Baker McKenzie.

Pensions Update

May 2017

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Pensions Disputes News

Finance Act 2017 receives Royal Assent

On 27 April 2017 the Finance Bill received Royal Assent and became the Finance Act 2017. For further details, see our April 2017 Update.

Pension Schemes Act 2017 receives Royal Assent

The Pension Schemes Act received Royal Assent on 27 April 2017 and became the Pension Schemes Act 2017. For further details, see our April 2017 Update.

Government response to consultation on draft contracting-out regulations

On 26 April the government published its response to the consultation on the Contracting-out (Transfer and Transfer Payment) (Amendment) Regulations 2017. An impact assessment was also issued.

The draft Regulations propose the introduction of an easement in limited circumstances to permit the transfer of pensioner members with consent to schemes which have never been contracted out.
In its response to the consultation which ran from 10 April, the DWP recognised that whilst the

pension being paid from the receiving scheme cannot be less than that provided under the transferring scheme, the pension payment can be in a different form.

The DWP confirmed that it will be considering further changes to contracting-out transfers later in the year and commented that *"we do intend to consider extending the transfer of pensioner members to new schemes more generally in the near future together with bulk transfers that are made without member consent"*.

To access the consultation and associated documents, including the draft Regulations please click here.

Fraud compensation levy raised

The Fraud Compensation Fund (the "FCF") run by the Pension Protection Fund (the "PPF") provides compensation to eligible pension schemes which have an insolvent employer and have suffered financially due to dishonest activity. In the wake of potentially numerous claims on the FCF, **the PPF has decided to raise a fraud compensation levy of 25p per member, which is expected to make approximately £5 million.**

Collection of the levy by the Pensions Regulator (the "Regulator") commenced on 1 April 2017 alongside the general levy. For more information about the fraud compensation levy 2017/18 please click here.

Regulator's Corporate Plan published

The Regulator has published its Corporate Plan which sets out the Regulator's eight priorities for 2017-2020, which include successfully completing the remaining stages of roll out for auto enrolment, ensuring effective regulation of master trusts, and intervening early where defined benefit ("DB") schemes are underfunded or avoidance is suspected to ensure the full protection of members' benefits.

Key performance indicators will be utilised by the Regulator to determine its success in achieving its targeted priorities. Key outcome indicators will also be adopted to help evaluate the overall effectiveness of the Regulator.

To access the Corporate Plan and supporting documentation please click here.

Regulator publishes Annual Funding Statement for Defined Benefit Pension Schemes

The statement is relevant to employers and trustees of DB schemes, especially those currently carrying out actuarial valuations. It comments on key issues identified by the Regulator affecting schemes with 2017 valuations including: market conditions; risk management; affordability and managing deficits; notifiable events; assumptions, investment strategy, and employer covenant.

The Regulator confirms his commitment to ensuring that members receive their benefit entitlement at retirement, and advises a greater focus on proactive case work. The Regulator also states that he will use the full range of his powers to achieve the right outcome.

There is also commentary on fair treatment between schemes and shareholders, and likely intervention where shareholders are being prioritised at the expense of the employer covenant. **Of note to employers, the impact of dividend payments on the employer covenant is highlighted for consideration.**

To access the Annual Funding Statement click here.

Derivatives Regulation: Pension funds to benefit from further three year mandatory clearing exemption

On 4th May 2017 the European Commission issued a legislative proposal to amend EMIR (the European regulation which in 2012 introduced, amongst other things, reporting, clearing and risk mitigation obligations with respect to derivatives contracts, Regulation (EU) No 648/2012). The Commission considered a number of options concerning targeted adjustments to specific provisions in EMIR. A number of preferred policy options were identified one of which is that pension scheme arrangements (PSAs) should be provided with an extended transitional exemption from the clearing obligation. At present PSAs have a temporary exemption from the clearing obligation which runs until 16 August 2018. This proposal would extend that temporary exemption from the clearing obligation until three years after entry into force of the amending legislation with the ability of the Commission (after having carefully assessed the need for such an extension) to extend that derogation for an additional two years. Whilst this proposal will have to go through the EU process and may take 18 months to 2 years before coming into force, it signals a willingness on the part of regulators to extend the temporary exemption of PSAs from the EMIR clearing obligation until a suitable technical solution is developed by CCPs for the transfer of non-cash collateral as variation margins.

