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What's Happening in Pensions

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Same sex spouses, civil partners and part-time workers

The Supreme Court has handed down **the final judgment** in *Walker v Innospec Limited*. Mr Walker, with support from Liberty, has persuaded the Supreme Court to overturn the Court of Appeal's decision, winning his husband the right to a survivor's pension calculated on the same basis as if Mr Walker were married to a woman.

The Equality Act provision allowing schemes to limit equality for civil partners and same sex spouses to retirement benefits accrued by reference to service from 5 December 2005 (plus contracted-out minimum benefits from 6 April 1988 only) was declared contrary to EU law and ineffective.

Schemes which have not already provided benefits to surviving civil partners and same sex spouses as if they were the surviving spouse of a member of the opposite sex will need to consider this issue as a priority. Consideration will also need to be given to cases where a member has died since December 2005 and either a surviving civil partner or same sex spouse has not been given equal benefits.

The decision raises difficult questions, not considered by the Supreme Court, about survivors' GMPs and benefits for widowers, which we are considering.

This case had been joined at the Court of Appeal stage with a claim by Mr O'Brien, a former part-time judge, against the Ministry of Justice for a fully retrospective pension notwithstanding that equality for part-timers was only granted from 2000, when EU law required it. (Before that, part-timers, in order to bring a claim, had to establish unlawful indirect sex discrimination.) The same Supreme Court judges also handed down **a separate judgment** in respect of that case. Distinguishing it from Mr Walker's claim, due to separate strands of case law on the different pieces of EU legislation, they have asked the European Court to answer a question about the retrospective effect (or otherwise) of the EU part-time work directive.

Given that both these cases arose from European law, the government will no doubt be mindful of the issues that they raise as part of its Brexit negotiations.

See our **briefing note** for more detail.

General election implications

Following the general election, there is a new Secretary of State for Work and Pensions, David Gauke MP, and a new pensions minister, Guy Opperman MP.

There was no mention of pensions in the **Queen's Speech** on 21 June 2017. The only mention in the government's accompanying **briefing paper** was of a bill, now published (the **Financial Guidance and Claims Bill**), to create a new statutory body, accountable to Parliament, to take on the roles currently played by The Pensions Advisory Service, Pension Wise and the Money Advice Service. The new body will be funded through existing levies.

There have since been the following developments in other areas:

- **Money purchase annual allowance and employer-funded pensions advice**

  The pre-election government said that it would reintroduce withdrawn Finance Bill provisions in a new Finance Bill after the election. These include provisions on the reduction of the money purchase annual allowance (MPAA) from £10,000 to £4,000 and improvements to the income tax exemption for employer-funded pension advice.

  The government has now **confirmed** that *"Where policies have been announced as applying from the start of the 2017-18 tax year or other point before the introduction of the forthcoming Finance Bill, there is no change of policy and these dates of application will be retained"*. That means that the government still intends to make both of the above changes effective from 6 April 2017. See our **briefing note** for more on this.

- **Pensions Regulator powers**

  The Conservatives made various promises about new powers for the Pensions Regulator in relation to corporate activity and dividend payments, proposed fines for wilful underfunding, and potential criminal penalties for directors. See our **briefing note** for more detail.

  We now expect a white paper "later this year", building on the government's DB pensions green paper consultation that closed in May (see **WHiP Issue 63**). The government announced in a **written statement** to Parliament that *"It will address the commitments in the Government's manifesto in relation to the regulation and rules governing defined benefit private pensions. The paper will also consider innovative delivery structures, such as consolidation and measures to drive efficiency within the sector."*

- **State pensions**

  The Secretary of State was required by the Pensions Act 2014 to report on state pensions by 7 May 2017. The government missed that deadline. It said that the government to issue the report should be one that could implement it, and so deferred it until after the election. It has now published its **report**. The headline **announcement** is the government's intention to increase the state pension age from 67 to 68 between 2037 and 2039, rather than between 2044 and 2046. However, legislation to implement this will not be introduced to Parliament until after the next review, in 2023, so this will not be until after the 2022 general election.

  The Conservatives previously stated that they would replace the “triple lock” on state pension increases with a “double lock” (the better of price and earnings inflation) from 2020. Their **Confidence and Supply Agreement** with the DUP, however, recorded agreement that the triple lock will continue to be applied.

