Trustee Knowledge Update – November 2019

Welcome to the November 2019 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 and legislation

Pension Schemes Bill

As anticipated, the Pension Schemes Bill provides the statutory structure for the authorisation and supervision of new collective money purchase schemes. Also included is primary legislation requiring schemes to provide information to pensions dashboards. This will be compulsory, and schemes will need to get their data in order, but the detail will be in regulations. Although we now know that this Bill did not make it through Parliament before the General Election, there appears to be cross-party support for the main aims and it may well be re-introduced in a similar form by the next Government.

Set out below are some of the key provisions. For trustees of DB schemes the main areas of focus will be the changes to the statutory funding regime and the new, wide-ranging powers for TPR. Trustees of DC schemes will be subject to TPR's new information gathering powers and there is a tweak to the definition of "administration charges" for the purposes of the charge cap.

DB scheme funding – new statement on funding strategy

The policy intention of these changes is to address "poor decision-making" and make sure that trustees take a more strategic and long-term view. Trustees will be required to:

- Determine their funding and investment strategy (to be agreed with employer) - "*a strategy for ensuring that pensions and other benefits under the scheme can be provided over the long term*".
- Provide a written statement to TPR of the strategy and various supplementary matters.
- Appoint a chair, who signs this statement.

In addition, the statutory funding objective provisions in the Pensions Act 2004 are to be amended to state that technical provisions must be calculated in a way that is consistent with the agreed strategy.

Strengthening of TPR powers – and the £1 million fine

TPR's strengthened powers can broadly be divided into information gathering and protecting benefits. In relation to information gathering:

- TPR will be able to require those connected with a pension scheme (this includes trustees, employers and professional advisers) to answer questions and provide explanations relevant to the exercise of any of TPR's functions. It will be a criminal offence to neglect or refuse, without reasonable excuse, to attend before TPR or to answer questions or give explanations. Failure to comply will also be subject to fixed penalties of up to £50,000 and escalating penalties of up to £10,000 per day.
- Providing false or misleading information to TPR including registrable information, information in the scheme return, notifiable events, and information provided under the new interview powers will be subject to civil penalties of up to £1m (as well as being a criminal offence).
- TPR is to be given power to enter premises for the purposes of investigating whether it has grounds for issuing a contribution notice ("CN") or financial support direction ("FSD"). Wider purposes for entering premises may be prescribed in regulations.
- Described in the White Paper as a "declaration of intent", an employer (or someone associated or connected with an employer) must notify certain events to TPR. Regulations will set out details of the events and the timing for notification and can extend the type of person who must notify. Events are expected to include the sale of a controlling interest in the employer, the sale of the business or assets of the employer and granting of security in priority to the scheme. The notice must be copied to the trustees. Failure to notify TPR in accordance with the requirements without reasonable excuse will be subject to a penalty of up to £1m and providing false or misleading information will be a criminal offence.
- Trustees' right to obtain information from employers is being supported by a penalty of up to £1m for knowingly or recklessly providing false or misleading information to trustees.

In relation to the protection of benefits:

- There are two new grounds on which TPR could issue a CN. These are the Employer Insolvency Test (where an act materially reduces the likely recovery from an employer on insolvency) and the Employer Resources Test (where an act materially reduces the resources of an employer). Both have a statutory defence where the target properly considered the risk and took reasonable steps to eliminate it. Failure to comply with a CN becomes a criminal offence subject to an unlimited fine or subject to a civil penalty of up to £1m.
- There are two new criminal offences of, without reasonable excuse, preventing the recovery of a section 75 debt and conduct risking accrued scheme benefits. These are both very widely drawn. These new offences could alternatively give rise to civil penalties of up to £1m.

New restrictions on DB transfers

As part of the attempt to combat pension scams, statutory transfers of DB benefits will be restricted to transfers to personal pension schemes, authorised master trusts, pension schemes where there is a genuine employment link and certain overseas pension schemes (in limited circumstances). Transfers outside these parameters will still be allowed if scheme rules permit. There will be consultation on regulations which will provide the detail of the new restrictions. The requirements for establishing a genuine employment link may be quite onerous – including providing payslips and evidence of contributions in the receiving scheme.

