Pensions law team

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Pensions law trustee update

Speed read

Defined benefit (**DB**) and defined contribution (**DC**) considerations

- **The Pension Regulator's (TPR) latest COVID-19 response -** Most reporting requirements that were paused as a result of the COVID-19 crisis were resumed from 1 July. *SH Comment: trustees need to ensure they meet the resumed deadlines and get the necessary advice for their schemes.*
- **Additional disclosure obligations by 1 October 2020 -** Trustees of both defined benefit and defined contribution schemes will need to make further changes to their statement of investment principles (**SIP**) and produce an implementation statement under the new requirements. *SH Comment: trustees need to ensure they understand which deadlines and upcoming requirements apply to their schemes.*
- **Pension scams** – Pension scammers are taking advantage of the economic uncertainty caused by COVID-19. TPR has set up a webpage on avoiding scams which sets out practical steps trustees should take to try and protect members. *SH Comment: trustees should familiarise themselves with TPR's webpage and ensure they are particularly alive to the risk of scams at this time.*
- **Corporate Insolvency and Governance Act 2020 (CIGA)-** CIGA was published in response to COVID-19 with a view to assisting companies struggling as a result of the crisis. One of the biggest changes that the CIGA introduces is a new moratorium period. *SH Comment: during a moratorium period, certain pension obligations of an employer will cease to be payable. Trustees should consider if this is likely to affect their scheme and the impact it may have.*

DB considerations

- **GMP equalisation** – HMRC has provided clarification on some of the tax implications of carrying out GMP equalisation exercises on a dual method basis. *SH Comment: if trustees are considering carrying out a GMP equalisation exercise using a dual method basis, they should be aware of the HMRC guidance and consider if there will be any additional tax implications for their members as a result.*
- **Retrospective equalisation only permitted in very limited circumstances -** The Court of Appeal has handed down its judgment in the case of *Safeway v Newton* and in doing so, has closed the door on retrospective equalisation in all but a small number of pension schemes. *SH Comment: it appears that retrospective equalisation is only possible for schemes (i) whose amendment power permits retrospective equalisation; and (ii) which attempted retrospective equalisation after 1 January 1996 and before 6 April 1997.*
- **Retail Prices Index (RPI) rules lottery continues -** There have been a further two High Court cases which considered whether a sponsoring employer was permitted to move away from RPI for the purposes of uprating member benefits. *SH Comment: it is possible this reoccurring issue may be less of a concern in the future if the recommendations to align RPI with CPIH are taken forward.*

DB and DC issues

TPR’s COVID-19 response: update

TPR has published an update on the easements it announced in response to COVID-19, which we covered in our April 2020 snapshot. Most reporting requirements that were paused resumed from 1 July. This includes reporting late valuations and recovery plans, delays in transfer quotes and payments, and failures to prepare accounts. Where deficit repair contributions have been suspended, trustees will need to submit a revised recovery plan or report missed contributions.

TPR announced it will continue to assess breaches of administrative and compliance requirements on a case-by-case basis and respond pragmatically where these breaches are COVID-19 related. Trustees and employers will, of course, need to consider whether there are also consequences under scheme rules or related agreements (such as guarantees or other security arrangements) in the event of any breach.

Additional disclosure obligations – what needs to happen before 1 October 2020

The countdown is on for trustees to be fully compliant with additional disclosure obligations. Changes will need to be made to the SIP and an implementation statement will need to be produced which will apply from 1 October 2020.

Trustees of occupational DB and DC schemes	The SIP must include the trustees’ policy in relation to any arrangement with an asset manager relating to: • how the asset manager is incentivised to align its investment strategy with the trustees’ investment policies; • how the asset manager is incentivised to make a decision based on medium to long-term financial and non-financial performance of issuers of debt or equity and to engage with such issuers in order to improve their performance in the medium to long term; • how the method of evaluation and remuneration of the asset manager’s performance is in line with the trustees’ investment policies; • how trustees monitor portfolio turnover costs; and • the duration of the agreement with the asset manager.
	The stewardship policy must be expanded to include a statement regarding how the trustees monitor their investment companies’ capital structures, how they manage actual or potential conflicts of interest and how they monitor and engage with stakeholders.
Trustees of occupational DC schemes	The trustees must draft and publish an implementation statement covering: • the extent to which the SIP has been followed; • any review of the SIP in the year or the date of the last review of the SIP if a review in the year was not undertaken; • an explanation of any changes that have been made to the SIP; and • a statement on the voting behaviour by or on behalf of the trustees.

