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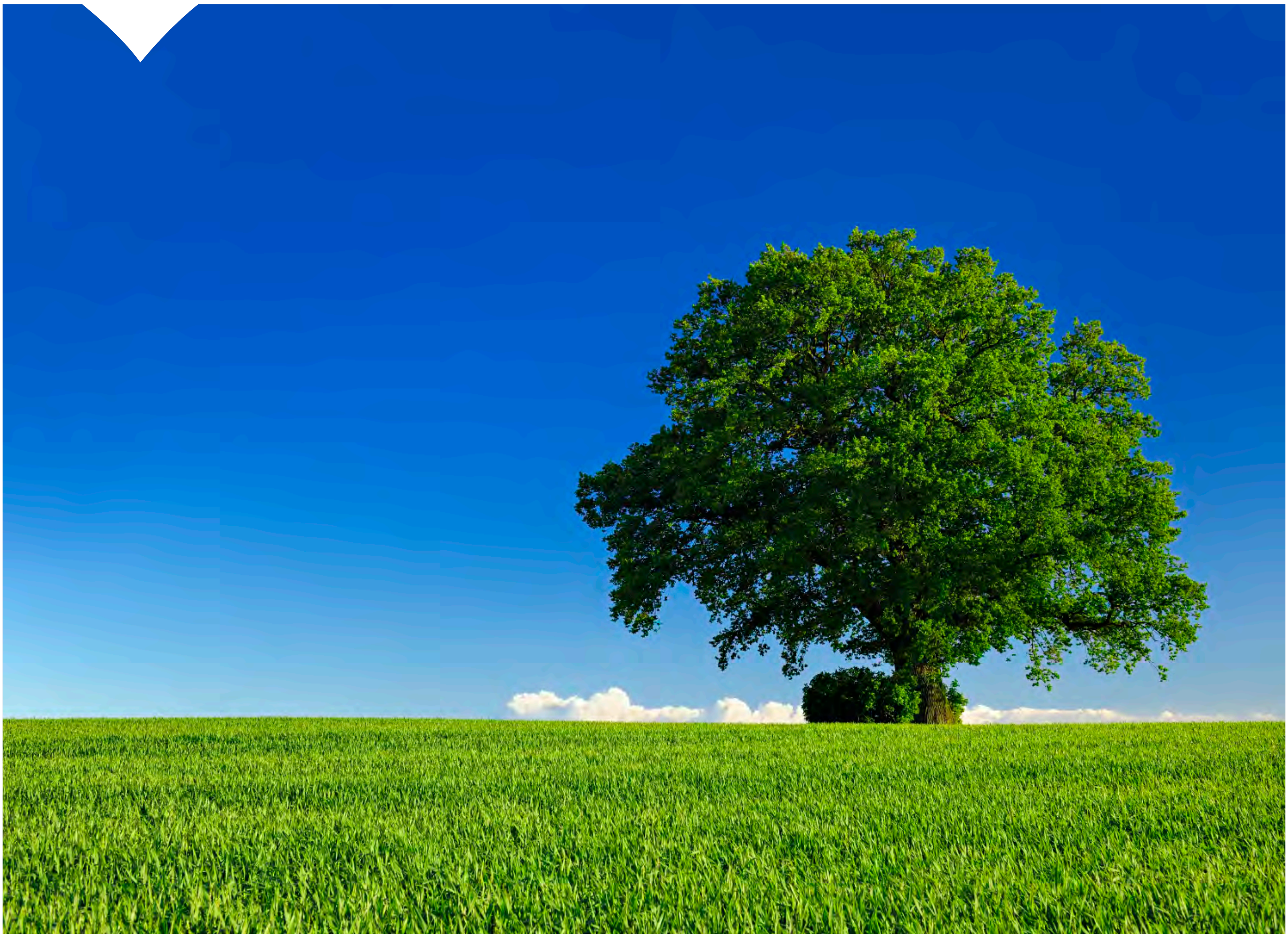
May 2017

# Trustee Quarterly Review

Quarterly update for pension scheme trustees



# Introduction

Welcome to the May 2017 edition of our Trustee Quarterly Review. The Review is published by the Mayer Brown Pensions Group each quarter, and looks at selected legal developments in the pensions industry over the previous quarter that we believe are of particular interest to trustees of occupational pension schemes. Each article summarises the relevant development and provides a short commentary on its likely implications for trustees. The Review also includes details of upcoming Pensions Group events at Mayer Brown, and a timeline of important dates and expected future developments.

Please speak to your usual contact in the Pensions Group if you have any questions on the issues covered in this edition of the Review.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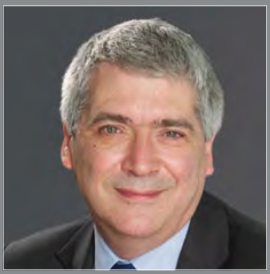


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# Spring Budget 2017

The Chancellor announced a new tax charge for overseas transfers, a change to the tax registration process for master trusts, and a (currently shelved) reduction to the money purchase annual allowance in the last Spring Budget.

## Overseas transfer charge

By way of reminder, a transfer of pension benefits to a scheme located outside the UK will be an unauthorised member payment unless made to a qualifying recognised overseas pension scheme (**"QROPS"**) – an overseas scheme recognised by HMRC as being broadly similar to a UK registered pension scheme.

