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Pensions law trustee update

Speed read

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

- **The Pension Schemes Bill -** The Pension Schemes Bill (the **Bill**) includes proposed extensions to the powers of the Pensions Regulator and introduces new criminal sanctions and civil liability for certain actions. *SH comment: The future of the Bill is uncertain as its second reading in the House of Lords was shelved in light of the upcoming general election. It is, however, likely that a future government will continue along the path of increased regulation, and the Bill provides a useful guide on the areas likely to be of focus.*

- **Due diligence required before transferring out -** Recent Pensions Ombudsman decisions suggest the standard expected of trustees when carrying out due diligence before transferring-out a pension benefit is higher than that expected before 2013. *SH comment: Trustees should ensure they take account of all relevant guidance when considering a transfer-out request.*

- **An end to LIBOR -** It is not possible to rely on the London Interbank Offered Rate (**LIBOR**) being available after 2021 following the Financial Conduct Authority's announcement that, after this time, banks would no longer be required to submit rates needed to calculate LIBOR. *SH comment: As a result, trustees should consider how any investments their scheme holds which are linked to LIBOR can be amended and any cost implications of such changes.*

DB considerations

- **Is retrospective equalisation possible?** It was generally accepted that retrospective equalisation of retirement ages for male and female members was not possible. A recent decision of the Court of Justice of the European Union has, however, cast this conclusion into doubt. *SH comment: Those schemes which have an amendment power that allows retrospective amendments and which may previously have attempted to equalise retrospectively, may consider revisiting whether this was effective. However, a word of warning… the case offers scant guidance as to the extent of the exception permitting retrospective equalisation.*

- **An end to RPI?** The Chancellor has announced plans to consult on whether to align the Retail Prices Index (**RPI**) with **CPIH** (the Consumer Prices Index including owner occupiers' housing costs and Council Tax) between 2025 and 2030. *SH comment: Trustees should consider the impact this change may have on both scheme assets and liabilities.*

- **Rectifying pension scheme documents –** The Court of Appeal has confirmed that the correct test for determining whether a pension scheme document can be rectified is a subjective one. Rectification will be permitted if it can be evidenced that the employer and the trustees independently had the same intentions with regard to the document. There is no need for evidence of the parties having communicated this common intention between themselves. *SH comment: It nevertheless remains important that trustees ensure that their pension scheme documents accurately reflect their intentions before signing them and that detailed records of any negotiations/agreements entered into before signing the documents are kept.*

DB and DC Issues

The Pension Schemes Bill – new powers for the Pensions Regulator and increased regulation

STOP PRESS: *The future of the Bill has been cast into doubt after its second reading in the House of Lords was shelved in light of the upcoming general election. It is however likely that a future government will continue along the path of increased regulation, and the Bill provides a useful guide on the areas likely to be of focus.*

The Bill proposes changes to a number of areas of pensions law. Of particular note are the changes proposed to the powers of the Pensions Regulator (**TPR**) and the introduction of new criminal offences and civil liability.

The Bill proposes to extend the circumstances in which TPR can pierce the corporate veil and impose liability for deficits in defined benefit pension schemes on companies which do not actually participate in the scheme. TPR currently has the power to do this in certain circumstances by issuing a contribution notice. The Bill adds an additional two grounds when a contribution notice can be imposed.

New criminal offences

Offence	Penalty
Failure to comply with a contribution notice.	A fine
Avoidance of employer debt - where a person engages in a course of conduct that: • prevents the recovery of the whole or any part of a debt due by an employer to the scheme (under section 75); • prevents such a debt becoming due; • compromises or settles such a debt; or • reduces the amount of such a debt that would otherwise become due. The person must have intended the act to have such an effect and not have a reasonable excuse for acting in that way.	A fine and/or imprisonment for up to 7 years
Conduct risking accrued scheme benefits – where a person acts in a way that detrimentally affects in a material way the likelihood of accrued scheme benefits being received. The person must have known or ought to have known that the course of conduct would have had that effect and cannot have a reasonable excuse for engaging in that conduct.	A fine and/or imprisonment for up to 7 years