Trustees of DB schemes	The SIP must be published on a publicly available website.
	Trustees must draft and publish an implementation statement: • explaining how and the extent to which they have followed their engagement policy; and • describing the voting behaviours by and on behalf of trustees, including the most significant votes cast by trustees or on their behalf.

The PLSA has produced a guide for trustees on the applicable requirements and deadlines.

The Stephenson Harwood pensions law team would be happy to advise on the detail of these requirements, together with the specific deadlines applicable to your scheme and any exemptions that may apply.

Pension scams

Scams are becoming increasingly common on the back of mass unemployment and the immediate pressure placed on household incomes following the COVID-19 crisis.

What should trustees do?

Trustees and administrators play an important role in educating and protecting members and keeping retirement savings away from scammers. TPR has a webpage dedicated to avoiding scams which includes practical steps that should be taken by trustees and administrators. These include:

- having a scam prevention page on the scheme website;
- printing and including TPR's pension scams guide in the annual member statements and transfer packs; and
- conducting thorough due diligence when a member asks to transfer by using TPR's scheme transfer checklist and the combating pension scams code of good practice.

Corporate Insolvency and Governance Act 2020 (CIGA)

The CIGA was passed to help companies who are in financial difficulty as a result of COVID-19 stay afloat. From a pensions perspective, the CIGA may limit the ability of trustees of pension schemes to pursue funds from an employer in the short term.

One of the key provisions of the CIGA that could have an impact on pension schemes is the moratorium period provisions.

What is the moratorium period?

Directors of struggling companies can obtain a 20 day moratorium period, which can be extended by up to 12 months.

While the moratorium is in place, the employer will receive a payment holiday in respect of certain pension debts which fell due before, or during, the moratorium.

What pension debts are still payable during the moratorium period?

The CIGA lists a number of debts that must still be paid in the moratorium period and this includes "wages and salary arising under a contract of employment". Contributions to an occupational pension scheme are specifically included in the definition of "wages and salary" and therefore will continue to be paid.

What pension debts will not be payable during the moratorium period?

There are concerns, however, that certain pension obligations will not be payable during this period. These include:

<u>Defined benefit schemes</u>

- Deficit repair contributions
- Section 75 debts
- Contribution notices and financial support directions

<u>Personal pension schemes</u>

- Ongoing contributions to personal pension schemes are not payable during the moratorium period, although this appears to be an oversight in the legislation.

Trustees will need to take advice where necessary to help them understand how the CIGA may affect their ability to enforce pension obligations against sponsoring employers who enter into moratorium periods. There are also other provisions of the CIGA which may affect pension schemes, for example regarding restructuring, which trustees may also need to consider if this becomes applicable to their sponsor.

DB issues

GMP equalisation (dual record methods only)

As we all know, the *Lloyds* judgment put to bed the question of whether or not GMP benefits need to be equalised between male and female members. The answer is yes. Unsurprisingly, however, the process of achieving this is not so simple and the judgment left a number of uncertainties.

Some of these concerned the tax treatment of certain allowances and payments in light of GMP equalisation exercises. HMRC has provided guidance to help answer some of the outstanding questions.

