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Current issues

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Articles this month:

Regulator's financial support direction gets judges' backing

The Upper Tribunal has concluded, in the first judicial decision of its kind, that the Pensions Regulator had the necessary jurisdiction to issue a '*financial support direction*' against companies in the ITV group, and that it was reasonable for it to do so.[1]

Financial support directions

The Regulator has the power to issue a financial support direction (FSD) if it concludes that a defined benefit scheme's sponsor is '*insufficiently resourced*': meaning, roughly summarized, that its resources add up to less than half of the estimated buy-out-based scheme deficit, at a time when '*connected*' or '*associated*' companies have the wherewithal to make up the balance of that deficit. The potential targets of the FSD are generally the employer and its associated or connected companies. The Regulator is required to notify the targets about its intention to impose an FSD within two years of the effective date of its determination that the sponsor is insufficiently resourced.

Financial support can take several forms. The targets must come up with a proposal that meets with the Regulator's approval.

The ability to impose FSDs came into force on 6 April 2005.

Timeline

The case concerned a joint venture, between Granada (now ITV) and Thorn (now Carmelite), conceived almost twenty years ago. In 2000, they sold their respective TV-rental businesses to a new company, Box Clever, which funded the purchase from a loan secured on its assets. As well as the respective purchase prices, Granada and Thorn each obtained half ownership of Box Clever.

The new business established a DB scheme in 2001. Granada and Thorn had no funding obligations toward it.

Box Clever went into administrative receivership in 2003. At that time the scheme had a £25m funding deficit, on a gilts basis; the shortfall has grown since, to around £115m.

In 2009, the Regulator issued a letter to Carmelite (formerly Thorn) saying that it would not have jurisdiction to issue an FSD (based on its understanding at the time of the legal effect of the appointment of the administrative receiver). In 2011, having been persuaded that its legal analysis of the jurisdiction issue was wrong, it refused to provide the same comfort to Granada.

[1] *Granada UK Rental & Retail Limited and Others v The Pensions Regulator and Another* [2018] UKUT 0164 (TCC).

The Regulator decided to issue a financial support direction against five companies in the ITV group in late 2011, based on its view that the scheme's participating employers were insufficiently resourced on 31 December 2009.

Objections

The targets challenged the Regulator's ability to impose the FSD upon them. Their objections were, in summary, that—

- they were not '*connected*' or '*associated*' with the scheme's employers at the relevant time at the end of 2009, according to the relevant statutory definitions of those terms (which are based on the ability to control a third or more of the employers' voting power);
- all of the relevant events pre-dated the introduction of FSDs, and there is a presumption that legislation does not have retrospective effect;
- by deciding not to pursue Thorn/Carmelite, which it had mistakenly concluded was out of its jurisdiction, the Regulator was guilty of a discriminatory difference in treatment; and
- there was no 'moral hazard' in the sense of an attempt by the target companies to shift their pensions responsibilities onto the PPF and its levy payers—because the PPF did not exist at the relevant time.

They also argued, more generally, that it was not reasonable to impose the FSD on them in the circumstances, taking into account matters such as the relationship between the targets and the scheme employers, the benefits that the targets received, and their degree of involvement with the pension scheme.

Judgment

The Tribunal decided, unanimously, that the Regulator has jurisdiction to issue a financial support direction against the targets, and also that it is reasonable for it to do so.

The chain of control had not been broken by the appointment of the administrative receiver.

The presumption against retrospectivity was engaged only lightly, if at all. Unlike a contribution notice, with a FSD there is no '*imputation of serious wrongdoing*'. The test for a FSD is whether the employer is insufficiently resourced at the time when the exercise of the power is considered, not whether specific events occurred. Although that state of affairs might be the result of historical decisions, the aims of the legislation would be thwarted if the Regulator was to be unable to use its power whenever the seeds of the problem were sown in the past. It was notable in this respect that the other circumstance in which a FSD can be made is when the employer is a 'service company' (one that has no assets other than the employees whom it supplies to other companies in its group), and that Parliament was unlikely to have intended for it to apply only to service companies created after 5 April 2005. There were indications in the legislation that Parliament had not intended any cut-off date as regards the matters that the Regulator could take into account. The Tribunal did '*not see how the legislation could properly be applied if there were … a temporal limit in the great majority of cases where the causes of the scheme's weakness can be traced back to myriad different decisions taken by the employer or the trustees … over many years.*' Any interference with the targets' property rights was '*proportionate and justified.*'

In the Tribunal's view, it was right that the mistake that led to Carmelite receiving the comfort letter was not replicated for the benefit of ITV, and the Regulator's decision to pursue ITV alone was objectively justified. '*It is not surprising that once the Regulator has focused its limited resources on one group of financially stable potential targets, it holds back from taking on the challenge of pursuing another.*'

Although 'moral hazard' was an important consideration in the creation of the FSD legislation, there was nothing to suggest that FSDs were intended to be confined to cases where companies acted irresponsibly in the knowledge that the PPF would bear the resulting increased burden. The Tribunal had a little more sympathy for the targets'

arguments about the absence of a clearance regime for activities prior to 6 April 2006. However, it thought that the potential unfairness was clearly outweighed by other considerations.

