

# Leaders in Pensions

## Trustee Knowledge Update – August 2017

Welcome to the August 2017 edition of our Trustee Knowledge Update which summarises recent changes in law and regulation. 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.

### Government ([www.gov.uk](http://www.gov.uk))

#### State Pension Age

The Government has [announced](#) that State Pension age is to be increased at a faster rate than previously set. SPA will now increase to age 68 for all by 2039. This particularly affects those born between 6 April 1970 and 5 April 1978. This change is in response to an [independent review](#) of State Pension age, published by John Cridland CBE in March 2017.

**Action points:** Trustees should ensure that, where scheme booklets and other communications refer to State Pension age, they accurately reflect the position. Trustees should also consider reviewing any bridging pensions or state pension offsets to ensure they work as intended.

#### White Paper on Defined Benefit Pension Schemes

David Gauke MP, Secretary of State for Work and Pensions, has confirmed in a [ministerial statement](#) that the Government intends to follow up February's DB Green Paper on Security and Sustainability in Defined Benefit Pension Schemes with a White Paper, "*later this year*". The White Paper will "*set out proposed next steps on what reform is needed to support the sector....consider innovative delivery structures, [and] consider the need to evolve and adapt the regulatory regime to improve security for members*".

**Action points:** For information only, no action required by trustees.

#### Financial Guidance and Claims Bill

The Financial Guidance and Claims Bill sets out the provisions establishing a new single financial guidance body ("SFGB") to replace TPAS, Pension Wise and the Money Advice Service. The name of the new body will be confirmed in regulations.

**Action points:** Once the new financial guidance body is established, trustees will have to amend communications to signpost members to the correct place for pensions guidance.

#### The European Union (Withdrawal) Bill

The Bill repeals the European Communities Act 1972 with effect from "*exit day*" but confirms that EU-derived legislation and directly effective EU law continues to apply on and after exit day. Courts and tribunals will not be bound by decisions of the European Court on or after exit day, however, cases concerning EU law which is retained on and after exit day are to be decided in accordance with existing case law (including decisions of the European Court). This does not apply to cases brought before the Supreme Court which will not be bound by EU case law.

**Action points:** Trustees should note that existing laws (including case law) derived from EU law will remain in force on and after exit day. This will include rules on equal treatment, investment and scheme funding.

## Legislation

### Finance Act 2017

The Finance Act includes new rules on overseas pensions and changes to the taxation of qualifying overseas pension schemes (see [Trustee Knowledge Update - May 2017](#)).

Provisions reducing the money purchase annual allowance (MPAA) from £10,000 to £4,000 and increasing the income tax exemption for employer-funded pensions advice from £150 to £500, which were removed in order to accelerate the passage of the Bill prior to the General Election, will be introduced, with retrospective effect from 6 April 2017, in a new Finance Bill when Parliament returns after its summer recess.

**Action points:** It is now clear that the MPAA change will be made effective from 6 April 2017. Trustees should review any member communications and check how the scheme administrator intends to implement the change.

### The Occupational Pension Schemes Charges and Governance (Amendment) Regulations 2017

These regulations prohibit charges being imposed on members to recover the cost of commission payments to advisors on or after 1 October 2017 in relation to agreements entered into before 6 April 2016, in respect of payments made to advisers on or after 1 October 2017. This provision applies to schemes holding DC benefits which at least one employer uses for automatic enrolment.

The regulations also ban early exit charges being imposed on a member who has reached normal minimum pension age (generally age 55) and only apply if the member takes, converts or transfers benefits before normal pension age. The total ban will apply only to members joining a scheme on or after 1 October 2017. For existing members there will be a 1% cap on early exit charges (or the amount provided for under the scheme as at 1 October 2017 if lower). No new charges may be introduced on or after 1 October 2017. This will apply to all schemes holding DC benefits. The DWP has issued [guidance](#) on how market value adjustments and terminal bonuses are to be treated when calculating the cap.

**Action points:** Trustees of affected schemes should check that they are compliant with the new provisions.

### The Pension Schemes Act 2015 (Transitional Provisions and Appropriate Independent Advice) (Amendment) Regulations 2017

Coming into force on 6 April 2018, these regulations require trustees to provide a risk warning in relation to

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"safeguarded-flexible benefits". These are benefits calculated by reference to a pot available for the provision of benefits which are neither money purchase nor cash balance benefits (most commonly, these will be benefits with guaranteed annuity rates (GARs)). The risk warning must include a clear statement that the benefits under the scheme include a potentially valuable guarantee and two pension illustrations, using assumptions specified in the regulations, must be provided.

