Trustee Knowledge Update

Welcome to the August 2015 edition of our Trustee Knowledge Update which summarises recent changes in the law. It is aimed at helping trustees (including trustee directors) comply with the legal requirement to have knowledge and understanding of the law relating to pensions and trusts. This edition focuses on the key legal developments over the last three months.

Legislation (http://www.legislation.gov.uk)

Schemes that were Contracted-out Regulations and Pensions Act 2014 (Savings Order) 2015
These Regulations deal with the treatment of contracted-out benefits after the abolition of defined benefit contracting-out in April 2016. The key points to note are:

- Amendments to formerly contracted-out schemes will need to satisfy certain requirements. These requirements are set out in the Regulations and broadly retain existing provisions.
- Post April 1997 benefits and GMPs can be paid as a lump sum in the same circumstances as currently.
- There are additional provisions in relation to GMPs, broadly replicating current requirements in relation to spouse's benefits and revaluation.
- The sections setting out the requirements for reference scheme test benefits in the Pension Schemes Act 1993 are preserved so that scheme rules that contain a reference scheme test underpin by cross referring to the legislation will continue to work.

Government (http://www.gov.uk)

Response to consultation on regulations on cessation of Contracting-out
As well as issues picked up in the Regulations discussed above, the consultation makes the following points:

- There will be further consideration of how best to deal with reference scheme test underpins in DC schemes as the issue is "*more complex than we first thought*".
- There will be no power to modify scheme rules where they refer to the basic state pension, or where a scheme has integrated its structure with the state scheme. However, basic state pension will continue to be provided for in annual uprating orders.
- The issue of notifying or consulting members about changes due to the abolition of contracting-out will be addressed in a future consultation.
- DWP accepts that legislation is not clear on how trivial commutation/small pots from GMP should be calculated and will consult on changes in due course.
- Issues on GMP conversion/equalisation are "*being explored separately*".

Tax (www.hmrc.gov.uk/pensionschemes/index.htm)

Finance (No 2) Bill 2015
The Finance Bill 2015/16 implements many of the changes announced in the Summer Budget. The key points are:

- From April 2016 there will be a taper to the annual allowance for those with incomes (including pension savings) above £150,000. For each £2 of income above £150,000, an individual's annual allowance will reduce by £1. Once an individual's income reaches £210,000 or more, their annual allowance will be £10,000. The taper will not apply where income (excluding pension savings) is below £110,000.
- All pension input periods (PIPs) for annual allowance purposes will be aligned with the tax year from 6 April 2016. To begin the alignment process, all open PIPs ended on 8 July 2015 and the next PIP runs from 9 July 2015 to 5 April 2016. There are special tax provisions for these shorter PIPs.

  All members have an annual allowance of £80,000 for the period from 6 April 2015 to 8 July 2015 (as the changes mean they may have 2 PIPs ending in that period). Where relevant, the DC annual allowance will be £20,000 for that period. The PIP from 9 July 2015 to 5 April 2016, will technically have a nil annual allowance, but up to £40,000 of unused annual allowance from the previous period (including £10,000 of DC annual allowance) can be carried forward. This is in addition to any existing unused annual allowance carried forward from the three previous tax years.
- The 45% tax charge on certain lump sum death benefits paid on death after age 75 is removed for death benefits paid on or after 6 April 2016. Tax will be payable at the recipient's marginal rate instead (where the benefit is paid directly to the recipient).
- The tax treatment of DB lump sum death benefits is brought in line with other lump sum death benefits. Where those lump sums are not paid out within two years of the scheme administrator becoming aware that the member has died, they will be taxed in the same way as the lump sum death benefits referred to above. Currently, such a lump sum would be an unauthorised payment.

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It is proposed that the lifetime allowance will fall from £1.25 million in April 2016 to £1million. HMRC confirms that there will be similar forms of protection for members to those available when the lifetime allowance fell in 2014. However, the notification process will be different, individuals will not need to notify HMRC in advance or within a 3-year deadline. HMRC is considering options around removing deadlines and aims to publish full details later in summer. "*In the meantime, pension providers and employers should consider what communications they need in advance of 6 April 2016 to individuals who may be affected*."

Newsletter 71
This outlines recent changes relating to overseas transfers and explains the difference between a ROPS (a Recognised Overseas Pension Scheme) and a QROPS (a Qualifying Recognised Overseas Pension Scheme). A ROPS must satisfy certain factual tests relating to governance and benefits. A QROPS is a ROPS that has notified HMRC and undertaken to provide specified information on an ongoing basis. Registered Pension Schemes can only make authorised transfers to a QROPS.

