

Leaders in Pensions

Trustee Knowledge Update

Welcome to the February 2014 edition of our Trustee Knowledge Update. It aims to inform trustees about changes in the law to help them to comply with the legal requirement for each trustee (or trustee director) 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 that trustees may need to be aware of.

Regulator (www.pensionsregulator.gov.uk)

Draft DB funding documents

The Regulator has started consultation on a new defined benefit funding Code of Practice and an approach to regulating DB schemes. The documents reflect the Regulator's proposed new statutory objective *"to minimise any adverse impact on the sustainable growth of an employer"* in relation to the exercise of its funding functions. It also reflects the experience of the last 8 years of both the Regulator and the industry.

The proposed revised Code is principle-based and emphasises the importance of trustees and employers working together to establish long-term funding plans, and encourages trustees to take an *"integrated approach to managing key scheme risks: namely funding, investment and the employer's ability to meet its obligations to the pension scheme"*. The draft Code emphasises the need for trustees to understand employer's business plans and to work collaboratively with them. It also suggests that where trustees are taking investment risks, they should assess them against the strength of the employer covenant.

The consultation period closed on Friday 7 February 2014 and the Regulator anticipates that the new Code will be in force by July 2014. However, the Regulator urges schemes currently undergoing valuations to *"bear in mind the messages"* set out in the draft Code.

Final DC Code of Practice and Guidance

We have mentioned drafts versions of the new DC Code of Practice and DC Guidance in previous editions. They finally came into force on 21 November 2013.

Trustees of schemes that have any DC benefits in them (including DC AVCs) need to ensure that they are aware of the contents of the Code and Guidance and have appropriate procedures in place to ensure compliance.

The Regulator has six principles that it expects to be followed in the running of DC schemes and these are underpinned by 31 "quality features". The Code and Guidance provide details on what the Regulator expects schemes to do to comply with these quality features. They cover areas such as investment, member communications, administration, risk management and trustee knowledge. The Regulator also expects that trustees will produce a governance statement setting out the extent to which they have complied with the quality features.

Much of the Code and Guidance reflects the content of existing publications so trustees should not find that they are having to do a lot of new things. Nevertheless, the documents may identify issues that trustees have not previously looked at and should be given careful consideration.

Guidance on asset-backed contributions

The Pensions Regulator has issued more detailed guidance for trustees on the issues that they should look out for when entering into asset-backed contribution arrangements ("ABCs"). The Regulator recognises that ABCs *"may help employers meet their obligations to schemes and can, in certain circumstances, improve a scheme's security by providing access to valuable assets which were previously out of reach"*.

However, the Regulator identifies a number of risks that such arrangements can pose and says that trustees should undertake a "robust" evaluation of any proposed ABC and ensure that they understand the risks. They should also *"consider whether there are any less risky alternatives to support the scheme, such as an appropriate recovery plan, or an appropriate recovery plan coupled with contingent assets to provide additional security"*. The guidance also sets out a number of specific issues for trustees to consider.

Where trustees are looking to enter into this type of arrangement, they need to ensure that they are familiar with this guidance and consider the issues that the Regulator identifies.

Update on record-keeping

The Regulator is urging schemes to *"continue the drive to improve the quality of their record-keeping by correcting errors in 'common data' and by putting plans in place to improve the quality of conditional data"* and has said that it intends to review its record-keeping guidance later this year. It *"will not be setting targets for conditional data in the same way that we did for common data - but we absolutely expect schemes to be able to demonstrate that they have credible plans in place to improve this data. We may set targets around the timings for these plans to be implemented."*

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

Briefing on employers recovering VAT

HMRC has issued a response to a European Court decision last year looking at the VAT which can be reclaimed in relation to pension scheme investment-related activities.

Previously, HMRC allowed employers to deduct VAT on expenses incurred in relation to the general management of an occupational pension scheme but not in relation to the costs of managing scheme investments. However, last year, the European Court decided in the PPG case that a Dutch employer was entitled to deduct VAT on administration and pension fund management services, so long as there was a *"direct and immediate link"* between those services and the employer's own supplies.

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HMRC has now announced an immediate change in policy. It now accepts that the VAT on investment-related services, which “go further than management of the investments”, may be recoverable by an employer. However, HMRC warns that specific costs of investment management, such as the costs of managing a property within a pension fund, are not general costs of the employer and cannot be recovered. The supply must be received by the employer.