Pensions Regulator annual funding statement

The Pensions Regulator has published its latest **annual funding statement**. This is aimed primarily at schemes undertaking valuations with effective dates between 22 September 2016 and 21 September 2017 but is relevant to trustees and sponsoring employers of all DB schemes.

There are several material changes this year, reflecting a tougher approach by the Regulator. Headline points are as follows:

- For the first time in one of these statements, the Regulator sets out its expectations of trustees based on specified levels of employer covenant strength and characteristics of the scheme. Broadly:

  - Schemes with strong or tending to strong employers where the funding is on track should as a minimum continue with the current funding arrangements.

  - Trustees of schemes with strong or tending to strong employers that have weak technical provisions and long recovery plans should seek higher contributions to mitigate against risks such as the employer covenant weakening.

  - Trustees of schemes with weaker employers but who assume they have a strong covenant because of a stronger and larger group should seek legally enforceable support. The Regulator will not take account of the wider group covenant unless the trustees can rely on it.

- Trustees of stressed schemes need to evidence to the Regulator that they have taken appropriate measures, including (among other things): considering the effect of dividends paid by the employer; seeking non-cash support and security from the employer or wider group; and (where scheme rules allow) considering winding up the scheme.

- Trustees are expected *"to seek and duly consider robust advice from their scheme actuary on the valuation assumptions"*. This comment is made in the context of the current industry debate about discount rates (there is no mention of the debate on mortality rates). *"Where trustees are looking to change the method used to set the discount rate following their review, we expect them to have a sound rationale behind the change and to document it clearly. This also applies where trustees continue to use the same method as before, documenting why the method remains prudent."*

- *"Trustees need to have a contingency plan in place detailing actions they would need to take to correct the scheme’s position in the event of a downside risk materialising. This is particularly important for trustees who decide to continue to run significant risk levels. This contingency plan needs to be agreed with the employer in advance and should be legally enforceable."*

- *"Trustees should focus on the ability of the employer to contribute cash to the scheme while there remains good visibility of covenant."*
- The Regulator is likely to intervene where it believes that schemes are not being treated fairly, particularly:
  - in circumstances where recovery plan end dates are being extended unnecessarily (eg, where there is sufficient affordability to increase contributions); and
  - where the employer covenant is constrained and payments to shareholders (including dividends and share buy-backs) are being prioritised, thereby restricting or reducing pension contributions.

  "One aspect we will consider is the impact of dividend payments on the employer covenant. Trustees need to ensure that contributions to the scheme feature prominently in their employer's considerations and that its legal obligations to the scheme as a creditor are recognised ahead of shareholders with no legal entitlement to dividends, but who may exert pressure on the employer to obtain them.

  We expect schemes where an employer's total distribution to shareholders is higher than deficit reduction contributions being paid to the pension scheme to have a relatively short recovery plan and that the recovery plan is underpinned by an appropriate investment strategy that does not rely excessively on investment outperformance.

  Where this is not adhered to, we will consider opening an investigation to assess whether the levels of contributions being paid to the scheme are too low and whether the level of payments to shareholders suggests that the employer has greater affordability. Where we believe there is sufficient affordability to increase contributions to the scheme, we will take steps to ensure that an appropriate balance is struck between the interests of the scheme and shareholders by the employer."
- The Regulator is taking a tougher approach when schemes fail to submit their valuations on time. Trustees should engage with the Regulator and provide a clear timetable, agreed by all parties, for completing the valuation.

The Regulator has also **published** an **analysis document** to support the funding statement.

Barnardo's RPI/CPI case

The Supreme Court has granted permission to appeal in the Barnardo's case.

In that case, the Court of Appeal held that the Barnardo's DB scheme's definition of "Retail Prices Index" (RPI), which includes *"any replacement adopted by the Trustees without prejudicing Approval"*, does not permit the trustees to switch to the Consumer Prices Index (CPI) while RPI remains an officially published index. (See **WHiP Issue 61** for more detail.)

The Court of Appeal also (but without setting a binding precedent because it did not need to be decided) confirmed the decisions in *Danks v QinetiQ* and *Arcadia* (see **WHiP Issues 33** and **48** respectively). In those cases, the High Court held that, where under scheme rules the trustees have a choice of index, until that choice is made it is not possible to say that a member has a subsisting right to an increase based on any particular index. Accordingly, section 67 of the Pensions Act 1995 – which restricts amendments that affect or could affect subsisting rights - would not prohibit the switch.

