees of Lloyds Bank in 2017, alongside pension trustees and the Lloyds Trade Union, in an effort to equalise GMPs. The group are looking to close an apparent pension gap of around £2,000 between men and women employees in Lloyds's defined benefit (DB) schemes. This affects around 230,000 female scheme members who joined the scheme between 1978 and 1997.

According to Lloyds Trade Union, the part 8 claim is seeking “the Court’s ruling on whether the equalisation obligation (if any) is only engaged if an opposite sex comparator can be identified for the affected member, or if the obligation arises without the need to identify a comparator”.

The High Court hearing is due to last two weeks, and a ruling is expected later in 2018.

Comment

The outcome of this case will be watched closely by those involved with final salary schemes. If successful, the claim could cost Lloyds an approximate £508 million, with the cost of equalising the 2,400 contracted-out pension schemes in the DB sector amounting to a further £20 billion.

There are implications for all schemes with GMPs accrued in the period May 17, 1990, (the date of the Barber judgment) to April 5, 1997.

Pensions Ombudsman: Mr T (PO-13049) – no duty on employer to inform member of tax charge

Summary

The Deputy Pensions Ombudsman (DPO) has dismissed a complaint by a member that his employer was legally obliged to inform him that he would be liable to pay a member's unauthorised payments charge if he took a refund of his widows' pension contributions as a lump sum. The DPO ruled that there is no statutory obligation on an employer to notify members of the implications of changes to tax legislation.

Legal background

Under the Finance Act 2004 (FA 2004), there are several criteria that must be met for a lump sum to be considered a pension commencement lump sum (PCLS) and therefore exempt from liability to income tax. In particular, it must be paid within 12 months of the member's entitlement to a pension under the scheme. Where a lump sum is paid outside of these rules, it is deemed to be an unauthorised payment and is subject to an unauthorised payments charge payable by the member.

Facts of the case

The complainant, Mr T, argued that his employer, HMRC and the scheme's administrator, MyCSP, failed to inform him that he would be liable to a tax charge on his Widows' Pension Scheme (WPS) refund, contrary to Cabinet Office guidelines issued in September 2016 (the Guidelines).

The Guidelines explained that WPS refunds are treated as part of a member's PCLS and must be paid at the time that the member received their pension or be subject to the unauthorised payment charge, and stated:

“Eligible individuals should be given two options regarding their WPS refund: Option 1: [25 per cent of the value as a lump sum, with the balance converted to a pension. Option 2: taking the refund as a lump sum. They must be informed that they will be liable to pay tax on this amount. The tax charge will be at least 40 per cent.”

The Cabinet Office considered it good practice for scheme administrators to follow this guidance.

Mr T was a member of the 1972 section of the Principal Civil Service Pension Scheme (the Scheme) and retired in July 2005 at age 56 with an immediate pension.

In June 2009, HMRC’s in-house pensions team wrote to Mr T to inform him that he was eligible for a WPS refund amounting to £13,790 (the June letter). The June letter stated that lump sums such as this were “generally considered ‘unauthorised’ under current tax legislation and may be liable to a tax charge”. The letter gave Mr T two options as follows:

“Option 1

To avoid your refund being taxed as an unauthorised payment you may change your net refund into a continuing pension plus a lump sum. The lump sum shown below is the maximum amount of lump sum pension schemes may pay in this way.

Option 2

This option allows you to take all of your refund as a lump sum. As an “unauthorised” payment under the new tax legislation, it may be liable for tax. We will pay your refund without tax deducted but it is then your responsibility to tell Her Majesty’s Revenue and Customs (HMRC) that you have received an unauthorised payment from the scheme. You should record the payment on any Self-Assessment return you are asked to complete ... ”

In a subsequent phone call, the pension team told Mr T that the refund “may” be subject to a tax charge. Mr T chose to take the entire WPS refund as a lump sum, as per Option 2.

On June 19, 2009, the pensions team authorised the payment of £13,790 and reminded Mr T that he was responsible for informing HMRC when he received the “unauthorised scheme payment” as he was potentially liable to pay tax on it.

On July 1, 2009, the Scheme wrote to Mr T confirming that the payment would shortly be made and that due to changes in legislation, “the refund is subject to a 40 per cent tax charge” (the July letter). Mr T said that he did not receive the July letter.

In 2012 HMRC made a demand for an unauthorised payment charge of £5,516 on his WPS refund. Mr T appealed and the payment was suspended until March 2015 when he received a demand for £6,194 (the original sum plus interest). The amount outstanding at the time of the complaint was approximately £8,000.

The claim

Mr T complained that HMRC and MyCSP failed to inform him that he would be liable to pay a tax charge on his WPS refund, contrary to the Guidelines, which amounted to maladministration. He argued that HMRC, as his employer, was legally required to provide him with information about legislative changes that would affect his benefits. Had he been

presented with the tax implications of the two options, he would not have chosen to take a refund of his WPS contributions. Further, he did not receive the July letter which, in any event, was sent after he had made his decision.

HMRC and MyCSP rejected Mr T's complaint, concluding that they were not legally obliged to inform him of the tax charge. Mr T had been warned that the refund would be taxed and, as such, it was his responsibility to investigate what tax charges would apply.

Determination

The complaint was dismissed. The DPO agreed with the Adjudicator's opinion that there was no legal obligation on either HMRC or MyCSP to inform pension scheme members that they would be liable to tax at 40 per cent if they elected to receive the WPS refund as a lump sum. Although the Guidelines stated that members "must be informed that they will be liable to pay tax if the refund is taken as a lump sum", the Adjudicator considered that this did not materially change the outcome of Mr T's complaint. The June letter warned that taking the WPS refund as a lump sum might give rise to a tax liability, and Mr T could have discovered the position by making enquiries at the time.