Employers who receive supplies of services that fall within HMRC’s revised criteria can make claims going back up to four years. Any claim must set out the basis of the change, and the amount now claimed. HMRC reserves the right to seek further background information.

The Brief also signals the end of HMRC’s 70/30 rule. Where it was not possible to break down a fee into general management and investment activities, employers could assume that 70% of activities were management and the remaining 30% were investment. Use of the 70/30 rule will still be allowed for a six-month transitional period.

The PPG decision concerned a defined benefit scheme. However, the Brief refers to a pending European case which will address the issue of VAT paid on investment management services under DC schemes. Following the judgement, HMRC will take any “appropriate steps” in relation to input tax claimed by managers of DC schemes.

Individual protection

The Government has published further documents in relation to the form of “individual protection” (“IP2014”) that will be available following the reduction of the lifetime allowance to £1.25 million in April 2014.

IP 2014 will give individuals a personalised lifetime allowance equal to the value of their pension savings on 5 April 2014 subject to a maximum of £1.5 million. If the standard lifetime allowance rises above an individual’s personalised lifetime allowance, IP 2014 will cease to apply. It will be available to anyone with pensions savings in excess of £1.25 million on 5 April 2014, including those who already have enhanced and fixed protection.

Applications for IP2014 must be received by HMRC by 5 April 2017. There will be a gap between the introduction of IP 2014 and the date on which individuals may apply for protection. There is draft guidance on what schemes might do where a member wants to take benefits after April 2014 but before IP 2014 has actually been granted. Commentators suggest that IP could provide a useful fall back for people where enhanced or fixed protection is accidentally lost.

Trustees should also be aware, as we have reported previously, that there is a new form of fixed protection. Some scheme rules have provisions which deal with the existing form of fixed protection. However, such rules may not be drafted widely enough to capture the new form of fixed protection and trustees should consider reviewing such provisions.

Update on Scottish tax reliefs

The Scotland Act 2012 introduced the Scottish rate of Income Tax (SRIT), which is expected to be implemented in April 2016. The rate paid by Scottish taxpayers will be

calculated by reducing the basic, higher and additional rates of Income Tax by 10% and adding a new Scottish rate set by the Scottish Parliament.

The Government has decided that, in order to ensure that, as far as possible, Scottish taxpayers receive the correct amount of relief into their pension pot, relief at source (“RAS”) will be paid at Scottish rates for Scottish taxpayers. HMRC intends to provide information to pension scheme administrators to allow them to identify which of their members are Scottish taxpayers. Currently it is planned that from April 2018 industry should be ready to make RAS claims at the Scottish basic rate. In the meantime, to ensure that pension scheme members who are Scottish taxpayers are not disadvantaged, the Government has agreed that from April 2016 scheme administrators can continue to claim RAS at the UK basic rate of tax for all members and HMRC will identify Scottish taxpayers and make any adjustment, with the relief given direct to the scheme member.

Legislation (<http://www.legislation.gov.uk>)

Revaluation Order 2013

The lower revaluation percentage for the period 1 January 2013 to 31 December 2013 is 2.5%. The higher percentage is 2.7%. The lower percentage applies only to service on or after 6 April 2009.

Same Sex Marriage Regulations

Same sex marriages will be possible in the UK from 29th March 2014.

Scheme rules will not automatically include rights for same sex spouses but schemes will be obliged to provide survivor’s benefits to them, at least in respect of pensionable service after 5 December 2005. If trustees wish to provide benefits in respect of service prior to 5 December 2005, an amendment may be required. These regulations allow trustees to make such amendments by resolution (subject to obtaining employer consent).

It is worth noting that the Government is due to review the law relating to same sex survivor benefits by the summer and the legal position may therefore change. However, such changes may not come into force for some time.

PPF (www.ppf.gov.uk)

2014/15 levy determination

The PPF has issued its final levy determination and supporting documents for 2014/15. Trustees should be aware that the deadline for the submission of scheme returns for 2014/15 and the certification of contingent assets is **5pm on 31 March 2014**.

The calculation formulae and basic levy parameters are unchanged from last year. The contingent asset standard documents and certification requirement for trustees also remain unchanged.