**Action points:** Trustees should clarify whether their scheme contains safeguarded-flexible benefits. If it does then they should, in discussion with the scheme administrator, review their communication materials and put in place processes to identify when a risk warning will be required.

## The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

These regulations came into force on 26 June, implementing the 4<sup>th</sup> EU Anti-Money Laundering Directive. They introduce new record keeping requirements for pension scheme trustees and additional reporting requirements for schemes which pay relevant taxes (these include SDLT and SDRT so will affect schemes with direct property or equity holdings). The record keeping requirements mean trustees must keep certain prescribed information (including passport details for those living overseas) in relation to all "beneficial owners" which include the trustees, employers, members and beneficiaries. Guidance is awaited from HMRC on exactly what information must be recorded and reported.

The regulations also include new registration, risk assessment and due diligence requirements for trustees or directors "acting in the course of business". HMRC guidance confirms that individuals or companies offering professional trustee services to certain "low risk" trusts (including occupational pension schemes) do not need to register. This is in line with previous HMRC practice.

**Action points:** Trustees should be reviewing the records that they keep on members and beneficiaries in order to ensure they comply with the new requirements. Further guidance from HMRC on exactly what is required is awaited.

## Regulator ([www.pensionsregulator.gov.uk](http://www.pensionsregulator.gov.uk))

### Annual Funding Statement

TPR's annual funding statement is aimed primarily at trustees and employers of DB schemes undertaking valuations with effective dates between 22 September 2016 and 21 September 2017, but is of general relevance for all DB schemes. It highlights the importance of schemes having contingency plans in place in line with TPR's previous guidance on Integrated Risk Management (IRM) and investment.

An area of particular focus is where TPR believes a scheme is not being treated fairly compared to shareholders. This might include circumstances where recovery plans are being extended unnecessarily or where payments to shareholders are being prioritised, restricting or reducing the level of contributions to the scheme. Trustees are expected to ensure that contributions feature prominently in employer considerations and that the employer's legal obligations to the scheme are recognised ahead of

shareholders. Where an employer's distribution to shareholders is higher than the deficit contributions being paid then TPR would expect there to be a short recovery plan underpinned by an appropriate investment strategy. If this is not the case then it will consider intervening to ensure an appropriate balance is struck between the interests of the scheme and shareholders.

TPR expects trustees to take "decisive" action where the scheme's funding position has been on a downward trajectory for more than one valuation.

**Action points:** TPR has signalled its intention to intervene more quickly in future where trustees and employers cannot agree appropriate scheme funding arrangements. Trustees should familiarise themselves with the annual funding statement and other relevant TPR publications before entering into funding discussions with the employer.

## Section 89 regulatory reports on BHS, Hoover and Coats

TPR has issued regulatory reports on three major cases it has been involved in.

The report on the BHS settlement includes a section setting out the areas TPR expected the trustees to investigate and obtain independent advice on as part of their "moral hazard assessment" including dividend payments, prior corporate restructurings, related party transactions, property transactions, financing arrangements and group tax arrangements. The final section of the report is headed "Doing things differently" and sets out how TPR has reflected on its approach to regulation as a result of its BHS experience. Two key areas where it considers it could have performed better are the timeliness of its engagement and the clarity of communications.

The report on Hoover confirms that TPR has approved a proposal for a regulated apportionment arrangement (RAA) in relation to the Hoover (1987) Pension Scheme (HPS). Under the agreement, the HPS trustees will receive £60m from Hoover as well as their expenses and a 33% stake in the company. HPS is expected to transfer to the PPF. TPR's view is that this is a better outcome for HPS than an uncontrolled insolvency of the employer and maximises the return for the PPF. It should also enable Hoover to continue trading.

The third report covers a settlement with three Coats pension schemes. TPR became involved when it became aware that Coats was selling off its investment shareholdings with a view to making significant returns to shareholders. Coats committed not to distribute the funds while TPR was investigating. Agreements were eventually reached which included upfront payments (representing all the cash remaining from the original disposals), a change in statutory employer and a full guarantee from Coats on a buy-out basis.

**Action points:** For information only.

## Compliance and enforcement reports: Chair's Statements and Scheme Returns

TPR has issued two compliance and enforcement reports reminding trustees of their duties in relation to Chair's statements and scheme returns. TPR reports that it has issued 85 fines for failure to issue a Chair's statement. TPR states that it is adopting a zero tolerance approach to



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non-compliance with the requirement to complete a scheme return. It sees non-compliance as a symptom of potential wider governance failings and is looking to take greater enforcement action in future.