And what's not in the Bill?

Some of the changes flagged in the White Paper in March 2018 have not made it into the Bill. These include:

- A new authorisation regime for DB superfunds. This is expected to come in the future but DB superfunds can still operate under current legislation and TPR guidance.
- Changes to simplify the FSD regime.

The Bill also does not currently include any of the proposed changes to legislation on the Pensions Ombudsman, nor anything on GMP conversion.

Action points: Trustees of DB schemes should already be looking to the long-term when considering funding and investment – the Bill formalises this. Further detail will emerge once TPR starts consulting on its revised Code of Practice.

Consultation aligning RPI with CPIH

The Chancellor of the Exchequer has announced that consultation will begin in January 2020 on aligning RPI with CPIH. The Chancellor's view is that ending the publication of RPI could be disruptive and damaging to the economy and he will not consent to its publication being stopped. He however accepts that RPI methods should be changed to align it with CPIH. Consultation will begin in early 2020 on:

- When the changes to RPI should be made: the potential window is assumed to be between 2025 (as the Chancellor has said he will not consent before then) and 2030 (when the UK Statistics Authority will be able to make those changes unilaterally).
- How, technically, the changes should be made.

It is understood that there is no plan to consult on whether RPI should be changed to align with CPIH. That decision has been taken and so it should be assumed the change will happen at some point between 2025 and 2030. Also published is a letter from the Chancellor confirming that the Government has no current plans to stop issuing gilts linked to RPI.

Action points: The change in the basis of calculation will impact on liabilities for schemes still using RPI. It will also mean that long-term RPI-linked assets will reduce in value. Affected trustees will need to review their funding and investment strategies. For a small number of schemes, the change may trigger a gateway to switch index under the rules.

Pensions Regulator

TPR updates DB investment guidance

TPR has updated its DB investment guidance. The update reflects recent changes in requirements for the content of Statements of Investment Principles ('SIP's). New content includes:

Investment Governance: TPR expects trustees to have 'suitably documented' investment governance arrangements. If trustees do not think they have the necessary skills and expertise they should consider the options for addressing their weaknesses. Any steps taken should be documented.

Fiduciary management: Trustees should consider the implications of the CMA review and take advice on how to comply with the new requirements (which include having strategic objectives in place with investment consultants by 10 December 2019 and running competitive tenders for the appointment of fiduciary managers).

Stewardship: This section includes the new requirement to include details of engagement activities in the SIP. Trustees are encouraged to sign up to the FRC stewardship code.

ESG and financial and non-financial factors: The guidance summarises the new SIP requirements and expands on what environmental, social and governance (ESG) factors might include. Trustees are expected to take account of risks affecting the long-term financial sustainability of investments when setting investment strategies. TPR is clear that trustees are never obliged to take members' view into account but that having a policy in place on how they will take non-financial matter into account is likely to avoid uncertainty or disputes.

Action points: All trustees of DB schemes should familiarise themselves with this new guidance.

TPR updates DC guides

TPR has updated two of its six DC guides. In the 'Communicating and reporting' guide, TPR has made changes to reflect requirements which came into force on 6 April 2019 on the provision of information about pooled funds and provided clarification about preparing a Chair's statement where a scheme ceases to be a 'relevant scheme'. In the 'Value for members' guide TPR has made minor updates to reflect the fact that the Cost Transparency Initiative has produced standard templates for trustees to use to obtain information about costs and charges.

Action points: Trustees of DC schemes should take note of these changes.

TPR revises record keeping guidance

TPR has revised its record keeping guidance. Trustees are expected to review scheme data at least once a year and must report on it in the scheme return. If data issues are identified then trustees should be putting in place an improvement plan, the guidance includes detail on what might go into a plan and how it might be delivered. Trustees are also referred to PASA data guidance issued in February 2019.

The new guidance also includes sections on GDPR, cyber security and business continuity. Trustees are expected to have a cyber incident response plan and business continuity plan in place and include data security provisions in contracts with scheme administrators and other service providers.