The only substantive change from last year’s Determination is a simplified re-certification procedure where a contingent asset had not been certified in the previous year, but has been certified within the last five years.

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Government (<http://www.gov.uk>)

Chancellor's autumn statement

As had been anticipated, the main changes announced were in relation to state pension age. It will be increased from age 67 to 68 from the "mid-2030s" (a change from 2046). There is also a new formula for calculating state pension age based on average life expectancy which means that it is likely to rise to 69 by the late 2040s.

Cases

West of England Ship Owners Insurance Services Limited Retirement Benefits Scheme (High Court)

This was an appeal from a decision of the Deputy PPF Ombudsman concerning the failure score of a Luxembourg-based employer. The policy of Dun & Bradstreet Luxembourg, unlike D&B in the UK, was not to automatically access publicly filed company accounts when calculating employer failure scores but to use financial statements sent to it by companies. As the employer had never sent such statements to D&B Luxembourg, its failure score was much worse than it would have otherwise been. The PPF accepted that the trustees could not reasonably have been expected to know that the Luxembourg office did not collect financial data, but said the onus was still on them to check. The Deputy Ombudsman held that it would not be a legitimate exercise of the PPF's powers to calculate a levy by unfair means and ordered the levy to be recalculated.

However, on appeal, the PPF succeeded in its arguments that the levy determination should not be interpreted by reference to public law duties of reasonableness. The PPF had no discretion to depart from the determination, and the scope of the PPF Ombudsman's power could not be wider than that of the PPF. Essentially, if D&B had applied its "normal and ordinary course of business" approach, that was the end of the matter: *"Issues of fairness and irrationality, or indeed any form of value judgment about the appropriateness of the practice adopted by D&B in the ordinary course of business, do not come into it."*

The case lays down a clear marker that trustees and employers will struggle to successfully appeal PPF levy calculations unless they can actually show that the PPF has not complied with its own levy determination. Inherent unfairness in the determination, it would seem, cannot be remedied by the PPF Ombudsman.

MNOPF Trustees v Watkins (High Court)

Until 1999, the MNOPF trust deed and rules provided for discretionary revaluation of deferred pensions for pre-1978 service, and for automatic statutory revaluation for later service. In 1999 the solicitors produced a new deed and rules which they explained by letter was designed to incorporate deeds of variation, changes after a restructuring, rule changes regarding ill-health and spouse pensions, and to update statutory references. However, the new rules had an additional, unintended effect in that they appeared to provide for automatic increases in respect of all service, not just post-1978 service. The trustees brought a claim for rectification.

The judge noted that although the rectification claim was unopposed, that did not mean that it would automatically

succeed. The trustees had to show compelling evidence that the deed and rules did not, or might not, reflect their true intention at the time.

However, the evidence of the contemporary express statements of intention demonstrated that the trustee board thought that it was approving the deed and rules consistent with the brief in the solicitors' letter, which did not mention any changes to revaluation. There was no material indicating that the board had considered giving guaranteed increases to deferred pensions accrued before 1978. Indeed, there was evidence that the board had decided not to give discretionary increases that year due to lack of funds, and it would therefore have been odd if they had decided to adopt automatic revaluation at the same time. There was also evidence that the offending amendment had been suggested to solve a drafting problem, and that its effect had not been appreciated. After the amendment, the trustees had not changed the way in which they revalued pre-1978 pensions, and it was legitimate to have regard to this in seeking to ascertain the trustees' intention.

All these elements together made out a compelling case that a mistake had been made, and that the requirements for rectification had been satisfied.

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

Bradbury – no breach of implied duty of good faith in seeking to impose cap on salary increases through member's pay award

In August 2012's TKU Update we considered the Bradbury v BBC case in the High Court. The BBC had offered members the choice of remaining active members of their scheme (but with future pay awards limited to 1% for pension purposes), or joining a new career average (CARE) scheme under which future pay awards would not be subject to any pensionable cap. The member agreed to transfer to CARE but subsequently complained that the BBC's conduct breached (1) the scheme rules, (2) section 91 Pensions Act 1995 which prevents the surrender or forfeiture of accrued rights and (3) the employer's implied duty of good faith. The Court held that there had been no breach of either the rules or of section 91, but declined to answer the question on good faith in order to allow the BBC an opportunity to gather evidence.

