Baker McKenzie.

Pensions Update

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Legislation in force from April 2017

A raft of new legislation has come into force for the new tax year. Key legislation for trustees and employers to be aware of includes:

- **technical changes to contracting-out legislation from 6 April 2017:** affects the requirements governing schemes which were, prior to 6 April 2016, contracted-out on a salary related basis, including:
    - reducing the rate of fixed-rate revaluation for guaranteed minimum pensions ("**GMP**") for those leaving pensionable service after 5 April 2017 from 4.75% a year to 3.5% a year;
    - clarifying the circumstances and period over which an inheritable GMP can be paid following alterations to state bereavement benefits; and
    - changes to the circumstances and timing in which contribution equivalent premiums can be paid;
- **technical changes to automatic enrolment for post staging date employers:** the changes which we reported on our March Update and which are relevant to new employers who did not receive a staging date under the original staging timetable, came into force on 1 April 2017;
- **changes to NEST rules:** various changes were made to the NEST rules from 1 April 2017

including the removal of the annual contributions limit and the removal of restrictions on bulk transfers in and out of NEST;

- **changes to the overseas pension scheme and recognised overseas pension scheme tests:** following consultation, which we reported on in our December Update, legislation came into force from 6 April 2017. The key proposals in the consultation have been implemented in the final legislation including the removal of the 70% rule and allowing benefits to be paid before the age 55 if the payment would be an authorised payment if paid by a registered pension scheme. The final form regulations can be viewed here. HMRC guidance (which has been updated since it was first published in December) can be accessed here;
- **new form of authorised payment for pension advice allowance:** subject to certain conditions being met, the payment of a pension advice allowance will, from 6 April 2017, qualify as a authorised payment.
- **PPF long service compensation cap comes into force:** this new element of the PPF compensation cap, which we have reported on in previous Updates came into force on 6 April 2017. For further details, see our March 2017 and September 2016 Updates.

Update on Finance Bill 2017

The Finance Bill 2017, which implements announcements which were made in the 2016 Autumn Statement and the Spring Budget was introduced to Parliament earlier in the month.
At the time of writing, it appears that the Government will now drop a large number of the provisions of the Bill, including, in relation to pensions, provisions which would have (i) introduced an income tax exemption to cover the first £500 of pensions advice provided to an employee where the advice is paid for by the employer and (ii) reduced the money purchase annual allowance (which is triggered following flexible access to benefits), from £10,000 to £4,000.

The Financial Secretary to the Treasury, Jane Ellison, has said in relation to the dropping of these clauses "*there has been no policy change and the Government will legislate for the remaining provisions at the earliest opportunity, at the start of the new Parliament*."

Pensions provisions which will remain in the Bill include provisions which (i) make changes to the UK tax treatment of overseas pensions and (ii) introduce an overseas tax charge on transfers to a qualifying recognised overseas pension scheme (QROPS).

New restrictions on early exit charges and extension of prohibition on member borne commission payments in occupational pension schemes published

Draft Regulations have been published which seek to impose restrictions in occupational pension schemes in relation to DC charges which are equivalent to those which apply in relation to FCA regulated arrangements.

Key points in relation to the draft Regulations are:

- **New restrictions on early exit charges**: the draft Regulations impose a 1% cap on early exit charges for existing members of relevant occupational pension schemes at the point the legislation comes into force (expected to be 1 October 2017) and a total ban for new members of such schemes after that date. The new restrictions would apply to DC schemes and hybrid schemes to the extent they are providing DC benefits. The intention is for the restriction to apply to all charges imposed on members when seeking to access their pension early, which they would not face if they carried out the same transaction at their normal pension age (for example a transfer of benefits).
- **Extension of prohibition on member borne commission payments:** the draft Regulations seek to implement the second phase of the Government's ban on member borne commission payments in relation to relevant occupational schemes which are used for automatic enrolment. Schemes which would be impacted by the change will be DC schemes and hybrid schemes to the extent they are providing DC benefits. The first phase of this policy was implemented in April 2016 and prohibited member borne commission payments under new arrangements entered into by trustees from 6 April 2016 and variations or renewals of pre 6 April 2016 agreements. This second phase will extend the prohibition to cover charges being

imposed on members to recoup the cost of commission payments to advisers in relation to agreements entered into before 6 April 2016, unless the payment is made before the Regulations come into force (expected to be 1 October 2017). As such, it will catch charges such as trail commission payable under pre 1 April 2016 agreements.

Trustees of DC schemes and hybrid schemes providing DC benefits should be aware of the forthcoming changes and review existing contractual arrangements to ensure that they will be compliant with the new requirements, which are expected to come into force from 1 October 2017. Service providers, who are also required to comply with the restrictions, will be required to provide certain confirmations to trustees by specified deadlines to confirm compliance with the new requirements.

