Trustee Knowledge Update

Welcome to the November 2016 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

Bridging Pension Regulations

The Finance Act 2004 provides that pensions in payment can only be reduced in specified circumstances or the pension will become an unauthorised payment. One of the permitted circumstances relates to bridging pensions. The Finance Act formerly allowed a pension to be reduced between age 60 and 65 by up to 125% of the basic state pension (or 250% where the member had never been contracted-out). This did not tie in with the change to the single tier state pension or rising state pension age and so has been repealed with effect from 6 April 2016.

These regulations provide that where a member reached state pension age before 6 April 2016, pension can be reduced by the same amount as previously. For members who reach state pension age after 5 April 2016, pension can be reduced by up to 200% of the new state pension between age 60 and 65 (or state pension age if later).

Action points: *It is unlikely that any bridging pensions in scheme rules will not be permitted under the new regime, but schemes that provide larger bridging pensions and which were not contracted-out should check that they remain within the new limits.*

Pension Schemes Bill 2016

The Bill largely deals with the authorisation and on-going supervision of master trusts (both new and existing). The new supervisory regime is likely to come in to force some time in 2018 and will require master trusts to apply for authorisation from the Regulator and satisfy the Regulator in relation to a number of criteria or ultimately to wind-up.

Master trusts will need to have a "scheme funder" who is a separate legal entity (only carrying out functions in relation to the master trust) and who may also need to meet capital requirements. Those running the scheme and carrying out key functions will need to be "fit and proper" and the scheme must have adequate systems and processes in place to ensure it is well run. The scheme will also need to have a plan of what it proposes should things go wrong.

The Bill also contains provisions which will allow charging restrictions to be extended and override the terms of existing contracts. This provision is intended to support the introduction of "*a cap on early exit charges in certain occupational pension schemes*" and support the Government's "*commitment… to ban member-borne commission charges arising under existing arrangements in certain occupational pension schemes*".

Action points: *For more details on the master trust provisions see our October edition of Horizon. Trustees of schemes with non-associated employers will need to check the definition of master trust in the Bill to see whether their scheme is caught by the new requirements as the definition is quite wide.*

Regulator (www.pensionsregulator.gov.uk)

Regulator interventions

The Regulator has had a busy few months and seems keen to demonstrate a new found willingness to impose sanctions where required. With this in mind, it has issued several regulatory intervention reports showing how it has exercised its powers in different situations:

- In the first case, an application was made for clearance in relation to a transaction that would have left a small scheme with an employer with no assets or trade but a significant cash payment would have been paid to the scheme (equal to around 22% of the buy-out deficit). The Regulator was concerned that the additional cash did not reflect the value of the reduced covenant and the transaction did not represent a fair return for the scheme. The only sum that would mitigate the potential damage to the scheme was the amount required to fund benefits in full. It was subsequently agreed that benefits would be secured in full.
- Trustees had executed a deed of amendment in 2010 which converted accrued DB benefits to DC rights. Enquiries indicated that this had not been the trustees' intention and the scheme had continued to be treated as a DB scheme by all parties. The scheme's sole participating employer became insolvent in 2014 and it was not clear whether the scheme could enter the PPF. An application was submitted to the Regulator to void the amendment as it had not properly complied with the requirements of section 67. The PPF supported the application. The Regulator agreed to set aside the deed and the scheme was able to enter the PPF.
- Trustees failed to complete a scheme return within the period allowed. The Regulator wrote to them on 15 March 2016 and advised that if they did not provide a scheme return by 1 April 2016, or explain what reasonable steps they had taken to comply, it would issue them with a penalty notice. The Regulator subsequently imposed a £300 fine on each trustee.
- A firm of professional trustees has been ordered to pay fines of £2000 in relation to a failure to produce a chair's statement in three separate schemes. The maximum fine of £2,000 was imposed because the scheme had a professional trustee in place and there were no mitigating factors. The Regulator said: "*Professional trustees are expected to meet a higher standard of care and to demonstrate a greater level of knowledge and understanding than other trustees*".

Action points: *The Regulator appears to be showing a willingness to exercise powers it has seldom used. However, in the first two cases it had worked with trustees to find the best outcome for the members and in the third case, provided fair warning of its intentions so none of these cases should cause alarm.*

Cases

Barnardo's v Buckinghamshire (Court of Appeal)

The employer asked the trustees to consider switching from RPI to CPI for revaluation and pension increases. The trustees applied to the High Court for a ruling on whether they had the power to do so under the scheme rules.

