

Leaders in Pensions

Trustee Knowledge Update

Welcome to the November 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.

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

VAT Briefing

HMRC was due to change its approach to when and how employers can recover VAT on costs incurred in running a pension scheme on 1 January 2016. However, there was much concern about whether schemes and employers would be able to meet this deadline given the uncertainty over how the new requirements might work in practice. Thankfully, HMRC has just announced that it is extending the transitional period before the new requirements come into force until 1 January 2017.

Action points: *The latest announcement from HMRC provides only limited further information on the various options available to schemes to deal with the recovery of VAT. However, it does promise further guidance on these options by the end of this year. Therefore, trustees may wish to continue their existing arrangements and defer further consideration of how to deal with this issue until HMRC have provided the promised guidance.*

Newsletter 73

There is a reminder for trustees that they should now be operating a transitional pension input period which will end on 5 April 2016.

As the 45% special lump sum death benefit tax charge (on lump sums paid late or after age 75) will largely be replaced by marginal rate tax charges from April 2016, there is guidance on how this tax charge should be operated. Normal PAYE rules will apply. Where a lump sum is paid and the beneficiary receives no other benefits, an emergency tax code will be needed and the administrator will need to issue a P45 when the lump sum is paid.

When the lifetime allowance falls to £1million in April 2016, there will be two forms of protection available: Individual Protection 2016 (IP2016) and Fixed Protection 2016 (FP2016). There will be no application deadline but individuals will need to apply for protection before they take their benefits.

HMRC is introducing a new online self-service for members to apply for protection which will be available from July 2016. Members will no longer receive a certificate, instead once they have successfully applied for protection the online service will provide them with a reference number. HMRC is also introducing an online service for scheme administrators to check the protection status of their scheme members.

Action points: *Members who want to rely on FP2016 need to think about how they will stop accruing benefits before 6 April 2016. Trustees need to be aware that scheme rules that provide for an automatic cessation of accrual where members have fixed protection may not work where the member has not actually applied for protection but intends to.*

Countdown Bulletin 10

The latest edition of the Countdown bulletin contains:

- a reminder that scheme administrators must register for HMRC's scheme reconciliation service by 5 April 2016 in order to use it; and
- confirmation that HMRC will not track contracted-out rights from 6 April 2016.

Action points: *Trustees need to ensure that administrators are taking the necessary steps to deal with the end of contracting-out in April 2016 and that they have started the GMP reconciliation process.*

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

Pollet - member's transfer value should have been paid within one month

The Ombudsman held that trustees of a DC scheme should have paid the member's transfer value to a SIPP within one month of the date the SIPP provider sent them a completed transfer request and discharge form. A month would have been a reasonable time frame to disinvest the member's benefits and pay them to the provider.

The Ombudsman ordered the trustees to make the transfer and compensate the member for any investment shortfall as a result of its failure to act within that time frame. He also asked them to pay £500 for distress and inconvenience.

A further point was what constituted an appropriate declaration for a transferring member to sign. The Ombudsman found that although the trustees were entitled to use a "standard disclaimer", they had not been entitled to request a further declaration from the member to the effect that he would take no action against them (whether for breach of trust, breach of duty, maladministration or otherwise) in connection with the transfer, that he would pay any tax liability that the trustee might incur in relation to the transfer and that he would indemnify the trustees against all costs, losses, penalties, fines, liabilities and expenses incurred or suffered as a result of actioning the transfer. This, said the Ombudsman, was "an attempt to 'settle' any potential possible claims against [the trustees] in respect of anything that they may have done in return for doing something they have no legal right to refuse".

Action points: *This shows the importance of having good administrative procedures in place to ensure transfer requests are actioned promptly. It also provides useful pointers on how enforceable disclaimers signed by members may prove to be.*

Trustees should note that, this was an atypical transfer case, with unusual background facts (one former trustee had been suspended by the Regulator and two directors were imprisoned for fraud) which contributed to a very long delay for the member in question. A different decision may have been reached on different facts.

Leaders in Pensions

Regulator (www.pensionsregulator.gov.uk)

Section 89 report on Docklands Light Railway Scheme

The trustees and Serco, the sole statutory employer in the scheme, could not reach agreement on the recovery plan and schedule of contributions following the 2009 valuation.