Pension advice allowance

HMRC's Pensions Tax Manual has been updated to include guidance on the DC pension advice allowance. This is an allowance which may be paid tax free using a member's money purchase rights, subject to certain conditions.

This includes a paragraph on what retirement financial advice, in HMRC's view, can be paid for using the allowance. **PTM142000** says:

> *"The payment must be used to pay for retirement financial advice for the person requesting it, or the implementation of such advice. Regulated financial advice means advice in respect of the person's financial position, including their pension arrangements and the use of their pension funds. HMRC is satisfied that this includes advice on how to use assets to fund care in old age, advice on whether in retirement the person will need to access sources of income other than their pension savings (for example, by equity release from their home), and advice on how to draw an income for retirement from all their pension pots and their stocks and shares ISA, but does not include inheritance tax planning or advice solely on an investment fund that will not be used for retirement income."*

Another new section of the Manual says that taking a pension advice allowance can affect a scheme-specific lump sum protection, namely: *"Payment of a pension advice allowance in respect of the member without them becoming entitled to all pension and lump sum rights on the same day results in their scheme specific lump sum protection being lost"* (**PTM063130).** We doubt that this is a correct interpretation of the legislation and note that if HMRC is right then there could also be implications for individuals with protected pension ages, which HMRC does not mention. Neither possible consequence can have been intended. This point is being raised with HMRC by industry groups.

For more on the pension advice allowance, see our briefing note, **DC pension advice allowance**.

Anti-money laundering etc. regulations

New regulations aimed at preventing money laundering and terrorist financing via trusts may impose duties on pension scheme trustees (and other trustees) to keep fuller personal records of beneficiaries and provide information to HMRC. The extent of the new obligations is currently unclear.

The government has laid **The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017**. These are designed to comply with **the Fourth EU Money Laundering Directive**. They were laid on 22 June 2017 and took effect from 26 June, which was the implementation deadline imposed by the directive.

The regulations (and the directive) are ambiguous and the extent of the obligations imposed on occupational pension scheme trustees will in practice depend on forthcoming government guidance. At worst, pension scheme trustees might have to supply HMRC with detailed information about all scheme beneficiaries (by 31 January each year) but it seems unlikely that the government will want to interpret the law in that way.

We will report more fully when the position is clearer.

FCA asset management market study

The Financial Conduct Authority has published the final report on its **asset management market study**. Please see our **briefing note** for details of the aspects of the report most directly affecting occupational pension schemes.

FCA retirement outcomes review

The Financial Conduct Authority **has published** the interim findings of its Retirement Outcomes Review. This looks at the decisions that individuals are taking, following the introduction of the "pension freedoms", about accessing their DC pension savings and the options and help available to them.

The FCA has found that the new norm involves accessing DC pots early and drawing benefits as cash or via drawdown, rather than purchasing an annuity. The annuity market is shrinking as a result. The FCA has concerns about individuals not shopping around or taking advice. It has particular concerns about the move to drawdown, with many individuals seemingly buying drawdown products purely in order to access their full tax-free lump sum without having also to buy an annuity. It is considering asking the government to change the law to allow access to a pension commencement lump sum without the need to make a decision about the remainder of the DC pot.

The FCA invites comments by 15 September 2017 and intends to publish its final report in the first half of 2018.

BA case

British Airways has failed in the **High Court** in all of its material claims against the trustees of its Airways Pension Scheme regarding their decisions to:

- exercise their unilateral power of amendment in 2011 to give themselves a unilateral power to award discretionary revaluation and indexation increases above those required by the scheme rules (this followed the scheme automatically switching from RPI to CPI when the government changed the basis for public service pension schemes); and
- in 2013 to exercise that power to give a 0.2% annual increase (which was approximately half the difference between the CPI and RPI increases).

Key facts

The Airways Pension Scheme (a former public service pension scheme) provides for uncapped annual revaluation and indexation increases in line with annual orders made by the Treasury (which apply to public service pension schemes). When the government announced in June 2010 that it would use CPI instead of RPI as the measure of price inflation for the purposes of these orders, that meant that increases under the APS would be in line with CPI rather than RPI.

The CPI annual increase has tended to be lower than the RPI increase. The trustees considered what, if anything, to do in response to the development. The scheme was, and still is, in deficit and a recovery plan was in place. Some trustees wanted to "hardwire" RPI increases into the rules by amending the increase rule. Ultimately, in February 2011, the trustees voted to introduce a discretionary power allowing them unilaterally to grant discretionary increases above those provided as of right. The rules were formally amended on 25 March 2011. There are provisos that professional advice has to be taken and that two-thirds of the trustees must have agreed.

