

Current issues

February 2018

Articles this month:

Advice-requirement changes force dual transfer calculations

RPI not 'inappropriate' or 'invalidated' as increase measure

PPF update

Financial Guidance and Claims Bill update

Government agrees to make changes to encourage social-impact investing

NEST Order consultation outcome

Pensions briefs find new owners

GMP Increase Order

HMRC newsletters

Advice-requirement changes force dual transfer calculations

Changes to the circumstances in which defined benefit (DB) scheme members must obtain transfer advice, effective from 6 April 2018, will in some cases force schemes to calculate cash equivalents on two different bases.¹ The issue affects schemes that pay transfer values that are higher than the minimum required by law.

Background

A pension scheme member who has rights to 'safeguarded benefits' (including defined benefits) worth more than £30,000 must obtain 'appropriate independent advice' before transferring or converting them so as to acquire 'flexible benefits' (including defined contribution benefits). The requirement was introduced on 6 April 2015 as a consequence of the 'Freedom and Choice' reforms to DC benefit options within the tax legislation. The measure of whether the benefits are worth more than £30,000 is the member's cash equivalent transfer value, before any permitted reductions (for example, on account of underfunding).

Changes

Responses to a call for evidence made in November 2015 convinced the Department for Work and Pensions (DWP) that it needed to fine-tune the appropriate independent advice legislation to cater for benefits that are both 'safeguarded' and 'flexible', such as DC pots with guaranteed annuity rate terms. It published draft Amendment Regulations for consultation purposes in September 2016. The feedback that it received persuaded it that the cash equivalent of a member's safeguarded benefits, for the purposes of the advice requirement, should ignore not only permitted reductions, but also the option to calculate transfer values using a basis that is more generous to the member than the statutory default 'best estimate' method. Revised Amendment Regulations that incorporate this change were submitted for Parliament's approval in December 2017. They come into force on 6 April 2018.

As a result of these amendments schemes that pay transfer values that are higher than the minimum may also have to calculate 'best estimate' cash equivalents in order to determine whether the member must obtain financial advice before transferring. For example, if the transfer value offered to the member is, say, £32,500, but it includes a 10 per cent premium over a best-estimate cash equivalent, financial advice is not mandatory, and the trustees would have to say so in correspondence with the member.

¹ The Pension Schemes Act 2015 (Transitional Provisions and Appropriate Independent Advice) (Amendment No 2) Regulations 2017 (SI 2017 No. 1272).

RPI not 'inappropriate' or 'invalidated' as increase measure

The High Court has ruled that, for the purposes of a pension scheme's increase rule, the Retail Prices Index (RPI) has not become '*inappropriate*' or been '*so amended as to invalidate it*' during the last decade.² The sponsoring employer was, as a result, unable to trigger a switch to another inflation index.

Background facts

The scheme's rules had been revised on numerous occasions over the years. In effect, though, there were two relevant renderings of the pension increase rule: the one contained in the 1993 version of the rules, and the one that superseded it in 2002 and was subsequently retained so as to appear in the 2016 rules.

The current, 2016 rule provides for pensions in payment to rise in line with increases in the cost of living, which are to be determined by the RPI

'or if this ceases to be published or becomes inappropriate, such other measure as the Principal Company, in consultation with the Trustees, decides.'

The historical, 1993 version said that that if the RPI,

'ceases to be published, or is so amended as to invalidate it in the view of the Principal Company as a continuous basis for purposes of calculating increases, the Principal Company shall substitute such other index or appropriate basis of comparison as it shall in consultation with the Trustees decide.'

The Court was asked to decide, amongst other things,

- whose (if anyone's) job it was to decide whether the RPI had become '*inappropriate*' under the 2016 rule, or whether it was an objective question on which the Court could rule;
- whether developments in relation to the RPI since 2010 were sufficient by themselves or in combination to lead to the conclusion that the RPI had become '*inappropriate*' or '*so amended as to invalidate it... as a continuous basis for purposes of calculating increases*';
- if it was necessary for the relevant determination to be made within a reasonable time after occurrence of the event(s) in question, and if so had that reasonable time already passed (so that the possibility of switching indices was no longer open); and
- which increase-rule variant now applied to the benefits of those who had become entitled to benefits before the 2016 rules came into effect.

