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Trustee Knowledge Update - May 2019

Welcome to the May 2019 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

DWP guidance on GMP conversion

The DWP has, with the assistance of an industry working group, published long-awaited statutory guidance on GMP conversion. This is an important issue for many schemes currently reviewing the practicalities of implementing last year's Lloyds Bank High Court judgment on equalising benefits for the effect of GMPs. The GMP conversion legislation, which has been in force since 2009, allows schemes to convert the GMP into a non-GMP benefit, so that affected members' benefits are no longer subject to the additional, and complex rules that apply to GMPs. Please see our LawNow article for more detail.

Action points: Trustees of schemes with GMPs accrued between 1990 and 1997 should be considering how best to equalise benefits following the Lloyds Bank decision. For many schemes, conversion will be a sensible solution but further guidance and legislation is still in the pipeline and detailed advice should be taken.

Pensions Dashboard

The DWP has published the Government's response to its December 2018 consultation on pensions dashboards. The next stage will be for the Money and Pensions Service ("MAPS") to establish a delivery group to develop a plan setting out how the dashboards will be delivered. The DWP expects that, in 2019, industry will develop and test consumer-facing dashboards. It also expects MAPS to begin work to deliver a non-commercial dashboard.

The DWP is suggesting a phased approach to introducing dashboards with larger schemes going first. The delivery group will develop and manage the implementation timetable. It is anticipated that 3-4 years from the introduction of the first public-facing dashboard would be a reasonable period for full implementation. Large DC schemes, particularly Master Trusts, will be encouraged to supply data on a voluntary basis from "2019/20" and are encouraged to start preparing for participation now.

Primary legislation will be brought forward, subject to securing parliamentary time, to require schemes to make member data available to them through their chosen dashboard.

Action points: No immediate action, but trustees will need to ensure that the data they supply to any dashboard is accurate and up to date.

Collective Defined Contribution Schemes

The DWP has issued its response to consultation on collective defined contribution ("CDC") schemes. Although this is intended only for the Royal Mail pension scheme at the moment, the Government seems keen to roll it out more widely. The response largely confirms the Government's direction of thinking in the original consultation document.

In a CDC scheme, contributions are invested in a collective fund. At retirement, members receive a regular pension income from the fund based on the value of their contributions but the income is not guaranteed and will be subject to fluctuations depending on the fund's performance. CDC benefits will be classified in legislation as money purchase benefits (out of the reach of the PPF, employer debt and scheme funding requirements).

The framework of primary legislation will appear "*as soon as Parliamentary time allows*", with secondary legislation to be brought forward in draft: including "*detailed provisions related to valuation, adjustment of benefits, transfers, wind up, disclosure and other technical requirements*".

Action points: For information only. CDC schemes offer less funding risk to employers than a DB scheme but can give members a better retirement income than a traditional DC scheme and so could, if the legislation is workable, become a popular option.

Age discrimination - bridging pension exemption

Regulations which came into force on 15 May 2019 amend the Equality Act (Age Exceptions for Pension Schemes) Order 2010 to allow bridging pensions and other integrated pensions to operate in line with State pension ages in excess of 65 without breaching age discrimination laws. The amendment is not retrospective, so trustees may need to rely on objective justification arguments in relation to bridging benefits that have been reduced before it comes into force.

Action points: Trustees should review scheme rules to ensure they operate as intended in the light of increasing State Pension ages and consider whether any changes are appropriate.

Extension of civil partnerships

The Civil Partnerships, Marriages and Deaths (Registration etc) Act 2019 comes into force at the end of May 2019. It gives the Secretary of State regulation-making power to extend civil partnerships to individuals who are not of the same sex. That power must be exercised so that these regulations are in force by 31 December 2019.

Action points: For noting: the scope of the regulation-making power extends to pensions matters.

Regulator (www.thepensionsregulator.gov.uk)

Annual Funding Statement

The Pensions Regulator (TPR) has published its Annual Funding Statement ("AFS"). It is particularly relevant to DB schemes with valuation dates between 22 September 2018 and 21 September 2019 and other schemes currently reviewing their funding and risk strategies, but should be of interest to all trustees of DB schemes.

