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Trustee Knowledge Update – August 2018

Welcome to the August 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

Consultation on strengthening TPR powers in relation to defined benefit schemes

Following on from the White Paper reported in the May TKU, the DWP has issued [consultation](#) on a number of proposals for extending and strengthening TPRs powers and protecting pension schemes on corporate transactions.

The proposals include introducing more employer-related notification events and earlier reporting. The new notifiable events proposed include the sale of a material proportion of the business or assets of a scheme employer which has funding responsibility for 20% or more of scheme liabilities and the granting of security on a debt to give it priority over debt to the scheme.

A new requirement to issue a “declaration of intent” will arise on the sale of a controlling interest in a sponsoring employer, sale of business or assets of a sponsoring employer and granting of security in priority to scheme debt. The declaration will be addressed to the trustees and must explain the nature of the transaction, the consultation with the trustees and how any detriment to the scheme will be mitigated.

Existing civil penalties will remain for “low-level” non-compliance but there will be a new power to issue a civil penalty of up to £1m for more serious ones (these will have to “have resulted in actual harm to the pension scheme or have the potential to do so if left unchallenged. There will also be new criminal offences for wilful or grossly reckless behaviour in relation to a DB scheme, non-compliance with a contribution notice and failure to comply with the notifiable events framework.

Action points: Assuming these proposals come into force as planned (which will not be until 2019 or 2020) trustees should be getting early notice of significant events affecting the employer covenant. TPR will expect them to respond robustly where necessary.

Consultation on Pension Funds and Social Investment

The DWP has [consulted](#) on draft regulations “clarifying and strengthening trustees’ investment duties”. The proposed regulations extend the requirements of the statement of investment principles (SIP) and require trustees of schemes offering DC benefits to publish their SIP.

The new SIP requirements are proposed to apply to all schemes (DB and DC) with more than 100 members with effect (as currently planned) from 1 October 2019 (i.e. schemes will have to have a new compliant SIP in place by that date). The SIP (and any default strategy where one is required) must include the trustee’s policy in relation to “financially material considerations” including how those considerations are taken into account in the selection, retention and realisation of investments.

“Financially material considerations” are defined as including “environmental, social and governance considerations (including climate change)”. Climate change is referred to as a specific item as the Government considers it is “a systematic and cross-cutting risk” and also, in presenting it as a separate item, it makes clear to trustees that it is not the only development which presents environmental risks and opportunities.

The SIP must also contain the trustee’s policy on “undertaking engagement activities” in respect of their investments with “relevant persons” about “relevant matters”. This is widely drafted. Relevant persons include the investee company, investment managers and co-shareholders. This is an acknowledgement that many trustees will not have the opportunity for direct engagement with the investee company. The relevant matters on which the trustees might engage include social and environmental impact and corporate governance as well as performance, strategy and risk.

The draft regulations also require trustees to prepare a statement explaining the extent to which the views held by members (including the views they hold on non-financial matters) will be taken into account. This requirement will not kick in until the next SIP amendment on or after 1 October 2019.

The draft regulations also include requirements for trustees of schemes with DC benefits to publish their SIP and their statement of member engagement on a publically available website.

Action points: For information only at this stage. These proposals follow on from the recommendations of the Law Commission.

Regulator (www.pensionsregulator.gov.uk)

Revised quick guide to the Chair’s Statement

TPR has published an updated [quick guide](#) for trustees of schemes with DC benefits on preparing a Chair’s Statement. It replaces the original issued in November 2017. It is accompanied by a [Technical Appendix](#) which lists all the requirements and the relevant parts of the legislation. TPR has been reported as saying that the new guide will be applied retrospectively and all Chair’s Statements will be considered against it.

The guide is more detailed than the previous version, giving examples both of what TPR expects to see and of some common mistakes. It also includes the new requirements for reporting and assessing charges and transaction costs which came into force in April 2018.

Leaders in Pensions

The failure to produce a compliant Chair's Statement gives rise to a mandatory fine of between £500 and £2,000.