Judgment

The judge decided, *inter alia* (as judges are wont to say), that

- pension increases for all of the members concerned were now governed by the 2016 rule;
- the question of whether the RPI has become inappropriate is one of objective fact;
- none of the various goings-on in the recent history of the RPI, alone or taken together, would justify the conclusion that it had become inappropriate or been so amended as to invalidate it; and
- there was no basis on which to insert an implied term into the 2016 rule to the effect that the power would lapse if not exercised within a reasonable time.

As a result, the employer was unable to replace the RPI with the Consumer Prices Index (CPI) for pensions increase purposes—a step that would have reduced its liabilities. Even if, as the judge hypothesized, the employer had the sole power to decide whether the RPI had become inappropriate, it would be a fiduciary power that it would

² *British Telecommunications PLC v BT Pension Scheme Trustees Limited & Another* [2018] EWHC 69 (Ch).

have to exercise in the members' interests, rather than its own. He also noted that it would weigh against a conclusion that the RPI had become inappropriate if '*jettisoning*' it would mean that there was a risk that pension increases would not keep up with pensioners' experience of inflation—and he thought that there were '*reasonable grounds*' on which to conclude that such a risk would arise from a switch away from the RPI.

On the other hand, he agreed that a wholesale loss of confidence in the RPI could, at least in principle, be enough to show that it had become inappropriate. This observation came with the caveat that the identification of the precise '*tipping point*' would be '*a highly fact-sensitive judgment call*'.

As ever in indexation cases, the minutiae of the scheme rules were decisive. The judge's comments about the requirements for a conclusion that the RPI has become inappropriate may nevertheless be of wider interest. The question of whether there ought to be a statutory override allowing a switch from RPI to CPI by those constrained by their rules is expected to be addressed in the Government's forthcoming White Paper on 'Security and Sustainability in Defined Benefit Pension Schemes'. Those who are anxious to read it will be dismayed to learn that it will not now be published until '*some stage this spring*' (spring being '*an elastic term*' meaning '*before the summer period*').³

PPF update

PPF finalizes 2018/19 levy details

The Pension Protection Fund (PPF) has published its Final Determination setting out how it intends to calculate the 2018/19 levy.⁴ Little has changed since the draft Determination issued for consultation purposes in September, with the PPF confirming that it expects to receive £550 million in levies for 2018 and that the levy scaling factor will be set at 0.48.⁵

The proposed changes to the insolvency measures (involving rebuilding the risk scorecards, incorporating credit ratings and having an industry-specific model for financial institutions) will be implemented as planned.

Contingent assets

The PPF has also responded to its October 2017 consultation on contingent assets, noting that very few points were raised in response to its proposals. It has published revised contingent asset agreements (used for group company guarantees, securities over certain assets, or bank guarantees), along with final contingent asset guidance.⁶

The new agreements will address issues with the wording in Type A and Type B agreements where the PPF believes the current wording could be construed as meaning that payments made in respect of the guaranteed obligations of the employer would erode the fixed cap if the employer becomes insolvent.

Contingent assets agreed from 18 January 2018 must use the new forms. Arrangements entered into before this date can be certified or recertified for 2018/19 without using the new versions. Certain existing agreements will need move to the new agreements in 2019/20 if they are to continue to be recognized.

All type A contingent assets generating expected levy savings in excess of £100k will require a 'guarantor strength report' in order to gain recognition from 2018/19 levy years onwards. Schemes are advised to investigate and procure such reports in advance of 31 March 2018 to ensure their agreements are recognized.