The AFS follows the same approach as in previous years by segmenting schemes based on strength of covenant and funding position but now also taking into account investment expectations.

TPR now expects trustees to set a long-term funding target (LTFT) and set an investment strategy consistent with it. Setting an LTFT involves the trustees and employer agreeing a strategy for achieving their long term goal (e.g. buy-out) which recognises how the balance between investment risk, contributions and covenant may change over time. TPR will expect all schemes to follow a similar practice in setting a LTFT, consistent with its integrated risk management guidance. Trustees should also be able to demonstrate how their shorter term investment and funding strategies are aligned with the LTFT.

Another theme in the AFS is scheme maturity. TPR expects maturity issues to assume greater significance in funding and investment strategies in future (as the majority of schemes are now closed). As schemes approach higher levels of maturity, trustees should ensure employer funding is at a level where the risks are being appropriately managed, particularly where there are high levels of transfers-out.

TPR continues to highlight its concerns over schemes being treated fairly compared with other stakeholders (particularly shareholders). Its expectations in relation to shareholder dividends are:

- where dividends and other distributions to shareholders exceed deficit payments to the pension scheme, TPR expects a strong funding target and short recovery plan;
- if the employer is weak or tending to weak then scheme deficit payments should be larger than distributions (unless the recovery plan is short and the funding target is strong);
- if the employer is weak or unable to support the scheme then TPR expects payments to shareholders to have ceased.

In terms of TPR's new more direct approach, it will be contacting schemes where it has concerns about "*equitable treatment*" (i.e. dividends v deficit payments) and over-long recovery plans.

TPR currently hopes to consult "*in the summer*" on various options for the revised funding Code of Practice, and in 2020 on the Code itself.

Action points: Trustees of DB schemes (even those not currently undergoing a valuation) should familiarise themselves with the Annual Funding Statement.

Trustees hit with significant fines

TPR has published a Determination Notice issued against Link Pension Trustees, the professional trustee of a non-associated multi-employer DC scheme, which was fined:

- £25,000 for failing to obtain audited scheme accounts for four years;
- £18,750 for failing to provide statutory money purchase illustrations (SMPIs) for two years;
- £30,000 for failing to report any of these accounts and SMPI failures to TPR.

The press release also refers to an additional £30,000 fine for failure to have at least three trustees on a master trust board.

The Determinations Panel followed the criteria set out in TPR's Monetary Penalties Policy, which was adopted in 2017.

The Panel decided that it would impose separate fines for each annual breach of the audited accounts and SMPI requirements, whilst acknowledging that in other cases it might properly choose to impose a single fine for multiple breaches. It also rejected the trustee's arguments that a lack of direct financial detriment to members meant that it was unreasonable to take regulatory action: the financial impact of a breach on members was merely one factor that TPR had to consider in choosing whether to enforce.

Action points: Once again, TPR has laid down a marker that it is unafraid to impose large penalties on trustees. Multiple breaches can easily add up to a large fine.

DC winding up guidance

TPR has produced new regulatory guidance for trustees on winding up a DC scheme. This includes sections on the decision to wind up, entering formal winding up, securing benefits and completing the winding up (including a useful checklist of final steps).

Action points: Trustees of DC schemes which are considering, or are in the process of, winding up should take into account this new guidance.

PPF (www.ppf.co.uk)

PPF contingency plan for employer insolvency

The PPF has produced a guide for trustees who think their employer may be in trouble and there is a risk of their scheme entering an assessment period.

The guide recommends steps which trustees could put in place to mitigate some of the risks resulting from employer distress, particularly those areas which affect members (such as a shared payroll) and practical issues such as accessing documents on company premises or databases.

Action points: Although aimed at trustees of schemes with distressed employers, some of the contingency planning in this guide would be good practice for all trustees of DB schemes to consider (such as ensuring governing documents are up to date and complete and identifying all statutory employers).

