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Pensions Update

November 2018

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We are pleased to announce that the Baker McKenzie Pensions team has once again ranked highly in the legal directories, achieving Band 2 in Chambers & Partners and Tier 2 in the Legal 500. All four Pensions Partners, Jeanette Holland, Chantal Thompson, Arron Slocombe and Jonathan Sharp, are recognised as leading lawyers in the field. Robert West was also awarded the ranking of Senior Statesman by Chambers & Partners and was placed in the Legal 500 Hall of Fame for Pensions. Robert is now Senior Counsel with the Firm but continues to be an integral part of the Pensions team. We are very proud our team's achievements and are happy to see sources comment "*the team at Baker McKenzie demonstrate excellent client service and are always willing to assist.*" (Chambers UK 2019, Pensions).

EU Draft Withdrawal Agreement

On 14 November 2018 the UK Cabinet approved the Draft Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (the "Draft Withdrawal Agreement"), a legally binding document which includes provisions on the EU-UK "divorce settlement" and on the transitional period, and the Outline of the Future Relationship (a political declaration which outlines what the future relationship will look like).

If the Draft Withdrawal Agreement is ratified, the implications for sponsoring employers and trustees of defined benefit (DB) schemes will be heavily dependent on its effect on the sponsoring employer's business during the various periods envisaged under the agreement (the transitional period, any Northern Ireland backstop' period and any future relationship), including, in the case of DB schemes, any Brexit-related restructuring undertaken during any of those periods.

Various hurdles still need to be overcome before the Draft Withdrawal Agreement is ratified. If it is not ratified, the impact of a no deal scenario in a pensions context will similarly be heavily dependent on its effect on the sponsoring employer's particular business and the industry in which the sponsoring employer operates.

Sponsoring employers should continue to maintain an ongoing dialogue with the pension

scheme's trustees as they prepare their contingency plans for both a deal and no deal scenario.

To read the full alert setting out key implications for business of the Draft Withdrawal Agreement, please click here.

Pensions Regulator updates DC investment guidance

The Pensions Regulator (the "Regulator") has updated its guide to Investment Governance (which accompanies the DC Code of Practice no.13).

The guide contains two new sections:

- Impact investment, often referred to as social and/or environmental impact investment, i.e. investments that aim to deliver tangible positive impacts on society and the environment (as well as generating investment returns). The guide notes that the impact of an investment decision is a subordinate concern to the primary purpose of pension investing, which is to deliver returns. Nevertheless, the Regulator states that "*there is no barrier to investments that have a social impact as a by-product where that primary purpose is met*". It also states that trustees can choose actively to take account of impact considerations where they have good reason to believe that scheme members share their view and there is no risk of significant financial detriment to the fund.

- Patient Capital, which involves the provision of long-term finance to high potential firms to enable them to reach their full potential (e.g. start-ups). The Regulator notes that these investments are typically illiquid and would represent a small proportion of a fund's overall asset allocation. The guide recommends that trustees complete due diligence before investing to ensure they properly understand the main drivers of the expected return and how risks are managed and mitigated, as well as understanding the expected time horizon and illiquidity of the investment in the context of the scheme's overall investment portfolio.

Following *Hampshire* decision, PPF provides further guidance on approach to calculating compensation

As we reported in our September Update, the CJEU ruling in the *Hampshire* case established that pension scheme members should receive at least 50 % of the value of their accrued old age benefits if their employer became insolvent. The Pensions Protection Fund ("PPF") had previously indicated that it would be taking action to make adjustments to PPF compensation and Financial Assistance Scheme ("FAS") assistance for the "small" number of members affected. It has now issued a paper setting out a high level summary of the approach it intends to follow. The paper confirms that the PPF will pay arrears as well as correcting compensation going forward.

The PPF expects that members who are receiving less than 50 % of their entitlement will mostly be those whose PPF compensation or FAS assistance is capped and/or those for whom there is a difference between the indexation/revaluation rates that they were due in their original scheme, and in the PPF/FAS. It will be writing to members to try to obtain the necessary information to complete its records and enable corrections to be made. It will concentrate initially on capped pensioners as it believes that this is the group most likely to be substantially affected.

The paper confirms that the PPF ultimately expects the Government to introduce legislation to implement the ruling and it will be working with the Department of Work and Pensions (DWP) to try to ensure that the approach it takes now is also likely to be consistent with future legislation.

DWP publishes consultation on Collective Defined Contribution ("CDC") schemes

On 6 November 2018, the DWP published a consultation document entitled "Delivering collective defined contribution pension schemes" to gather views from the pensions industry on how CDC schemes might operate and be regulated.