Following the Chancellor's announcement, certain transfers to and from a QROPS are liable to a new 25% tax charge called the overseas transfer charge. The charge will apply to any transfer from a UK registered pension scheme to a QROPS which is requested on or after 9 March 2017, unless one of the following conditions is met:

- the member is resident (for tax purposes) in the same country in which the QROPS is established;
- the member is resident (for tax purposes) in a country within the European Economic Area (**"EEA"**) and the QROPS is established in another country within the EEA; or
- the QROPS is an occupational pension scheme, overseas public service scheme or established by an international organisation (like the UN), and the member is an employee of a sponsoring/participating employer of the scheme or the relevant international organisation.

The charge will also apply if the member does not provide certain prescribed information to the scheme administrator before the scheme makes the transfer.

The charge will not apply to transfers which were requested before 9 March, but which are executed after that date (unless the transfer is made to a different QROPS to that named in the transfer request). For these purposes, a transfer has been requested where the member has made a substantive request in relation to which the scheme administrator is required to take action.

If an overseas transfer charge arises on a transfer from a registered pension scheme to a QROPS, the scheme administrator should deduct the tax due from the member's funds before making the transfer, and should report and account for the tax in the usual way using the scheme's Accounting for Tax return.

Members and QROPS managers may also face a tax charge if the member's circumstances change during the five years following a transfer to the QROPS; if they fail to provide the manager of the QROPS with certain prescribed information; or on a further transfer out of the QROPS.

Additional requirements have been imposed on overseas schemes which must be met in order for the scheme to remain a QROPS beyond 13 April 2017. The existing difficulty faced by scheme administrators, who have no means in practice of confirming that a receiving scheme is in fact a QROPS, remains and we suggest that trustees who are making an overseas transfer should seek a warranty as to the scheme's status from the receiving scheme manager where possible.

By way of reminder, the QROPS regime was also amended with effect from April 2017 by:

- removing the old rule which required at least 70% of UK tax-relieved funds to be used to provide a pension for life, and
- introducing a rule permitting a QROPS to pay benefits before age 55 in circumstances where that payment would be an authorised member payment if it was made by a registered pension scheme.

## Money purchase annual allowance

Individuals who have flexibly accessed money purchase pension savings in a registered pension scheme may only make further tax-relieved contributions to a money purchase pension scheme up to a reduced annual limit referred to as the money purchase annual allowance (**"MPAA"**).

The government announced its intention to reduce the MPAA from £10,000 to £4,000 in the 2016 Autumn Statement. The Chancellor confirmed in the Spring Budget that the proposal would go ahead with effect from 6 April 2017.

However, the status of the proposed reduction is unclear at the time of writing. The provisions that would have enacted this change were removed from the Finance Act 2017 during its passage through Parliament in the run-up to the June general election. The prevailing view within the industry appears to be that the reduction will be implemented should a Conservative government remain in place following the election.

## Master trusts

The Chancellor also announced that the government will amend the tax registration process for master trust pension schemes to align it with the Pensions Regulator's new authorisation and supervision regime (created by the Pension Schemes Act 2017), with the intention of increasing consumer protection.

## Comment

Trustees with pending transfer requests to overseas pension schemes (including requests made before 9 March) should ask the receiving scheme to confirm that it is still a QROPS.

Trustees should also make sure that their transfer documentation has been updated to reflect the changes to the tax regime surrounding overseas transfers. Issues are most likely to arise in connection with transfer requests to an overseas personal pension scheme where either the member or the receiving scheme is registered outside the EEA. Trustees may also wish to take this opportunity to review their transfer request documentation and procedures more generally.

Members who have already accessed their pension savings "flexibly" should be warned that they may face an annual allowance charge if their own, or their employer's, contributions to a money purchase arrangement in this (or any future) tax year go over the £4,000 limit. Members who are contemplating flexible access may also wish to know that future contributions may be subject to a lower maximum than would have applied previously.

Tom Wild

# Taking retirement advice – introduction of pensions advice allowance

Regulations came into force on 6 April 2017 that introduce a pensions advice allowance (the "**advice allowance**"), allowing individuals with DC and hybrid benefits to withdraw up to £1,500 over their lifetime to pay for retirement advice.

## Background

The advice allowance is part of the solution to fill an 'advice gap' identified by the Financial Advice Market Review (**"FAMR"**). The FAMR found that, although taking advice often results in increased savings rates, less than a third of people take financial advice on their pension, and many perceive it to be unaffordable. Following the FAMR's recommendation, the government consulted on a new allowance to allow individuals to access a small part of their pension pot to redeem against the cost of retirement advice.

## New authorised payment

The advice allowance enables individuals to withdraw up to £500 from their DC or hybrid pension pot to pay for retirement advice. The £500 allowance:

- can be used up to three times in a member's lifetime, but not more than once in a tax year;
- is available to members with DC or hybrid benefits;
- is available to members of any age; and
- must be paid directly to a regulated financial adviser.

The advice allowance can be used for regulated advice that covers all of the member's savings, including savings in other pension schemes and non-pension investments such as ISAs. This is a change from the previous adviser charging system, where funds withdrawn from a member's pension pot could only be used for advice about the pension scheme from which the charge was taken.

The advice allowance is a new type of tax-free authorised payment. This tax-free amount is in addition to the member's right to take a tax-free lump sum at retirement.

Trustees are not obliged to offer the advice allowance. If they wish to do so, they will need to amend their scheme's rules using the scheme's amendment power. No overriding statutory power has been introduced to facilitate this.

## Comment

Trustees of DC and hybrid schemes should consider whether they wish to offer the advice allowance to members. On the one hand, this may make the provision of quality financial advice more affordable, but on the other hand, it may create unwanted additional administration. If the advice allowance is desirable, a rule amendment will be required.