The draft Regulations are the subject of a consultation, which runs until 31 May 2017. The consultation and draft Regulations can be viewed here.

DWP consults on potential amendments to the Employer Debt Regulations

The main focus of consultation is on the application of the Employer Debt Regulations (made under section 75 of the Pensions Act 1995) to multi-employer defined benefit occupational pension schemes and, in particular, to schemes for non-associated employers. Concern had been expressed about the way in which the current Regulations may impose substantial debts upon employers in such schemes when they cease to employ active members (thereby triggering employment cessation events).

The proposal is that, in such circumstances, it should be possible for an employer to defer the requirement to pay an employer debt. This facility (described as a deferred debt arrangement) would be subject to the condition that the employer retains its responsibilities to the scheme and continues to be treated as if it were an employer in relation to the scheme. The proposal is not limited, however, to schemes for non-associated employers.

Some additional, more technical, amendments are also proposed, including changes to address issues which may arise when successive debts are triggered for the same employer and when employers are restructured.

The consultation was issued on 21 April 2017 and closes on 18 May 2017. The consultation can be viewed here.

Pension Schemes Bill 2016-17 awaiting Royal Assent

Outstanding issues on the Bill, which provides for greater regulation of master trusts, were resolved on 5 April 2017. It is expected that the Bill will receive Royal Assent before Parliament dissolves on 3 May 2017.

No adjustment to PPF Levy rules for schemes without a substantive employer

We reported in our March Update on the Pension Protection Fund's (PPF) consultation on a levy rule for schemes with no substantive employer. **The PPF has now issued a Policy Statement stating that there is no clear case for adjusting the proposals set out in the February consultation paper, and so will apply that methodology in these cases for this Levy year.** The PPF has stated that there will be a further review of the methodology before the Levy rules are finalised for the 2018/9 Levy year. The Policy Statement can be viewed here.

PPF consults on Levy rules for the next triennium

The PPF has issued its consultation on the calculation of the Levy for the three years from 2018. The PPF's proposals have been developed in consultation with Experian and industry stakeholders, and are aimed at more accurately assessing the insolvency risk across pension plans. **The PPF expects the outcome to be that two thirds of pension plans will see a decrease in the Levy, but that some plans with larger employers will see an increase.**

The PPF-specific insolvency risk model was developed with Experian and was launched for the 2015/6 Levy year. The proposals involve producing new insolvency risk "scorecards" for different categories of employers, which will more accurately take account of insolvency risk experience. The proposals also consider using public credit ratings for the largest employers, and whether to use industry specific scorecards.

Other proposals include whether the Levy should include any recognition for good governance of pension plans.

The consultation closes on 15 May 2017, and will be followed by a second consultation in the Autumn, setting out conclusions and seeking further views from stakeholders.

The consultation can be viewed here.

Regulator publishes investment guidance for trustees of DB plans

The guidance is aimed as providing trustees with practical information to support them in complying with the Regulator's Code of Practice No. 3 - Funding Defined Benefits. It forms part of the strategy to produce simpler guidance for occupational pension schemes, **and will be helpful to trustees when reviewing and taking advice on investment strategy.**

The guidance summarises the trustees' legal duties, covering, inter alia, purpose of investment, investment powers, delegation to fund managers, and taking advice.

The guidance can be viewed here.

First criminal prosecution by the Regulator for failure to comply with information notice

A solicitor and his firm have been prosecuted for failing to provide documents to the Regulator pursuant to an information notice. The judge ordered payment of fines and costs totally £16,000. Information notices are a key enforcement tool for the Regulator.

Regulator issues consultation on draft monetary penalties policy and revised professional trustee description

The consultation seeks views from industry stakeholders on:

- the general approach to the calculation of penalties
- the amount of penalties for individuals and other entities
- joint and several liability penalties
- penalties for professional trustees; and
- scheme return penalties.

The consultation also seeks views on the Regulator's revised description of professional trustees, **which identifies a professional trustee as being a trustee who acts as a trustee of a scheme in the course of the business of being a trustee, and is an expert in trustee matters.**

The consultation closes on 9 May 2017. The consultation can be viewed here.

Comments from our Pensions Disputes Group

The Court rules again on RPI/CPI

The Thales UK Pension Scheme provided career average revalued earnings ("**CARE**") benefits in respect of service from January 2008. It had also received transfer payments from the Thales Optronics Pension Scheme ("**TOPS**") whose members were entitled to benefits on a final salary basis under “the TOPS Rules”. The Court was asked to determine the construction of the rules in both the CARE section and TOPS section in relation to the way pensions were uprated.