The relevant definition in the scheme rules referred to RPI "*or any replacement adopted by the Trustees without prejudicing Approval*." The key question was whether the RPI definition allowed the trustees to adopt a new index at any time as a replacement for RPI, or whether they could only do so after a new index had "*replaced*" RPI.

The High Court held that the latter interpretation was correct, and that so long as RPI remained an officially published index, the trustees had no power to adopt CPI in its place. RPI was not "replaced" when ONS stopped recognising it as a national index: "*the ONS itself continues to compile RPI and to recognise its continued use for certain official purposes. However commercially sensible it might be for CPI (or some other index) to be used in the sort of situation where, in the past, RPI was used, that is not a "replacement" of RPI in any ordinary sense of the word*". The Court of Appeal, by a majority, dismissed the appeal and confirmed that the trustees had no power to move from RPI to CPI.

The Court also expressed its view on the application of section 67 of the Pensions Act 1995 (which prevents amendments which may reduce members' subsisting rights) agreeing that where trustees were able to switch to CPI for future increases, this would not breach section 67.

> **Action points:** *The judgement is largely of interest to schemes with similar increase wording. However the confirmation that trustees can use a power in their rules to switch without triggering the requirements of section 67 is welcome and may offer comfort to some trustees who are in doubt whether they can use a similar power.*

Webber v Department of Education (High Court)

The member's pension had been overpaid between 2002 and 2009. However, when attempts were made to recover the overpayment, the member complained to the Pensions Ombudsman.

The case went back and forwards between the Ombudsman and the High Court a number of times as the member resisted attempts to reclaim the overpayment.

The key issue of interest in this particular hearing was how far back overpayments could be reclaimed for. Limitation periods meant that the member had a defence against recovery of overpayments made more than 6 years before the date any limitation period was to be regarded as having stopped (the "cut-off date").

There were several potential cut-off dates:

- The date the member complained to the Ombudsman (April 2011) or the date the Ombudsman formally accepted the complaint (November 2011);
- The date the scheme wrote to the member notifying him of the overpayment and providing details (November 2009); or
- The date the member invoked the scheme's IDRP (July 2010).

The Court held that the correct cut-off date was December 2011 (when the scheme sent a formal reply to the Ombudsman, acknowledging the complaint and its intention to dispute it). This meant that only overpayments in the six years prior to December 2011 could be reclaimed.

> **Action points:** *This case opens up the possibility that members could deliberately delay bringing a claim to the Ombudsman to make use of limitation periods and reduce the amount of any overpayment that can be reclaimed. Trustees who currently use a two stage IDRP may wish to consider whether a single stage procedure might be appropriate in some cases.*

Horton v Henry (Court of Appeal)

Mr Henry, a bankrupt, had the right to crystallise his personal pension policies, but chose not to do so. His trustee in bankruptcy applied for an income payments order (under which a bankrupt must pay a proportion of income to the trustee) over the undrawn pension funds. In order to do so, the trustee in bankruptcy needed to show that the member was "*entitled*", in the language of the Insolvency Act 1986, to the undrawn pension.

There has been confusion in this area for several years, with conflicting High Court authorities. The Court of Appeal had to decide whether a bankrupt became "*entitled*" to a payment from a pension scheme when, under the rules, he was able to receive the payment merely by asking for it or whether he was only "*entitled*" to a pension which was actually in payment (i.e. where the member had exercised his right to draw down pension). They decided in favour of the latter interpretation.

> **Action points:** *Trustees need to be aware of when insolvency practitioners may have a claim on member funds. This case puts beyond doubt that trustees in bankruptcy may not use a potential entitlement to flexible DC benefits to make a 'landgrab' for undrawn DC funds.*

British Gas Trading v Lock (Court of Appeal)

Mr Lock's remuneration package consisted of basic salary plus results-based commission (the latter accounting for some 60% of his earnings). However, he received only basic pay when taking annual leave. In 2014 the European Court held that his holiday pay calculation should include commission that was "intrinsically linked" to his contract of employment.

The Court of Appeal had to decide whether the UK Working Time Regulations could be read as complying with European law in line with the judgement of the European Court. In a very narrow judgement, it concluded that UK law could be interpreted in line with the European Court's judgement and therefore the decision could be given effect.