The government had intended to make complementary changes to the existing £150 income tax and National Insurance exemption for employer-arranged pensions advice from 6 April 2017, by replacing it with a new £500 exemption that also covered advice on general financial and tax issues relating to pensions. The provision for this change was removed from the Finance Act 2017 during its passage through Parliament in the run-up to the June general election, although the government intends to introduce the change – again from 6 April 2017 – after the election.

Bo Young Park

# Employer debt in multi-employer schemes – proposed new deferral option

The government has published a consultation on draft regulations that would introduce an option for employers in a multi-employer scheme who cease to employ active members to defer payment of the section 75 debt thereby triggered.

A number of conditions would need to be met in order for the deferral option to be used, including a funding test, written trustee consent (based on the trustees being satisfied that the arrangement would not be detrimental to the scheme or members), and the scheme not being in wind-up, in PPF assessment, or likely to enter PPF assessment in the next 12 months. The deferral option would also not be available to employers undergoing a restructuring as a number of other section 75 debt management options already exist for such situations. The option would, however, be available to employers who are in a period of grace arrangement.

A deferred employer would continue to be a scheme employer for funding purposes, and would remain liable for their share of any orphan liabilities. The deferral arrangement would come to an end when:

- the deferred employer employs an active member (in which case the employer would be treated as if an employment cessation event had not occurred);
- the deferred employer chooses to trigger the section 75 debt (subject to trustee consent);
- an insolvency event occurs in relation to the deferred employer (in which case the employer would be treated as if an employment cessation event had not occurred);
- the deferred employer commences winding-up;
- the scheme winds up triggering a section 75 debt;
- the deferred employer restructures;
- a freezing event occurs in relation to the scheme; or
- the trustees serve notice on the deferred employer for failure to comply with its scheme funding obligations or because the employer's covenant is likely to weaken in some other way in the next 12 months.

The consultation closed on 18 May. If the proposed changes go ahead, they will come into force on 1 October.

## Comment

Management of employer debt in multi-employer schemes remains an ongoing problem, and the proposed introduction of a further means of doing so will therefore be welcomed. However, the draft regulations contain a number of issues. For example, as they are currently drafted, the deferred employer debt would become payable on a scheme freezing event (e.g. where the scheme closes to future accrual). There does not seem to be any particular logic, given that a scheme freezing event would not otherwise trigger an employer debt, as to why the deferred debt should become payable at that point. In addition, the draft regulations do not contain a definition of "restructuring" which is essential if schemes are to be confident as to when the deferral option is available. It is to be hoped that these issues are resolved if the government proceeds with introduction of the deferral option.

Katherine Carter

# DB funding – Pensions Regulator's 2017 statement

The Regulator has published its 2017 DB funding statement. This is primarily aimed at schemes undergoing valuations with an effective date between 22 September 2016 and 21 September 2017 ("**2017 valuations**"). The statement highlights some of the key issues that the Regulator has identified as facing schemes with 2017 valuations.

The Regulator's analysis shows that scheme liability values have generally increased compared with three years ago and that, while most major asset classes have performed well, this has not been at a level sufficient to compensate in full for these increased liability values. As a result, many schemes are likely to have larger deficits than anticipated at their last valuation. In that context, the statement's key messages are summarised below.

## Market conditions and risk management

The continuing uncertainty over future economic conditions and the persistent low risk environment underline the importance of effective risk management. Risk management is an ongoing process, and trustees should monitor risks and take action where required, irrespective of the scheme's funding position. Schemes should have contingency plans in place to recover their funding position and to mitigate the impact of any further downside risk materialising. Such plans should be agreed with the employer and should be legally enforceable.

## Affordability and managing deficits

The Regulator believes that 80-95% of schemes with 2017 valuations have employers who can manage their deficits and do not have long-term sustainability issues. The Regulator has segmented these schemes based on their risk profile, and suggests the following appropriate action for each segment:

- Schemes with strong/tending to strong employers where the scheme's funding position is on track to meet its objectives and where technical provisions are not weak and recovery plans are not unduly long should continue with their current funding plan as a minimum – recovery plans should not be extended without good reason.
- Schemes with strong/tending to strong employers, but which have a combination of weak technical provisions and long recovery plans should seek higher contributions now.
- Schemes with weaker employers who assume they have a strong covenant because the wider corporate group is strong, but who have no formal support in place should seek legally enforceable support from the wider group – the Regulator will not take the wider group covenant into account if the scheme cannot legally rely on it.

Trustees of the remaining 5% of schemes, i.e. whose employers are weak/tending to weak, should seek to obtain the best possible funding outcome in the scheme's specific circumstances. Trustees should be able to evidence that they have taken appropriate measures such as closing the scheme to future accrual, maximising non-cash support and security available to the scheme, and improving the scheme's ability to control risk.

## Valuation assumptions

Trustees should consider with their advisers the impact of changing market conditions on the longer term view of expected risk and return – scenario planning and sensitivity analysis may assist with this. Trustees should seek and consider robust actuarial advice on their valuation assumptions. Whether trustees decide to continue to use the same discount rate approach as before or to change the approach used, they should have a sound rationale behind their decision, and should document it clearly.

## Investment strategy

The Regulator will intervene where it believes that a scheme is taking too much investment risk or where there is little or no asset diversification.

## Employer covenant

Where the trustees have good visibility of the employer covenant, they should focus on the employer's ability to contribute cash to the scheme.

## Scheme maturity

Trustees should regularly monitor and assess the scheme's cash flow, and should have an appropriate cash flow management policy in place, taking into account the liquidity characteristics of the scheme's investments. Cash flow management is especially important for mature schemes.