On the subject of the reasonableness of a FSD, the judges said that it is not necessary to identify criticisms of the structure of a transaction, or its implementation, or the way that a business is run. The key question was whether the structure left Box Clever vulnerable to adverse movements in the markets so that ITV should bear some responsibility for the resultant risks. The absence of moral hazard was regarded as '*a neutral factor*'. Granada and Thorn '*extracted considerable cash from the business with no risk of recourse to their assets … they have all the power to be expected of a parent company over its subsidiary but with none of the obligations to support that subsidiary which are the norm when financial difficulties arise.*'

The Tribunal decided that the Regulator should issue an FSD to each of the targets, specifying that financial support is put in place within six months. The amount of support and the form it will take is still to be settled.

At a time when the Regulator stands accused of languor in the exercise of its powers, along comes a case in which it acted, but a resolution has taken ten years—and counting, as we understand that ITV plans to appeal. Whether or not it will be judged to have won on points after going the full twelve rounds, it cannot be faulted for lack of tenacity. We wonder how the legal fees racked up by the parties compare to the current scheme deficit.

Financial Guidance & Claims Act 2018

The *Financial Guidance and Claims Act 2018* received Royal Assent on 10 May 2018. The Act will create a new organization, responsible for provision of government-sponsored financial guidance, and enable the Department for Work and Pensions (DWP) to ban unsolicited direct marketing in relation to pensions (and, potentially, other consumer financial products and services). Those responsible for running trust- and contract-based pension schemes will acquire new obligations to direct members towards appropriate guidance in some circumstances.

The single financial guidance body

The Act will establish a '*single financial guidance body*' (SFGB), consolidating certain functions of the Pensions Advisory Service (TPAS), Money Advice Service and Pension Wise. One of its jobs will be to provide the public with free and impartial information about pensions matters; and in particular to help scheme members (and their surviving beneficiaries) decide what to do with '*flexible*' (mainly money-purchase and cash-balance) benefits.

Directing members toward guidance

Secondary legislation will oblige the trustees or managers of occupational pension schemes to ensure that their members are referred to appropriate guidance (such as the information provided by the SFGB) whenever they submit an application to transfer or otherwise access flexible benefits. Before proceeding with the transaction the trustees will be obliged to obtain confirmation either that the members availed themselves of the guidance or that they decided not to do so.

The details of the new requirements (such as what constitutes 'appropriate guidance', and what the trustees must do in order to comply) will be set out in regulations. Analogous rules will be made by the Financial Conduct Authority (FCA) in connection with contract-based schemes.

Cold-calling ban

The DWP has been given powers to prohibit unsolicited direct marketing (for example 'cold-calling') about pensions. If the necessary secondary legislation is not in place by the end of June 2018, Secretary of State McVey will be obliged to make excuses to Parliament in July. The DWP will also be required to keep under review the position in relation to other consumer financial products, and ban unsolicited direct marketing of them too, if appropriate.

Nuclear Decommissioning Authority: pension reform

The Department for Business, Energy & Industrial Strategy (DBEIS) proposes to amend statutory provisions protecting the pension rights of certain persons employed under the ægis of the Nuclear Decommissioning Authority (NDA), to enable them to receive career-average revalued earnings (CARE) benefits for future service.[2]

Background

Following the recommendations of the Independent Public Service Pensions Commission in 2011, the Government embarked on a campaign of reform, changing the nature of the public sector's defined benefit schemes from one founded on members' final salaries to CARE-based accrual. Underlying the switch were (among other things) a desire to make public service pensions more affordable and sustainable, and a wish to achieve fairness between different schemes and between public-sector workers and other taxpayers.

The NDA is a non-departmental public body, and largely funded by the Government. So, the public-sector pensions reforms should, at least in principle, extend to the final salary schemes for which it is responsible: the Combined Nuclear Pension Plan (CNPP) and the Site Licence Company section of the Magnox Electric Group of the Electricity Supply Pension Scheme (MEG-ESPS). However, some of the members who would be affected are '*protected persons*': they have their future pension rights safeguarded by legislation that was put in place either when electricity supply was privatized, or when the NDA was established.[3] In broad terms, whilst they remain actively employed for NDA purposes, they are entitled to continue to accrue pension rights on a basis that is '*no worse*', or '*no less favourable*', than that which they enjoyed at the time of privatization or formation of the NDA, as appropriate.

So, even though the replacement CARE structure was the result of a statutory consultation exercise, and was accepted by the relevant trade unions and their members, it cannot be introduced without amending the statutory protections.

