

Leaders in Pensions

Trustee Knowledge Update

Welcome to the August 2016 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.

Regulator (www.pensionsregulator.gov.uk)

DC Code of Practice and DC “How to” Guides

The Pensions Regulator’s revised Defined Contribution Code of Practice is now in force.

The Code has six broad headings which cover:

- The trustee board (chairs of trustees, member nominated trustees, and master trusts);
- Scheme management skills (managing risk, knowledge and understanding, and conflicts of interest);
- Administration (core financial transactions and record-keeping);
- Investment governance (including investment strategies, and security and liquidity of assets);
- Value for members (including restrictions on costs and charges); and
- Communicating with members and general reporting obligations.

The Regulator has issued additional guidance under each heading intended to help trustees to determine how they might meet the standards set out in the Code in practice. The Regulator has also provided an assessment tool for trustees so they can evaluate their scheme against the standards set out in the Code.

As previously, the Code applies not just to DC schemes, but to DC benefits such as AVCs in DB schemes.

Action points: *All trustees of schemes with any DC benefits (including AVCs and transfer credits) should consider the new Code and address any areas where their current governance arrangements fall short of what the Regulator expects.*

Annual funding statement

The statement is primarily aimed at schemes undertaking valuations with effective dates in the period 22 September 2015 to 21 September 2016, but is relevant to all DB schemes. The analysis suggests that:

- In most schemes, liabilities have grown faster than assets. Deficits may have increased by 20-35% and schemes may have to change their recovery plans.
- The ratio of deficit recovery contributions to dividends has declined over the last five years. More than half of FTSE350 companies paid out ten times or more to shareholders than to their pension scheme.
- For employers who reported a profit, around 60% could increase contributions (to less than 10% of their profits or the same or lower percentage of profits than currently) to maintain existing recovery plan end dates.

As a result of this, the Regulator expects:

- Most schemes to set funding strategies based on lower expected investment returns from most asset classes.
- Trustees to seek higher contributions where there is sufficient affordability for the sponsor, without a material impact on its sustainable growth plans.
- Where increased contributions are not possible, discuss why this is the case.

Action points: *This emphasises the need for trustees to be aware of the wider financial position of the employer when conducting funding negotiations and considering the contributions the employer can afford.*

Statement for trustees on leaving the EU

The Regulator suggests that trustees should:

- Talk to employers in a collaborative way and consider the impact of Brexit on the employer’s covenant.
- Continue to ensure that where deficit repair contributions “were constrained to allow for investment in sustainable growth of the sponsor, that it continues to be used to strengthen the covenant to the scheme”.
- Not be overly focused on short-term market movements, but consider the impact of market volatility on scheme funding plans and decision-making.
- Where the scheme is exposed to an inappropriate level of risk, reconsider investment strategy.
- Continue with valuations as normal having regard to existing Regulator guidance.
- Monitor DC investments.

The Regulator will provide further guidance as necessary.

Action points: *The decision to leave to EU has no immediate impact for trustees outside of the effect it has on scheme investments. Trustees should already have strategies in place to monitor this.*

Regulator issues first Chair’s statement fine

The Regulator has warned DC trustees that they will be fined for failing to produce a Chair’s statement. The fine is mandatory and can be up to £2,000.

The Regulator has published a report on the first fine it has imposed. A trustee received the minimum £500 fine after it promptly complied with its duty to notify the Regulator of the breach, and quickly took action to prepare the statement.

Action points: *This illustrates the importance of ensuring that a Chair’s statement is produced by the deadline (7 months after the end of the scheme year) or, if it is missed, action is taken as quickly as possible to produce one.*

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Ombudsman (www.pensions-ombudsman.org.uk)**PO-4280 Mrs X - no-worse-off guarantee removed**

The member joined the B&Q DB scheme which entitled active (but not deferred) members with 20 years' pensionable service to a 2/3rds pension at normal pension age. The scheme booklet at the time did not distinguish the position of deferred members, although it did provide that "[i]n the event of any discrepancy between [the] booklet and the Trust Deed and Rules, the latter will prevail". When the B&Q scheme merged into the Kingfisher scheme, members were given a guarantee that their benefits on retirement would "be at least as good as those which would then have been paid under the B&Q Scheme".

