Issue 61 December 2016

What's Happening in Pensions

IN THIS ISSUE:

Contracting-out and GMP inequality

- Resolving GMP-related inequalities
- Amendments to contracting-out legislation
- Fixed rate GMP revaluation

Civil partner lawfully denied a survivor's pension

Switching from RPI to CPI

Pension scams

EMIR: margining requirements

FCA asset management market study

BHS: Pensions Regulator warning notices

Money purchase annual allowance

Early exit and commission charges

General levy

Foreign pension schemes

Lifetime ISA

Contracting-out and GMP inequality

The Government has launched a **consultation** on a possible method for schemes to resolve GMP-related inequalities. It also proposes amendments to improve the contracting-out legislation and a reduction of the fixed rate for GMP revaluation. Responses are requested by 15 January 2017.

Resolving GMP-related inequalities

An industry working group has formulated a ten stage process for addressing GMP-related inequalities, to replace the widely criticised method described in draft guidance published in January 2012 (see **WHiP Issue 32**). The Government has considered the new process. It is minded to take it forward and seeks views on it. The timescale for implementing this is uncertain, as it requires primary legislation and so depends upon a Bill becoming available.

The proposed method involves one-off calculations and actuarial comparisons of the future expected cash flows for each affected member with those that would apply if the member were the other sex. This is done for benefits (not just the GMP) accrued between 17 May 1990 (the date of the Barber judgment) and 5 April 1997 (when GMPs stopped accruing). The greater benefit is then converted into an ordinary scheme benefit under

the existing GMP conversion process, which is to be improved. Any GMP that accrued before 17 May 1990 and the excess-over-GMP for the periods of GMP accrual can also be put through the conversion process.

The Government says that it believes that this method meets the equalisation obligation derived from EU law but it will neither require schemes to use this method nor provide a "safe haven" statutory guarantee that using the method will protect trustees from challenge. Trustees must decide for themselves what to do.

An 18 page annex sets out the ten stage process. There will be Government guidance when the legislation has been finalised. The ten stages are, briefly, as follows:

1. **Reach agreement with the employer:** This includes not just agreement that equalisation and conversion is to be done but also agreement about the valuation basis. There will also need to be agreement about what (if anything) to do about payments of unequal benefits already made to pensioners and survivors.

2. **Identify the "selected members" and agree the "conversion benefits"**: The trustees should agree these with the employer. They may also wish to consider whether to apply a *de minimis* threshold or apply "rough justice" adjustments in order to save costs.

3. **Set the conversion date**: Again, this should be done with the employer's agreement.

4. **Pre-conversion notification**: Member communications should initially be at a high level, noting only that the benefit shape may change but will not reduce in actuarial value and saying that more personalised information will be provided when the conversion has been done.

5. **Valuation**: The member's benefits are valued and a parallel valuation is done on the same basis as if they were the other sex. Schemes will have to consider whether to use the cash equivalent transfer value method to value benefits, or whether another method is more appropriate (especially for pensioners). Of course, a unisex basis must be used. A decision is needed as to whether to treat active members as continuing in service or leaving at the conversion date.

6. **Equalisation**: Each member who is worse off than they would have been had they been the other sex is treated as having a conversion amount of the higher value.

7. **Conversion – determining the post-conversion benefit**: The member's conversion amount is translated back into benefits for pre-1997 pensionable service during which the GMP accrued, using a valuation basis consistent with that used in step 5.

8. **Post-conversion notifications**: "Selected members" would receive a second notification about the conversion of their benefits, telling them the new amount and shape. HMRC is notified (if still legally required).

9. **Certification**: The actuary will certify completion and actuarial equivalence.

10. **Modification of scheme to effect conversion**: The trustees resolve to amend the scheme to provide the converted benefits. Scheme rules may require this to be done prior to conversion.

The working group is still considering some issues, including the requirement to provide a survivor's benefit and the treatment of pensions in payment.

The January 2012 draft regulations that would remove the need for a complainant to point to an actual comparator in respect of GMP-related inequalities (see **WHiP Issue 32**) will be considered in the light of responses to the consultation.