## Fair treatment of schemes

The Regulator emphasises the importance of schemes being treated fairly when compared to shareholders – it will intervene if it does not believe that this is occurring. Trustees should ensure that the employer's legal obligations to the scheme are recognised ahead of shareholders who have no legal entitlement to dividends. Where an employer's total distribution to shareholders is higher than its deficit reduction contributions, the scheme should have a relatively short recovery plan and an investment strategy that does not depend excessively on investment outperformance.

## Regulator approach to funding

The Regulator intends to be clearer in its expectations of trustees and employers and plans to escalate its actions more quickly in future, using its full range of powers as necessary. It will also develop its approach to smaller schemes by tailoring the way it works with such schemes so that the protection of members of smaller schemes receives increased focus. The Regulator also plans to take a tougher approach where valuations are not submitted on time (i.e. within 15 months of their effective date).

## Comment

Clearly, schemes with 2017 valuations should review the statement and bear its messages in mind when negotiating their funding packages – in particular, the Regulator's comments on the fair treatment of schemes when compared with shareholders which is a theme upon which the Regulator is increasingly focusing. However, all schemes should note the Regulator's stated intention to escalate its actions quickly and to use the full range of its powers as this may suggest that the Regulator plans to adopt a tougher approach generally to scheme funding.

Katherine Carter

# Green Paper – security and sustainability in DB pension schemes

The government has published a green paper which explores concerns that have been raised about the funding and regulation of DB pension schemes. It draws together suggestions from various commentators on how the system might be changed to deliver better outcomes.

The green paper contains some useful discussion about perceived problems and ideas for change. However, its overall conclusion is that the evidence does not point to any significant problems with the legislation currently governing such schemes or the way in which they are regulated. The government asked for views and comments by 14 May.

The green paper looks at four areas – funding and investment, employer contributions and affordability, member protection, and consolidation of schemes. Various issues are explored under each of these headings, some of which are highlighted below.

## Funding and investment

Some commentators have expressed the view that the current regulatory regime, in particular the approach to scheme valuations, is causing overly cautious investment choices. Solutions suggested are more training and guidance to improve trustee decision-making, requiring professional trustees to be appointed, and giving the Pensions Regulator a more proactive role in the valuation process, for example, determining the level of risk a scheme should be taking.

The green paper says that, despite there being no evidence that the sector as a whole is in crisis, there is a widespread perception that some employers are unable to sustain their contributions, that deficits are substantial, and that members' benefits are at risk. Newspaper headlines focus on large buy-out deficit figures, giving a false impression that the government is keen to dispel. The government thinks it would help if more was done to improve members' understanding of the value of their benefits and the actual risk of them not being paid. Suggestions include publishing a range of deficit measures, and giving members a better explanation of the long-term risk.

## Employer contributions and affordability

Some commentators have suggested that DB schemes have become an unsustainable drag on employers' resources, and that some dilution of members' benefits should be allowed. However, the government is not persuaded that there is a case for across-the-board changes, allowing a reduction in members' benefits so as to relieve pressure on employers. It does though see that there could be a tailored approach with different measures targeted at "stressed" sponsors and schemes. Among the measures suggested are:

- making it easier to separate schemes from stressed employers (currently, regulated apportionment arrangements are available only where the sponsor is expected to become insolvent in the next 12 months);
- allowing pension increases to be suspended or the scheme's inflation measure to be changed from RPI to CPI where there is currently no power to do so; and
- a tougher funding regime and/or shorter recovery plans for employers with significant resources and severely underfunded schemes.

## Member protection

The principal theme of this section of the green paper concerns the role of the Pensions Regulator. A key recommendation of a report issued by the Work and Pensions Select Committee in December 2016 was that the Regulator should be given enhanced powers in relation to scheme funding, corporate events and information gathering. In particular, the Committee's view was that it would be more effective if the Regulator had power to act proactively to prevent certain corporate activities, rather than only being able to impose financial penalties retrospectively.

The green paper expresses caution about these sorts of measures, however, as the government would not want increased Regulator intervention to damage the competitiveness of UK business or to inhibit legitimate business activity.

## Consolidation of schemes

Some commentators have floated the possibility of smaller DB schemes joining together to become one consolidated scheme, and the government believes that this is worth exploring. The advantages of consolidation may take the form of cost savings through economies of scale, more effective investment performance, and better governance, depending on the extent to which the arrangements are combined. There is a range of different consolidation models that could be adopted, from the ring-fenced model where assets and liabilities remain separate with administration and/or trusteeship and/or investment arrangements being shared, through to full consolidation where assets and liabilities are combined as well. The latter type of consolidation would present the most challenges, and new legislation would be needed to allow benefit structures to be harmonised and to deal with sharing of expenses and the potential for cross-subsidy.

The government is not convinced that it would be desirable for there to be any compulsion, e.g. for stressed schemes to be required to consolidate, but the green paper suggests that a suitable legislative framework could be provided for schemes wishing voluntarily to form a consolidated arrangement.

## Comment

The green paper is lengthy and covers a wide range of issues. A few of the solutions suggested by commentators and explored in the green paper would represent a fundamental change (such as those relating to pension increases). The green paper indicates that the government has little appetite for taking forward any radical proposals at this stage. Although it says that the government is interested in exploring the case for stronger Pensions Regulator powers, it emphasises that care would need to be taken to ensure they were proportionate and workable and not detrimental to the effective functioning of the economy. However, in light of the Conservatives' election pledge to introduce a requirement for notification to the Regulator of certain M&A transactions, as well as new Regulator powers to block transactions in certain circumstances and to levy punitive fines, it may be that the post-election government's view in this respect will change.