In 2011 Kingfisher consulted on closing the scheme to future DB accrual, and did so in June 2012. Although the member had over 20 years' service, she was no longer entitled to a 2/3 pension because she was now treated as a deferred member. The member complained that the closure to accrual and the removal of the guarantee for future service were invalid, and that consultation had been flawed. She also argued that she had a contractual right to the benefit based on the original booklet and a reasonable and continued expectation of an entitlement to a 2/3rds pension.

The Ombudsman found that the Consultation Regulations had been complied with and the employer was entitled to take its own interests into account when considering the consultation feedback.

The member had no enforceable right to higher benefits. Although she had a legitimate expectation that the guarantee would not be "unpredictably removed", there was no suggestion that it could never be amended. It was also well-established that explanatory material provided to members did not generally override scheme rules, and the disclaimer in the 1985 booklet made this clear, as well as stating that the company "reserve[d] the right to terminate or amend the scheme at any time".

Action points: This case was helped by clear statements in the booklet about the supremacy of the rules and the right to amend and terminate the scheme. Trustees should ensure their booklets have similar wording.

PO-9713 Mr N - member could not reasonably rely on online projection in isolation

The member retired early on the basis of an online benefit projection. Unfortunately, the figures contained an error. On discovering his actual pension was lower, the member claimed he should be paid the figure given by the projection. The trustees refused.

The Deputy Ombudsman said that "given the very clear warnings and disclaimers attached to the figures contained within the on-line projection, I do not consider it was reasonable [for N] to have reached his decision to take early retirement solely upon these figures and before obtaining a formal quotation of his expected benefits. I do not view the clear warnings provided about the use of figures provided in on-line projection as 'small print', but rather a very sensible inclusion to advise users that the amount payable at retirement may differ".

Action points: This case shows the value of clear wording on illustrations explaining that they are just that and that actual benefits may differ.

Cases**Pollock v Reed (High Court)**

The scheme had a large deficit and without restructuring, the employer was likely to go into administration and the scheme into the PPF. The trustees sought court approval of a bulk transfer without member consent to a new scheme, with lower revaluation and pension increases but with benefits at least as good as PPF compensation. The new scheme would have a capped guarantee from the employer's US parent.

The trustees were satisfied that the transaction was in members' interests but were concerned whether regulation 12(3) of the Preservation Regulations permitted a transfer without member consent in these circumstances. The regulation provides that a transfer without member consent cannot be made unless the actuary has certified that "the transfer credits to be acquired for each member under the receiving scheme... are, broadly, no less favourable than the rights to be transferred." The Court was asked whether the actuary could take into account the fact that members would end up in the PPF if no action was taken.

The judge held that the security of benefits was not a factor that could be taken into account by the actuary in the certification process. Security was a point for the transferring trustees to consider in agreeing to the transfer, in accordance with their fiduciary duties. The judge also said that "there is no scope for a different construction or analysis of regulation 12(3) where the transferring scheme is in winding up from the situation where it is ongoing".

The judge commented that as part of the trustees' decision making process, they were entitled to rely upon professional advice and were not required to "second guess" it in any way.

Action points: The cost of increases and revaluation in excess of statutory requirements is one which many employers would like to address but it seems that a bulk transfer without member consent to a new scheme is not an available mechanism for doing so.

Hampshire v The PPF (Court of Appeal)

The member was in receipt of a pension but below normal pension age when his employer became insolvent and his scheme transferred to the PPF. Therefore, the PPF compensation cap applied and his PPF compensation was less than half of his entitlement under the scheme.

The member brought a complaint based on article 8 of the Insolvency Directive which requires Member States to ensure that "necessary measures" are taken to protect the interests of employees and former employees in respect of their pension rights. The Court of Appeal, by a majority, held that that this meant that EU member states had to ensure that each employee of an insolvent employer received at least half of their accrued pension benefits.