Separately, the Government **is consulting** on how to address GMP inequalities in public service pension schemes. The abolition of the additional state pension and the "contracted-out deduction" in April this year

leads to GMP-related inequalities in public service pension schemes. The Government considers that none existed before then. A temporary arrangement that is currently in place to address this will end on 5 December 2018. The Government is now considering permanent solutions.

Amendments to contracting-out legislation

Draft regulations have been published which will make amendments to the contracting-out regulations from 6 April 2017. These include:

- changes to the protections on amending section 9(2B) rights (ie, contracted-out rights accrued between April 1997 and April 2016);
- clarification of the rules on revaluing GMPs following a transfer; and
- allowing HMRC to extend the notification and payment periods for contributions equivalent premiums (CEPs) in certain circumstances, including following the reconciliation of contracted-out liabilities.

Fixed rate GMP revaluation

The Government, in line with a report by the Government Actuary, proposes that the annual percentage figure for fixed rate GMP revaluation be 4% from 6 April 2017. The figure is reviewed every five years. It has been 4.75% pa since 6 April 2012.

The rate is based on a medium term view of national average earnings increases, based on the assumption that most individuals leaving pensionable service between 6 April 2017 and 5 April 2022 (after which any change following the next review would be implemented) will be fewer than ten years from their GMP pensionable age. In accordance with previous reviews, the rate includes a fixed 0.5% pa premium for the certainty of revaluing in line with a fixed rate.

Civil partner lawfully denied a survivor's pension

The European Court has given its judgment in ***Parris v Trinity College Dublin***. Dr Parris's civil partner will not be entitled to a two-thirds survivor's pension due to a provision in the scheme rules which only allows survivors' pensions where the marriage or civil partnership was entered into before the member reached age 60. Civil partnership was not introduced before Dr Parris turned 60. The European Court decided that there was no unlawful discrimination on grounds of sexual orientation or age.

The judgment notes that Dr Parris has been living in a stable relationship with his partner for over 30 years. Civil partnership became possible in Ireland from 1 January 2011. Dr Parris turned 60 in April 2006. Although Dr Parris has dual Irish/British citizenship and civil partnerships have been permitted in the UK since December 2005, the Irish civil partnership laws exclude the retrospective recognition of civil partnerships registered abroad. The couple entered into a civil partnership in the UK in April 2009 but this was not recognised in Ireland until 12 January 2011. Dr Parris retired, aged 64, on 31 December 2010.

Dr Parris claimed that the scheme rule amounted to unlawful discrimination because it applied a criterion that he was not able to satisfy because of his sexual orientation and/or age.

The European Court, going against the opinion of its Advocate General, held as follows.

- **Sexual orientation discrimination**

  The Court noted that the benefits accrued by Dr Parris for himself and any spouse or civil partner related to a period of work entirely completed before the Irish civil partnership laws came into force.

It held that Ireland was not required:

(a) to provide before 1 January 2011 for marriage or a form of civil partnership for same sex couples;

(b) to give retrospective effect to the legislation; nor

(c) as regards the survivor's benefit, to lay down transitional measures for same sex couples where the member of the scheme had already reached the age of 60.

The provision was therefore not contrary to the sexual orientation discrimination requirements of the EU equal treatment directive.

This is difficult to reconcile with the 2008 European Court judgment in the *Maruko* case, in which the German member's life partner (similar to a UK civil partner) was denied the pension that an opposite sex spouse would have received. In that case, the European Court decided that the survivor was entitled to a pension in respect of all of the member's pensionable service. In the present case, the European Court affirms another part of the *Maruko* judgment but does not refer to, let alone consider, its decision in that case not to apply a temporal limitation. This is despite the Advocate General basing her opinion in this case on that decision.

In the ongoing *Walker v Innospec Limited* case, which is due to be heard by the House of Lords, Mr Walker is seeking an equal pension entitlement for his same sex spouse (formerly his civil partner) in relation to periods of service before the UK's law was changed to allow civil partnerships. He has been seeking to rely on the European Court's decision in *Maruko*. For more background, see our briefing note **Equal marriage and civil partnership**.

- **Age discrimination**

  Although there was clear age discrimination, the European Court held that that this was not contrary to EU law.

  The equal treatment directive provides that "*the fixing for occupational social security schemes of ages for admission or entitlement to retirement or invalidity benefits … does not constitute discrimination on the grounds of age, provided this does not result in discrimination on the grounds of sex*".