On the same date, and again in February 2012, the trustees voted on a discretionary increase but each time there were not enough votes in favour. In February 2013, there was another review. This time, the trustees' unanimous provisional decision was for an increase of 0.2%, being half the difference between the CPI and RPI annual increases.

In June 2013, the trustees confirmed their decision but did not definitively set an implementation date, with the result that there was doubt about the effective date. In November 2013, they decided by an 8/4 majority to grant a 0.2% increase with effect from 1 December 2013.

Scheme rules relevant to the case

The scheme has six member-nominated trustees (MNTs) and six employer-nominated trustees.

The amendment power says that the provisions may be amended or added to by the trustees "in any way", save for provisos (among others) that two-thirds of the trustees must have voted in favour and that no amendment can change "the purposes of the Scheme". It formerly required amendments to be confirmed by regulations made by the relevant government minister but that provision was removed on privatisation. There has never been any requirement for employer consent.

The trust deed describes the "main object" of the scheme as being "to provide pension benefits" and a "subsidiary object" as being to provide benefits in cases of injury or death. It adds: "The Scheme is not in any sense a benevolent scheme and no benevolent or compassionate payments can be made therefrom."

Another clause provides for the possibility of discretionary benefits. These can be awarded by BA but it must provide any necessary additional funding.

The increase rule applies to both deferred pensions and pensions in payment and operates as described above. The added discretionary power includes a proviso carried across from the amendment power for a 2/3rds majority of the trustees to have voted in favour.

The decision

BA challenged the trustee decisions on various grounds concerning how the MNTs had approached the decision-making (see below). BA lost on all counts, with the trustees being found to have made valid exercises of their powers, with one minor exception: the June 2013 trustee decision to award the discretionary increase without definitively specifying an implementation date was held to be ineffective. (That did not significantly affect the financial outcome because an effective decision specifying an implementation date was taken by the trustees only a few months later.)

The judge applied existing law to the very specific facts of the case. He found that the trustees had acted within the scope of their powers and for purposes for which the powers were conferred. He held that, despite several of the trustees having strongly-held views, they had not pre-determined what they would do, they had genuinely engaged with the processes, and they had not taken into account irrelevant considerations. An important factor was that the trustee board had developed a framework (prepared by the actuary in 2012) to guide the trustees when deciding how to exercise the discretionary increase power and sought professional advice on its content.

We will consider the decision in detail in a forthcoming briefing note. An appeal is expected.

GMP equality

Lloyds Banking Group and the trustees of three group schemes will ask the High Court to consider the trustees' duties in respect of equal pension claims by female members. They complain that their pensions are smaller than comparable men's, with the discrepancies due to unequal GMPs. Their trade union says that 230,000 Lloyds scheme members could be affected. Representative beneficiaries from the three schemes have been added.

Only female members are affected in these schemes because, unusually, they provide uncapped revaluation of deferred pensions. In schemes that do not do this, it is not only female members who may be able to claim sex discrimination.

According to the **Lloyds Trade Union newsletter**, the High Court is asked ("in broad terms") to rule on the following questions:

- Where male and female members of each of the three Schemes have earned GMPs referable to service in the period 17 May 1990 to 5 April 1997, is there an obligation on the Trustee to adjust non-GMP benefits payable under the Scheme in order that the total benefits received by male and female members with equivalent age, service and earnings histories are equal? Answering this question is likely to involve considering the legal issues identified already. As part of these issues, the Trustee seeks the Court's ruling on whether the equalisation obligation (if any) is only engaged if an opposite sex comparator can be identified for the affected member, or if the obligation arises without the need to identify a comparator.

- If there is an equalisation obligation, is there a single correct method by which the Trustee should seek to achieve such equalisation of benefits (and, if so, what is that method)? As part of this question, the Trustee seeks the Court's ruling on whether it must as a matter of law adopt one of the methods identified already, or some other method of equalisation.

- If there is a choice of methods, how should the Trustee's powers under section 68 of the Equality Act 2010 (or any other relevant powers) be exercised in order to achieve such equalisation of benefits? This question will involve deciding in principle which method (insofar as legally permissible), or any other suitable method that has been identified, should be adopted for each of the Schemes. The Trustee intends to invite the Court to accept a surrender of its discretion as to the exercise of such powers.