Action points: In our experience TPR is applying an extremely strict approach to its reviews of Chairs' Statements. It has issued fines against trustees who have prepared Chair's Statements in good faith but which contain minor defects. In TPR's view, the legislation does not give it discretion not to fine in these circumstances. It is therefore extremely important to ensure that future Chair's Statements comply fully with the legislation and guidance.

21st Century Trusteeship – Managing Risk and Managing Conflicts

TPR has issued the [seventh](#) and [eighth](#) modules of its 21st Century Trusteeship project. These consider respectively risk management and managing conflicts.

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

Trustee fined £25,000 for failing to submit actuarial valuations

TPR has published a [determination notice](#) in which it fines a corporate trustee £25,000 for failing to submit its scheme's 2012 and 2015 actuarial valuations on time. During a period of engagement of almost two years with TPR the trustee missed a number of agreed deadlines. The trustee had suggested that the valuation had not been finalised because an imminent merger with a larger scheme within the group was proposed. TPR made it clear that this was not a reasonable excuse.

In assessing the level of fine, TPR referred to its Monetary Penalties Policy. It considered that the breach was towards the top end of "band 2" and that the starting point should be £20,000. It then considered that in view of a list of aggravating factors (including previously late 2006 and 2009 valuations, failure to report the breach in a reasonable time, failure to meet agreed deadlines, lack of reasonable excuse for the delays, a "flagrant disregard" of its legal obligations and the trustee being a professional trustee) that the final penalty should be £25,000.

Action points: TPR has been under scrutiny recently (not least from Frank Field) and here we see it being tough with a trustee, albeit nearly five years after the valuation was due. One of the criticisms of the trustee was its failure to engage with TPR earlier in the process. TPR has made it clear that it does not want trustees to agree an inappropriate valuation just because a deadline is imminent or has been missed. Rather they should contact TPR for assistance.

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

Newsletters 99, 100 and 101

Highlights from HMRC's monthly newsletters in May, June and July include:

- Clarification of the guidance on errors in situations where the mistake has been made by an IFA;

- A reminder about HMRC's policy on confirming registered status for the purpose of transfers;
- Confirmation that from April 2019 the Welsh Assembly will be able to set income tax rates for residents; and
- A reminder that there is no time limit within which HMRC must register a scheme, but if it has not done so within 6 months of an application then the applicant can appeal to the tribunal as if registration had been refused.

Action points: For information only.

New Manage and Register Pension Schemes service

HMRC has confirmed the launch of its new platform for pension schemes. Matters dealt with by the service include the registration of scheme administrators, the registration of schemes and the management of registered schemes. Initially the service is for new registrations only. Existing schemes will be transitioned in due course.

Action points: This for information only. No active steps are required at this stage.

Cases

British Airways PLC v Airways Pension Scheme Trustee Ltd (Court of Appeal)

In an important decision on the scope of trustee powers under a pension scheme, the majority of the Court of Appeal has ruled that the trustees of BA's Airways Pension Scheme did not act for a proper purpose in amending the Scheme rules to allow discretionary pension increases to be paid to members, and in subsequently using that power to award an increase.

The original backdrop to these proceedings was the Government's decision in 2010 to change statutory minimum pension increases from RPI to the generally lower CPI basis. This had a knock-on effect of reducing pension increases payable under the Scheme, which provided for annual increases to be paid based on statutory orders.

The trustees decided to use their unilateral amendment power to introduce a rule allowing them to award discretionary annual increases, subject to taking appropriate professional advice. In 2013, they used this new power to award additional pension increases for that year of 50% of the difference between CPI and RPI. Last year, the High Court held that the trustees had been entitled to do so. It also found that a restriction in the Scheme's objects clause, which prohibited "benevolent or compassionate payments", was not infringed merely because the effect of the trustees' award was 'generous' to members.

The employer contended that by making the amendment, and exercising the new power, the trustees had stepped outside their legitimate role in relation to the Scheme (the Scheme's Trust Deed described their function as to "manage and administer the Scheme"), and assumed the role of 'paymaster' in the employer's business. It argued that the combined exercise of the amendment and new increase powers had the effect of setting, rather than delivering, the remuneration which it paid its current and former employees in the form of pensions.