The Court decided to make a reference to the European Court of Justice to ask it to confirm this point and whether article 8 could be relied on by a member against the PPF to override the compensation cap.

Action points: This does not require any action by trustees but the level of PPF compensation available to members in the event of employer insolvency is something that they should be aware of.

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The Girls' Day School Trust v GDST Pension Trustees (High Court)

The trustees sought rectification of the scheme's trust deed, by way of summary judgment. The version executed by the parties was an earlier draft which did not include some important provisions.

The judge was satisfied that there was no real prospect of challenge to the trustees' argument that they intended to enter into a deed in the terms of the final version. However he was only prepared to grant summary judgement if there was no taint of "a deal done behind closed doors".

In order to ensure sufficient publicity, the judge said that he would publish his full judgment and the trustees must inform members of it, offering them a hard copy and providing a web address for it. In addition, the judge held that the order for rectification would not take effect for 42 days.

Action points: *Summary Judgment is a quicker and more cost effective way to obtain rectification, where an error has clearly been made. However, this case emphasises that the Courts will not just rubber stamp such an application.*

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

Countdown Bulletin 17

HMRC records will show which schemes held GMP liability as at April 2016, but will not record transfers after that date. Schemes will need to maintain their own records.

There are 3948 schemes covering 13.8million members using the scheme reconciliation service. This gives some idea about how quick HMRC is likely to be when dealing with queries. Queries will be prioritised based on when a scheme registered its interest in using the service. Schemes will be given a time slot to submit queries. If schemes miss their slot, it may be difficult to allocate another but HMRC may agree to different timescales where, for example, larger schemes are not able to submit all their queries at the same time.

Action points: *All schemes should have started their reconciliation process now. It is important to have all data ready and any issues identified in time to raise them with HMRC in the allocated slot.*

Countdown Bulletins 18 and 19

There is a reminder that HMRC no longer requires notifications about movements of formerly contracted-out members. Forms only need to be submitted where there is a claim for a contributions equivalent premium.

As part of the scheme reconciliation process, questionnaires about readiness to undertake the process are being sent to schemes to help HMRC allocate time slots in which HMRC will deal with reconciliation queries for each scheme. Failure to reply to the questionnaire may result in delays in time slots being allocated.

HMRC has confirmed that it will no longer accept late registration requests for the scheme reconciliation service even where there are exceptional circumstances.

Action points: *Schemes must keep records where they are transferring members with contracted-out benefits. Transfers are a cause of significant differences between scheme and HMRC records.*

Newsletter 78

The tapered annual allowance applies where a member has earnings above £150,000 (including pension contributions) and it operates to gradually reduce the annual allowance to £10,000 where the member earns £210,000 or more. This newsletter confirms that a scheme administrator must provide a pension savings statement to a member who is subject to the tapered annual allowance if their annual pension savings in the scheme exceed the normal annual allowance (currently £40,000).

Individuals who are subject to the tapered annual allowance can use mandatory "scheme pays" (where the scheme must meet the annual allowance charge in return for a reduction in the value of the individual's overall benefits) if: their annual allowance charge for the tax year exceeds £2,000 (subject to some additional restrictions where the £10,000 DC annual allowance applies); and their annual pensions savings in the scheme for the tax year exceeds the normal annual allowance.

Action points: *The administration of the tax limits relating to benefits is becoming more complex and trustees should check with their administrators that they have procedures in place to deal with all of the recent changes.*

Newsletter 80

This newsletter confirms the launch of the new online-only service for members to apply for fixed protection 2016 and individual protection 2016 (the new forms of protection in relation to the fall in the lifetime allowance (LTA) which took effect on 6 April 2016). This replaces the interim paper process which has been in place since April.

Members will no longer receive paper certificates with details of their LTA protection but will be able to view the relevant information online and print as necessary. From August 2016, only permanent reference numbers will be recognised by HMRC. Members with interim protection will need to re-apply using the new online process. HMRC requests that scheme administrators encourage members to do this where relevant.