³ Guy Opperman (the Pensions Minister), *Hansard*, HoC Debates, 11 January 2018, Column 586 <<https://hansard.parliament.uk/Commons/2018-01-11/debates/FC1368E3-A08F-4FB4-A0CC-CA2FD4BCAB26/Plumbers%E2%80%99PensionScheme>>.

⁴ <www.pensionprotectionfund.org.uk/news/pages/details.aspx?itemID=475>.

⁵ See *Current Issues* November 2017, <www.hymans.co.uk/news-and-insights/research-and-publications/publication/current-issues-november-2017/>.

⁶ <www.pensionprotectionfund.org.uk/News/Pages/details.aspx?itemID=479>.

PPF levy ceiling & compensation cap

The *Pension Protection Fund and Occupational Pension Schemes (Levy Ceiling and Compensation Cap) Order 2018* has been laid before Parliament. As well as restricting the compensation that the PPF will pay in some cases, it establishes one of the statutory limits on the aggregate levies that the PPF can attempt to collect. The latter aspect of the Order has no practical effect at the moment because of a separate constraining rule, and because the PPF has already announced that it intends to target a considerably lower figure for the coming year.

The PPF estimates the amount that it needs to raise in advance of each levy year (which starts in April). The *Pensions Act 2004* restricts the amount that it can seek to collect in two ways: the levy estimate for a particular year cannot be more than 125 per cent of the previous year's estimate; and it cannot exceed the levy ceiling.

The Order sets the levy ceiling for the year commencing 1 April 2018 at £1,024,372,330. It is calculated by increasing the previous year's ceiling by the increase in average UK earnings, which was 1.7 per cent for the 12 months to 31 July 2017. In December 2017 the PPF announced that it intends to raise just £550 million for the 2018/19 levy year. The levy ceiling will not, therefore, affect the amount that is to be collected in the coming year.

The annual compensation that can be paid to those (other than those in receipt of ill-health or survivors' pensions) who are below their scheme's normal pension age at the beginning of the PPF's assessment period is limited to 90 per cent of the compensation cap. The cap is also increased annually in line with average earnings, although a different reference period is used. The Order provides that the compensation cap at age 65 for the year from 1 April 2018 will be £39,006.18, meaning that the maximum capped pension for someone of that age will be £35,105.56 (unless the 'long-service adjustment'⁷, brought into force in April 2017, applies).

Financial Guidance and Claims Bill update

The *Financial Guidance and Claims Bill*, which will establish a single financial guidance body to replace the Money Advice Service, the Pensions Advisory Service and Pension Wise, has completed its journey through the House of Lords and is now progressing through the House of Commons.

The Bill was introduced to Parliament in June 2017 and progressed through the House of Lords between July and November. The Lords made several amendments, including requiring the single financial guidance body to advise the Secretary of State for Work and Pensions if it thinks a ban on cold-calling on any products or services would be beneficial and permitting the Secretary of State to introduce regulations to make such a ban.

The Work and Pensions Committee also published a report on what it sees as priorities for the Bill in December 2017.⁸ It concluded that:

- whilst the Lords' amendment to the Bill would have allowed the Secretary of State to make regulations to ban cold calling, it was tied to the introduction of the single financial guidance body, which may not be in place until 2020—the Committee preferred to see the clause amended to require a ban to be in place by June 2018 with the detail and scope being set out by regulations; and
- scheme members who take a transfer or access money purchase benefits should be defaulted into taking guidance or advice, although they could opt out.

The Bill is now progressing through the House of Commons and began its Committee stage on 1 February 2018. The Government has published an amendment that would oblige trustees or managers to ask people whether they sought guidance or advice before applying to transfer or access money purchase benefits. If the person has not, the trustees or managers would have to recommend guidance or advice and ask the applicants whether they wish to proceed. This amendment replaces the similar but more onerous clause inserted by the House of Lords, which

⁷ The long-service adjustment is three per cent for each additional year of pensionable service over 20 years. The adjusted compensation will be subject to a maximum of twice the ordinary capped amount.