In this Determination, the Ombudsman considered, and rejected, the member's claim that the BBC had breached its implied duty of good faith. He noted that the BBC was publicly accountable and that it had considered its response at a high level and taking professional advice. Its decision was not irrational or perverse or one that no reasonable employer in its position would have adopted. The Ombudsman also rejected arguments that the BBC's conduct amounted to improper coercion and that it had a collateral purpose of using the pension reforms to 'encourage' long serving employees to leave the BBC. He concluded that *"[i]n the light of the scheme deficit, its potential future liability, its resources and its overall obligations and the steps taken by it to address the problems it faced in relation to the Scheme... the BBC did not breach its Implied Duties towards Mr Bradbury in seeking to impose the Cap."*

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The decision confirms other case law in a pension context which has emphasised that it will not be easy for scheme members to establish a breach by the employer of its good faith duty.

Thew – Bridging pensions were not discriminatory, and did not have to match actual state pension age: but terms had to be explained

The member was in pensionable service under the scheme between 1972 and 1981 (with the relevant scheme rules at the time providing for a state pension deduction from age 60) and again from 1982 to 2010 (the scheme rules at the time providing for a state pension deduction from age 64, by reference to the dynamic definition of “pensionable age” in the Pensions Act 1995).

The member sought to take early retirement in 2010, aged 56. She was originally told that her state pension deduction would apply from age 64. However, after she later sought clarification of this, and began an IDR complaint, the trustees told her that the deduction applied from age 60 in relation to her first period of service, and 64 in relation to the second. The member complained that she had relied on the incorrect information when retiring.

The Deputy Pensions Ombudsman agreed with the trustees that under the rules the state pension deduction came into play at age 60 for the first tranche of service and at age 64 for the second. This was notwithstanding the fact that neither of these timings corresponded with state pension age (following the most recent amendments to the Pensions Act 1995, the member’s current state pension age was in fact 65 years and 7 months). The DPO also held, referring to the ECJ case of *Birds Eye Walls*, that there was no unlawful discrimination in the provision of bridging pensions.

However, the information provided to the member by the trustees about such pensions had been incomplete and

misleading and references to “state pension age” had not been explained. It was not reasonable to have expected the member to trawl two sets of scheme rules to find her correct pension deductions, but it was reasonable for her to have assumed that “state pension age” meant the age at which her state pension became due. The member had relied on the incorrect information and her decision to retire had been based on it, at least in part. However, she took no steps to mitigate her loss and while she might have lost earnings, she had had the benefit of additional leisure time. The trustees were directed to pay £500 for distress and inconvenience: the £75 which they had offered was not sufficient.

Miscellaneous

Fair Deal: Fair Deal provides that when public sector employees are transferred to independent providers delivering public services, their new employers must provide similar pensions to those that they were receiving in the public sector.

The main change in the new Fair Deal guidance is that transferred employees will continue to be eligible for membership of their public sector pension scheme as long as they remain continuously employed as part of the outsourced service and this continues to be the case on any subsequent compulsory transfer. Employees that were eligible to join the public sector scheme but had not done so will continue to be eligible to join post-transfer, as long as they are re-enrolled into the scheme on the day the new employment begins.

Employers may also offer a ‘broadly comparable’ scheme in limited circumstances. These include where the current contract holder has a contractual obligation to offer a particular scheme, or where procurement law prevents the contracting authority from requiring the bidder to offer access to the public sector scheme.

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. Our 2014 trustee training courses are taking place on **10th June 2014 and 14th October 2014**. If you have any enquiries about any of these courses or would like to reserve a place, please contact **Karen Mumgaard – E:** karen.mumgaard@cms-cmck.com.

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.

Get to grips with the requirements of the Pensions Regulator with our **Field Guide for trustees**. You will need to be a subscriber to our Law-Now website (which is free) to access this guide. Register at <http://www.law-now.com/register>. You can also get help here with understanding the Pensions Act 2004 and all related regulatory publications by viewing our online **Plain English guide to the Pensions Act**. If you are interested in the Pensions Ombudsman’s activities, visit our website www.law-now.com/po-info.

The Pensions team is part of the CMS Cameron McKenna 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 3 February 2014.

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