The DPO held that there was no statutory obligation on employers to notify employees of the implication of changes to tax legislation. The DPO accepted that Mr T may not have received the July letter, but considered that he did receive the June letter and therefore, it was reasonably foreseeable that the refund of widows' pension contributions as a lump sum could be taxed as an unauthorised payment. While the tax position could have been made clearer, the Mr T was provided with sufficient warning of the possibility that the lump sum would be subject to a tax charge to have prompted him to ask for further information before choosing to take the WPS refund as a lump sum.

Comment

Details are set out in regulations about the provision of scheme information to members, but outside of these specific situations, uncertainties may arise. Complaints turn on their own facts and the outcomes are often hard to predict: for instance in *Cherry* (PO-7096), the PO found that the employer had a duty of care to provide the member with information about tax penalties in a situation where the member had been re-employed and had a protected pension age; whereas in *Ramsey* (PO-3290), the PO held there was no duty on the employer or trustee to warn the member about the impact of the reduced annual allowance.

In this case, the determining factor appears to have been that tax is a matter for the individual. Although the member was not categorically informed that he would be liable for a tax charge if he took the lump sum, he was given sufficient warning that a tax charge may apply and should then have made his own enquiries.

Pension developments in the pipeline

Below is a summary of pension changes expected in the near future in addition to those outlined above. Changes since the last update are in *bold and italic*:

Steria (Pension Plan) Trustees Ltd v Sopra Steria Ltd and others: High Court claim seeking declaration regarding the requirement to obtain a section 37 certificate. The case was heard on May 22, 2017. The claim has been stayed until *June 18, 2018*, with both parties having been ordered to update the court before *April 5, 2018*.

Clarification of trustees' fiduciary duties in relation to longer term investment risks – the DWP has confirmed in a response to a written Parliamentary question that it will publish its full response to the 2017 Law Commission report, *Pension funds and social investment*, by June 2018.

EMIR – new requirements to the exchange variation margin relating to derivatives applied from March 1, 2017. If an investment manager uses over the counter derivatives, schemes should check that arrangements are in place for trustees to comply with the new regime. A further EMIR exemption extension for pension scheme arrangements applies to August 16, 2018. The European Securities and Markets Authority (ESMA) issued a press release on July 3, 2018, clarifying the clearing obligations for pension scheme arrangements (PSAs) in the light of the proposed regulation amending EMIR (the EMIR Refit Regulation).

The EMIR Refit Regulation will simplify clearing rules for small and non-financial counterparties and provide a temporary exemption for PSAs from the mandatory clearing of derivatives. This is necessary as the current and final exemption for PSAs from the clearing obligations under EMIR expires on August 17, 2018. The temporary exemption allowed time for a suitable technical solution for the transfer of non-cash collateral as variation margins to be developed by central counterparties (CCPs). While there is not yet a suitable technical solution, no further extensions are available under EMIR.

ESMA's statement sets out its expectations between the temporary exemption under EMIR expiring and the new exemption under the proposed EMIR Refit Regulation coming into force. ESMA expects national competent authorities "not to prioritise their supervisory actions towards entities that are expected to be exempted again in a relatively short period of time (under the proposed Regulation) and to generally apply their risk-based supervisory powers in their day-to-day enforcement of applicable legislation in a proportionate manner".

The EMIR Refit Regulation is due to be considered by the Council of the EU and the European Commission in July 2018. The European Parliament adopted the proposed Regulation on June 12, 2018.

The Pension Schemes Bill 2017 received Royal Assent on April 27, 2017. The legislation is concerned principally with provisions relating to the authorisation of master trusts. The new regime for master trust regulation, upon which the Government's response to the consultation is awaited, is likely to be brought fully into force on October 1, 2018.

The DC scheme Chair's annual governance statement must be completed within seven months of the end of the scheme year. For example, schemes with a March 31, year end must submit the statement by October 31, 2018. TPR issued trustee [guidance](#) on the statement in November 2017 and the guidance was updated in June 2018.

IORP II – the expected transposition date is January 12, 2019.

Brexit should be achieved by March 29, 2019. The UK will then leave the EU from the effective date of withdrawal agreement or, failing that, two years after giving Article 50 notice unless European Council and UK unanimously decide to extend period.

New regulations - DC bulk transfers without member consent – the Occupational Pension Schemes (Preservation of Benefit and Charges and Governance) (Amendment) Regulations 2018 came into force on April 6, 2018. The easements are the removal of

- The need to obtain an actuarial certificate stating that the transfer credits in the receiving scheme are broadly no less favourable than the rights to be transferred (Coming into force *October 1, 2019*, to allow current transfers time to complete).
- The requirement for there to be a scheme relationship.

New regulations – the Occupational Pension Schemes (Administration and Disclosure) (Amendment) Regulations 2018 came into force *April 6, 2018*, setting out new requirements to improve transparency on DC benefit costs and charges to members. They do not apply to DB schemes providing only DC AVCs. Members must be provided with access to information via a website with seven months of the scheme's year-end date – meaning the earliest date is *November 6, 2018*, for schemes with year-end *April 6, 2018*.

VAT – HMRC's existing practice on VAT and pension schemes is to continue indefinitely. Employers should consider taking steps to preserve (or enhance) their pensions-related VAT cover.

Auto-enrolment – cyclical re-enrolment now applies within a six-month window related to the employer's staging date. e.g. employers with a July 1, 2015, staging date must complete the cyclical re-enrolment process between April 1, 2018, and September 30, 2018. Total minimum contributions were increased to five per cent (of which minimum employer contribution of two per cent) from *April 6, 2018*. Total minimum contributions will increase to eight per cent (of which minimum employer contribution of three per cent) from *April 6, 2019*.

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