

Leaders in Pensions

Trustee Knowledge Update – February 2020

Welcome to the February 2020 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 widely anticipated, the Pension Schemes Bill has been re-introduced into Parliament in substantially the same form as the pre-election Bill. We summarised the content of the Bill in November's [TKU](#).

At the second reading of the Bill, a number of peers raised concerns about the breadth of the proposed new criminal offences and the effect this could have on legitimate business activities. This will be considered in more detail at the next stage of the parliamentary process.

Action points: Although unlikely to reach the statute book until the summer at the earliest, trustees and employers should still be familiarising themselves with key new provisions including those relating to TPR powers and DB scheme funding.

Pensions Regulator

Guidance on tendering and setting objectives for fiduciary managers and investment consultants

TPR has issued [guidance](#) for trustees in relation to the CMA Order on investment consultancy and fiduciary management (see the August 2019 [TKU](#)). Appropriate amendments will be made to the guidance when the Order is replaced by DWP regulations (expected in April 2020).

There are four sets of guidance:

Choose an investment governance model: This focuses on investment consultancy and fiduciary management models. It sets out key matters trustees should consider before choosing an investment governance model, including agreeing a set of investment beliefs and objectives.

Set objectives for your investment: Trustees must have strategic objectives in place where they receive investment consultancy services. Objectives are only required for services covered by the definition of "investment consultancy services" in the Order, but as a matter of good governance TPR encourages trustees to set objectives for other services. Trustees should consider how the objectives contribute to achieving the scheme's overall investment objectives and consider the method and regularity for assessing performance against the objectives.

Tender for fiduciary management services: The guidance sets out the circumstances in which trustees with existing fiduciary management mandates must complete a competitive tender process as well as guidance for new mandates. The guidance lists nine key principles which trustees should apply to the tender process and the appendices include an example of how the process might work and topics trustees might consider. The guidance suggests trustees may want to engage with the employer in the process "to ensure the longer-term objectives of the employer for the scheme are better aligned" and because the

employer might be able to help with the procurement process. The tender process will require a significant time and resource commitment and trustees should allow for this in their business plan. TPR states that trustees may want to consider carrying out a competitive tender even where not required by the regulations.

Tender for investment consultancy services: TPR considers that it is good practice for trustees to consider running a competitive tender for the appointment of an investment consultant even though one is not required by the Order.

On a wider point, TPR has said that it considers it to be good practice for trustees to have a process in place to measure the performance of all advisers and service providers to ensure they are meeting the objectives for the service, delivering value for money and are performing their delegated activities in line with the trustees' requirements.

Action points: Trustees should ensure that their arrangements with investment managers and consultants comply with the CMA Order and with TPR's guidance. They should also consider more broadly the performance of other service providers and advisers.

BHS Pension Schemes Determination Notice

TPR has published a Determination Notice confirming the decision to issue Contribution Notices (CNs) against Dominic Chappell totalling £9,542,985. That sum represents monies directly or indirectly extracted from BHS for the benefit of Mr Chappell, his family, associates and advisers without reasonable basis, thus reducing the sums available to the pension schemes on BHS's insolvency.

To recap, in March 2015 RAL (a company of which Mr Chappell was a director and the majority shareholder) purchased the parent company of BHS from Arcadia for £1. BHS was the principal employer of two DB pension schemes (one for staff and one for executives). The deficit in the schemes in March 2015 has been estimated at £531m. BHS ceased trading in August 2016. As part of a settlement reached with Sir Philip Green, a new scheme was set up into which the majority of members transferred. Approximately 2,000 members remain in the old BHS schemes with an estimated buy-out deficit of around £25m.

TPR found that Mr Chappell had been a party to a series of acts or failures which affected in a material way the likelihood of accrued scheme benefits being received. In this case an experienced board was replaced with individuals with no or limited retail experience and this could be seen as causing material detriment, as could the failure of Mr Chappell/RAL to engage with the problems presented. Factors which TPR considered when concluding it was reasonable to issue the CNs included:

- Mr Chappell showed a reckless disregard for the interests of the schemes despite being aware of the significant problems;

Leaders in Pensions

- he brought about the sale in circumstances which he knew or should have known were ill-suited for turning round the business;
- his performance in running BHS was unreasonable;
- the sums sought were reasonable. They were either for the direct benefit of Mr Chappell, for the benefit of RAL before the sale or did not deliver any value to BHS.

Comment: TPR clearly sets out the factors it took into account when deciding to issue the CNs. This may become even more relevant in the future given that the Pension Schemes Bill is introducing new grounds for issuing CNs and widely drawn criminal offences for conduct harmful to DB pension schemes.

DB and hybrid scheme return checklist

TPR has published a new [checklist](#) for DB and hybrid scheme returns. There are no changes to the scheme return this year but some technical alterations have been made in relation to contingent assets and deficit repair contributions.

Action points: Trustees of DB and hybrid schemes should ensure that the information held on Exchange is accurate and up to date by 31 March in time for the PPF levy assessment.