New civil liability

Cause of action	Penalty
Failure to comply with a contribution notice.	Fine of up to £1 million
Avoidance of employer debt (as above).	Fine of up to £1 million
Conduct risking accrued scheme benefits (as above).	Fine of up to £1 million
A party failing to notify TPR of an event which is a notifiable event under legislation. The notifiable events regime has also been expanded and the Bill includes more detail as to the information that is required to be given to TPR when a notification is to be made.	Fine of up to £1 million
Knowingly or recklessly providing TPR or a trustee with false or misleading information in certain circumstances.	Fine of up to £1 million

The Bill also makes changes in a number of areas which may be of interest to trustees of both DB and DC schemes, including:

- imposing additional requirements on trustees of defined benefit pension schemes with regard to funding and investment strategy;
- providing a framework for collective money purchase pension schemes and the introduction of pension dashboards; and
- imposing restrictions on statutory transfers out.

Early 2013 a watershed point for transfer due diligence

An Ombudsman determination considered a complaint from "Mr R" that his former pension plan provider failed to carry out sufficient due diligence about his transfer. In light of the receiving scheme turning out to be a scam arrangement, Mr R sought reinstatement of his pension rights with the transferring plan plus interest on those rights.

The complaint was rejected by the Ombudsman, with a key factor for that decision being the standard to be expected within the pensions industry around the time of the transfer.

The transfer process started in late 2012 and was completed on 21 February 2013. The determination noted that completion of the transfer coincided with the time that TPR issued guidance about pension liberation scams. While the Ombudsman's determination noted that industry practice on transfer due diligence changed at that time in light of TPR's guidance, it also stated that it was reasonable to allow a short period of time for providers to consider and implement the guidance. Therefore the Ombudsman concluded that, for this transfer at least, the due diligence checks carried out by the transferring plan were appropriate at that point in time and so the plan's provider could not be held responsible for any loss of pension.

The transfer occurred in the short grace period after TPR's scam guidance was issued but before the time by which the Ombudsman expected schemes to have implemented improved due diligence processes for pension transfers. The outcome for Mr R could have been quite different had the transfer occurred a few months later, as a recent Ombudsman determination concerning a Mr N demonstrated. In that case, the transfer occurred in August 2014 and the transferring scheme was criticised for not putting in place robust and compliant procedures reflecting the TPR's pensions liberation guidance. As a result, the transferring scheme was required to reinstate the member's benefits.

Whilst the precise expiry date for the grace period following the TPR's 2013 guidance remains unclear, this determination is a reminder that the Ombudsman now expects trustees to take account of regulatory and industry guidance when conducting transfer due diligence. With that in mind, pension scheme trustees, administrators and providers should consider the recent update to the PLSA's voluntary code of good practice on combatting pension scams.

Pension trustees should be aware of the end of LIBOR in 2021

Pension schemes may have investments whose returns are linked to LIBOR, which is a key interest rate benchmark. LIBOR is a measure of the average rate at which banks are willing to borrow wholesale unsecured funds and is calculated based on submissions from selected panel banks. It is published in five currencies and a range of tenors.

During the 2007 financial crisis, concerns arose that interbank rates such as LIBOR were being manipulated, leading to greater regulatory scrutiny and wide-ranging reforms to LIBOR. However, the underlying market which LIBOR measures is no longer liquid, impacting its stability. Consequently, in July 2017, the Financial Conduct Authority (**FCA**) announced that, after 2021, banks would no longer be required to submit rates needed to calculate LIBOR. It is now therefore widely accepted that it is not possible to rely on LIBOR being available after 2021.

The Bank of England and the FCA have recommended that the Sterling Overnight Index Average (**SONIA**), a 'near' risk-free reference rate, be adopted as the alternative to Sterling LIBOR across financial products and markets. SONIA is an overnight rate, based upon interest paid on certain funds the previous business day. It is viewed as robust as it is anchored in active, liquid underlying markets. It is therefore meant to be a better measure of the general level of interest rates than LIBOR. SONIA will usually result in a rate which is lower than the sterling LIBOR rate.

Some market participants have already started to prepare for the forthcoming changes. For example, Associated British Ports received consent from noteholders in June 2019 to switch the reference rate for its floating rate notes due in 2022 from LIBOR to a SONIA-based rate.