Beverly Cox

# Pension Protection Fund levy – consultation on rules for next levy triennium

In March, the PPF published a consultation on the framework for the next PPF levy triennium covering the levy years from 2018/19 to 2020/21.

## Background

The PPF has been engaging with stakeholders over the last levy triennium, including seeking input from an industry steering group, and has set out some proposed changes to the PPF levy framework for the levy years from 2018/19 to 2020/21 in its consultation document. The consultation closed on 15 May, and the PPF intends to publish a second consultation in the autumn setting out its conclusions and detailed draft rules for the 2018/19 levy.

The PPF recognises that stakeholders value stability and that the current levy framework works well, so it is seeking only to make changes that it thinks are necessary and beneficial. The PPF recognises that the proposed changes will result in some schemes, particularly those with larger employers, paying a higher levy, but expects that approximately two thirds of schemes will actually see a reduction in their levy.

The suggested changes for the next levy triennium and the proposals that the PPF is seeking views on are summarised below.

## Scorecards

The PPF uses scorecards to assess the risk of a sponsoring employer's insolvency. It currently has eight scorecards for different types of sponsoring employer. In order to reflect actual insolvency experience that it has seen, the PPF wants to change the scorecards to ensure more accurate insolvency risk scores. In brief, the PPF intends to revise how employers are allocated to scorecards, to ensure that scorecards are tailored to employer size, and to amend the scorecards for employers who file small accounts to provide more predictability.

In addition, the PPF is asking for views on whether it would be sensible to calculate the levy using scores as at 31 March each year, rather than to continue to average monthly scores, as this would be simpler.

## Assessing insolvency risk

The PPF suggests that there could be significant benefits in using credit ratings and industry scorecards for the largest employers, as well as taking a different approach to insolvency risk assessment for smaller schemes such as those with proximity to the government or no substantive employer.

## Small schemes

The PPF wants to simplify the levy system and, in particular, to find ways of reducing the administrative burden for smaller schemes (which lack the same resources as schemes with larger employers). Therefore, the PPF is keen to better understand what elements of the system are particularly problematic for schemes with smaller employers.

## Certifying risk reduction

The PPF is proposing changes to the risk reduction certification. The changes include requiring a guarantor strength report (to demonstrate that the guarantor would be able to satisfy the guarantee on its insolvency) to be prepared in advance of certification for very high value Type A contingent assets (parent/group company guarantees), as well as making it easier for guarantor employers to have a guarantee taken into account and for multiple guarantors to be accepted so that more employers can benefit from levy reductions.

The PPF is also going to review its template contingent asset documentation. The PPF has said that, in order to be recognised for levy purposes, existing contingent assets will need to be amended or re-executed on the new standard terms to ensure consistency.

## Good governance levy discount

Finally, the PPF is seeking views on the possibility of introducing a levy reduction for good governance.

## Comment

Most DB schemes will welcome the fact that, for the most part, the PPF plans to leave the current levy rules unchanged. However the proposals relating to contingent assets could potentially be more controversial. While there are plans to enable employers to more readily benefit from levy reductions using contingent assets, the proposed requirement for existing contingent assets to be moved onto the new template documentation could be onerous. Any scheme that intends to use a contingent asset or has a contingent asset in place already should have the possibility that a new template document will need to be used on their radar. In addition, the proposed requirements that a guarantor strength report will need to meet may mean that covenant advisers will find it difficult in practice to give such reports, which will in turn make certification of high value guarantees more challenging.

Beth Brown

# Cap on early exit charges and extension of ban on member-borne commission charges

On 31 March 2017, the Financial Conduct Authority introduced a cap on early exit charges in contract-based pension schemes. Following a consultation last year, the government has decided to introduce an equivalent cap for trust-based pension schemes. The government is now consulting on draft regulations introducing the cap and extending the ban on member-borne commission charges (the "**draft regulations**"). The consultation closes on 31 May.

## Early exit charges cap

In broad summary, the draft regulations introduce an early exit charge cap for trust-based pension schemes as follows:

- The cap would apply with effect from 1 October 2017.
- The cap would apply in relation to money purchase benefits.
- The cap would cover members who:

  (a) have reached "normal minimum pension age" for tax purposes (at present, age 55 in most cases);

  (b) have not yet reached the scheme's normal retirement age; and

  (c) are taking, converting or transferring their benefits.

- For members who joined the scheme before 1 October 2017, the cap would be the lower of:

  (a) 1% of the value of the benefits being taken, converted or transferred; or

  (b) the amount provided under the scheme's rules on 1 October 2017. (The trustees would not be able to introduce, vary or increase a charge which was not in the scheme's rules on 1 October 2017.)

  If the member is subject to more than one charge, the cap would apply to the combined level of those charges.

- For members who join the scheme on or after 1 October 2017, charges on taking, converting or transferring benefits would be banned.
- The government has stated that it intends to exclude market value adjustments and terminal bonuses from the cap. Guidance is awaited in this regard.
- If a member's benefits are already subject to the 0.75% cap on charges imposed on money purchase schemes which are being used for automatic enrolment, that cap would take precedence – the draft regulations would not allow that cap to be increased to 1%.
- The requirement to secure compliance with the cap would fall on the person who imposes the charge (or who, but for the draft regulations, would impose the charge). This is likely to be a service provider (such as the scheme's administrators or fund managers) rather than the trustees.
- A service provider would have to provide written confirmation to the trustees within one month of 1 October 2017 (or, if later, within one month of becoming a service provider to the scheme) that it is complying with the cap. The service provider would also have to notify the trustees as soon as practicable (and in any event within one month) if the written confirmation ceases to be accurate.
- If the trustees have a contract with a service provider which provides for charges, the draft regulations would override any term in the contract which would otherwise allow a charge to be levied.