  The Court held that the relevant rule "fixes an age for entitlement to an old age benefit" and so is within the permitted exception. The fact that it was legally impossible for the member to meet the age-related criterion did not affect that conclusion because that was a consequence of national laws that, as noted above, were not contrary to EU law.

The Court also held that where a national rule creates neither discrimination on the ground of sexual orientation nor discrimination on the ground of age, that rule cannot produce discrimination on the basis of the combination of those two factors.

Switching from RPI to CPI

The Court of Appeal **has upheld**, by majority decision, the High Court's decision (see **WHiP Issue 54**) that the Barnardo's DB scheme's definition of "Retail Prices Index" (RPI), which included "*any replacement adopted by the Trustees without prejudicing Approval*", did not permit the trustees to switch to the Consumer Prices Index (CPI) while RPI remains an officially published index. It also unanimously expressed the view (but without having to decide the matter) that the High Court in the *QinetiQ* and *Arcadia* cases was correct that the exercise of a power to change index was not a scheme "modification" which would engage the statutory prohibition on amendments adversely affecting subsisting rights.

The Barnardo Staff Pension Scheme's 1988 Rules include pension indexation and revaluation rules that apply increases based on increases in the Retail Prices Index. That term is defined as:

> "*... the General Index of Retail Prices published by the Department of Employment or any replacement adopted by the Trustees without prejudicing Approval. Where the amount is to be increased "in line with the Retail Prices Index" over a period, the increase as a percentage of the original amount will be equal to the percentage increase between the figures in the Retail Prices Index published immediately prior to the dates when the period began and ended, with an appropriate restatement of the later figure if the Retail Prices Index has been replaced or re-based during the period.*"

The Court had to decide whether "replacement" means replacement by the publishing authority or replacement by the trustees. (It was not argued that CPI has already replaced RPI for relevant purposes.) Two of the three judges agreed with the High Court judge that there is no "replacement" of RPI within the meaning of the rules for so long as RPI remains an officially published index. This decision was informed by the inclusion of the second sentence of the definition, which suggested that replacement by the authorities was envisaged. The scheme's Inland Revenue limits appendix also supported this interpretation. The factual background, of the replacement of the Cost of Living Index by the Interim Index of Retail Prices and then RPI, and the change of publishing body, was also enlightening.

This meant that the Barnardo's scheme trustees cannot switch from RPI to CPI by applying the definition.

The Court unanimously expressed its agreement with the High Court decisions in *Danks v QinetiQ* (see **WHiP Issue 33**) and *Arcadia* (see **WHiP Issue 48**) on the application of section 67 Pensions Act 1995. (It did not, however, make a formal decision on this issue because it would only have been relevant in this case if the first question had been decided differently.) Section 67 restricts modifications that would or might affect subsisting rights. The Court of Appeal agreed that under the scheme rules the trustees have a choice of index and until that choice is made, it is not possible to say that a member has a subsisting right to an increase measured in any particular way. Accordingly, section 67 would not prohibit the switch.

The decision (including the section 67 question) will reportedly be the subject of an appeal to the Supreme Court, if it gives permission.

Pension scams

The Government **is consulting** on three proposals to tackle pension scams.

- **Limiting the statutory cash equivalent transfer value (CETV) right:** The Government proposes to amend the CETV legislation, restricting the right to a CETV to circumstances where:

  - *"the receiving scheme is a personal pension scheme operated by an FCA authorised firm or entity*

  - *a genuine employment link to the receiving occupational pension scheme could be demonstrated, with evidence of regular earnings from that employment and confirmation that the employer has agreed to participate in the receiving scheme; or*

  - *the receiving occupational pension scheme was an authorised master trust"*

  The proposed requirement for a genuine employment link to the receiving scheme would reverse the decision in *Hughes v Royal London*, in which the High Court decided that the transfer right in existing legislation exists if the transferring member has employment earnings, even if they do not relate to a scheme employment (see **WHiP Issue 56**).

In other cases, trustees would need to consider any discretion to transfer that they may have under the scheme rules.