Trustees should note the likely end of LIBOR in 2021 and the potential impact that this will have on investments (both present and proposed) which use LIBOR as a reference rate. For example, consideration should be given as to:

- how the investments can be amended to take account of a different rate (most likely SONIA for sterling and other risk free rates for other LIBOR currencies); and
- the cost implications this may have (for example, whether fees could be charged for amending the interest rate, as well as any effect which altering the benchmark rate will have on returns).

DB issues

An end to RPI?

The Chancellor has announced plans to consult on whether to align RPI with CPIH between 2025 and 2030.

RPI's status as a 'National Statistic' was revoked in 2013, but it has remained in widespread use – not least in many private sector defined benefit pension schemes. A review of price indices published by the Institute for Fiscal Studies in January 2015 recommended that, given the fundamental flaws in the way RPI is calculated, the Office for National Statistics (**ONS**) should maintain RPI as a legacy measure only. CPIH became the lead inflation index in the ONS's statistical releases from 21 March 2017.

The Government has previously consulted on whether pension schemes should be permitted to move from RPI to CPI on the grounds of rationality and fairness. The results of the consultation were published in the March 2018 White Paper "*Protecting Defined Benefit Pension Schemes*". The Government found there was no clear consensus on whether "fairness" meant protecting employers who may be at a competitive disadvantage if RPI is hard-coded into their pension schemes rules, or protecting pension scheme members who were promised pension increases on a certain basis.

The Economic Affairs Committee's January 2019 report recognised this challenge but found that RPI's continued publication in its current form was untenable. It recommended that the UK Statistics Authority (**UKSA**) request a programme of periodic improvements to RPI.

The UKSA is legally obliged to produce RPI. It cannot, without consulting the Chancellor, change the index until 2030 (when the last relevant index-linked gilts mature) in a way that would detrimentally affect index-linked gilts. In a letter to the Chancellor dated 4 March 2019, the UKSA made two recommendations:

1. that publication of RPI should cease; and
2. since recommendation 1 would require primary legislation and therefore take time, a second parallel course of action: to align RPI with CPIH.

The Chancellor was asked to consent to both recommendations.

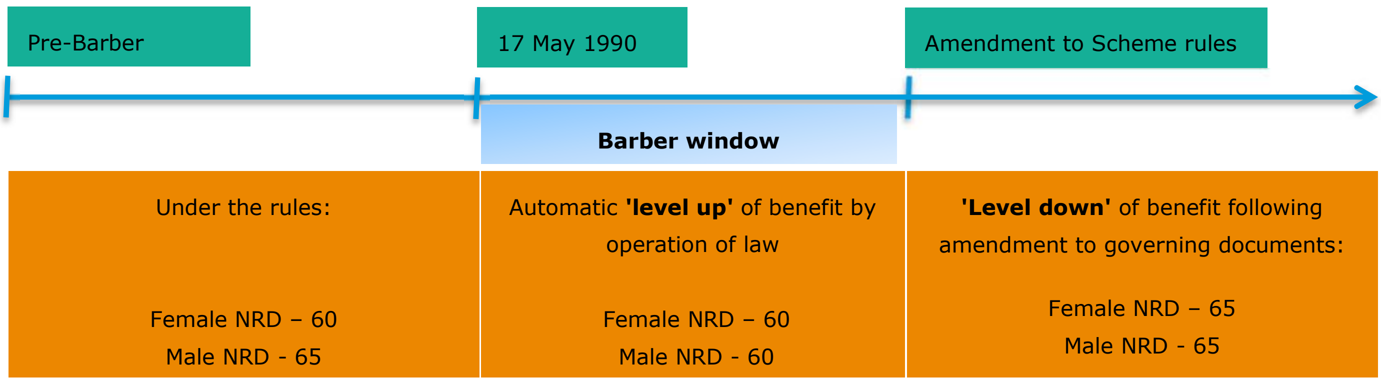
The Chancellor's response of 4 September 2019 noted that RPI is widely used across the economy and ceasing to publish RPI would be highly disruptive. The Chancellor would not agree to promote legislation that would remove the requirement for the UKSA to publish RPI.