TPR has issued a press release confirming that it has asked the trustees of 400 schemes to conduct a data review within six months. These schemes are believed to have failed to review their data in the last three years.

Action points: TPR is very active in this area at the moment. Trustees should ensure that scheme administrators are undertaking sufficient data reviews.

HMRC

Newsletter 114

This newsletter includes an update on HMRC's GMP Equalisation Working Group. This says that HMRC aims to publish high level GMP equalisation guidance in December 2019 on the lifetime allowance, lifetime allowance protection and annual allowance. HMRC also say that they continue to work on other issues including the payment of serious ill-health lump sums, small pots and trivial commutation. The implication is that guidance on this, if it comes, will not come during 2019.

Comment:. Trustees of affected schemes will need to carefully consider HMRC guidance on the tax consequences when equalising benefits for the effects

Countdown Bulletin 49

This bulletin confirms the services which HMRC will provide in relation to formerly contracted-out schemes now that the scheme reconciliation service has formally ended. They include making the GMP amount available to schemes via the GMP Checker Service and dealing with queries about the amount, but only at 'life events' (e.g. retirement or death). Schemes can use the on-line GMP Checker service at any time, but if they disagree with the GMP supplied, a query can only be sent to HMRC if a 'life event' is occurring. Other queries which are not related to the GMP Checker should be submitted by email.

Comment: As the GMP reconciliation process now comes to an end, this bulletin provides useful information for trustees on the assistance they can expect from HMRC in future.

Cases

EC2 Master Ltd v TPR – Upper Tribunal

This case concerns an appeal against fines for a non-compliant chair's statement. EC2 argued that TPR could only issue mandatory penalties where trustees had failed to prepare a Chair's statement, not where one had been prepared but was considered by TPR to fail to comply with one or more of the content requirements. The tribunal rejected this: the trustees were not just required to prepare 'a statement', but a statement containing the detailed information required by the regulations. The Tribunal ruled that the statement was deficient in five respects.

The judgment also reveals the internal criteria for revoking penalty notices which had been devised and deployed by TPR in reviewing Chair's statements. These related to factors such as specified delays on TPR's part in providing feedback or imposing a penalty. EC2 claimed procedural unfairness in how the criteria had been applied. The judge rejected this on the facts, although he did not accept TPR's argument that as a matter of principle the Tribunal was not entitled to consider the fairness of a TPR review decision confirming the issue of a penalty notice.

Comment: This ruling confirms TPR's position that it has no choice but to issue a penalty even for what may be considered by trustees to be very minor breaches in the Chair's statement. It sheds some light on the internal workings of TPR and sets a marker for how a future tribunal might approach a challenge to the fairness of TPR's procedures.

Re Prudential Assurance Company Ltd

In this 'insurance business transfer scheme' application, the High Court refused to sanction Prudential's proposed £12bn annuity sale to Rothesay Life, covering 370,000 policyholders, notwithstanding that the independent expert appointed by the court was satisfied that the transfer would have no material adverse effect on the security of policyholders' benefits; and that the FCA and PRA were content for it to proceed.

In exercising his discretion to decline approval, the judge accepted the argument of the opposing policyholders that they chose the Prudential on the basis of its age and established reputation, that Rothesay lacked those attributes, and that the court should give some weight to the policyholders' exercise of contractual choice. The judge accepted that the Prudential had made no contractual promise to policyholders that it would not transfer their policies to another provider, and that it was entitled at law to seek to do so. However, there was considerable force in the policyholders' submissions that they reasonably assumed this would not happen.

The judge said that it was not a 'fanciful' possibility that either provider might require external financial support over the annuitants' lifetime and, if so, there was a material difference in the potential availability of assistance for the two companies. Moreover, the fact that the Financial Services Compensation Scheme (FSCS) might pay full compensation to policyholders were Rothesay to fail was not something that the court could consider.

We understand that Prudential and Rothesay have lodged an appeal.

