Trustee Knowledge Update – May 2018

Welcome to the May 2018 edition of our Trustee Knowledge Update which summarises recent changes in law and regulation. It is aimed at helping trustees (including trustee directors) comply with the legal requirement to have knowledge and understanding of the law relating to pensions and trusts. This edition focuses on the key legal developments over the last three months.

Government and legislation

Finance Act 2018

This Act changes the requirements for registration and de-registration of occupational pension schemes where an employer is dormant (from 6 April 2018) or where the scheme ceases to be an authorised master trust (expected to be from October 2018 when the new master trust rules are anticipated to come into force).

> **Action points:** For information only at this stage. HMRC has not provided any further clarity for schemes with supportive sponsoring employers who may technically fall within the "dormant" definition.

Financial Guidance and Claims Act 2018

This Act provides for regulations to be banning cold-calling and other unsolicited contact in relation to pensions. Of more direct relevance to trustees will be regulations requiring additional signposting for members, encouraging them to seek guidance before making important decisions about accessing or transferring their benefits.

> **Action points:** Once the new signposting regulations are published, trustees should be reviewing their member communications and ensuring administrators adapt their systems to identify when the new information must be provided.

Data Protection Bill

The Data Protection Bill continues its passage through Parliament, although we are anticipating that it will receive Royal Assent by the time the General Data Protection Regulation comes into force on 25 May 2018. Recent amendments to the Bill include a helpful broadening of the provision which enables trustees to hold special categories data (for example relating to health or sexual orientation) without the explicit consent of the data subject.

> **Action points:** GDPR will be upon us on 25 May (although the ICO is heralding this date as the start of the process rather than the end). Priority should be given to issuing privacy notices to members and putting in place contractual agreements with the main data processors (including the scheme administrator).

Government White Paper – Protecting DB Pension Schemes

The White Paper, published on 19 March, includes a number of proposals for the better protection of DB pension schemes. These include enhanced powers for TPR, a new DB scheme funding code of practice (which will focus on long-term strategies) and new models for the consolidation of DB schemes. For more information on this, please read our Law-Now article.

> **Action points:** No immediate action required but trustees may want to participate in the various detailed consultations which will follow.

Consultation on corporate governance and insolvency

Following hot on the heels of the White Paper is a consultation from the Department for Business, Energy and Industrial Strategy which sets out proposals to improve the corporate governance of companies which are in or approaching insolvency. A key proposal is the introduction of new measures to penalise directors of parent companies where they make a decision to sell an insolvent subsidiary in circumstances which harms creditors (including pension schemes). It also invites input on whether reforms are required to the rules regulating dividend payments, one concern being the payment of dividends where there is a large pension deficit. Consultation closes on 11 June.

> **Action points:** No action required, unless trustees wish to participate in the consultation. Some aspects of the consultation are clearly focussed on how pension schemes can be better protected in the light of the BHS and Carillion experiences.

Disclosure of DC transaction costs and charges

Amending regulations provide that trustees of schemes caught by the 2015 DC governance requirements (broadly most schemes providing DC benefits other than just AVCs) must now also:

- include in the Chair's statement information on the levels of charges and transaction costs for each default arrangement and each fund which members are able to select;
- include in the Chair's statement an illustrative example of the cumulative effect of those charges and costs over time on the value of a member's DC benefits; and
- publish certain information (in accordance with DWP guidance) on transaction costs and charges taken from the Chair's Statement, free of charge, on a publically available website.

> **Action points:** Trustees should familiarise themselves with the new Chair's statement and publication requirements and ensure that the required information is obtained from investment providers.

Bulk transfer of DC benefits without member consent

Regulations came into force on 6 April which amend the Preservation Regulations to enable bulk transfers of pure DC benefits without member consent where:

- the receiving scheme is an authorised master trust;
- the transferring and receiving employers are associated and the members are current or former employees; or

- the trustees have taken and considered appropriate advice from someone independent of the receiving scheme.

The DWP has issued guidance for trustees which looks at what an "appropriate adviser" might be and how the trustees should determine that it is independent from the receiving scheme. The guidance also suggests good practice in selecting an adviser, what the advice should cover and how trustees should go about assessing the receiving scheme. It confirms that "not every aspect of the receiving scheme must be equal or superior to the transferring scheme for trustees to conclude that the proposed transfer is in the members' interests" and that it is desirable but not critical to maintain the "absolute value" of the member's pot.