Cases

Keymed (Medical & Industrial Equipment) Ltd v Hillman & Woodford (High Court)

This case concerned employer allegations against two former senior directors who were also individual trustees of its staff pension scheme. The allegations involved the directors having set up a separate executive pension scheme for themselves, disapplying Inland Revenue pension increase limits within it, amending its rules to remove the young spouse reduction (when one of the defendants wished to marry someone much younger than him), and adopting allegedly unduly conservative funding and investment strategies.

The employer claimed that there had been breach of directors' duties, breach of trustee duties and conspiracy

and said that by their actions the defendants had preferred their own interests to those of the employer.

The employer argued that trustees had legal duties to a sponsoring employer. However, the Court said that it was undesirable that trustees should have the "*divided loyalty*" of owing duties to both scheme beneficiaries and employer. If the employer's interests conflicted with those of the beneficiaries, a trustee's course was clear: the employer's interests were subordinate to those of the beneficiaries. The defendants, as trustees, owed no duties to the employer.

The court then considered the funding and investment strategy adopted by the trustees. The judge did not see this as prejudicial to the employer: "*the scheme employer - in having a conservatively run scheme - will have the benefit of knowing that there will not, years down the line, be an unfunded liability which suddenly has to be funded*". The mere fact that a conservative investment and funding strategy was being followed could not justify any inference of impropriety or breach of duty towards the employer. And the fact that the scheme's funding and investment strategies were "*exceptional*" when compared to other schemes was an irrelevant factor.

In conclusion, the court found that the defendants had acted honestly and not breached their company law duties as directors, or their obligations as trustees. All of the employer's claims against them failed.

Action points: This judgment supports the view that trustees are entitled to take into account the interests of the employer, but only where they do not conflict with their primary duty to promote the purposes of the trust.

BIC UK v Burgess (Court of Appeal)

Trustee minutes from 1991 recorded their decision to use scheme surplus to provide additional pension increases. The trustees subsequently announced the purported change to members and, from April 1992, administered the scheme on that basis. However, there was no record of the employer having formally resolved to agree to the proposal, and the increase was never reflected in the scheme rules.

Last year, the High Court decided that the trustees had validly determined to introduce the increases and - on the evidence of key witnesses - that the employer had agreed to this. The judge then accepted the trustees' argument that a later Trust Deed and Rules, executed in 1993 (but expressed as retrospective to 1990) could be used to validate the disputed increases.

However, the Court of Appeal has now decided that that it was not enough for the court to have identified powers under the 1993 Deed and Rules that could have been used to make the rule amendments: there needed to be a basis for regarding those powers as having been exercised at the time. There was no positive evidence that the trustees or employer, at the time, had decided or intended to use the 1993 Deed to retrospectively validate the disputed increases. The High Court had therefore re-written history "*to an impermissible extent*". The employer's appeal was allowed and the purported increases were struck down.

Unfortunately, the Court of Appeal did not need to address other intriguing points raised in the High Court proceedings, including the judge's view that there was no limitation period restricting the 'recoupment' of overpayments to members (i.e. deducting them from sums which would otherwise be paid to pensioners in future).

Action points: Although the Court helpfully confirmed that retrospective amendments may be acceptable as a matter of principle, trustees and employers cannot lose sight of the need to comply with relevant formalities when making them.

Safeway Ltd v Newton (Advocate-General)

The Advocate-General ("A-G") of the Court of Justice of the European Union ("CJEU") has given his Opinion as to whether EU case law establishes a principle which, in all circumstances, outlaws retrospective levelling-down during the Barber window, where the employer and/or trustees had power to make a retrospective change under domestic law.

The scheme amendment power in *Safeway* allowed the principal employer and trustees to amend the scheme by deed, but the amendment could take effect from "*the date of any prior written announcement to Members*". The question was whether the scheme had equalised retirement age with effect from 1 December 1991 (the date of a letter to members confirming the purported equalisation) or only from May 1996 (when a deed formally amending the rules, stated to take effect from December 1991, was executed).