**Action points:** For information only.

## Tax ([www.hmrc.gov.uk/pensionschemes/index.htm](http://www.hmrc.gov.uk/pensionschemes/index.htm))

### Scottish Rate of Income Tax

From April 2018, the introduction of the Scottish rate of Income Tax means that members will receive tax relief on their contributions based on their tax residency status. From January 2018, HMRC will be telling scheme administrators operating relief at source the tax residency status of individual members. As part of this, a new electronic submission service, the Secure Data Exchange Service (SDES), is being set up. SDES will be the only system used by HMRC to notify schemes of the residency tax status of their members. Scheme administrators already using Secure Electronic Transfer (SET) will be automatically migrated from August 2017 and need not enrol in SDES. There will also be a real time residency tax status look up service for scheme administrators to check the status of new joiners.

**Action points:** Trustees with members in Scotland should ensure that they are registered either with SET or SDES.

## Cases

### Walker v Innospec (Supreme Court)

Mr Walker worked for Innospec between 1980 and 2003 and was a member of its pension scheme. He entered into a civil partnership in 2006 and married his partner in 2013. The scheme provided for payment of a spouse's pension, but the employer and trustees chose not to provide the same pension in relation to civil partners or same sex spouses, save in respect of benefits accrued after the Civil Partnership Act came into force in December 2005. In doing so, they relied on the Equality Act 2010, which provides that applying such a cut-off for civil partners or same sex spouses is not unlawful discrimination. As a result, Mr Walker's spouse would only receive a GMP, which was a fraction of the full pension that a different sex spouse would have received.

In 2012, an Employment Tribunal held that the employer and trustees had directly discriminated against the member, but the employer successfully appealed to the Employment Appeal Tribunal. In October 2015, the Court of Appeal dismissed the member's appeal: although sympathetic to Mr Walker's position, it held that at the time the member was earning his pension entitlement, the discriminatory treatment of which he complained was lawful.

Allowing Mr Walker's appeal, the Supreme Court held that the relevant Equality Act provision was, in so far as it allowed restriction of payment of benefits based on periods of pre-5 December 2005 service, incompatible with the EU (anti-discrimination) Framework Directive and must be disapplied. The Court declared that Mr Walker's husband was entitled to a spouse's pension calculated on all the years of his service with Innospec, so long as they remained married at the date of Mr Walker's death.

The Court said that it was clear under EU law that, unless there were unacceptable economic or social consequences

of giving effect to Mr Walker's entitlement to a survivor's pension for his husband it was unlawful to subject him to unequal treatment as to the payment of that pension.

**Action points:** Survivors' benefits for same sex partners should be paid in full on the same basis under scheme rules as applies to different sex spouses. Trustees will need to liaise with their administrators on this. Where restrictions have operated in the past, trustees should take advice on appropriate steps to identify and remedy underpayments.

### IBM v Dagleish (Court of Appeal)

The case concerned the decision of IBM to close DB sections of the IBM schemes to future accrual and impose restrictions on future pay increases counting for pension purposes. Issues also arose concerning the introduction of a new, less generous, early retirement policy and the manner in which statutory employee consultation was undertaken. The High Court decision of Warren J, which was largely in favour of the representative beneficiaries (RBs), has been almost entirely overturned.

Warren J had held that acting contrary to the "*reasonable expectations*" of the members (which he found had been engendered by the employer through a number of statements made over a number of years) was a breach of the employer's duty of good faith. He had contrasted "*mere expectations*" which will happen in the ordinary course of events if things carry on as they were with "*reasonable expectations*" being expectations as to what will happen in the future, engendered by the employer's own actions, which give employees a positive reason to believe that things will take a certain course.

The Court of Appeal found that Warren J had failed to approach the case on the basis that it was for the decision-maker (IBM) to assess the weight of those factors. Instead, he had concluded that if "*reasonable expectations*" were established by the RBs, effect must be given to them unless there was no other possible course open to the employer. This was not the correct approach. The existence of the "*reasonable expectations*" was a relevant factor to be taken into account but to elevate them to a status in which they had overriding significance was wrong in law. The correct question was whether the decision taken was one which no rational decision-maker could have reached. The Court of Appeal found that it was not.