HMRC used to maintain a list of QROPS but realised that it could not confirm if a scheme met the ROPS requirements. Therefore, it now only maintains a ROPS notification list which shows *"that the scheme manager has notified*

HMRC, wishes to appear on the list and has undertaken to provide information… but this is all it shows. It does not show that the scheme meets the ROPS requirements".

HMRC emphasises in this Newsletter that in the event of an overseas transfer, it is the responsibility of the individual member and the scheme administrator (usually the trustees) of the transferring scheme to check the receiving scheme meets the requirements to be a QROPS. Checking the published list the day before the transfer will confirm whether the scheme has notified HMRC not whether the scheme meets the ROPS requirements.

Regulator (www.pensionsregulator.gov.uk)

Guide for employers on DB funding code
This is aimed at helping employers understand how the DB code of practice applies to them. It explains that the code balances trustees' duties to pay benefits with employers' objectives to grow their business whilst ensuring pension promises are kept. "*The new quick guide emphasises the benefits of trustees and employers working collaboratively together in an open and transparent way, understanding the long-term plans for the business and the pension scheme and managing the associated risks accordingly."*

Annual DB Funding Statement
This is primarily aimed at trustees undertaking valuations with an "as at" date between 22 September 2014 and 21 September 2015 and sets out the Regulator's "*views on current market conditions and how trustees and employers can agree appropriate funding plans which protect members' benefits without undermining the sustainable growth of the employer*".

The Regulator confirms that schemes do not need to remove all risk: "*Schemes with capacity to take additional risks should be able to address higher deficits through appropriate changes to their funding strategy...*

Other schemes… should seek higher contributions with a view to maintaining the same recovery plan end date – where this is affordable to the sponsor without adversely impacting its plans for sustainable growth. Where constrained affordability results in lower deficit recovery contributions than trustees think the scheme needs, they should maintain a higher level of due diligence and put in place strategies for managing the risks to the scheme."

The Regulator expects most funding strategies to be based on lower investment returns than previously. Where the employer prioritises business investment over reducing a deficit in the scheme, the investment should be used to improve the employer covenant. The scheme "*should be treated fairly and the other stakeholders of the employer should likewise adequately support its growth plans, eg through dividend blocks or restrictions*."

Assessing and monitoring the employer covenant
This replaces the Regulator's 2010 guidance on monitoring the employer covenant and is longer with more practical examples. The Regulator says, as a minimum, trustees should undertake a full covenant review at each valuation. The assessment should provide sufficient information for the trustees to be able to answer a list of questions, including the following:

- Which employers can the scheme access value from?
- What is the trustees' assessment of the employer's current and future profitability and how do these compare with the likely funding needs of the scheme?
- Over what period of time can the employer afford to repay the scheme's funding deficit?
- Is the scheme being treated equitably with other stakeholders?
- How much value could the scheme recover in an insolvency of the employer?
- What are the risks to the covenant and how may it change over time?

The guidance also goes through the factors that trustees should consider when determining whether they need external covenant advice.

Recovery plan analysis for 2012/13
The Regulator has published its analysis of valuations in the 12 months to September 2013. 72% of schemes in the period had an increased deficit and half of schemes increased deficit recovery contributions. The average length of recovery plans was 8.5 years and the majority of schemes extended their recovery plan period.

Updates to DC scheme return form
The Regulator has updated its scheme return form for DC schemes. The following new questions have been added:

- Schemes affected by the charge cap are asked to confirm they comply with the requirements and to give details of any members for whom the scheme is non-compliant and explain why.
- The name of the Chair is required or confirmation the scheme is exempt from the requirement to have one.
- Schemes are asked to confirm if any members have been auto-enrolled or if the scheme has been used to satisfy the auto-enrolment requirements for existing members.

Cases

Sterling Insurance Trustees Ltd v Sterling Insurance Group Ltd (High Court - unreported)
The scheme was set up in 1998. Pension was calculated by reference to "final pensionable salary" and "total pensionable service". The trust deed contained a restriction prohibiting any amendment that would "*substantially reduce in aggregate the value... of the benefits accrued due in respect of any Member up to the date of such alteration, modification or addition*".

In 2004, the scheme was amended so that "final pensionable salary" was fixed as at the end of September 2004. The Court was asked to determine whether this amendment was valid and, in particular, what was meant by the words "*benefits accrued due*" in the amendment power.

The judge held that "*accrued due*" meant a benefit which was due for payment. However, this interpretation would give the provision very limited effect. The use of the words "*in aggregate*" was a strong pointer in favour of a vision of a package of benefits, and it was unlikely that the draftsman had thought of payments that were due but not paid or that there would be several such benefits to be aggregated. As a result, the court had to consider whether to impose its own construction.

The court had to be satisfied that something had gone wrong with the wording and consider whether it could and should be corrected. In this case, the use of "due" in the amendment power was a mistake because, on its natural and ordinary meaning, it did not fit with the remainder of the provision which was intended to protect member benefits. The amendment power would therefore be construed as if the word "due" were not there. As a result, the link to salary at the date of leaving service was protected.