> **Action points:** *This maintains the prospect of knock-on consequences for pension schemes where rules define pensionable earnings by reference to elements of variable pay, or provide that all pay is pensionable. In such cases the employer may have supplied incorrect figures to calculate contributions and benefits. However, the Court's conclusion is confined to Mr Lock's case and does not offer any guidance to employers on calculating variable pay in such circumstances. As a result, this remains an issue for trustees to be aware of but where no action may be taken for some time.*

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

Finance Act 2016

This Act reduces the lifetime allowance to £1 million from April 2016 (subject to members being able to apply for certain protections). Amongst other things, it will also:

- Allow serious ill-health lump sums to be paid from an arrangement that has already been accessed;
- Replace the 45% tax charge on serious ill-health lump sums paid to individuals over 75 with tax at the individual's marginal rate; and
- Allow defined contribution pensions in payment to be paid as trivial commutation lump sums.

> **Action points:** *The reduction in the lifetime allowance (and the availability of new forms of protection) is the main issue for trustees to be aware of. However, the more minor changes may benefit some members, particularly the changes to serious ill-health lump sums.*

Update on VAT

HMRC VAT Brief 14 announced a 12 month extension to the transitional period on changes to reclaiming VAT on pension fund management costs. This means that existing VAT arrangements can continue until 31 December 2017.

HMRC VAT Brief 17 summarises HMRC's current position on the various options for dealing with reclaiming VAT on pension fund management costs in the future and makes the following points:

- **Tripartite contracts**: Only costs recognised in the employer's Profit and Loss Account may attract a deduction for Corporation Tax purposes and direct payment by an employer of asset management costs under a tripartite contract will not entitle it to a corporation tax deduction.
- **"On supply" agreement**: Any VAT a trustee incurs on administration and other general scheme-related services, used by it to make an onward taxable supply to the employer, will be deductible by it in full. However, VAT incurred on asset management costs may have a direct and immediate link to ongoing investment activities and any deduction by a trustee in respect of VAT will need to reflect this.
- **VAT grouping**: Costs of administration and other general scheme services will be overhead costs of the VAT group, deductible in accordance with the group's activities as a whole; but where a VAT group incurs VAT on asset management services the VAT deduction will need to reflect any dual use. Corporate trustees have raised worries about exposure to the joint and several liability provisions that apply to VAT grouping so HMRC re-iterates that it is "*unable to recover VAT from the scheme assets except to the extent that the relevant VAT debt is attributable to the administration and operations of the pension scheme*".

> **Action points:** *Assuming that HMRC reach a final position on how they think the various options work, many sets of trustees will be approached by employers during 2017 to determine how the issue of VAT can best be dealt with and may need to restructure scheme charging arrangements accordingly.*

Newsletter 82

There is a reminder that schemes operating relief at source were required to submit individual information for 2015/16 to HMRC by 5 October 2016. Failure to submit the information will hold up any interim repayments pending the information being supplied to HMRC. Where information is submitted but fails processing, on the third attempt HMRC will stop repayments until the information is re-submitted.

> **Action points:** *Schemes operating relief at source should already have provided the relevant information to HMRC but it may be worth checking that scheme administrators have done so.*

PPF

2017/18 Levy Consultation - 22 September 2016

The PPF has published its consultation and draft documents for the 2017/18 levy. The levy parameters, levy bands, levy rates and levy estimate (of £615m) are unchanged from 2016/17, with the levy rules themselves "*very substantially the same*". In particular, there are no substantive changes to the Contingent Asset Appendix and Guidance, or to the Asset Backed Contributions Appendix and Guidance.

The PPF is considering a new approach to eligible schemes which no longer have a substantive sponsoring employer following a restructuring: "*if a scheme remains eligible for PPF protection, we believe we should ensure that such a scheme's levy reflects the true risk the scheme presents and not imply a cross-subsidy from other levy payers*." However, there are as yet no specific proposals.

The final policy document and levy documents will be published in December.