## Member-borne commission charges

Since 6 April 2016, a ban has been in place on arrangements under which service providers in pension schemes being used for automatic enrolment impose charges on members to recover the cost of commission paid to advisers. However, this ban currently only applies to new arrangements entered into on or after 6 April 2016, or to existing arrangements that are varied or renewed on or after that date.

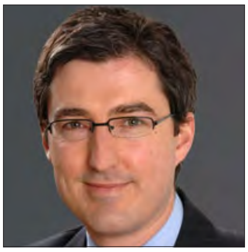
The draft regulations propose implementing the next phase of the ban, by extending it to cover arrangements entered into before 6 April 2016. Payments made before the draft regulations come into force on 1 October 2017 would not be affected. In addition, it is still only pension schemes being used for automatic enrolment which would be covered by the ban.

The existing exchange of information provisions (between trustees and service providers) would be updated by the draft regulations to reflect the extension of the ban.

## Comment

A 2016 Pensions Regulator survey of trust-based schemes found that only 4% of the schemes surveyed would apply an early exit charge.  Despite this statistic, trustees should still consider taking steps now to check whether the early exit charges cap would apply to their scheme if implemented as proposed in the draft regulations.

Trustees should already have considered whether the existing ban on member-borne commission charges impacts their scheme.  They should turn their attention now to the potential impact of an extension of the ban.



Giles Bywater

# Power to change indexation measures – further Court guidance

The High Court has held that the indexation provisions in two sections of a DB pension scheme's rules did not permit a move from the Retail Prices Index ("**RPI**") to the Consumer Prices Index ("**CPI**").

## Background

DB pension schemes are generally required to revalue deferred pensions and to increase pensions in payment by statutorily-prescribed minimum percentages to reflect inflation. Before 2011, the government used RPI to calculate these minimum percentages. However, in 2011, the government announced that going forward it would use CPI.

Many schemes have written the statutory revaluation and pension increase requirements into their rules, often referring explicitly to RPI as the basis for calculating revaluation and increases. The government's decision to move to CPI has caused many of these schemes to question whether they too can switch to using CPI.

## Facts

The principal employer of a DB pension scheme wished to clarify a number of questions concerning the indexation provisions in the rules governing two sections of the scheme. The rules governing the first section (Section A) provided that if RPI was not published or its compilation was materially changed, then the principal employer, with the agreement of the trustees, was to determine the nearest alternative index to be applied. The rules governing the second section (Section B) provided that if RPI was revised to a new base or otherwise altered, all subsequent pension increases would be on a basis determined by the trustees having regard to the alteration made to RPI.

The principal employer asked the Court to determine:

- whether the compilation of RPI had been materially changed, and if so, what was the nearest alternative index to RPI; and
- whether RPI had been "otherwise altered", and if so, what alternative bases could be used.

## Decision

The Court held that the test in the rules governing Section A was directed at the actual compilation of the index and not at the impact which any change might have. The introduction of a specially tailored house prices index (UK HPI) into RPI constituted a material change in compilation of RPI. As a matter of interpretation of the rules, RPI as changed by the introduction of UK HPI, rather than CPI, was the nearest alternative index to RPI as it stood before the introduction of UK HPI, and it was not open to the principal employer to adopt any other index.

In relation to Section B, RPI had been "otherwise altered" by the introduction of UK HPI. As a matter of interpretation of the rules, RPI as altered by the introduction of UK HPI should be the basis determined by the trustees in response to that alteration, and it was not open to the trustees to adopt any other index.

## Comment

Although this decision turns very much on the specific wording of the scheme's rules, it provides another piece in the jigsaw of the interpretation of scheme indexation provisions. In particular, the Court's view that RPI as amended by the introduction of UK HPI is the closest alternative index to RPI as it stood before the introduction of UK HPI, rather than CPI, may provide helpful guidance to employers and trustees of schemes who also have power to adopt an alternative index in the event of a change to RPI. The decision also contains a helpful overview of the differences between RPI and CPI.

Stuart Pickford

Katherine Carter

*This article is based on a bulletin previously published in PLC Magazine.*

# Operation of indexation underpin – Court consideration

The Court of Appeal has considered the operation of a replacement pension increase rule which was expressed to apply both prospectively and retrospectively.

## Background

Legislation requires pension schemes to grant annual increases to certain DB pensions in payment. Guaranteed minimum pensions earned between April 1988 and April 1997 must be increased in line with inflation capped at 3%. DB pensions earned on or after 6 April 1997 must be increased in line with inflation capped at 5% (known as 5% limited price indexation) (**"5% LPI"**) for service before 6 April 2005, or capped at 2.5% for service on or after that date. There is no statutory duty to increase other DB pensions. Scheme rules may require higher increases than the statutory minimum.

## Facts

The case concerned a DB pension scheme. The scheme's rules contained a provision that prohibited amendments which would prejudicially affect pensions in payment at the amendment's effective date and benefits accrued before the amendment's effective date (the **"amendment condition"**).

The scheme rules provided for pensions in payment to be increased annually by 3% compound (the **"original rule"**). In June 1991, a deed of amendment purported to replace the original rule with a rule requiring annual increases of 5% LPI (the **"replacement rule"**). Since June 1991, the scheme was administered so that pensions in relation to both pre- and post-June 1991 service were increased annually by 5% LPI.