Leaders in Pensions

In the Court of Appeal, Lewison LJ said that the amended Scheme rules would have purportedly given the trustees unlimited power to design the scheme and this did not correspond with their function under the Trust Deed. In seeking to give themselves responsibility for designing the Scheme's benefit structure, as opposed merely to managing and administering it - in circumstances where the Scheme was in deficit and the employer would have to fund the additional benefits - the trustees had gone beyond the proper purpose of their power of amendment.

Peter Jackson LJ agreed, placing emphasis on considering the amendment power in the context of the purpose of the Scheme as a whole. The Scheme rules already provided for specific situations in which the employer could be required to pay more, but contained no provision for unilateral discretionary increases by the trustees. He agreed with Lewison LJ that the description of the trustees' role in the Trust Deed was significant; and that there was a conceptual distinction between a scheme in surplus and a scheme in deficit. The purpose of the amendment power under the Scheme was to give the trustees "a wide power to make those changes which may be required by the exigencies of commercial life". It could not be used for purposes contrary to the Trust Deed.

It is worth noting the dissenting judgment of Patten LJ, who described the purpose test set out by his colleagues above as one which would put trustees "in a position of complete uncertainty about the scope of their powers." In his view, the changes made to the Scheme included a number of safeguards, and adequate protection for the employer was provided by the fact that the trustees had to exercise their powers under the Scheme in good faith and a proper trustee-like manner.

There was, however, unanimity from the Court on the other issue appealed by the employer. All three judges agreed with the High Court's assessment that there had been no breach of the restriction preventing "benevolent or compassionate" payments.

The decision turned to an extent on the facts of the case, which the Court accepted were novel. However the judgment also considers some of the key previous case law on the exercise of trustee amendment powers.

We understand that an appeal to the Supreme Court is being considered.

Action points: Any case at Court of Appeal level which discusses the fundamental purpose of a pension scheme and the role of its trustees is one that justifies careful consideration by both trustees and employers.

G4S plc v G4S Trustees Ltd

This case concerned the question of whether members of a scheme which has closed to accrual but who maintain a final salary link are "active members" for the purposes of the employer debt legislation.

Active membership is defined by reference to whether the members are in "pensionable service". The judge noted that the definition of pensionable service had two limbs. The first was the requirement for service in any description or category of employment to which the scheme related; the second was the requirement that it qualified the member for pension or other benefits under the scheme. In relation to the second limb, the concept of pensionable service was not identical to the year-on-year accrual of pension benefits,

but it was clear as a matter of statutory construction that where accrual had ceased but final salary linkage remained, there was no pensionable service after the closure date. That was because there was no service under which pension benefits continued to accrue. The final salary link was a way of quantifying the benefit which had already accrued at the closure date.

As the members were no longer active members, the scheme was already a frozen scheme.

Action points: This is a helpful decision for both trustees and employers of multi-employer schemes which are closed to accrual but maintain a final salary link. It clarifies that such schemes are "frozen" and therefore an employer debt will not be triggered when an employer ceases to employ any final salary link members.

ITV PLC v The Pensions Regulator (Upper Tribunal)

This case concerns the "moral hazard" powers of TPR, in particular in relation to financial support directions (FSDs). In December 2011, TPR issued an FSD against five companies in the ITV group in relation to the Box Clever Group Pension Scheme. Box Clever was a joint venture arrangement set up in 1999 by Granada (now ITV) and Thorn and financed by £860m debt, none of which was secured on assets of Granada or Thorn. Granada received approximately £530m as a result of the transaction. The Box Clever Group went into receivership in 2003. In 2004, Granada became part of ITV. By the end of 2009, the Scheme had a deficit of £62m. The current deficit is estimated at £115m.

In early 2012 the Determinations Panel of TPR concluded that it was reasonable for TPR to issue FSDs, even though they related to events which had happened between 1999 and 2003, and TPR did not come into existence until April 2005. In addition, although ITV did not exist until 2004, it stood in the shoes of Granada as the ultimate parent company of the group which benefited from the JV's formation, meaning that it was reasonable to issue an FSD against it. Granada did not directly control Box Clever, but it had a representative on its board and was involved in establishing and overseeing the Scheme. This gave it sufficient control over Box Clever and the Scheme to make it reasonable to issue the FSDs.