A reminder on transfer payments

TPR has published a [blog](#) setting out its expectations for trustees in relation to transfers, particularly those from DB schemes. TPR expects trustees to provide all relevant information to members in a clear and timely manner so that they have time to obtain appropriate independent financial advice. Trustees should not transfer any benefits until they have received a written request from the scheme member to transfer – and specifically checked that they have received any necessary independent financial advice. Trustees are also reminded that where appropriate they should refer to the [industry code](#) on incentive exercises.

Action points: There is no new information in this blog, but it is a useful reminder for trustees.

Pension Protection Fund

PPF Levy 2020/21

The PPF published its final levy [Policy Statement](#) and associated documentation on 19 December. The PPF's general intention is to use "essentially the same approach" to charging the levy as for 2019/20.

Key deadlines are as follows:

- online submission of scheme data, submission of asset-backed contribution certificates, certification of new contingent assets and re-certification of existing ones must be completed by midnight at the end of 31 March 2020. The deadline for hard copy contingent asset documents is now 5pm on 1 April 2020;
- the deadline for any mortgage exclusion or accounting standard change certificates is also midnight at the end of 31 March 2020 (to be sent to Experian);

- deficit reduction contributions must be certified by 5pm on 30 April 2020;
- Exempt Transfers must be certified by 30 April 2020, and Full Transfers by 30 June 2020.

The PPF has produced an information note about GMP equalisation in relation to the levy. This states that new submissions of s179 valuations by 31 March 2020 should include an interim allowance for GMP equalisation, in line with the *Lloyds Bank* judgment. However, this may be calculated on a best estimate basis.

Action points: Trustees wanting to submit contingent assets for PPF levy purposes should take urgent action. It can be very time consuming with third party opinions and reports required.

Cases and Pensions Ombudsman

PPF compensation – must meet poverty threshold

The CJEU has ruled in [Pensions-Sicherungs-Verein VVaG v Günther Bauer](#) that the EU Insolvency Directive does not require member states to put measures in place to fully fund lost pension rights on the insolvency of an employer. However, the Court's approach suggests that current PPF practice (of providing at least half a member's accrued benefits following an earlier ruling of the CJEU in *Hampshire*) would not meet the Directive's requirements if the pensioner would fall below the poverty line after the pension reduction.

The CJEU held that member states had a margin of appreciation and the Directive did not require a full guarantee of pension rights. It reiterated that each member must receive at least half of their promised pension on insolvency. However, critically, it also analysed the underlying objective of the Directive as being to protect members in circumstances where the livelihood of the member and his family might be threatened. The Court therefore concluded that regardless of whether the "50% test" was met, any reduction in pension would be unlawful if it seriously compromised an individual's ability to support themselves. The test for this was whether as a result of the reduction, the member is living, or would have to live, below the at-risk-of-poverty threshold of his EU member state (as determined by Eurostat): this is broadly below 60% of median income.

The suggestion of a new "poverty line" test, to be applied in addition to the 50% member-by-member minimum, will have some impact on PPF funding and may pose a significant administration burden. The PPF and the Government will need to give serious thought to how to respond.

Comment: For trustees, an obvious concern will be the potential knock-on effect for PPF levies. Schemes could also be affected even where they have a PPF surplus but a buy-out basis deficit when winding up, because the statutory priority order on wind-up links directly through to applicable PPF compensation levels.

Pension increases – the only way is up

The High Court has ruled in relation to the [Britvic Pension Plan](#) that the pension increase rule did not allow the

Leaders in Pensions

employer to determine annual pension increases at less than the default rate in the scheme rules.

The scheme rules stated that pensions would increase by RPI subject to a maximum of 5% “or any other rate decided by the principal employer”. The employer argued that this allowed it to apply either a higher or lower pension increase rate each year.

The Court found on the evidence before it (including letters and summaries provided to employees when they transferred into the scheme on its inception; and documents concerning the bulk transfer which led to the establishment of the scheme rules) that the draftsman’s understanding was that there would be guaranteed increases each year, capped in line with the RPI or such *higher* rate as the employer might decide. It was not open to the employer to determine a lower rate.

The judge held that something had therefore clearly gone wrong with the language: the draftsman had used the word “other” when he really meant “higher”, not least as he would have had the minimum pension increase requirements in section 51 Pensions Act 1995 in mind, and would have wanted to draft something that complied with section 51. The employer’s reading of the clause was an “excessively literal” one.

Comment: This judgment is an example of the court taking into account the context of a particular rule rather than a strict literal interpretation.

No switching from RPI

In another [case](#) concerning pension increases, the High Court has found that the scheme rules did not allow the principal employer and trustees to move away from providing pension increases based on RPI.

The scheme rules required pension increase to be based on the “Retail Prices Index” which was defined as the general index of retail prices published by the Office for National Statistics or where that index is not published, any substituted index agreed by the principal employer and the trustees.

The judge found that the index of retail prices was still “published”, albeit that it has been widely criticised and there are proposals to change the basis on which it is calculated. The trigger which would allow the principal employer and trustees to select a different index had not been engaged.