In 2014, the trustees issued proceedings to determine whether the way in which pensions in payment had been increased since June 1991 was correct. The trustees and the employer agreed that the amendment condition meant that the increase calculation method in the original rule operated as an underpin when calculating the increases to be applied to pensions in respect of pre-June 1991 service. However, the trustees argued that the pre-June 1991 element of a member's pension should be increased year-on-year by the greater of 5% LPI and 3%. This would result in an increase in liabilities of about £17m.

The employer argued that the pre-June 1991 element of a pension to be paid each year should be calculated by looking at the entire period from the date of retirement (rather than the year-on-year approach favoured by the trustees) and taking the higher of:

- the value of that element as at the date of retirement increased each year by 3% compound; and
- the value of that element as at the date of retirement increased each year by 5% LPI compound, subject to a floor of 0% to avoid the effects of any negative retail prices increase.

This would result in an increase in liabilities of about £5 million.

The High Court held in favour of the trustees, and the employer appealed.

## Decision

The Court allowed the appeal. It held that it was necessary to focus on the rights that were protected by the amendment condition – members with pre-1991 service had an accrued right not to a 3% annual increase in the abstract, but to a 3% increase applied to a figure which had itself been increased by 3% and not by any higher figure. The employer's approach should be adopted as it protected those rights, but did not give members the best of both worlds, i.e. more than they would have been entitled to under either the original rule or the replacement rule.

The Court also noted that the employer's approach caused the least interference to the integrity of the modified scheme, consistent with the principles outlined in *Foster Wheeler Limited v Hanley*. In *Foster Wheeler*, the Court of Appeal had held (in the context of equalisation) that if some departure from the provisions of the scheme is required to give effect to members' rights, it should generally represent the minimum interference with the scheme provisions.

## Comment

Although the circumstances in which the underpin arose in this case are unlikely to be widespread, the approach taken by the Court on how an underpin should be administered could be of wider significance. The decision is also a useful confirmation that the "minimum interference" approach adopted in *Foster Wheeler* can be applied when giving effect to rights other than those arising as a result of *Barber*.

Stuart Pickford

Katherine Carter

*This article is based on a bulletin previously published in PLC Magazine.*

# In other news...

## Pension Schemes Act 2017

This Act has received Royal Assent. The authorisation and supervision framework for master trusts that it introduces is expected to come into force in October 2018. However, the transitional supervision regime for existing master trusts has immediate effect. Existing schemes which fall within the Act's definition of a "master trust" should ensure that they are aware of, and comply with, the transitional supervision regime.

## GMP equalisation – consultation response

The government has published a response to its consultation on a draft methodology for GMP equalisation and proposed changes to the GMP conversion legislation to facilitate equalisation. The government intends to give further consideration to the consultation responses with the industry working group that designed the methodology. The government will then decide what further changes might be necessary to the methodology, and what amendments might be required to legislation to enable schemes to convert benefits more easily.

## Transfers of contracted-out rights in payments – new regulations

Regulations will come into force on 3 July that allow transfers of contracted-out rights in payment with member consent to schemes that have never been contracted-out where:

- the transferring scheme is in PPF assessment; or
- a regulated apportionment arrangement has been entered into.

The government has confirmed that it will consider further changes in relation to transfers to schemes that have never been contracted-out later in 2017.

## DB investment – Pensions Regulator guidance

The Regulator has published guidance for trustees of DB schemes on setting and monitoring investment strategies.

## General pension scheme levy – 2017/18 rate

The rate of the general levy payable by schemes with 500,000+ members has been reduced by 25% for 2017/18. The rate for other schemes remains unchanged.

## Pensions Regulator – fines and professional trustee standards

The Regulator has published a consultation on a draft policy for monetary penalties and a revised description of a professional trustee. The draft policy outlines the approach that the Regulator will take towards exercise of its discretion to impose fines, and sets out the factors that the Regulator will take into account. The consultation closed on 9 May.

## Pension Protection Fund – long service compensation cap

The increased PPF compensation cap for members with more than 20 years' service came into force on 6 April.

## Compromising pension disputes

The Court of Appeal has held that s91 Pensions Act 1995 (which prohibits the surrender of benefits) does not apply to disputed pension rights. As such, s91 would not invalidate a settlement agreement under which, in return for £100 each, partners in a firm that were both employers and members of a scheme would give up additional benefits to which they had become entitled as a result of a High Court decision that certain deeds of amendment were invalid. The value of the benefits being given up varied between the partners, but the Court concluded that the nominal level of the monetary compensation did not matter – the real consideration was the agreement by both sides not to pursue the matter in further Court proceedings. However, the compromise did have to be entered into in good faith.

## Compensation for delays in processing a transfer

The High Court has held that, when considering whether administrator delays in processing a transfer warranted compensation for financial loss, the Ombudsman should not assume that no compensation was payable if the member contributed to the delays. The Ombudsman should instead consider whether, "but for" the administrator's delays, the transfer would have been processed by the relevant date. The Court also commented that the Ombudsman should consider increasing its upper limit for compensation for maladministration that does not infringe a legal right to £1,600.

## Part-time workers – pro-rating of pension entitlements

The Employment Tribunal has held that a rule in a pension scheme which provided for the pro-rating of part-time workers' pension entitlements to reflect actual full-time years worked compared with potential full-time years worked did not amount to indirect sex discrimination. The Tribunal also held that, even if it was wrong in that conclusion, the rule could be objectively justified.