- **Banning cold calling in relation to pensions:** The Government proposes to ban all telephone cold calls in relation to pensions. The Government can only prohibit registered UK firms from cold-calling but will publicise the ban in order to send a clear message to consumers that no legitimate firm will ever cold call them. The consultation paper outlines the scope of the ban and asks if it should be extended to unsolicited electronic communications.

- **Making it harder to set up fraudulent schemes:** The Government is concerned about the ease of setting up SSASs, noting that single member schemes do not have to be registered with the Pensions Regulator. It proposes that only active (ie, non-dormant) companies be permitted to register a pension scheme with HMRC. It is also asking for additional suggestions of ways to clamp down on the establishment of small schemes by fraudsters.

The consultation closes on 13 February 2017.

EMIR: margining requirements

The European Commission has adopted final regulatory technical standards (RTS) under EMIR relating to the requirement for the bilateral exchange of collateral in connection with non-centrally cleared OTC derivatives transactions. Following recent announcements from the European Parliament and the Council, it is now highly likely that the RTS will enter into force in January 2017. Certain specific requirements under the RTS take effect on various dates thereafter.

The RTS impose a number of obligations relating to the exchange of variation margin and initial margin for non-centrally cleared OTC derivatives transactions, as well as requirements governing the content of exchange of collateral agreements and collateral risk management procedures. For those that are subject to the EMIR margin rules, the most pressing concern is likely to be the requirement to exchange variation margin in relation to non-centrally cleared OTC derivative transactions entered into on or after 1 March 2017.

We discuss the various requirements under the RTS and their practical implications in our briefing **here**.

FCA asset management market study

The Financial Conduct Authority (FCA) has published an **interim report** in its Asset Management Market Study. The report contains the FCA's preliminary findings and proposals and invites affected parties to submit further observations. The proposed measures may significantly affect asset managers and investment consultancy firms. Pension scheme trustees will also be interested in the findings.

The purpose of the study, undertaken under the FCA's competition powers, was to understand how competition works within the asset management market and whether the FCA should introduce measures to remedy any failings.

Regarding **the operation of the asset management market**, the FCA is concerned about weak price competition for actively managed funds, transparency, and access to the benefits of economies of scale. It also found that smaller schemes fare worse than larger schemes as regards the quality of information reported to them.

The FCA is also concerned that trustees are generally uncritical of investment advice, perhaps fearing the perceived consequences of acting against the advice of their consultants. Trustees generally find it difficult to

monitor the investment advice they receive and some trustees rely too heavily on their investment consultants, resulting in them effectively transitioning to fiduciary management without a conscious decision to do so.

The FCA proposes the following remedies:

- a strengthened duty on asset managers, perhaps at statute level, to act in the best interests of investors, including reforms that would hold asset managers accountable for how they deliver value for money and would introduce independence on fund oversight committees;
- introducing an all-in fee approach to quoting charges so that investors can easily see what is being taken from the fund;
- requiring increased transparency and standardisation of information on costs and charges;
- exploring with the Government the potential benefits of greater pooling of pension scheme assets; and
- requiring greater and clearer disclosure of fiduciary management fees and performance.

Regarding **investment consultancy firms**, the FCA is concerned about lack of effective competition and conflicts of interest, especially in relation to fiduciary management. It is:

- consulting on whether to refer the investment consultancy market to the Competition and Markets Authority; and
- recommending that the Government considers bringing the provision of asset allocation advice by investment consultants within the FCA's regulatory perimeter.

For consideration of the report from the perspective of asset managers, please see our **briefing note**.

The deadline for submission of comments is 20 February 2017. The FCA expects to publish its final report and any amendments to its rules in the second quarter of 2017.

BHS: Pensions Regulator warning notices

The Pensions Regulator **has announced** that it has sent warning notices to various parties in relation to the BHS acquisition and insolvency. These represent the first steps in proceedings that the Regulator intends to take with a view to imposing contribution notices and financial support directions.

The notices have been issued to Sir Philip Green, two companies in his and his family's Taveta group, Dominic Chappell (who fronted the BHS acquisition) and the acquiring company. In accordance with normal practice, the notices have not been published. The Regulator has said that they are each over 300 pages long.

Money purchase annual allowance

The Government **is consulting** on reducing the money purchase annual allowance (MPAA) from £10,000 to £4,000 from 6 April 2017.