Comment: This is the latest in a long line of cases concerning switching from RPI. As Nugee J reminded us in his judgment, “*all these cases turn on the construction of the particular terms used in the scheme in question and, save insofar as they lay down general principles, no direct assistance can be obtained from them*”.

British Steel – Pensions Ombudsman determines in favour of trustees

The Ombudsman has now issued final determinations in all four lead complaints.

Background: The complaints focused on the trustees’ decisions to change their CETV and early retirement calculation factor (ERF) methodology from 1 April 2017, with the result that members requesting a transfer value or early retirement after that date received significantly higher benefits than those who had already done so. Members complained that trustee communications had scared them into transferring out or taking early retirement sooner than they would otherwise have done, and argued that the trustees should have changed the calculation basis earlier and been more open in telling members about it.

Communications: The Ombudsman found that the relevant trustee communications were not misleading and did not amount to scaremongering. It was necessary to share information with members, given the press coverage of Tata Steel at that time and the inevitable concerns this raised. The trustees’ task was to find a balance between providing too little information and overwhelming members with extensive and comprehensive information. The Ombudsman accepted this was a difficult balance to find and made no criticism of how the trustees had proceeded.

CETVs: The CETV calculation basis applicable when a member was provided with his guaranteed CETV was a matter for the trustees, and any calculation correctly applying that basis was not maladministration. There was no requirement for the trustees to notify or consult members on their intention to update the CETV calculation basis, nor to offer members the option to obtain a CETV on the new calculation basis where they had already been provided with a CETV on the former calculation basis. Had the trustees alerted members to a potential, but uncertain, future improvement in CETVs, it would have alerted members to the possibility of taking a CETV, with the investment risk potentially shifting to the member on transferring out of the scheme (which would not be in the member’s financial interests).

Early retirement factors: Similarly, the ERFs applicable at the point of a member’s early retirement were a matter for the trustees, and so any pension calculation correctly applying those ERFs was not maladministration. It was reasonable that members were not informed of the changes to ERFs: changing them did not require consultation with members under the Pensions Act.

Statement of Investment Principles (SIP): The change to the CETV calculation basis had been carried out as a direct result of the trustees’ earlier amendment to the scheme SIP. However, there was no requirement for the trustees to inform members of changes to the scheme’s investment strategy or SIP and it was not necessary, at the point the trustees decided to move to low risk investments, to explain to the members the impact that would have on CETVs.

Conclusion: The Ombudsman was satisfied that the trustees obtained and considered appropriate advice in reaching decisions about the future of the scheme, the

Leaders in Pensions

calculation changes and the scheme's Statement of Investment Principles. There was no maladministration and the complaints would not be upheld.

Comment: This ruling is generally good news for trustees. In particular the Ombudsman's finding that there was no obligation on the trustees to notify or consult members when updating the CETV calculation basis or early retirement factors is relevant to most schemes.

MISCELLANEOUS

Data protection – revised ICO guidance

The Information Commissioner's Office (ICO) has revised its guidance on "special category" (sensitive) personal data under the General Data Protection Regulation (GDPR). In order to process special categories data, trustees must first (as with all personal data it processes) establish a lawful basis for the processing from a list of options set out in GDPR. The processing must then satisfy a further condition which relates specifically to special categories data. Many trustees rely on an exemption allowing such data to be processed on the basis of "employment, social security and social protection". The new guidance casts some doubt on whether this exception can be used to cover processing by pension schemes. However, elsewhere the guidance takes a pragmatic approach to an alternative exemption allowing the processing of special category data in relation to possible legal claims.

Action points: Trustees should consider reviewing their data protection policy and privacy notice to focus on the "legal claims" condition for processing special categories data. This may entail notifying members (for example, in the next scheduled newsletter). Trustees should also consider whether other scheme GDPR documentation needs amendment.

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 9 June 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.

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 13 February 2020.

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

PASA master trust transition guidance

This, the first [document](#) from the Master Trust Transition Working Group (MTTWG), is aimed at those involved in the administration processes for master trust transitions.

The guidance focuses on the two most common scenarios for transition of members to master trusts:

- from master trust to master trust, where the legislative "continuity option 1" is being deployed ("regulated transition"); and
- from single employer DC trust to master trust ("non-regulated transition").

It includes a section on legal considerations including trust law duties (which include taking a holistic view of the pros and cons of transfer, together with appropriate due diligence) as well as the preservation rules and the requirements of the master trust legislation. Parties are reminded of the need to consider issues around trustee protection, consultation by employers, amendment or wind-up of the transferring scheme, getting advice on the transfer agreement (including out of market pre-funding) and HMRC lifetime allowance and other protections.

There are also sections on communications, data transition and asset transition: and model migration project plans. The guidance has been welcomed by TPR.

Action points: Any trustees considering or in the process of making a bulk transfer to a master trust (or indeed any DC bulk transfer) should take this guidance into account.