The Chancellor recognised the statistical arguments for the second proposal to fix RPI by aligning its methodology with the ONS's headline measure of inflation. The Chancellor notes, however, there would be significant effects of these changes on users of RPI and time will be needed for those who use RPI to prepare. As a result, he will not consent to such a change any earlier than February 2025. The Government will consult publicly on whether the change should be made earlier than 2030 and, if so, when between 2025 and 2030 the change should occur. The consultation was due to begin in January 2020, but this was before a general election was announced and subject to Brexit having been delivered by this time.

Is retrospective equalisation possible?

Equalisation – a quick recap

Historically, male and female members often had unequal normal retirement dates (**NRDs**) in occupational defined benefit pension schemes. Usually, male members had a higher NRD than female members. It has been commonly understood that, since the European decision of *Barber* on 17 May 1990, this practice was unlawful discrimination. As a result, since 17 May 1990 and until schemes amended their rules to provide male and female members with equal NRDs, the NRD of the disadvantaged sex (usually the male) was automatically changed to that of the advantaged sex. This usually resulted in a more expensive outcome for schemes and, as a consequence, they then generally amended their rules to provide both sexes with an equal, but later, NRD. The period between the *Barber* decision and a scheme amendment to reflect equal NRDs is known as the 'Barber window'.



Safeway v Newton – the decision of the CJEU

In the case of *Safeway v Newton*, the scheme purported to equalise retirement ages of male and female members with an announcement, but only amended the rules to reflect this sometime afterwards. The amendment power in the scheme did allow for retrospective amendments. The question raised was, essentially, whether equalisation could be effected retrospectively or not given the retrospective amendment power.

The Advocate General's decision reflected the general industry understanding that equalisation could not be validly achieved retrospectively.

The decision of the the Court of Justice of the European Union (**CJEU**) has, however, potentially muddied the waters in this area. The CJEU held that, whilst legal certainty generally precludes retrospectivity, retrospective equalisation may be possible if, in addition to respecting the legitimate expectations of the persons concerned, those measures are warranted by an overriding reason in the public interest. The CJEU gave an example of where the public interest might allow retrospective equalisation - where it was "…*necessary to prevent the financial balance of the pension scheme from being seriously undermined*."

This decision therefore casts some doubt on the premise that retrospective equalisation is never permissible. Those schemes which have an amendment power that allows retrospective amendments and which may previously have attempted to equalise retrospectively, may consider revisiting whether they fall within the "financial balance" exception. However, a word of warning… the case offers scant guidance as to the extent of that exception.

Court of Appeal confirms "common intention" test for rectifying pension scheme documents

The Court of Appeal's recent decision in *FSHC Group Holdings Ltd v GLAS Trust Corp Ltd* (**FSHC**) has confirmed the correct test to be applied for the purposes of rectifying (i.e. correcting) incorrect pension scheme documents.

Parties to a legal document, such as a contract or a pension scheme trust deed and rules, can ask the court for rectification of the document where it does not reflect the terms which they consider had actually been agreed. The purpose of rectification, therefore, is to resolve an accidental inconsistency between the parties' common intentions and what was actually recorded in the document.

Whilst this case was concerned with rectifying a contract, the Court cited the rectification of pension scheme documents in order to highlight a distinction between the common intention test for rectifying contracts and the common intention test for rectifying pension scheme documents.

Rectifying a contract

The common intention test for rectifying contracts requires (i) the parties to have had a common intention, and (ii) evidence of a mutual agreement between the parties in relation to those intentions - that is, those intentions must have been **communicated** between the parties.

Rectifying a pensions document

The Court confirmed that a pension scheme document made using an amendment power vested jointly in the employer and the trustees (or in the employer with the trustees' consent, or vice versa) can be rectified if it can be evidenced that the employer and the trustees independently had the same intentions with regard to the document. There is no need for evidence of the parties having communicated this common intention between themselves. The reason for this is that the amending document does not operate by both parties having mutually agreed it. One is approving what the other wants to do.

The approach in FSHC has subsequently been followed in the case of *Blatchford Limited v Brian Blatchford and others* where it was confirmed that the test is a subjective one and an outward expression of accord of that subjective intention is not required. If there is a joint continuing common intention, the consensus is established.

In spite of this, it is still vitally important that employers and trustees:

- ensure that their pension scheme documents accurately reflect their intentions and any agreements reached before signing them; and
- keep a detailed record of any negotiations/agreements entered into before signing the documents, such as meeting minutes and correspondence.