Action points: Trustees asked by the employer to consider a bulk transfer should carefully consider the terms of the new regulations and guidance, always remembering their overriding duties to act for the proper purposes of the scheme taking into account the best interests of the members.

Bulk transfer of contracted-out rights without member consent

Regulations came into force on 6 April which enable bulk transfers of contracted-out rights to take place in certain circumstances without member consent, to schemes that have never been contracted-out. The provisions apply only to "connected employer transfers". Consent will still be required for unconnected transfers.

Action points: These regulations will assist trustees and employers wishing to restructure or merge schemes which hold contracted-out rights.

Employer debt – new deferred debt arrangements

The employer debt regulations now include a new "deferred debt arrangement" (DDA) option for multi-employer schemes. A DDA will prevent the automatic debt trigger that would otherwise occur on an employer exiting the scheme, although it will continue to be treated as an active employer for the purposes of scheme funding and the Scheme Administration Regulations.

In order to enter a DDA the trustees must be satisfied that the deferred employer's covenant to the scheme is not likely to weaken materially within 12 months and that the scheme is unlikely to enter PPF assessment. Any decision to enter into or terminate a DDA is a notifiable event. A DDA will come to an end in a number of circumstances, including: by agreement of the trustees and employer; the employer becomes insolvent; the scheme starts winding up; the employer "restructures"; or the trustees serve notice on the employer in specified circumstances including where they are reasonably satisfied that the employer's covenant is likely to weaken materially in the next 12 months.

Action points: This gives employers a further option for managing employer debt, although the wide circumstances in which trustees may end a DDA may deter them from using it where other methods are available. Trustees asked to enter a DDA should take appropriate advice and note the new notifiable event reporting obligation.

Regulations confirming various increases and uprating percentages from 6 April 2018

A whole raft of regulations have been passed confirming increases from 6 April 2018 including:

- the qualifying earnings band for automatic enrolment will be between £6,032 and £46,350. The earnings trigger remains at £10,000;
- the first transitional period for money purchase automatic enrolment contributions ends and minimum contribution levels increase. The exact requirement will depend on which quality requirement the scheme is using;
- the higher and lower percentages for statutory revaluation and increases are 3% and 2.5% respectively;
- GMP revaluation and increase rates are both 3%.

Action points: Trustees should ensure that scheme administrators are applying the correct rates.

Regulator (www.pensionsregulator.gov.uk)

Annual Funding Statement

TPR's annual funding statement (AFS) sets out what it expects of trustees and employers in relation to DB funding. It is of particular relevance to schemes with effective valuation dates between 22 September 2017 and 21 September 2018 ('T13' schemes). Key points in the AFS include:

- Trustees are expected to focus on integrated management of the three broad areas of risk: covenant, investment, and funding.
- Trustees should have contingency plans in place which should, where possible, include legally enforceable rights of recourse (e.g. secured assets).
- TPR is concerned about the growing disparity between dividend growth and stable deficit repair contributions. Where dividends appear unreasonable relative to contributions TPR expects trustees to negotiate "robustly" with the employer to secure a fair deal.
- Trustees should be alert to other forms of "covenant leakage". This might include intra-group loans which reduce cash availability, transfers of assets at below-value or trading mechanisms to remove cash from the employer.

Action points: Although aimed at T13 schemes, the issues raised in the AFS are relevant for trustees of all DB schemes and should form part of their risk management considerations and ongoing discussions with employers.

TPR guidance on cyber-security principles for pension schemes

In this guidance, TPR defines "cyber risk" as the risk of loss, disruption or damage to a scheme or members as a result of the failure of its IT systems and processes, whether internal (e.g. unauthorised staff access) or external (e.g. hacking). The remedy is to build "cyber resilience" and to have an incident response plan designed to help the scheme respond quickly and protect its operation as far as possible. Cyber risk should be part of the scheme's ongoing risk register.

Action points: Trustees should consider this guidance carefully and take appropriate advice on how to build cyber resilience and have in place an appropriate incident response plan.

21st Century Trusteeship – advisers and service providers

TPR has issued the sixth module of its 21st Century Trusteeship project. It includes sections on selecting and appointing advisers, risk management and business continuity plans.

Action points: Trustees should familiarise themselves with the 21st Century Trusteeship materials as part of their ongoing training and development.