Action points: *Members approaching administrators about the new forms of lifetime allowance protection should be told that they need to make an online application. Administrators should also be aware that HMRC will no longer issue paper certificates.*

Automatic enrolment

Employers' Duties Amendment Regulations 2016

These Regulations will delay the increases in minimum auto-enrolment contribution rates by six months.

The rates will now rise from 2% to 5% on 6 April 2018, and from 5% to 8% on 6 April 2019. This means that minimum employer contributions will rise from 1% to 2% in April 2018 and then to 3% in April 2019.

Action points: *Auto-enrolment is not generally an issue for trustees. However, trustees do need to know whether their scheme is being used as an auto-enrolment scheme and what contributions they expect to be paid in. These Regulations may affect the amount paid to the scheme.*

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PPF

Annual Report and Accounts 2015/16

Following “a successful year despite the challenging economic backdrop”, the PPF reports £23.4bn in assets and a £4.1bn surplus. A significant increase to contingent liabilities (which are £1.6bn) includes provision for the British Steel Pension Scheme. The PPF regards itself as in a strong position to face the future and expects to be able to absorb Brexit without any adverse consequences.

There appear to be no plans to reshape the PPF levy going forwards. The PPF says that work is already underway on the levy triennium commencing in 2018/19 but that it does “not anticipate very substantial change”.

The PPF encourages schemes to ensure their information on contracted-out members is reconciled with HMRC in order to avoid additional liability on the PPF, should the scheme ever transfer.

Action points: *The lack of intention to change the basis of calculation of the PPF levy should be welcome news for trustees, as should the fact that, for the moment at least, the PPF appears to have sufficient funds and will not therefore be looking to raise significant additional amounts through the levy.*

Government

House of Commons Committees’ Report on BHS

The report concludes that Sir Philip Green had given “insufficient priority” to the pension schemes over an extended period and that the failure to resolve pensions issues “contributed substantially to the demise of BHS”. The Committees suggest that Sir Philip has a moral duty to resolve the situation urgently.

The report blames Sir Philip for:

- The schemes’ deficit (BHS had made insufficient contributions, and resisted paying higher ones);
- The failure of a proposal to address pension issues by a scheme restructuring agreed with the trustees and the Regulator; and
- Concealing the extent of the problems relating to pensions on the sale of BHS in 2015.

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 11 October 2016 and various dates throughout 2017. If you have any enquiries about 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 5 August 2016.

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

The Regulator is described as “reactive” and “slow moving”, but is absolved from ultimate blame. The Committee says the Regulator needs to be given “the powers, resources, leadership and commercial acumen to act decisively”.

The Work and Pensions Committee is undertaking a wide-ranging inquiry into the adequacy of DB scheme regulation; the Regulator; the implications of the regulatory approach for company behaviour; and the sustainability of the PPF.

Action points: *This serves as a cautionary tale to employers of the need to balance dividend payments against scheme contributions. The report may lead to greater activity by the pensions regulator and legislation to impose more onerous governance requirements on both employers and trustees.*

Miscellaneous

The Securities Financing Transactions Regulation:

From July, a new EU Securities Financing Transactions Regulation (“SFTR”) requires that pension schemes with collateral reuse arrangements in place (e.g. under longevity swaps, derivatives or stock lending transactions) provide specific notifications and consents. It also requires trustees to keep records of securities financing transactions (e.g. repurchase transactions or securities or commodities lending or borrowing). SFTR will require scheme reporting of such transactions, although this is not expected to apply until 2018. Trustees should ensure that their investment managers are in a position to confirm compliance.

Final text of second European pensions directive approved:

The final text of the new Pensions Directive has been published and is likely to be approved by the European Parliament sometime in the Autumn. Member states will have 2 years from the date the Directive comes into force to comply with it. This gives a likely compliance date of late 2018. Depending on when the UK exit process from the EU is triggered, we may not have left the EU by the date compliance is required and changes to UK law (particularly in relation to scheme governance) may be needed. However, the extent to which UK schemes will need to comply with the Directive may depend on the exit terms we negotiate. Trustees should keep a watching brief on this issue and any changes required.