Bradbury v BBC (High Court)
The BBC offered members the choice of remaining active members of the final salary section of the scheme (with future pay awards limited to 1% for pension purposes), or joining a new career average earnings scheme where future pay awards would not be subject to any pensionable cap. The member agreed to transfer to the career average scheme. However, he later complained that the BBC's conduct breached the scheme rules, section 91 Pensions Act 1995 and the employer's implied duty of trust and confidence.

The first two complaints were dismissed in an earlier case. This case was considering whether the employer had breached its implied duties. The Ombudsman had held that the BBC was justified in seeking to impose the cap and its decision was not irrational or perverse or one that no reasonable employer in its position would have adopted. In the light of the scheme deficit, its potential future liability, its resources, overall obligations and the steps taken to address the problems it faced in relation to the scheme, the BBC had not breached its implied duties towards the member.

The judge rejected the member's appeal from the Ombudsman's decision. The member had failed to demonstrate that the BBC's conduct had breached any "reasonable expectation" held by the members (meaning an "*expectation as to what will happen in the future engendered by the employer's own actions (and in relation to matters over which the employer has some control), which gives employees a positive reason to believe that things will take a certain course*").

The judge held that the Ombudsman was entitled to reach the conclusions he had on each of the factors which Mr Bradbury sought to impugn, namely improper coercion, collateral purpose, age discrimination and lack of proper consultation. None of the individual grounds raised gave rise to a breach of the implied duty. The judge said that it would require a very strong case indeed for a number of disparate objections (even arising out of the same conduct) to give rise, when taken together, to a breach of the employer's implied duties if none of the objections by itself gave rise to such a breach. As a matter of law and on the facts, the overall conduct of the BBC did not give rise to a breach of the employer's implied duties.

Ombudsman (www.pensions-ombudsman.org.uk)

Kenworthy – *trustees entitled to defer taking action to equalise GMPs*
The member complained that his pension had not been calculated correctly, disputing the approaches taken by both the current and former scheme actuaries. He also said the trustees were at fault in using a calculation method that did not provide for the equalisation of GMPs.

In relation to the actuaries' approach to calculation, the Ombudsman said that actuarial science was not exact but relied heavily on the judgment of individual actuaries. There was room for differences of opinion and two actuaries might quite properly hold different professional opinions about a particular matter. It was therefore not for him to decide which of the two different methods should be the one used in calculating the member's pension. The member's proposed, more generous method had not been considered reasonable by either actuary and in the Ombudsman's opinion it could not, therefore, be used to determine his benefits under the scheme.

The Ombudsman also considered the wider issue of GMP equalisation. The trustees had explained why they did not currently consider it an appropriate time to equalise benefits for the impact of GMPs and the Ombudsman said that their explanation was reasonable. He noted that further DWP comment on how GMP equalisation should be achieved had been expected, with an announcement being first delayed until spring 2014 and then into 2015. The trustees, who had said they were actively monitoring developments in this area and keeping the position under review, could continue to defer taking action to equalise GMPs until the issue had been resolved.

Contract Catering Consultants Limited Staff Retirement and Death Benefit Scheme – *sole director personally liable for maladministration*
In 2011, the Ombudsman had ordered the member's former employer to pay £42,800 of unpaid contributions to his new pension arrangement. The member, who had had difficulty in enforcing the order, now sought instead to get the money directly from Mr Trace, in his capacity as the sole director of Contract Catering (CCCL), the sole trustee of the scheme (as well as its only employer).

The Ombudsman said that in some circumstances directors of a company could be held personally liable where they act in a way which creates a personal obligation. Mr Trace had not disputed that in practice he was solely responsible for the day to day tasks involved in administering the scheme. As he was personally carrying out acts of administration of the scheme, he was "*personally liable for his actions as a de facto administrator*".

It was plainly maladministration for Mr Trace not to pass contributions on to the scheme provider and those contributions presumably remained within CCCL, which he controlled. If not, only he could know where they were, so he was personally liable for the member's loss. The Ombudsman said that he did not, however, make any finding against CCCL in its capacity as trustee.

He directed that within 28 days Mr Trace should personally pay the £42,800 to the member's pension arrangement, plus simple interest from September 2011. In addition, Mr Trace must also personally pay the member £2,000 to compensate him for the considerable distress and inconvenience caused by his maladministration.

Guidance Redress for Non-Financial Injustice
The Ombudsman has published a factsheet about redress for non-financial injustice (i.e. distress and inconvenience awards).