Managing Service Providers Statement

TPR has issued a statement summarising its expectations of good practice by trustees in the management of service providers, including planning for events which could have major consequences for their schemes such as the failure of a service provider. It reminds trustees that they remain accountable for the good administration of their schemes and should put in place sufficient controls around third party providers.

Action points: A key skill for trustees is the ability to effectively manage commercial relationships. It is also important to have a workable contingency plan in place for when things go wrong.

HMRC (www.hmrc.gov.uk/pensionschemes/index.htm)

Money laundering – change of approach by HMRC for pension schemes

HMRC has confirmed in Newsletter 98 that registered pension schemes do not need to register separately with the Trust Registration Service (TRS) where they have incurred one of the specified tax liabilities. Previous guidance from HMRC had required trustees of schemes incurring liability to certain taxes including SDRT and SDLT to register with TRS.

Action points: This is a welcome step from HMRC. Further guidance is still awaited to clarify whether schemes which have already registered with TRS need to take any steps to de-register.

Cases

Burgess & others v BIC UK Ltd (High Court)

The main question in this case was whether annual pension increases which had been awarded from 1992 were in fact being validly paid under the scheme rules. There was then an intriguing follow-up question as to whether, if not, the trustees could seek recovery of all overpayments made or whether limitation principles intervened to prevent this.

Much of the detailed judgment concerns the evidence of the events in 1991 and 1992 when the purported decision to award the disputed increases was made and implemented. Minutes of a February 1991 trustee meeting ("the 1991 minutes") stated that steps had to be taken to reduce the surplus in the scheme and that part of the surplus would be used to increase pensions by the lower of RPI or 5%, at the discretion of the trustees. The 1991 minutes went on to say that the trustees had resolved to carry out this action "as soon as possible". There were, however, no records of a resolution, or any pensions increase proposal, in employer board minutes over this period.

The trustees argued that they had decided to make pension increases in February 1991 and that the employer had agreed. The employer disputed both points. However the judge accepted the trustees' argument that resolving that "that the proposed action be carried out as soon as possible" meant their decision needed no further action by them. The judge recognised that there was no board minute recording any decision by the employer to approve the grant of the increases. However, he accepted the evidence of the key witnesses (who were executive directors of the employer at the time, as well as trustees) that the employer had in fact agreed to pay them.

Having made these findings of fact, the judge turned to the question of legal validity. Having carefully considered governing documents from both 1977 and 1993, the judge decided, on balance, that the increases had been validly made.

Despite finding that the increases had been validly granted, the judge went on to consider the extent to which the trustees would have been able to recover past overpayments, had his decision gone the other way. These comments do not form part of the decision and so will not be binding in future cases.

The trustees argued that the employer should be prevented from going back on the parties' common assumption that the increases were valid, and on which basis both parties had conducted their dealings. However, the judge agreed with the employer that if the trustees tried to restrict the employer in that way it would be a breach of their fiduciary duties: they would be preferring the interests of members who would benefit if the disputed increases were payable over the interests of those who would not, at a time the scheme was substantially in deficit.

The employer went on to argue that on the assumption the increases had not been validly granted, the trustees would be under a duty to exercise their equitable right of 'recoupment' to recover the overpaid sums from future pension payments. The trustees argued (citing the recent High Court case of *Webber*) that recovery of overpayments through recoupment was subject to a six-year limitation period under the Limitation Act 1980. However, the judge accepted the employer's argument that recoupment was an equitable remedy which was not subject to a limitation period.

Action points: Of most interest to many trustees will be the judge's comments on the non-application of limitation periods to recoupment. Trustees considering seeking to recover overpayments by reducing future pension payments should take advice. The contrasting cases of *Webber* and *BIC* have created some uncertainty in this area.

Air Products Plc v Cockram (Court of Appeal)

This claim concerned a former employee's long term incentive plan (LTIP). "Retirement" under the LTIP was defined as leaving company service "on or after a customary retirement age" and with a right to receive immediate pension benefits.

The claimant was a member of the employer's DB scheme, with a protected early pension age of 50. However, when he left employment at 50 and took his DB benefits, the employer did not allow him to take his options under the LTIP, saying that he was not retiring at "customary retirement age", which it said was 55 (the retirement date under its new DC scheme). The employer accepted that this policy constituted direct age discrimination, but argued that it was justifiable under the Equality Act.