Early exit charges and member-borne commission

The government **has confirmed** its proposals with regard to early exit charges and member-borne commission payments, following its April 2017 consultation (see **WHiP Issue 64**).

From 1 October 2017, the forthcoming Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2017 will:

- introduce restrictions on early exit charges payable by members of occupational pension schemes providing money purchase benefits. These reflect equivalent provisions already applied by the FCA in relation to personal pensions since 31 March 2017. Broadly, early exit charges cannot be higher than 1%; existing early exit charges below 1% cannot be increased; and new early exit charges cannot be made.

- extend the existing prohibition on member-borne commission payments by occupational pension schemes used for automatic enrolment, to cover contracts entered into before 6 April 2016. The existing prohibition of member-borne commission payments only applies to new contracts entered into since that date: see **WHiP Issue 56**.

Advice on transfers

The FCA **is consulting** on changes to its rules for advisers in relation to transfers of safeguarded benefits (which mainly means DB benefits).

Since the introduction of the DC pension flexibilities in April 2015, individuals have more options for accessing their pension savings. This, and historically high levels of DB cash equivalent transfer values, has led to increased demand for advice on transferring DB pensions.

"Appropriate independent advice" is required before a transfer of safeguarded rights worth more than £30,000 can be made with a view to acquiring a right or entitlement to flexible (DC) benefits. Trustees must obtain confirmation that the advice has been given before making such a transfer. That advice is within the scope of this consultation.

The proposed changes include requiring transfer advice to be provided as a "personal recommendation", and replacing the current transfer value analysis with a comparison to show the value of the benefits being given up. This will require a much more comprehensive assessment of the individual's personal circumstances and finances. The FCA quotes unbiased.co.uk as saying that advice with a personal recommendation typically costs between £1,500 and £5,000.

Whilst it remains the FCA's view that keeping safeguarded benefits will be in the interests of most individuals, it says that a transfer may now be suitable when it previously was not. Advisers will therefore no longer have to start from the assumption that a transfer will be unsuitable. This will be replaced with a statement in the FCA Handbook that, for most people, retaining safeguarded benefits will likely be in their best interests. An assessment of suitability should focus on whether a transaction is right for the individual and should be assessed on a case by case basis from a neutral starting position. The adviser needs to demonstrate that the transfer is (or is not) in the best interests of the client.

The **consultation** closes on 21 September 2017.

DC benefits with guaranteed annuity rates

The government **has published** a response to its consultation on valuing benefits with guaranteed annuity rates for the purposes of determining whether the requirement mentioned above for the member to take "appropriate independent advice" applies. Two sets of regulations, taking effect from 6 April 2018, specify the **valuation basis** and require **risk warnings** about the benefit being given up.

Pensions Ombudsman: distress and inconvenience

The Pensions Ombudsman appears to have responded to the High Court's recommendation that he increase his maximum award for non-financial injustice from £1,000 to £1,600.

In a recent case (*Baugniet v Capita and the Department for Education* – see **WHiP Issue 64**) the deputy judge urged the Pensions Ombudsman to increase his maximum award for distress and inconvenience from £1,000 to £1,600. The £1,000 figure (which has been applied other than in exceptional circumstances) was set by the High Court in 1999 in *Swansea City Council v Johnson*. The judge said that maintaining a limit of £1,000 was "out of touch with the value of money".

That now seems to have been done: there has been a **Deputy Pensions Ombudsman decision** that awarded the complainant £1,600 for distress and inconvenience.

At the time of writing, the Ombudsman's June 2015 **factsheet** on such awards had not yet been updated.

People with significant control

From 26 June 2017, **changes** apply to the PSC (people with significant control) regime that affects all UK companies (including pension scheme trustee companies) and LLPs. See **WHiP Issue 57** for outline details of the requirements to maintain a PSC register and provide information to Companies House.

The key change to note concerns the requirement to update information at Companies House. PSC information was previously required to be updated annually in a company's annual confirmation statement. Changes to the PSC register must now be entered in the register within 14 days and subsequently registered at Companies House (on Forms PSC01 to PSC09) within a further 14 days of the PSC register being amended.

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If you wish to discuss any points arising from this note, please speak to your usual contact in the Travers Smith Pensions team or to one of the Pensions partners: Susie Daykin, Daniel Gerring, David James, Dan Naylor, Paul Stannard and Philip Stear.

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