Topic	Concern	HMRC resposne
Annual allowance	GMP equalisation may result in an increase to the pension due at retirement. The concern was whether this increase would count towards a member’s annual allowance and have adverse tax consequences for a member if it caused them to exceed their annual allowance.	As any increase in pension as a result of GMP equalisation results from membership in the pension scheme during the period 19 May 1990-5 April 1997, it does not count as a new entitlement. **It will not, therefore, generally be tested for annual allowance purposes.**

		There is no need to revisit past pension input amounts. Pension input amounts for the year of GMP equalisation and the tax years thereafter will, however, need to reflect the amended equalised benefits for active members and deferred members not covered by the deferred member carve-out. Members who benefit from the deferred member carve-out should not be affected.
Lifetime allowance (including fixed, individual, primary and enhanced protection)	Members who benefit from one of the lifetime allowance protections (broadly entitling them to a higher lifetime allowance than would otherwise be the case) may lose such protection if there is any further benefit accrual. A concern was whether any increase in pension as a result of GMP equalisation would be regarded as further benefit accrual.	As any increase in pension as a result of GMP equalisation results from membership in the pension scheme during the period 19 May 1990-5 April 1997, it does not count as a new entitlement. **It will not, therefore, generally be tested against the lifetime allowance.** Certain members may need to notify HMRC if the value of their rights to be protected is higher than originally notified to HMRC. GMP equalisation may impact on the amount of a member's previous and future benefit crystallisation event amounts. This may lead to a member exceeding their lifetime allowance and incurring a lifetime allowance charge. Trustees should consider if this is likely to affect their members.
Previous lump sum payments (for example on serious ill health, trivial commutation and winding up)	Certain lump sum payments require the payment to extinguish the member's rights under the scheme. Some lump sum payments also contain a limit as to the amount of payment that can be made. A concern was if GMP equalisation results in further benefit entitlement after a previous lump sum had been paid, would this cause the previous lump sum to fail to fulfil these conditions and therefore be an unauthorised payment?	Where the lump sum in question includes a limit on the amount of the lump sum that can be paid (for example small lump sums), these will not stop being an authorised payment just because a further entitlement (due to GMP equalisation) arises that the scheme administrator could not reasonably have known about at the time of the lump sum payment. A trivial commutation payment, however, can only be paid if a member's benefits under all registered pension schemes is under a certain value on a nominated date. If a member's benefits increase as a result of GMP equalisation, this may mean a member's benefits on the nominated date exceeds the limit. In this case, the original payment would not be considered a trivial commutation payment and will be unauthorised unless it met the conditions of another type of authorised lump sum payment.

Future lump sum payments	'Top-up' payments to previously paid lump sums may arise as a result of GMP equalisation. The question is how would these be treated for tax purposes.	HMRC has made clear that such payments must satisfy the payment conditions at the time the top up payment is made, not the conditions in force the time the original lump sum was paid.

The HMRC guidance relates to benefit changes as a result of GMP equalisation achieved by a **dual recording keeping method**. It does **not apply to GMP equalisation achieved by conversion.** HMRC notes there may be tax implications for members where conversion is used and it will look to issue guidance on this area in due course.

Retrospective equalisation only permitted in very limited circumstances

The Court of Appeal (**CoA**) has handed down its judgment in the case of *Safeway v Newton* and in doing so, has closed the door on retrospective equalisation for all but a small number of pension schemes.

Background

The Safeway Pension Scheme (**Scheme**) purported to equalise male and female Normal Retirement Dates (**NRDs**) with effect from 1 December 1991 by issuing member announcements in September and December 1991 (the **1991 Announcements**). Equalisation was to be achieved by increasing female members' NRD to 65 in line with the NRD of male members. However, the Scheme rules were not amended to reflect this until 2 May 1996 when a deed was executed which purported to have retrospective effect from 1 December 1991.

In October 2017 the CoA held that, under the Scheme's power of amendment, an amendment to the Scheme's governing documentation could only be made by deed. The 1991 Announcements could not, therefore, have amended NRDs under the Scheme with effect from 1 December 1991. The amendment power did, however, allow for amendments to be made with retrospective effect. The question was, therefore, whether the 1996 Deed was valid retrospectively so as to change NRDs to 65 with effect from 1 December 1991 or whether the amendment could only have prospective effect from 2 May 1996. The CoA referred this question to the Court of Justice of the European Union (**CJEU**).