To bring him into line with industry practice, most awards will now range from £500 to £1,000. However, the factsheet says: "*sometimes higher awards are necessary, for example where there was ill-health or lifestyle choices were affected. Although the courts have historically held that an award over £1,000 should only be given in exceptional circumstances, there has been a recognised general shift in attitudes to make higher awards*."

The factsheet says that 'inconvenience' suffered by an applicant is: "the time and effort spent by an applicant in relation *to the maladministration and in having to pursue their complaint, including needing to go through a* *complaints process where the maladministration was both avoidable and identifiable at an earlier stage*." 'Distress' may be: "*concern, anxiety, anger, disappointment, embarrassment or loss of expectation… Distress can vary from mild irritation to (exceptionally) anxiety that requires medical treatment*."

Examples of questions the Ombudsman may consider in assessing distress and inconvenience include whether:

- the complaint could have been avoided, i.e. it was obvious there was maladministration;
- there were excessive delays by those handling the complaint that were readily avoidable;
- inconvenience arose on a single or multiple occasions;
- any distress was material;
- the respondent handled the complaint thoroughly, or dismissively.

Where non-financial injustice is not significant, no award is likely to be made.

Further pension liberation determinations
In **Crossland**, the member had transferred £100,000 of benefits to the Henley Retirement Benefit Scheme in early 2013. He complained that the trustee of the scheme had not responded to two requests to obtain a transfer value.

As in other liberation cases, the Ombudsman noted that the original transfer had been against the member's interests and that the member may be "*rightly concerned*" that the assets transferred were not secure.

Although the member could not be deprived of his statutory right to take a CETV, his letters to the trustee had not satisfied the statutory requirements for a transfer: the first had not named a receiving scheme, and the second had named one where the member would not be an active member. Nevertheless the trustee's failure to respond was maladministration. The Ombudsman therefore directed that if the member submitted a request for transfer value to a named scheme that met the prescribed requirements and was prepared to accept it, the trustee must pay the transfer value to that arrangement.

The Ombudsman added that the member should ensure that his next transfer application was either to a pension arrangement with an FCA-regulated provider or to one "*directly related to active employment*". He also recommended that, this time, the member take advice from an FCA-regulated adviser.

Hughes was another case brought by a member who had transferred from a personal pension scheme to the Capita Oak scheme (an alleged liberation scheme) and who regretted having done so. As in other liberation cases, the Ombudsman says: "*I cannot apply current levels of knowledge and understanding of pension liberation/scams or present standards of practice to a past situation*."

In this case, the member's transfer request was made in January 2013 and the transfer completed in March 2013, after the issue of detailed Pensions Regulator guidance, described by the Ombudsman as "*a point of change in what might be regarded as good industry practice*", in February 2013. However, the Ombudsman accepted that "*it would be reasonable to expect some time would be required for procedures to be updated and new literature prepared to reflect the guidance*" so the provider had not been at fault in permitting the transfer.

Miscellaneous

Code of Conduct on Administration Provider Transfers
This is a voluntary Code of Conduct for administrators where pension scheme administration transfers from one provider to another. It applies to both the transferring and receiving administrator, whether third party or in-house.

The Code says that the departing administrator "*should not seek to take advantage of the dependence of a successful transfer on its release of information, particularly member data, by charging a disproportionate amount in relation to its incurred additional costs*." Nor should it seek any form of indemnity from the client to avoid future litigation relating to the standard of the administration it has provided.

The incoming administrator should inspect the scheme rules to independently determine the bases for member benefit calculations, and is encouraged to check its understanding with the scheme actuary. If the administrator considers that current practice does not reflect the rules, it should highlight this to the trustees.

Dates for diaries: Trustee training remains one of the most important ways of ensuring that trustees have the knowledge and understanding required to perform their duties. Our remaining 2015 trustee training course is taking place on **13th October 2015**. If you have any enquiries about any of these courses or would like to reserve a place, please contact **Karen Mumgaard – E:** karen.mumgaard@cms-cmck.com. Further courses will take place throughout 2016.

If you are interested in any additional trustee or employer training, please contact **Karen Mumgaard** who can provide you with a list of our current training topics or discuss any particular training needs you might have.

General: For further information on our pension services, please contact **Mark Grant – E:** mark.grant@cms-cmck.com, **T:** +44 (0)20 7367 2325 or your usual pension partner. Please also visit our website at **www.cms-cmck.com**.

The Pensions team is part of the CMS Human Capital group and advises employers and trustees of schemes varying in size, from a few million pounds to several billion pounds. Additionally, we act for some of the largest firms of administrators, actuaries, consultants, brokers and professional trustees. We provide a full range of services in connection with occupational pension schemes, including all aspects of employment and EU law. The team also works closely with our corporate lawyers, providing support on mergers and acquisitions, insolvency lawyers supporting us on employer covenant issues, and the financial services team which specialises in regulatory and fund management matters.

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