⁸ <www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/news-parliament-2017/pension-freedom-report-17-19/>.

would have empowered the Financial Conduct Authority to require schemes to facilitate access to guidance or advice before transactions could proceed.

Government agrees to make changes to encourage social-impact investing

The Government intends to amend the legislation governing investment by trust-based, occupational pension schemes to give separate attention to financial and non-financial considerations, and require trustees to declare their policies (if they have any) on stewardship.⁹

In June 2017, the Law Commission published a report on *Pension Funds and Social Investment*, having been asked by the Minister for Civil Society, Rob Wilson, to ‘provide an accessible account of the law governing how far pension fund investment policy may or should consider issues of social impact... [and] whether there are legal or regulatory barriers to using pension funds for social impact (including investment in social enterprises).’¹⁰ Amongst other things, it recommended that trustees be required, in their statements of investment policy, to make known their stances on

- evaluating long-term risks to an investment, including sustainability risks arising from corporate governance or from environmental or social impact;
- taking account of members’ ethical concerns, etc.; and
- issues of stewardship (if they have a policy on the matter), including the exercise of formal rights (such as voting) and other forms of engagement with the businesses in which the invest.

The requirements would be imposed through amendments to the *Occupational Pension Schemes (Investment) Regulations 2005* (the Investment Regulations)¹¹. They would not be entirely new: the Regulations already oblige trustees to document ‘the extent... to which social, environmental or ethical considerations are taken into account in the selection, retention and realization of investments’, and ‘their policy (if any) on the exercise of the rights (including voting rights) attaching to the investments.’

In December, the Government issued an interim response, saying that it is ‘minded to make the proposed changes’. It plans to conduct a consultation exercise during 2018, leading to legislation ‘at the earliest reasonable opportunity.’ The Financial Conduct Authority (FCA) is considering recommendations that would impose analogous obligations on the independent governance committees (IGCs) of workplace personal pension schemes. Its response will be included in the Government’s full response, which is to be published in the summer.

It is worth making the distinction between financial and non-financial considerations in the legislation if it leads to more-informed debate amongst investors. In the meantime, we encourage trustees to educate themselves on responsible investment issues and to engage with their asset managers. We have developed a comprehensive framework for the evaluation of managers’ responsible investment credentials. Please contact your usual Hymans Robertson consultant if you are interested in more information.

⁹ <www.gov.uk/government/publications/pension-funds-and-social-investment-interim-response>.

¹⁰ <<https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2017/06/Final-report-Pension-funds-and-social-investment-interim-response.pdf>>.

¹¹ SI 2005 No. 3378.

NEST Order consultation outcome

The Department for Work and Pensions (DWP) has published the outcome of its November 2017 consultation exercise on proposed changes to the National Employment Savings Trust (NEST).¹²

In November 2017, the Government proposed to amend the NEST Order to:

- ensure that the contractual and consensual enrolment of workers is still possible once staging ends in February 2018;
- give the NEST Corporation the ability to close member's accounts if they have been open for 12 months and have never received any contributions;
- clarify that where there is a bulk transfer with consent by participating employers using NEST, workers can become members of the NEST (a similar provision for bulk transfers without consent was provided for by an earlier amendment); and
- require the NEST to carry out research with the scheme members and participating employers and their representatives, in connection with the operation, development or amendment of the scheme (this is so that the NEST can demonstrate that it satisfies the EU Data Protection Regulation requirements on lawful processing when carrying out research).

The majority of respondents to the consultation were supportive of the proposals, so the Government is going ahead with the amendments to the NEST Order. It confirms that the NEST plans to consult employers before closing empty schemes. The changes will come into force on 1 April 2018. A draft *National Employment Savings Trust (Amendment) Order 2018* has been laid before Parliament.

Pensions briefs find new owners

Following a Cabinet reshuffle, Esther McVey has replaced David Gauke as Secretary of State for Work and Pensions.¹³ Guy Opperman continues to hold the title of Parliamentary Under Secretary of State for Pensions and Financial Inclusion (AKA the Pensions Minister).