The CJEU held that, on the facts, the 1996 Deed did not achieve retrospective equalisation, but went on to note that retrospective equalisation may be possible "*…provided that, in addition to respecting the legitimate expectations of the persons concerned, those measures are in fact warranted by an overriding reason in the public interest…*".

The latest CoA judgment

The one remaining question to be considered by the CoA following the CJEU judgment was whether the introduction of Section 62 of the Pensions Act 1995 with effect from 1 January 1996 meant that the Scheme equalised with effect from that date. Section 62 (now superseded by section 67 of the Equality Act 2010) was intended to provide a domestic law framework for Article 119 in relation to pension rights by introducing an "*equal treatment rule*" for all UK occupational pension schemes.

The CoA unanimously agreed that the Scheme's NRD was validly equalised at age 65 on and from 1 January 1996 due to a combination of the introduction of Section 62 and the retrospective nature of the amendment power in the scheme rules.

Wider application?

This is a significant decision in relation to the equalisation of NRDs under UK occupational pension schemes as it confirms for the first time that the introduction of Section 62 made it potentially possible for any schemes which had not equalised NRDs by 1 January 1996 to retrospectively do so with effect from 1 January 1996.

However, the number of pension schemes which will benefit from a reduction in liabilities as a result of this judgment is likely to be limited. This is because the judgment only applies to those schemes which:

- are permitted to make retrospective changes under the terms of the scheme amendment power; and
- in compliance with that amendment power, made retrospective changes to equalise NRDs in the period after 1 January 1996 and before 6 April 1997 (when statutory restrictions in relation to retrospective scheme alterations were introduced by section 67 of the Pensions Act 1995).

For the majority of schemes which do not meet the above criteria, the CoA judgment appears to close the door on the possibility of successfully arguing for retrospective equalisation of NRDs.

RPI rules lottery continues

Whilst the DWP consultation on reform of RPI remains open, there have been a further two High Court cases considering whether a sponsoring employer was permitted to move away from RPI for the purposes of uprating member benefits in favour of the Consumer Prices Index (**CPI**).

Case	Scheme rule	Issue before the court	Decision of the court
Carr v Thales Pensions Trustees Limited	Annual increases to pensions were to be by reference to: "*the percentage increase in the* ***retail prices index*** *… as specified by order under Section 2 of Schedule 3 of the Pension Schemes Act*"	Since 2011, the two limbs of this rule had become inconsistent: • The first limb required the use of RPI. • The second limb referred to revaluation orders which, since 2011, referred to CPI rather than RPI. The pension scheme had moved away from the use of RPI in 2016 in reliance on the fact that the second limb of the definition would allow the use of CPI.	The High Court held that the first limb of the definition was in fact determinative and RPI was therefore hard-coded into the scheme rules. The second limb was merely a descriptive aid. At the time of drafting the draftsman would not have contemplated a divergence between the two limbs (as RPI was also used under statute at that time).

Ove Arup v Trustees of the Arup UK Pension Scheme	*"If the composition of the Index [RPI] changes or the Index is replaced by another similar index, the Trustees, after obtaining the Actuary's advice, may make such adjustments to any calculations using the Index (or any replacement index) as they consider to be fair and reasonable".*	It was argued by the employer that, despite the fact that RPI continued to be published and had not been discontinued, there had been a 'functional replacement' of RPI due to the changes made to the index and criticism of its appropriateness. The Trustee could, therefore, change the index from RPI to CPI or CPIH, or if they could not change the index itself, they could adjust the calculations using RPI that would achieve the same result.	This argument was dismissed on the ground that replacement of the index was an act to be done by the producer of the index. As RPI continued to be published there was no replacement. Moreover, the provision stating 'adjustments to any calculations using the Index' did not mean that RPI could be departed from but, instead, the trustees could counteract any changes to its composition in a fair and reasonable way when uprating scheme benefits.

Both of these cases demonstrate that the 'rules lottery' in determining whether RPI can be departed from is still very much alive and kicking, although this may become less of an issue if proposals to align RPI with CPIH are taken forward.

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