The Court of Appeal held that the discriminatory effect was objectively justified on the basis that the employer wished to achieve intergenerational fairness, reward experience and loyalty, and ensure a mix of generations of staff, and that applying the LTIP only to employees over 55 was a proportionate means of achieving that legitimate aim.

> **Action points:** An interesting and helpful case showing how even direct age discrimination can be justified in appropriate circumstances.

Shannan v Viavi Solutions UK Ltd (Court of Appeal)

The crux of the case was whether the scheme's principal employer was its original principal employer (Viavi) or Viavi's holding company (Management); and, in particular, whether a 1999 Deed replacing the scheme rules, which had been executed by Management (purporting to act as principal employer) and the trustees, was valid. The evidence showed that following a trustee meeting held shortly before the 1999 Deed was executed, both the trustees and employer representatives had wrongly assumed that Management was already the principal employer, and that it had validly replaced Viavi as principal employer some years earlier.

In 2016 the High Court decided that the 1999 Deed could be construed as providing Viavi's agreement to Management becoming the principal employer, despite the fact that Viavi was not a party to the 1999 Deed. The judge said that as Viavi was a wholly-owned subsidiary of Management, Management's consent was effectively Viavi's consent. Taken as a whole, the language of the deed achieved the parties' intention (to make Management the principal employer) and would be understood as such by a reasonable person with a background knowledge of the parties.

The Court of Appeal dismissed the employer's appeal, deciding that the substitution of the principal employer had been valid. It rejected arguments by the employer that the documentary evidence did not support the factual basis for the High Court's decision.

Interestingly, the judge, went on to consider whether the so-called "presumption of regularity" (the legal principle under which a court may presume that documents or proceedings have been properly completed in their usual manner) might have applied. She said that the presumption was of no assistance on the facts, agreeing with the judge in the *Entrust* case in 2012 that it was no more than a statement of the inference it was normally appropriate to draw in a given situation where primary evidence was lacking. The presumption was also directed at formalities, rather than parties' intentions.

> **Action points:** Yet another reminder of the importance of complying with scheme formalities. This was a practical outcome to a very technical claim. A finding in favour of the employer would have brought into question the validity of many changes made to the scheme, including the 1999 replacement rules under which it had been operating for nearly 20 years.

Miscellaneous

Data Protection - payment of ICO fees

A new ICO fee regime replaces registration with effect from 25 May. There are three Tiers of fee depending on turnover or number of staff with the maximum being £2,900 in Tier 3. The ICO will be writing to existing registered data controllers (including pension scheme trustees) indicating which Tier they believe they are in. Fees will not be due until 12 months after the last registration payment was made.

> **Action points:** Trustees should expect to receive a letter from the ICO at some point in the next 12 months. There is an exemption from the fee for "not for profit" organisations but it seems unlikely that pension scheme trustees will fall within it.

Ombudsman (www.pensions-ombudsman.org.uk)

For the latest on The Pensions Ombudsman and his work, please ask your regular CMS contact for a copy of our quarterly Pensions Ombudsman Update.

Dates for diaries: Trustee training remains one of the most important ways of ensuring that trustees have the knowledge and understanding required to perform their duties. We will be holding trustee training on 12 June 2018. If you have any enquiries about this course or would like to reserve a place, please contact **Megan Thorogood – E:** megan.thorogood@cms-cmno.com.

If you are interested in any additional trustee or employer training, please contact **Kieron Mitchinson** - **E:** kieron.mitchinson@cms-cmno.com who can provide you with a list of our current training topics or discuss any particular training needs you might have.

General: For further information on our pension services, please contact **Mark Grant – E:** mark.grant@cms-cmno.com, **T:** +44 (0)20 7367 2325 or your usual pension partner. Please also visit our website at **www.cms.law**.

The Pensions team is part of the CMS Financial Markets and Pensions group and advises employers and trustees of schemes varying in size, from a few million pounds to the largest schemes in the UK. Additionally, we act for some of the largest firms of administrators, actuaries, consultants, brokers and professional trustees. We provide a full range of services in connection with occupational pension schemes, including all aspects of employment and EU law. The team also works closely with our corporate lawyers, providing support on mergers and acquisitions, insolvency lawyers supporting us on employer covenant issues, and the financial services team which specialises in regulatory and fund management matters.