In the proposal the Commission states *"In contrast to the other options assessed, this will give CCPs, clearing members and PSAs more time to explore technical solutions and measures to facilitate them, while adhering to the objective of EMIR that the aim for PSAs remains central clearing as soon as this is feasible."*

Despite having transitional relief from the clearing obligation, pension schemes nonetheless have to comply with the EMIR margin requirements with respect to non-cleared OTC derivatives. The variation margin rules started to apply to the bulk of the derivatives market from 1 March 2017. More detail can be found here.

Pensions Disputes News

BA loses its challenge against the trustee's decision to grant discretionary pension increases

British Airways ("BA") has lost its challenge against the Trustee's unilateral decisions to grant themselves the power to award discretionary pension increases and to use this power to grant a 0.2% increase for the year 2013/14.

Increases in the Airways Pension Scheme ("APS") are linked to the Treasury's Pension Increase Review Orders ("PIROs"), due to its history as a public sector pension scheme. PIROs were moved from RPI to CPI in 2010. In order to address the likely smaller increases this would create, the Trustees amended the scheme rules to allow them to grant discretionary increases. Under the amended rules, the Trustees had to consider each year whether or not to exercise this power.

For the first few years the Trustees voted against using this power, but in 2013 they voted (and re-voted on multiple occasions, following objection from BA) in favour of granting a discretionary increase of 50% of the gap between RPI and CPI for 2013/14, namely an increase of 0.2% above the PIRO.

BA alleged that the Trustee did not have the power to award the increase, especially whilst the scheme was in deficit, that they had ignored advice and given "gratuitous" and "unearned" benefits.

Both the 2010 and 2013 recovery plans for the APS funded for the higher rate of increase under RPI. BA argued that this should not be used to justify the discretionary increases, whereas the Trustees noted that the current recovery plan would have supported an increase of up to 0.4% (being the difference between RPI and CPI).

The judge ruled that the APS rules allowed the Trustees to amend the scheme rules unilaterally "in any way" and the Trustees were therefore entitled to give themselves the power to grant discretionary increases.

He also found the eventual decision to grant a 0.2% increase under this new power had been properly taken. Although the deficit and BA's wishes were factors to be taken into account, their existence did not mean the power had been used for an impermissible purpose. The Trustees had adequately taken these and all other relevant factors into account and ignored any irrelevant factors.

The case is unusual as the trustee had a unilateral power to amend the scheme rules, which meant that it was able to grant itself discretion to award pension increases. Typically, the power of amendment will be exercisable jointly with the sponsoring employer. It is therefore unlikely that this case will result in an upsurge in trustees being granted the power to award discretionary increases to pensions where such a discretion does not exist already.

The case also highlights that the bar is a high one for employers wishing to challenge a decision taken by the trustees in exercise of a trustees' discretion, including a decision in relation to pension increases. Generally speaking, as long as a trustee can show it has taken into account all relevant factors and ignored any irrelevant factors, the decision should stand and the Court will not interfere with the decision made. The case also demonstrates the importance for trustees of recording their decision making process - the Court relied heavily on written evidence here.

We understand that BA intend to appeal the decision.

The judgment can be viewed by clicking here.

£40,000 fine imposed for employer's failure to comply with auto enrolment

The Regulator has issued a report on its decision to fine Johnsons Shoes Company for failure to comply with its auto enrolment obligations.