The Regulator issued a warning notice in 2012 saying it planned to direct that reports be commissioned to look at the funding position and the strength of Serco's covenant so it could consider how to exercise its funding powers. The decision to issue the warning notice was *"taken reluctantly in view of what the regulator believed to be the trustees' powers to seek appropriate contributions under the Scheme contribution rule... There was not a common interpretation between the parties and the regulator of the scope of the trustees' power under the Scheme rules."*

Regulatory action was suspended when further negotiations began between the parties. The trustees then started court action against Serco seeking further contributions under the provisions of the scheme. Eventually the parties reached a settlement under which Serco agreed to pay four payments of £8.25 million by January 2018 (underwritten by a parent company guarantee) and £4 million is to be paid by Docklands Light Railway Limited, the principal employer under the scheme rules. This will eliminate the whole of the scheme deficit.

The Regulator says in its comments that where it is involved in the valuation process, its *"focus will be to help the trustees of a scheme... reach an appropriate outcome as soon as possible."*

In addition: *"Where the trustees and employers have options available to them which are capable of addressing the funding issues...(such as the exercise of powers under a scheme's governing documentation), the regulator will generally expect these options to have been pursued before the regulator will consider exercising its powers. This underlines the importance for trustees to pay close attention to the terms of contribution powers available under the governing documentation of a given scheme."*

Finally, Serco was a fixed term franchisee and the Regulator says in relation to this that: *"it can be of particular importance that scheme valuations and funding plans are put in place in good time, to assist in orderly management and/or prevention of any deficit. As part of any covenant assessment or funding planning exercise, the trustees will want to take into account the fact of any upcoming end of franchise. However, unless there is good reason to do so, the regulator does not regard it as necessary to assume that the covenant support enjoyed by the scheme will fall away entirely at the end of that... employer's franchise."*

Action points: This is the first section 89 report considering the Regulator's use of its scheme funding powers.

Trustees unable to get agreement to the schedule of contributions and recovery plan within statutory time frames might draw some comfort from the Regulator's approach here and the fact that its preferred option was clearly to encourage dialogue between the parties rather than impose solutions of its own.

The Regulator expects trustees to carefully consider any powers they might have to impose contributions outside the statutory funding regime.

Compliance and enforcement policy for employers subject to auto-enrolment

This sets out how the Regulator intends to maximise compliance with the auto-enrolment regime.

Where employers have not complied with auto-enrolment duties because of a lack of understanding, the Regulator will work with them to help them become compliant. Where employers have complied with the spirit of the law, but committed procedural mistakes, the Regulator will consider whether a breach has occurred deliberately or not and reflect this in the approach it takes.

The Regulator will try to ensure workers are put back into the position they would have been had the employer paid the contributions that should have been paid under the statutory requirements.

There is a list of aggravating and mitigating factors that the Regulator will consider when contemplating enforcement action. These include: number of employees affected, length of breach, whether there were systemic failings, whether the employer's actions were deliberate or they have gained advantage, evidence of dishonesty and how proactive the employer is in dealing with the problem.

The document reminds employers that the DC quality features *"are the minimum features an auto-enrolment scheme is required to have"* and other regulatory guidance refers to *"other necessary characteristics to deliver a good outcome for their workers' savings"*.

Action points: Auto-enrolment is more of an issue for employers than trustees but trustees need to be aware of the pension arrangements other than their scheme that the employer uses for auto-enrolment.

Cases

Buckinghamshire v Barnardo's (High Court)

This is the latest High Court judgment on whether trustees could (or should) move from the use of RPI to CPI for revaluation and pension increases.

The judge found that so long as RPI remained an officially published index, the trustees did not have power to change index. The definitions of "Index" and "Retail Prices Index" in the scheme rules required there to have been an index *"in place of or in substitution for RPI"*, and for there to have been a *"replacement"* to RPI.

The judge suggests that:

- a *"replacement"* index would have to be one that had the same status as RPI at the time the rules in question were drafted, namely an officially published index, and based on price inflation in relation to a basket of elements, rather than e.g. wage inflation;
- RPI was not *"replaced"* when it stopped being recognised as a national index: RPI is still published and 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"*;
- even if RPI was *"replaced"*, that did not mean the trustees had to adopt the replacement.