In early 2016 the High Court followed the approach in previous cases and decided that equalisation was only effective from the date of the deed because, under the scheme's power of amendment, the letter was not sufficient to amend the trust deed. However, in 2017 the Court of Appeal took a different approach, saying that under domestic law, female members' right to a retirement age of 60 was 'defeasible' (i.e. capable of being changed) during the period from December 1991 until May 1996. It referred to the CJEU the question of whether European case law really did, in all circumstances, establish a principle which outlawed retrospective levelling-down during the Barber window, where the employer and/or trustees had power to make a retrospective change under domestic law.

The A-G suggests that the answer is "yes". In his view the point turned on whether the 1991 letter "*had full legally binding force*", in a way that would secure an effective remedy to provide equalisation at age 65. If it did not, the Barber window remained open until an effective remedy was in place (in this case, the date of the 1996 deed). It was not relevant to this analysis whether any right of women to retire at age 60 in the interim could be categorised as 'defeasible' or 'indefeasible'.

Action points: If the CJEU follows the A-G's lead, this case will confirm that retrospective levelling down in the Barber window is not allowed under EU law, even where scheme rules have a two-step amendment process.

Miscellaneous

New standards for professional trustees

The Association of Professional Pension Trustees has published the final version of the Professional Trustee Standards Working Group standards for professional trustees accompanied by an accreditation framework. The standards and accreditation regime are intended to improve and provide assurance on the quality of professional trustees (i.e. those falling within TPR's description of a professional trustee). The PMI, which will manage the

accreditation framework, is expected to provide further details of the accreditation process and costs in the "*near future*" and it is intended the process will commence by mid-2019. TPR has stated that it will expect all professional trustees to gain accreditation.

The standards themselves are split into three sections:

- general, for all professional trustees;
- additional requirements for Chairs;
- additional requirements for sole trustees.

The general requirements include fitness and propriety, expertise, the role of the professional trustee on the trustee board and managing conflicts. The standards apply on an individual basis and to achieve accreditation a trustee must:

- comply with a "fit and proper" requirement modelled closely on that required for trustees of master trusts;
- provide references from two reputable figures within the industry;
- have successfully completed the latest TPR Toolkit;
- have passed the PMI Level 3 Award in Pension Trusteeship; and
- complete an online soft skills test (yet to be developed) designed to assess "*other Professional Trustee skills and behaviours*".

Action points: All trustees satisfying TPR's description of a professional trustee should seriously consider obtaining accreditation once the final arrangements are in place. Accreditation will not be a legal requirement but many trustee boards and employers will look for accredited status when considering appointing or retaining a professional trustee.

EMIR REFIT

The Council of the European Union has announced that a preliminary agreement has been reached relating to a proposed amendment to the European Market Infrastructure Regulation ("EMIR REFIT").

One of the amendments, if endorsed by EU ambassadors, will provide a two-year extension to the temporary exemption for pension schemes from the clearing obligation. In addition, HM Treasury has issued a statement explaining how it plans to bring the extended exemption into UK law on Brexit, and it also confirms its intention to incorporate a temporary two-year clearing exemption for both UK and EEA pension schemes in a no deal scenario.

Action points: For information only.

Mandatory tenders for fiduciary managers

The CMA has published a draft Order which includes a requirement for mandatory tendering when pension scheme trustees first purchase fiduciary management services (for mandates of 20% or more of scheme assets), and to put existing untendered mandates out to tender within five years. The final Order is expected to come into force in June 2019.

The DWP has announced that it will be introducing regulations to bring these requirements into pensions law and to enable enforcement by TPR. The Government intends to produce draft regulations and consult on them this year and, subject to the outcome of that consultation and Parliamentary time, bring regulations into force and replace the CMA Order in 2020. TPR will also produce guidance to help trustees in running a competitive tender process for fiduciary managers. It will be entering into discussions with stakeholders in the next few months with a view to consulting this summer.

Action points: For information only.

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*.

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 2019, 8 October 2019 and 12 February 2020. 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 Finance 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 20 May 2019.

CMS Cameron McKenna Nabarro Olswang LLP is a limited liability partnership registered in England and Wales with registration number OC310335.