Comment: In our view, the decision should be read as limited to its facts. This case was about individual policyholders who had made a decision to choose Prudential to provide their annuity. The judge did not make any broader assertions about the selection of insurers in other scenarios such as a bulk buy-out.

West v Revenue and Customs Commissioners - FTT

These First-Tier Tax Tribunal proceedings related to the pension liberation activities of Fast Pensions. HMRC had assessed the member to tax (the unauthorised payment charge) on a loan made to him following the transfer of his pension. The member now accepted that the loan had been made using the pension monies but said that at the time he was completely unaware of the connection between the

transfer and the loan subsequently received: he had no intention to 'liberate' any funds from the receiving scheme.

The Tribunal agreed that HMRC had been entitled to make the assessment, however, the Tribunal's tone was different from that of many previous cases. It said that the member was a victim of exploitative behaviour, and invited HMRC to mitigate the consequences for him, noting that enforcement of the assessment remained within HMRC's discretion. The Tribunal urged HMRC, in targeting its resources, to prioritise pursuing the orchestrators and promoters of unlawful schemes rather than individual members who were deceived by them.

Comment: This decision shows a sympathetic approach from the tribunal to a member who has been the victim of a scam. We do not know whether HMRC has followed its steer and declined to enforce the tax charge.

Safeway v Newton – CJEU

In this equalisation case, the scheme amendment power required the principal employer and trustees to alter the scheme by deed, but the amendment could take effect from "*the date of any prior written announcement to Members*". The question before the courts was whether the scheme had equalised retirement age with effect from 1 December 1991 (the date of a letter to members confirming the purported equalisation) or only from May 1996 (when a deed formally amending the rules was executed).

In 2016 the High Court, in line with previous case law on retrospective amendments, decided that equalisation was only effective from the date of the deed in 1996. However, the Court of Appeal suggested that under the scheme rules, a female member's right to a retirement age of 60 was 'defeasible' (and therefore capable of being annulled) during the period from December 1991 until May 1996. The Court referred to the Court of Justice of the European Union the question of whether European case law really did establish a principle which outlawed retrospective levelling-down during the Barber window, even if English law allowed it.

The CJEU rejected the Court of Appeal's 'defeasibility' analysis and reaffirmed the importance of legal certainty. It was not possible for domestic law, the provisions of a scheme's trust deed and rules, administrative practice or the content of member communications to override the settled European case law. However, the CJEU did observed that "exceptionally" - if there was an overriding reason in the public interest, which respected legitimate expectations - retroactive measures to end discrimination could be adopted.

Comment: The CJEU confirms that scheme amendments levelling-up retirement ages upwards cannot be made retrospectively (other than in very exceptional circumstances).

MISCELLANEOUS

GMP equalisation working group guidance note on methods

The GMP industry working group has published its guidance note on methods of equalising benefits for the effects of GMPs. The note puts forward "good practice" suggestions - it is intended to be proportionate and pragmatic, not a substitute for professional advice. The note is divided into three parts. These consider correcting past underpayments, approaches for equalising future benefit payments and common unanswered issues.

Further guidance is promised 'in the coming months' on data, impacted transactions (including transfer payments and trivial commutations) and tax. The working group still anticipates that most schemes will choose to wait for the publication of HMRC guidance (expected next month) before implementing an equalisation project.

Action points: Trustees of schemes with GMPs should be considering, and taking advice, on how they should approach equalisation.

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

For the latest on The Pensions Ombudsman and his work, please see our most recent 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 12 February 2020. If you have any enquiries about this course or would like to reserve a place, please contact **Megan Thorogood – E:** megan.thorogood@cms-cmno.com.

If you are interested in any additional trustee or employer training, please contact **Kieron Mitchinson** - **E:** 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, **T:** +44 (0)20 7367 2325 or your usual pension partner. Please also visit our website at **www.cms.law**.

The Pensions team is part of the CMS Finance group and advises employers and trustees of schemes varying in size, from a few million pounds to the largest schemes in the UK. We also 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. We regularly advise on de-risking transactions acting both as transaction counsel for trustees and for bulk annuity providers. 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.