## Pensions liberation – discharge from scheme sanction charge

The Upper Tribunal has rejected an appeal against the First-tier Tribunal's decision that a scheme administrator should be discharged from liability to pay a scheme sanction charge arising in connection with a pensions liberation scheme because the administrator reasonably believed that no unauthorised payment was being made. The Tribunal held that there had been no error in law in the First-tier Tribunal's decision.

## Ombudsman Determination – transfers and pensions liberation concerns

The Ombudsman has decided that it was reasonable for an administrator to have refused to process a transfer in 2013 where it had legitimate concerns about the receiving scheme. The member was not in receipt of earnings from the receiving scheme's employer and the administrator's refusal to process the transfer was therefore in line with the Ombudsman's views prior to the February 2016 High Court decision in *Hughes*. It would be inequitable to find against the administrator for an incorrect interpretation of the law prior to that judgment as an incorrect interpretation of the law does not necessarily constitute maladministration. The administrator should review its decision now if the member still wished to proceed with the transfer.

## Ombudsman Determination – pausing transfer requests

The Ombudsman has decided that the trustees of a scheme acted reasonably in pausing a member's transfer request when they became aware of potential proceedings by the employer against the member as a result of which some or all of the member's pension benefits might be forfeited.

## Ombudsman Determination – recovery of overpayments and change of position

The Ombudsman has decided that payments made by a member to her children were not sufficient to demonstrate a change of position in relation to an overpayment recovery claim. It was not a question of whether the member had made the payments in good faith, but whether or not she would have made them had she not received the overpayments.

Katherine Carter

# Upcoming Pensions Group events at Mayer Brown

If you are interested in attending any of our events, please contact Katherine Carter (kcarter@mayerbrown.com) or your usual Mayer Brown contact. Other than our drinks party, all events take place at our offices at 201 Bishopsgate, London EC2M 3AF.

- **Trustee Foundation Course**
  12 September 2017
  5 December 2017

  Our Foundation Course aims to take trustees through the pensions landscape and the key legal principles relating to DB funding and investment matters, as well as some of the specific issues relating to DC schemes, in a practical and interactive way.

- **Trustee Building Blocks Classes**
  13 June 2017 – DC governance
  14 November 2017 – topic to be confirmed

  Our Building Blocks Classes look in more detail at some of the key areas of pension scheme management.

- **Annual Pensions Conference**
  3 October 2017

  Our Annual Pensions Conference will look at some of the challenges facing employers and trustees of occupational pension schemes in the current economic and regulatory environment.

- **Pensions Group Drinks Party**
  2 November 2017

  Our drinks party for clients and other industry contacts will be held at the Tower of London and will include a tour of the Crown Jewels.

## The View from Mayer Brown – Pensions Podcasts

Every month Richard Goldstein, a partner in our Pensions Group in London, places a spotlight on key developments that could affect your scheme in a podcast. Just 10-15 minutes long and available on iTunes, the podcasts provide a quick and easy way to stay on top of the current issues in pensions law.

Listen to or subscribe to The View from Mayer Brown Pensions Podcasts via iTunes here:

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Please note – subscribing above will only work on a device with iTunes installed. Alternatively, if you don't have iTunes, you can access the podcasts via our website.

# Dates and deadlines

**2017**
- Government review of automatic enrolment, including review of level and scope of DC charges cap
- Introduction of new valuation and risk warning requirements for transfers and conversions of safeguarded-flexible benefits

**8 June 2017**
General Election

**3 July 2017**
New rules on transfers with member consent of GMPs and contracted-out rights in payment to schemes that have never been contracted-out come into force.

**30 September 2017**
Automatic enrolment – end of transitional period for DB and hybrid schemes

**1 October 2017**
- Cap on early exit charges in DC occupational pension schemes and extension of ban on member-borne commission arrangements expected to come into force
- Proposed new deferral option for section 75 debts in multi-employer schemes expected to come into force

**31 December 2017**
End of transitional period during which 70%/30% split of combined investment and administration invoices can continue to be applied for VAT purposes

**5 April 2018**
Deadline for making resolution under s68, Pensions Act 1995 to remove protected rights provisions from scheme rules

**6 April 2018**
- Automatic enrolment - 2% employer contributions required for DC schemes
- CPI indexation of lifetime allowance to be introduced

**21 May 2018**
Deadline for implementation of Portability Directive into UK law

**25 May 2018**
EU Data Protection Regulation comes into force

**October 2018**
New authorisation and supervision regime for master trusts expected to come into force

**13 January 2019**
Deadline for implementation of IORP II Directive into UK law

**6 April 2019**
Automatic enrolment - 3% employer contributions required for DC schemes

**5 April 2021**
Deadline for employers to exercise statutory power to amend their schemes to reflect increase in employer NICs resulting from abolition of contracting-out

**Key:**

Important dates to note

For information

## About Mayer Brown

Mayer Brown is a global legal services organization advising clients across the Americas, Asia, Europe and the Middle East. Our presence in the world's leading markets enables us to offer clients access to local market knowledge combined with global reach.

We are noted for our commitment to client service and our ability to assist clients with their most complex and demanding legal and business challenges worldwide. We serve many of the world's largest companies, including a significant proportion of the Fortune 100, FTSE 100, CAC 40, DAX, Hang Seng and Nikkei index companies and more than half of the world's largest banks. We provide legal services in areas such as banking and finance; corporate and securities; litigation and dispute resolution; antitrust and competition; US Supreme Court and appellate matters; employment and benefits; environmental; financial services regulatory and enforcement; government and global trade; intellectual property; real estate; tax; restructuring, bankruptcy and insolvency; and wealth management.

Please visit www.mayerbrown.com for comprehensive contact information for all Mayer Brown offices.