Under both sections, increases are paid by reference to RPI, subject to certain provisos. The employer wanted to replace RPI with a different index, in this case CPI. This was possible under the CARE Section rules if the compilation of RPI had materially changed. If this happened, the Principal Employer, acting with the agreement of the Trustees, was required "to determine the nearest alternative index". This was also possible under the TOPS Section rules if the Court determined that RPI has been “otherwise altered”.

In relation to the CARE Section and the compilation of RPI being "materially changed" the Court found that a change in the compilation of RPI is material "*if it results in the RPI functioning and operating in a way which either does not fulfil its original purpose (to provide a measure of inflation for the typical household) or does so in a way which is materially different from the way in which it did so before the change*". After hearing expert evidence in relation to the indices, the Court found that the incorporation into RPI of a new housing price index resulted in a change which was "non-routine" and therefore a "material change". This meant that the employer, under the terms of the relevant rule, was required to determine the nearest alternative index.

In relation to an "alternative index", the Court held that the nearest alternative index must be the one which most closely reflects the existing elements of RPI. Following this, the Court confirmed that the nearest alternative index was RPI even with the new housing index now incorporated into it.

In relation to the TOPS Section, the Court considered that “otherwise altered "should be given a wide meaning, not limited to material changes. The Court held that the inclusion of the new housing price index had "otherwise altered" RPI.

This case is another example of how the specific wording in pension scheme rules dictates whether or not an inflation index is hard wired or can be replaced by another. As these cases turn on the specific wording of the rule in question, although they are helpful guides as to how to interpret these sorts of rules, each case should be considered based on the specific wording in the relevant rule.

Operation of a pension increase underpin

In *Dutton and Others v FDR* Limited, the Court of Appeal considered the question of how an underpin should operate in relation to increases to pensions in payment for an occupational pension scheme. The Court of Appeal reversed the High Court decision which had found in favour of members in the way in which the increase rule was interpreted. The interpretation by the High Court had increased the scheme deficit by £17 million.

Before 1991, the rules of the Scheme in question provided that pensions in payment should be increased each year at a rate of 3% compound. In June 1991, the Scheme’s rules were amended by deed to change this to an increase of the lesser of 5 per cent and LPI, purportedly in respect of past as well as future service. The Scheme had been administered on the basis that all pensions would receive an annual increase of 5% LPI for service both before and after June 1991.

The trustees applied to the High Court for directions as to how to administer the Scheme. The judge noted that the Scheme’s power of amendment provided that pensions in payment or accrued rights to a pension could not be prejudicially affected by any amendment. At the High Court, the judge held that this meant that for any member with a pre June 1991 pension, an annual approach should be taken whereby that element of pension should be increased by the higher of 3% compound or 5% LPI. This meant that, in effect, the restriction in the power of amendment meant that the 3% rate acted as an annual underpin.

The outcome at the High Court produced the most expensive result for the Scheme. However, the Court of Appeal reversed the ruling and found in favour of the employer’s interpretation of the rules. This interpretation required two calculations to be conducted for members with pre June 1991 service with the calculation that produced the better result for the member then being applied. The first calculation would consider the value of the pre June 1991 element of a pension increased year on year by 3% compound basis up to the date of the latest increase. The second calculation would consider the value of that element increased year on year by 5% LPI compound up to the date of the latest increase. The Court of Appeal concluded that this modified cumulative approach preserved the relevant right protected by the amendment power, as it enabled "a pensioner to take the benefits of the new rule if, in any given year, it produces a better outcome". The Court of Appeal also considered that this approach did least interference to the integrity of the modified scheme.

The Court of Appeal's approach, which applied the underpin cumulatively rather than annually, is one which many employer's will welcome due to its smaller financial impact on any Scheme where such an underpin operates.

Pensions Ombudsman - High Court proposes upper limit of £1,000 compensation for non-financial loss to be revised

The case of *Baugniet v Capita Employee Benefits Ltd (t/a Teachers' Pensions) and another* was an appeal from a Pensions Ombudsman determination. The determination related to a complaint about the service credit a member was given when he transferred the value of a personal pension which had been built up during previous employment to the teachers' pension scheme. However, it is the judge's comments regarding the amounts of awards for maladministration which is of particular interest. The judge noted that 1998 guidance regarding the upper limit for awards relating to maladministration not exceeding £1,000 was outdated and this should be rebased at £1,600 to take account of inflation since then. **Given that the guidance which governed these awards was published in 1998 it was not surprising that the Court felt that this should be revised. This should now be considered as the new upper limit**.

Contact us

If you wish to discuss any of these issues further, please contact your usual Baker McKenzie lawyer.

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