The MPAA was introduced in April 2015, alongside the "freedom and choice" DC flexibility options. It applies to an individual who has accessed a DC pension in one of the flexible ways (eg, drawdown or UFPLS) and applies a separate annual allowance to his or her money purchase pension input (which is also counted towards his or her annual allowance). It cannot be carried over. This is designed to restrict the amount of double tax

relief an individual can obtain by drawing benefits and then reinvesting them in a pension scheme. Note that the MPAA applies to cash balance pension savings as well as to "pure" money purchase.

The proposal is being made in order to limit further the amount of double tax relief that can be obtained. The reduction would apply even to those who have already triggered the MPAA because they have already drawn benefits flexibly.

The consultation closes on 15 February 2017.

Early exit and commission charges

The FCA has published a **policy statement**, and the DWP a **consultation response**, on capping early exit pension charges. These respond to consultations earlier this year.

With effect from 31 March 2017, early exit charges in **contract-based schemes**:

- will be restricted under existing contracts to 1% of the value of the benefits (and cannot be increased if they are less than 1%); and
- cannot be applied at all under new contracts.

For **occupational pension schemes**, the cap will be restricted in the same way as for contract-based schemes (see above) and will apply when drawing benefits flexibly before normal retirement age.

The restrictions will be implemented under the current Pension Schemes Bill. The Government will consult on draft regulations in early 2017 with a view to them coming into force in October 2017 (ie, several months later than the rules for contract-based schemes).

During the **second reading** of the Pension Schemes Bill in the House of Lords, the Government mentioned that the power to restrict early exit charges will also be used to make regulations preventing **commission charges** being imposed on certain occupational pension scheme members where they arise under contracts entered into before 6 April 2016 (ie, when the ban on such charges under new arrangements was introduced – see **WHiP Issue 56**).

General levy

The Government **is consulting** on draft regulations to change the general levy rates that occupational and personal pension schemes pay to the Government to fund the Pensions Regulator, the Pensions Advisory Service and the Pensions Ombudsman. The Government proposes a 25% levy reduction for schemes with 500,000 or more members, to apply from the 2017/18 levy year, in order to reduce a surplus. Another option mooted is to reduce all schemes' levies by 10%.

Responses are requested by 18 January 2017.

Foreign pension schemes

The Chancellor announced in the **Autumn Statement** (see paragraph 4.21) that the Government plans to consult on several measures concerning the UK tax treatment of non-UK pensions and lump sums. These are designed to align the tax treatment of foreign pensions and lump sums paid to UK residents with the tax

treatment of UK pensions and lump sums. The Government also intends to prevent "section 615 schemes" (which are schemes that can be set up in the UK for workers employed abroad) from gaining tax advantages.

Subsequently published **draft Finance Bill clauses**, **draft regulations** and an HMRC **guidance note** provide more detail.

Lifetime ISA

The FCA **has published** a consultation paper on Handbook changes to reflect the introduction of the Lifetime ISA (LISA). Its proposals include a requirement for LISA providers to warn customers that they may lose out an employer contribution if they decide to invest in a LISA instead of in a workplace pension arrangement.

The Government has also published **draft regulations** with more detail on how Lifetime ISAs will work.

This and previous issues of WHiP can be found on our website **here**.

If you do not already subscribe to our pensions mailings and would like to do so, please email **pensions@traverssmith.com**.

Hyperlinks in this document can be clicked via an up to date version of Adobe Acrobat Reader. We are not responsible for the contents of external websites to which we provide links.

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.

Travers Smith LLP
10 Snow Hill
London EC1A 2AL
T: +44 (0)20 7297 3000
F: +44 (0)20 7295 3500

www.traverssmith.com

The information in this document is intended to be of a general nature and is not a substitute for detailed legal advice. Travers Smith LLP is a limited liability partnership registered in England and Wales under number OC 336962 and is authorised and regulated by the Solicitors Regulation Authority. The word "partner" is used to refer to a member of Travers Smith LLP. A list of the members of Travers Smith LLP is open to inspection at our registered office and principal place of business: 10 Snow Hill London EC1A 2AL. Travers Smith LLP also operates a branch in Paris.