Part of the case involved the imposition by the employer of Non-Pensionability Agreements (NPAs) where members agreed that any future discretionary pay increase would not be pensionable. The Court of Appeal took a fairly robust attitude to the employer's decision to impose NPAs. There was not enough evidence to justify holding that the imposition of NPAs was a breach of the implied duty. The Court also decided that where employees did not have a contractual right to pay increases, it was not a breach of the implied duty for the employer to say that it did not intend to award pay increases in future unless employees agreed they were non-pensionable. This arguably gives employers the green light to impose NPAs on future non-contractual pay rises.

In relation to a change in the early retirement policy, the Court held that the existence of the retirement policy, however consistently and openly applied, did not provide a reason why that policy could not be changed. It was also confirmed that the employer did not have to give advance

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notice to members that it intended to change its current, generous policy of consent to early retirement and there was no breach of duty in giving members a short “early retirement window” to take advantage of the policy before it changed.

IBM did not appeal the decision of Warren J that they had breached its duties when consulting with members. The members requested an injunction to prevent IBM applying the changes until proper consultation has taken place. The Court refused to award an injunction. The Court did note, however, that the members are entitled to claim damages against the employer for breach of duty in the conduct of the consultation.

**Action points:** This judgment provides some clarity on the correct test to apply to employers when exercising discretionary powers both under contracts and pension trusts. The Court of Appeal’s conclusions remove some uncertainties for employers when considering altering future benefit accrual.

## Bradbury v BBC (Court of Appeal)

The BBC offered members the choice of remaining active members of their current section of the scheme (but with future pay awards limited to 1% for pension purposes), or to opt out and join a new CARE scheme under which future pay awards would not be subject to any pensionable cap.

The matter went through lengthy legal process, being considered twice by both the Pensions Ombudsman and the High Court. There were three main issues dealt with by the Court of Appeal, all of which have been decided in favour of the BBC.

Firstly, it was confirmed that the scheme rules allowed the BBC to limit the extent to which any future pay increases

would be pensionable. Employees had no right to any pay rise and the rules left it open to the BBC to determine how much of any pay rise would be pensionable.

The Court of Appeal found that section 91 of the Pensions Act 1995 (which restricts the assignment or surrender of pension rights) had no application. Mr Bradbury was not being asked to surrender an existing right to a pension because he had no right to any future pay rise or increase in pensionable salary. His right was to a pension calculated by reference to the level of pay stipulated in his employment contract.

Finally, the Court of Appeal agreed with Warren J’s analysis in the High Court that there had been no breach by the BBC of its duty not to conduct itself in a manner calculated or likely to destroy or seriously damage the relationship of trust and confidence with its employees without reasonable and proper cause. The BBC’s conduct had to be assessed against the background of a multi-billion pound scheme deficit in circumstances where both the trustees and trade unions agreed that something needed to be done. The BBC had not acted with any improper motive or collateral purpose in introducing the pensionable pay cap.

**Action points:** Although focussing on employer duties, this case will also be of interest to trustees of schemes where pensionable pay caps or other benefit restrictions are being proposed.

## Ombudsman ([www.pensions-ombudsman.org.uk](http://www.pensions-ombudsman.org.uk))

*For the latest on The Pensions Ombudsman and his work, please ask your regular CMS contact for a copy of our quarterly Pensions Ombudsman Update.*

**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 on 17 October 2017. If you have any enquiries about this course or would like to reserve a place, please contact **Carla Kelly** – E: [carla.kelly@cms-cmno.com](mailto:carla.kelly@cms-cmno.com).

If you are interested in any additional trustee or employer training, please contact **Kieron Mitchinson** (E: [kieron.mitchinson@cms-cmno.com](mailto:kieron.mitchinson@cms-cmno.com)) 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-cmno.com](mailto:mark.grant@cms-cmno.com), T: +44 (0)20 7367 2325 or your usual pension partner. Please also visit our website at [www.cms.law](http://www.cms.law).

The Pensions team is part of the CMS Financial Markets and Pensions group and advises employers and trustees of schemes varying in size, from a few million pounds to the largest schemes in the UK. 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.

The information in this publication is for general purposes and guidance only and does not purport to constitute legal or professional advice. It is not an exhaustive review of recent developments and must not be relied upon as giving definitive advice. The Update is intended to simplify and summarise the issues which it covers. It represents the law as at 9 August 2017.

*CMS Cameron McKenna Nabarro Olswang LLP is a limited liability partnership registered in England and Wales with registration number OC310335.*