The type of CDC scheme envisaged by the consultation (and for which new legislation would be

required) is one where contributions into the scheme are pooled and invested with a view to delivering a target benefit level to members. However, the benefit level offered is only a target or an estimate, i.e. it is not guaranteed by the employer like a defined benefit (DB) pension. This means that members will need to be made aware that the benefit levels aspired to may not be achieved and that the level at which pensions are paid or prospectively payable may go down, while the rate at which benefits are uprated each year will be subject to a degree of uncertainty.

The consultation acknowledges that Royal Mail and the Communication Workers Union have done a significant amount of work to establish a proposed CDC scheme structure, and that such schemes may be of interest to others in the industry. The document contains several detailed questions on the possible structure of CDC schemes in areas such as scheme structure, scheme funding and member communications. The consultation closes on 16 January 2019 and is available to view here.

Competition and Markets Authority consults on definitions of investment consultancy and fiduciary management services

In our July 2018 Update, we reported on the consultation on the Investment Consultants Investigation Provisional Decision Report by the Competition and Markets Authority ("CMA"). The CMA's main provisional findings were that it had identified competition problems within both the investment consultancy and in the fiduciary management markets. The CMA proposed several changes, including that trustees will have to run a competitive tender process when appointing their first fiduciary manager (and trustees who have already appointed a fiduciary manager must re-tender within five years).

On 2 November 2018, the CMA published a consultation paper containing draft definitions of "Investment consultancy service" and "Fiduciary management service" for the purposes of potential remedies that the CMA may impose following the publication of its final report. The CMA confirmed in its consultation that it is still working towards issuing its final report in December 2018.

Pensions Disputes News

CJEU rules that part-time judge entitled to pension calculated on the whole of his period of service

Initial proceedings in the long running *O'Brien* case, which first reached the CJEU in 2012, had established that Mr O'Brien, a retired part-time judge, who was paid on a daily fee basis, was entitled to a pension on the same (pro-rated) basis as a full-time, salaried judge. The case was then sent back to the UK courts to determine how much pension Mr O'Brien should receive. A point of difference arose between Mr O'Brien and the Ministry of Justice as to whether or not the pension should include periods of service before 7 April 2000 - the last date by which the UK was required to transpose the Equal Treatment Directive. In Mr O'Brien's case, this meant the difference between 27 years' and 5 years' service being taken into account.

The UK courts came to differing conclusions on this point, but the CJEU accepted Mr O'Brien's arguments in its preliminary ruling that counting service prior to the Directive did not equate to a retroactive application of the law. ***It has now ruled that Directive 97/81 should be interpreted as meaning that periods of service completed prior to the deadline for transposing that directive, which would have been taken into account when calculating the pension of a full-time worker, also have to be taken into account when calculating the pension entitlement of a comparable part-time worker***. The judgment appears to apply to part-time workers generally, not just to members of the Judicial Pension Scheme. The case has been remitted to the Supreme Court for a final judgment.

Supreme Court dismisses the appeal in the Barnardo's case

The Supreme Court has rejected the appeal brought by Barnardo's in relation to the correct

interpretation of the indexation and revaluation rules in the Barnardo Staff Pension Scheme, agreeing with the Court of Appeal that the trustees in this case did not have the requisite power to shift their inflation-protection increase rates from an RPI to a CPI basis.

As was the case in the Court of Appeal, the parties put forward two different interpretations of the relevant definition of "Retail Prices Index" under the Barnardo scheme's rules, which was defined as the "*General Index of Retail Prices published by the Department of Employment or any replacement adopted by the Trustees without prejudicing Approval*". Barnardo's, as the employer, advanced that this definition required a one-stage test, i.e. the provision meant RPI or any index adopted by the trustees as a replacement for RPI, whereas the trustees of the pension scheme and the representative beneficiaries contested that it was a two-stage process, i.e. the provision meant RPI or any index that replaces RPI and that is then adopted by the trustees.

The Supreme Court agreed with the Court of Appeal that it was a two-stage test. The judge who delivered the judgment gave eight reasons for his decision, but his primary arguments focused on the wording in the rules. He commented that "replacement" did not naturally suggest the selection of an alternative to an option which remained available, and also that the word order of the phrase "*a replacement adopted by the trustees*" suggested a sequence of events, i.e. that RPI should first be replaced as an available index. The judge also commented that the draftsman in this case did not appear to have foreseen circumstances in which RPI would cease to be considered as an appropriate index for the costing of living, and that "*only by relying on hindsight can weight be given to this consideration; and that is not legitimate*".

As has been the case with other RPI/CPI cases coming through the courts in recent years, the conclusions of this judgment are relatively scheme-specific, meaning that trustees should consider the precise wording in their rules to assess whether a shift can be made from RPI to CPI.

Contact us

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

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