In summary, the Upper Tribunal held that TPR had been justified in seeking to issue FSDs and that it was reasonable for ITV to be asked to provide financial support to the Scheme.

There are some interesting findings on the role of the trustees. The target companies had criticised the trustees for being too slow to close the Scheme to accrual and in not seeking to wind it up. The Tribunal did not think that postponing the wind-up decision significantly shifted responsibility for the deficit from the target companies to the trustees. However, the trustees' actions were not irrelevant, and "[t]he question of what account should be taken as regards the increase in the deficit attributable to this period should be left to be determined as a part of the process for determining the level of financial support to be provided".

The targets also contended that the *ITS v Hope* case established that trustees could not take account of the availability of PPF compensation when making decisions about the future of a scheme. However, the Tribunal said

Leaders in Pensions

that *Hope* had not laid down a general principle as to when trustees could legitimately take PPF availability into account: that was to be considered on a case-by-case basis. In this case, the trustees' aim was not to ensure that the PPF would be available to provide compensation, but to avoid PPF entry occurring through its negotiations with the shareholders or, if those failed, the TPR moral hazard process. *"The fact that the Trustee knew that the PPF would be available were neither of those objectives realised, does not in our view make the Trustee's strategy impermissible"*. The trustees' actions were perfectly consistent with the PPF's statutory purpose of providing a safety net for underfunded schemes.

Action points: Although mainly of interest to TPR and employers, the judgment includes some findings on the role of the trustees including the considerations they should give and the actions they should take when an employer fails. The Tribunal gives helpful guidance on the extent to which trustees can take into account the existence of the PPF when making important decisions about the future of the scheme.

Miscellaneous

Pension Scams Industry Group (PSIG) updated voluntary code

The PSIG has published version 2 of its [Code of Good Practice on Combating Pension Scams](#). The core principles behind the Code are unchanged (raising awareness of scams, having robust but proportionate processes in place, and being aware of known current scam strategies), with the update intended to reflect "a new world of pension scamming" (including the growth in international SIPPs and GROPS).

The new version:

- strongly recommends making an early telephone call to transferring members, as part of the due diligence process;
- encourages the referral of "insistent customers" to TPAS;
- says that if possible Scorpion guidance / scam awareness material should be provided in retirement packs as well as transfer packs;

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 10 October 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.

The information in this publication is for general purposes and guidance only and does not purport to constitute legal or professional advice. It is not an exhaustive review of recent developments and must not be relied upon as giving definitive advice. The Update is intended to simplify and summarises the issues which it covers. It represents the law as at 7 August 2018.

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- includes new suggestions for appropriate due diligence such as asking members about investment choice; where advice is required, checking where that advice is coming from; and checking that the entity has not been "cloned";
- makes changes to the list of questions for members including adding reference to investment, and to looking for indications of potential customer vulnerability; and
- places much stronger emphasis on suggesting, where scheme administrators get HMRC's "response 2" (confirmation of registered status will not be provided), that it is difficult to justify making a transfer and that receipt of the letter may be sufficient justification, alone, to refuse to transfer.

Action points: The code took immediate effect on its publication on 22 June and so should be considered in relation to any transfer request processed on or after that date, even if the request for a transfer was received before. Although not mandatory, the Ombudsman will take the Code into account when considering whether the trustees or scheme administrators are guilty of maladministration in relation to transfers.

Pensions Administration Standards Association (PASA) DC governance guidance

PASA's new [guidance](#) for the administration process of DC schemes looks at managing responsibilities in five core areas: data, decumulation, controls & processes, management information and transitions. PASA says that regular input from the employer and trustees is needed to ensure that processes are holistic and effective, members are engaged, data is good, issues are identified quickly and reporting is clear, informative, and understood by all parties.

Action points: Trustees and scheme administrators should familiarise themselves with this helpful voluntary guidance.

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

For the latest on The Pensions Ombudsman and his work, please see our most recent quarterly [Pensions Ombudsman Update](#).