> **Action points:** *The main deadline for trustees to submit 2017/18 levy documentation is midnight on 31 March 2017. For most schemes this will not be a difficult deadline to meet, but if sponsoring employers are considering taking any steps to reduce the levy, action should be taken sooner rather than later as the PPF will not accept late submissions.*

PPF - long service compensation cap

The provisions in the Pensions Act 2014 dealing with the PPF long service cap will be brought into force from 6 April 2017. They will amend the Pensions Act 2004 to introduce a long service cap which increases the standard compensation cap by three per cent for each full year of pensionable service above 20 years (ie. 21 years or more) subject to a new maximum of double the standard cap.

The new cap will affect people already in receipt of PPF compensation but historic compensation will not be reassessed. Lump sums already taken will not be retrospectively increased.

Where a scheme is in an assessment period, benefits in payment that have had the cap applied will need to be reassessed. The valuation of liabilities will "continue to be done on the basis that the long service cap did not exist".

> **Action points:** *The availability of PPF protection for scheme members is something that trustees should be aware of, particularly where there is a weak employer covenant. However, trustees should not take decisions designed to "game" the PPF.*

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

PO-9889 Mr X (Robins Davies & Little Scheme) - *no obligation to award interest*

The member complained that the trustees had wrongly decided not to award interest on a £19,000 extra payment made from the scheme after his pension was recalculated during the scheme's PPF assessment period (in order to reflect the PPF's discovery of an unclosed Barber window).

The Deputy Pensions Ombudsman held that the member had no absolute entitlement to interest on the additional payment under the rules or at law. All members in a similar position had been treated in the same way, the trustees' approach was reasonable, and no injustice had been caused such as to require a direction for interest.

> **Action points:** *Trustees often face complaints from members in relation to a decision not to award interest and this determination provides some relief (albeit in the context of PPF assessment). Trustees should also be aware of whether or not scheme rules permit the payment of interest.*

Miscellaneous

Consultation on valuing pensions for the advice requirement and introducing new consumer protections: From April 2015, members with "*safeguarded benefits*" in excess of £30,000 in a scheme have been required to take independent financial advice before they can transfer, or convert them into flexible benefits. "Safeguarded benefits" are benefits other than money purchase and cash balance benefits. Generally this means defined benefits but some benefits are capable of being both safeguarded benefits and flexible benefits (eg defined contribution benefits where there is some form of guarantee provided to the member such as a guaranteed annuity rate). Various issues have arisen in relation to valuing such benefits and as a result, regulations will address this.

There will also be a new requirement for transferring trustees to give all members with "safeguarded-flexible benefits" new risk warnings (whether their benefits are over the £30,000 threshold or not). These warnings will tell the member that they have valuable guarantees, be tailored to the nature of the guarantees, and explain the likely impact of surrendering them by reference to the impact on the member's pension (using illustrations of what the member should be entitled to if they take up their guarantee and what they would be able to buy on the open market). There will be specific trigger points for sending these warnings, including where the member requests a statement of entitlement or other valuation of their benefits and they must be sent out within one month of the trigger event.

Consultation on overseas transfers and advice requirement: DWP is considering whether the above advice requirement is appropriate where the member is transferring overseas and may not be able to find a financial adviser able or willing to give the required advice.

Inquiry into DB pension funds: The Work and Pensions Committee's enquiry into the appropriateness of the regulatory environment for defined benefit schemes and the adequacy of the PPF is ongoing.

It seems likely that the outcome will be a recommendation that greater powers are granted to the Pensions Regulator (not least because that is what the Regulator has asked for – particularly in relation to funding and a pre-clearance requirement for transactions which will significantly affect covenant strength). However, any change to legislation is likely to be some way off.

Insurance Act 2015: Most of the Act came into force on 12 August 2016 and the key change which will affect pension scheme trustees is the restatement of the requirement to give disclosure of material circumstances before an insurance contract is entered into. The new duty of "fair presentation" requires an insured to: disclose all material circumstances of which they know, or ought to know, or give the insurer sufficient information to put a prudent insurer on notice that it should make further enquiries.

Warning notices in relation to BHS: The Pensions Regulator has formally begun enforcement action seeking redress on behalf of the BHS pension schemes. It has sent Warning Notices to Sir Philip Green, Taveta Investments Limited, Taveta Investments (No. 2) Limited, Dominic Chappell and Retail Acquisitions Limited.

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. We will be holding trustee training courses on 21 February 2017, 13 June 2017 and 17 October 2017. If you have any enquiries about these courses or would like to reserve a place, please contact **Karen Mumgaard – E:** karen.mumgaard@cms-cmck.com.

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.