Leaders in Pensions

As the case concerned the interpretation of provisions in rules it is not an authority on when it is proper for trustees to exercise any power to switch. However, the judge did say that, where there is a power to switch between indexes, "it ought properly to be exercised only to ensure that the index in use best reflects the policy of providing protection from inflation".

Action points: Where a move from RPI to CPI is being considered by employers or trustees, this case emphasises the need to consider the precise wording of the scheme rules very carefully.

Maximilian Schrems v Data Protection Commissioner (European Court of Justice)

A requirement of UK and European data protection law is that: "Personal data shall not be transferred to a country or territory outside the European Economic Area unless that country or territory ensures an adequate level of protection for the rights and freedoms of data subjects in relation to the processing of personal data." One of the countries affected by this is the US and as a result, the European Commission decided that data transferred to US companies that have signed up to certain "Safe Harbor" principles would be adequately protected.

The Court of Justice held in this case that compliance with the Safe Harbor principles does not offer adequate protection to data. This is for a number of reasons, in particular that the Safe Harbor can be bypassed or ignored for US national security reasons. The Court stressed that US public authorities' access, on a generalised basis, to content in electronic communications must be regarded as an invasion of privacy.

The UK Information Commissioner's Office (ICO) has responded, saying that: "businesses that use Safe Harbor will need to review how they ensure that data transferred to the US is transferred in line with the law. We recognise that it will take them some time for them to do this". There is already guidance on the options available when transferring data outside of the EEA to ensure compliance with the law.

There is more to come on this as the ICO concludes by saying that it "will be working with our European colleagues to produce guidance following the European Court of Justice ruling."

Action points: Trustees who think that personal data is held in or transferred to the US by those involved in running the scheme need to consider the arrangements that the US recipient has in place to keep the data secure. They should also keep the transfer of data under review and look out for new guidance from the ICO.

O'Brien v Ministry of Justice and Walker v Innospec (Court of Appeal)

These two cases confirm the effectiveness of cut-off dates which limit the backdating of claims for equal treatment.

O'Brien v Ministry of Justice: The member, a part-time judge between 1978 and 2005, was entitled to a pension by virtue of the Part Time Workers Directive, which the UK was required to include in domestic law by 7 April 2000. He claimed that the calculation of his pension should take account of all his service since 1978, not just since April 2000. The employment tribunal agreed.

However, the Court of Appeal held that the fundamental principle of legal certainty required that: "the extent of [pension] rights falls to be determined on the basis of the Community rule which applied at the time of the period of service on the basis of which those rights were acquired." The Court concluded that at the time of the member's service before 7 April 2000 he acquired no pension rights, and could not do so retrospectively.

Walker v Innospec: The member worked for Innospec between 1980 and 2003 and entered into a civil partnership in 2006. The company pension scheme provided a spouse's pension, but only provided the same pension for civil partners for benefits accrued after December 2005. This is permitted under the Equality Act 2010, which provides that applying such a cut-off is not unlawful discrimination. Therefore, the member's civil partner would receive only a fraction of the pension that a spouse would.

In 2012 an employment tribunal held the member had been discriminated against and that to read the Equality Act in a way compatible with European law, it had to ignore the cut-off. The employer successfully appealed this decision and the member, in turn, appealed to the Court of Appeal.

During the course of these appeals, the member married his partner (following the introduction of same sex marriage in 2013). When same sex marriage was introduced, an equivalent December 2005 cut-off for spouse's benefits was permitted by legislation.

The Court of Appeal held that the member would only be able to succeed in his claim if he could show breach of a fundamental principle of EU law, which he could not. When the member was earning his pension entitlement, the discriminatory treatment he complained of was lawful. The Court was sympathetic to his position, but as Underhill LJ observed: "changes in social attitudes, and the legislation which embodies those changes, cannot fully undo the effects of the past." The appeal was dismissed.

Action points: The Government published a review of survivor benefits, including the impact of the 2005 cut-off in June 2014. It did not come to any firm conclusion, saying merely that it proposed to consider the issues "very carefully before making a decision on whether the law should be changed". It remains to be seen whether this decision will prompt any update from Government but no further action is required from schemes that have a similar cut-off at the moment.