Johnsons failed to complete its declaration of compliance with its auto enrolment requirements and resisted engagement with the Regulator and as such the company was issued with a fixed penalty notice. Although Johnsons began communicating with the Regulator it remained non-compliant and an escalating penalty notice (the "EPN") was then issued by the Regulator.

The EPN stated that if the requirements of the compliance notice were not met by a certain date, then Johnsons would be fined £2500 per day. Despite the compliance notice specifying the steps required to comply with its auto enrolment obligations, Johnsons remained non-compliant at the prescribed deadline and the EPN was then activated. The EPN accrual ceased when Johnsons submitted its declaration of compliance, provided evidence of such compliance and when the Regulator was satisfied that the company had implemented an effective mechanism to enable the backdating of contributions. By this point the Regulator's fine amounted to £40,000.

Johnsons missed the deadline in which to challenge the EPN and therefore, in the absence of exceptional circumstances, the Regulator refused to review the fine. Johnsons then brought an out of time appeal to the First Tier Tribunal, which was also consequently struck out.

As Johnsons failed to pay the EPN, the Regulator pursued the company to the County Court to recover the amount owed. Johnsons challenge to the proceedings was based on the argument that the Regulator did not have the power to issue an EPN. The Regulator then made an application to strike out the defence on two grounds (i) that Johnsons had not displayed any reasonable grounds of appeal and (ii) that it was an abuse of process as the EPN should have been challenged through the Regulator's review process and then the First Tier Tribunal and Johnsons had missed the deadlines to proceed with any of these challenges. Johnsons at this point agreed to pay the fine and the Regulator's court fee of £2,000.

The report demonstrates the Regulator's approach to pursing employers who do not comply with their auto enrolment duties and their focus on maximising company compliance. The Regulator's Section 89 report can be viewed here.

Former trustee convicted for refusing to comply with Regulator's information request

A former trustee and charity boss has been convicted under Section 77 of the Pensions Act 2004 for failing to provide documents to the Pensions Regulator requested under Section 72 of the Act without reasonable excuse.

Mr McLarry was repeatedly asked to provide documents to assist the Regulator with an investigation into unusual scheme investments. He refused, claiming that the bank statements were protected by legal privilege and that he would be breaching French privacy law by this disclosure.

The Regulator decided to prosecute Mr McLarry, the second time it has decided to take such action, and he was found guilty and ordered to pay £6500. The District Judge imposed the financial penalty to reflect the consequences of Mr McLarry's actions on the Regulator's investigation which had been delayed and had incurred increased costs.

For more information on this case, please refer to the Regulator's press release.

Earnshaw v Prudential Assurance Company [2017] EWHC 916 (Ch)

The Trustees and Employer of the Job Earnshaw & Bros Limited Staff Pension Scheme brought a claim against Prudential Assurance Company Limited who had been the administrator of the Scheme and had provided actuarial services.

Damages were sought against Prudential for breach of its duties in respect of: (i) issuing quotations and putting into payment early retirement pensions without applying the appropriate deduction; (ii) applying the incorrect equalisation date, leading to underpayments; and (iii) other computational errors for example errors in respect of pensionable salary.

Prudential made an application for summary judgment in relation to the early retirement and equalisation elements of the claim on the basis that there was no real prospect of success in relation to these two parts of the claim. The Judge agreed with Prudential and issued the summary judgment. This was on the basis that the early retirement pensions were payable, and had been paid, in accordance with the Rules of the Scheme; and that the equalisation claim was statute barred on limitation grounds. The Judge also found no compelling reason to proceed to full trial in respect of these aspects of the professional negligence claim.

To read the full judgment, please click here.

Stop Press

The trustees of the Lloyds bank pension schemes, bank and unions are filing a Part 8 claim in the High Court seeking a ruling on whether guaranteed minimum pensions (GMPs) should be equalised and if so, what method of calculation should be used. **The decision potentially impacts all schemes with GMPs.** We will keep you updated on further developments.

Contact us

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

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