The reshuffle also affects local government pensions. The Department for Communities and Local Government was renamed the Ministry of Housing, Communities and Local Government, whilst Sajid Javid continues as Secretary of State.¹⁴ Marcus Jones left the role of Minister for Local Government, which is now occupied by Rishi Sunak.

Separately, Labour's Alex Cunningham resigned from his role as the Shadow Pensions Minister. He was replaced by Jack Dromey MP.¹⁵

GMP Increase Order

The *Guaranteed Minimum Increase Order 2018* (which would come into force on 6 April 2018) has been laid before Parliament.¹⁶ The Order specifies the amount by which the guaranteed minimum pension (GMP) element of a person's occupational pension entitlement must be increased. For the 2018/19 tax year it provides for a 3.0 per cent increase.

¹² <www.gov.uk/government/uploads/system/uploads/attachment_data/file/677407/response-to-the-consultation-on-draft-national-employment-savings-trust-amendment-order-2018.pdf>.

¹³ <www.gov.uk/government/organisations/department-for-work-pensions>.

¹⁴ <www.gov.uk/government/organisations/ministry-of-housing-communities-and-local-government>.

¹⁵ <<http://press.labour.org.uk/post/169625699984/jeremy-corbyn-makes-frontbench-appointments>>.

¹⁶ <www.legislation.gov.uk/ukdsi/2018/9780111164310>.

HMRC newsletters

Her Majesty's Revenue and Customs (HMRC) has published Pension Schemes Newsletter 95.¹⁷

It includes:

- the number of tax repayment claims processed in the last quarter of 2017 in connection with 'Freedom and Choice' payments—with a total value of over £20 million;
- a status update on the migration of data to a new pensions online service—including a note that HMRC has identified some outstanding 'accounting for tax' (AFT) charges and will be contacting the scheme administrators; and
- a request for feedback on the content and format of the Pension Schemes Newsletters.

The latest edition of the *Countdown Bulletin* is also available.¹⁸

¹⁷ <www.gov.uk/government/publications/pension-schemes-newsletter-95-january-2018/pension-schemes-newsletter-95-january-2018>.

¹⁸ <www.gov.uk/government/publications/countdown-bulletin-31-january-2018/countdown-bulletin-31-january-2018>.



And Finally...

We have a veritable gallimaufry of gumpf for you this month.

The first was Her Majesty's Revenue and Customs' list of preposterous justifications and examples of expense-claim effrontery in connection with 2017/18's self-assessment tax returns.¹⁹ The stand-out instance was unquestionably,

'I couldn't file my return on time as my wife has been seeing aliens and won't let me enter the house.'

We were particularly intrigued by the ambiguity of the phrase '*seeing aliens*': did this mean that she was hallucinating, or was she taking marital infidelity to extraordinary (literally, out-of-this-world) levels?

Next up, the Parliamentary news headline '*Lords examines Asset Freezing (Compensation) Bill*'.²⁰ Pretty mundane, you might think, but it got AF's hopes up during the recent spell of wintry weather. Until he realized that it said 'asset', that is.

And finally, if anyone's interested in an insight into the workings of, and characters behind, a pension liberation scam, we recommend that they read the recent High Court judgment in *The Pensions Regulator v Payae Limited and Others*.²¹ Top tip for swindlers: if you're a man, get your co-conspirators to call you 'Jane' in email correspondence in order to throw 'The Man' off the scent. Also: make sure to write lots of ALL CAPS admonitions to your accomplices not to mention the—*nudge-nudge-wink-wink*—features of the racket that are most incriminating. Foolproof...

¹⁹ <www.gov.uk/government/news/aliens-vertigo-and-a-glasgow-nightclub-included-in-this-years-expenses-and-excuses>.

²⁰ <<http://www.parliament.uk/business/news/2018/january/lords-examines-asset-freezing-compensation-bill/>>.

²¹ [2018] EWHC 36 (Ch) <www.bailii.org/ew/cases/EWHC/Ch/2018/36.html>.