PPF (www.pensionprotectionfund.org.uk)

2016/17 Pension Protection Levy Consultation

The PPF has issued its annual set of draft levy documents – the final versions should be issued in December. After a number of innovations last year, this year the rules are "substantially the same". Key points to note are:

- **Schemes which wrongly identified themselves as "last man standing" before 2014/15:** The PPF threatens a hard line on schemes which it has now discovered had wrongly gained the benefit of the last man standing discount in previous levy years, including some "very large schemes". It says it will contact such schemes and proposes to re-invoice them for past levy years.
- **Asset Backed Contributions (ABCs):** As 2015/16 was the first year of the new ABC certification requirements, the PPF has focused on whether the

Leaders in Pensions

guidance was met overall (rather than every requirement in the levy rules being met), but warns “We may take a more rigorous approach in future years.” The re-certification principles set out in the draft ABC guidance should ensure the work required this year is more limited, and that in many cases there will be no need for new legal advice, and potentially a lighter-touch valuation.

- **Type A contingent assets – company guarantees:** The provisions are substantively unchanged, although the guidance has been updated to include the further factsheet on considering guarantor strength.
- **Mortgage exclusions:** For 2016/17, there are some additional information requirements in relation to mortgages and only immaterial mortgages will need to be re-certified.

The key deadline for PPF levy submissions is midnight on 31 March 2016.

Action points: *Although submission deadlines are not until the end of March, trustees who already have or are considering putting in place contingent assets or ABC arrangements should start to consider what action is required as early as possible.*

Miscellaneous

End of contracting-out and introduction of the single tier pension: DWP has begun consultation on the Pensions Act 2014 (Abolition of Contracting-out for Salary Related Pension Schemes) (Consequential Amendments) Order 2016.

One point raised in the consultation is what schemes will need to tell members on the cessation of contracting-out.

There will be no new disclosure requirements relating to the end of contracting-out. The existing requirement to tell members which service is contracted-out as part of the basic scheme information will be repealed from April 2017. The Government clearly envisages that the cessation of contracting-out will be a material change in the basic scheme information that trustees will need to notify to members. The time limits for notifying members of such changes are “before or as soon as possible after (and in

any event within three months after) the change”. This means that the long-stop date for telling members that they are no longer contracted-out is 5 July 2016. In practice, employers and trustees are likely to want to tell members before the change takes effect in April 2016.

There are other issues that trustees may wish to consider in relation to communicating with members. Currently, pre 1988 GMPs are not increased by occupational pension schemes but as part of the member’s additional state pension. Similarly, GMPs accrued between 1988 and 1997 are increased by up to 3% under scheme rules and any excess increase that would have been paid if the member was not contracted-out is paid through additional state pension. With the introduction of the single tier state pension, the element of GMP increases currently paid by the state will fall away. As a result, where member communications in the past have explained that part of the GMP increase will be paid through state pension, trustees may wish to revisit these communications and explain the new position.

Trustees may also wish to consider whether there are any other changes that need to be made to member communications (or indeed scheme rules) to reflect the introduction of the single tier state pension, for example in relation to basic state pension off-sets or bridging pensions.

CPI/RPI for year ending 30 September 2015: A number of statutory increase provisions (including revaluation) use inflation figures for the year ending 30 September in each year. The CPI fell by 0.1% in the year to September, meaning it was actually a period of deflation. This contrasts with a 0.8% increase in the RPI over the same period.

Trustees should be aware that where their scheme uses CPI as the measure for calculating increases, negative inflation will not enable them to reduce pension entitlements.

Surplus resolutions: Just a reminder for trustees who have not yet considered whether a resolution needs to be passed to protect any powers they have to refund scheme surplus. The last day for passing such resolutions is **5 April 2016** and members and employers need to be given at least three months’ notice of the intention to pass such a resolution (i.e. by 5 January 2016 at the latest).

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 23 February, 14 June and 11 October 2016. 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.

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.

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 11 November 2015. CMS Cameron McKenna LLP is a limited liability partnership registered in England and Wales with registration number OC310335.