Proposed amendments

The DBEIS plans to amend legislation to facilitate the reforms. The amendments fall roughly into two categories: changes to the statutory protections, and new powers for the scheme employers.

Statutory protections

The scope of the changes to the terms of the statutory protections will be strictly limited to the schemes and members covered by the NDA pension reforms: no other employers within the industry will be able to alter the basis on which pensions are provided for the protected persons that they employ.

Pensions built up prior to the introduction of the new CARE structure will continue to be based upon members' final salaries at termination of pensionable service. After the change, any protected persons who are employed for NDA purposes will be entitled to accrue pensions '*no worse*' or '*no less favourable*' than those of the new CARE scheme.

Employer powers

The 'lead employers', NDA and Magnox Limited, would be given powers

- to amend the schemes as necessary to implement the CARE reforms, without need for trustee or member consent, bypassing provisions in rules
- to make any ancillary changes as required to overcome unforeseen problems that come to light after the introduction of the CARE structure (clarification of rules or new administrative practices); and

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[2] *Nuclear Decommissioning Authority: pension reform* <www.gov.uk/government/consultations/nuclear-decommissioning-authority-pension-reform>.

[3] The *Electricity (Protected Persons) (England and Wales) Pension Regulations 1990* (SI 1990 No. 346); and s. 46 and Schedule 8 of the *Energy Act 2004*.

- adjust the contribution-band arrangements for the new scheme as necessary to hold average member contributions at 8.2 per cent of salary (the actual mechanism that will be used to achieve this is still being discussed by the NDA and trade unions).

As with the changes to the statutory protections, the use of these new powers would be limited to what is necessary to give effect to the reforms.

On the one hand, it is understandable the Government wishes to apply a consistent policy across the public sector; on the other, it seems potentially invidious that it can change its pension arrangements when other sponsors cannot. The DBEIS would no doubt answer that charge by pointing out that the proposed changes have been accepted by the relevant trade unions and the members that they represent. We wonder whether their acquiescence was at all influenced by the Government's initial proposal to limit cost and risk by imposing a pensionable-pay cap that would not have required amendment of the statutory protections.

Effective date of dismissal: what a difference a day—or seven—makes

The Supreme Court has ruled, by a narrow majority, that a notice of termination of employment posted to an employee's home address was only effective when she returned from holiday and had a reasonable opportunity to read it.[4] The immediate significance of the decision (and the only reason we mention it in this publication) was that the employee became entitled—by the narrowest of margins—to retire early on unreduced pension benefits.

The employee and her employer met to discuss the possibility of her being made redundant on 13 April 2011. At the meeting, she noted that she had annual leave coming up, from 18 April, and had booked a holiday in Egypt. She was contractually entitled to be given twelve weeks' notice of the termination of her employment. Both employer and employee knew that if her employment was terminated on redundancy grounds on or after her 50th birthday, on 20 July 2011, she would be entitled to an immediate unreduced early retirement pension—the additional costs of which would have to be met by the employer.

The employer posted the redundancy letter, by recorded delivery, on 20 April.[5] The employee's father-in-law collected it on her behalf from her local sorting office on 26 April. She opened and read it on 27 April, the day she arrived back home.

The question was, when did the twelve-week notice period start? If it was on 27 April, that meant that it expired *on the very day of her 50th birthday*.

Three of the five judges agreed that, in the circumstances, the notice was not effective until the employee read or had a reasonable opportunity to read it, so that she (just) qualified for her pension scheme's special redundancy terms.

This judgment is only indirectly pensions-related. We mention it, in part, because we cannot help but wonder whether the three judges were influenced, perhaps subconsciously, by the knowledge that the employer had issued the letter at a time when it knew that the employee would not be at home to receive it, and in the (mistaken) belief that it would forestall her entitlement to a valuable (costly) pension benefit.

Redundancy-retirement rules like the one in this case are familiar features of public-service pension schemes.

[4] *Newcastle upon Tyne Hospitals NHS Foundation Trust v Haywood* [2018] UKSC 22.
[5] It also emailed it to the employee's husband's address, but tried to recall the message more-or-less immediately, perhaps—we speculate—out of concerns about whether it was an appropriate means of conveying such information.

PPF cap too tight, says ECJ Advocate General

A preliminary opinion in a case before the European Court of Justice (ECJ) on the adequacy of the compensation provided by the UK's Pension Protection Fund (PPF) has concluded that it fails to meet the requirements of EU law.[6] The implication is that each scheme member must receive at least 50 per cent of his benefit entitlement on the insolvency of his or her employer. If the Court agrees, it will have repercussions for the PPF and those that pay its levies.

The opinion was delivered by one of the ECJ's Advocates General (AGs). Their role is to assist the Court by providing independent assessments of the cases assigned to them. The AG's opinion in a particular case does not *have to be* followed by the judges who ultimately rule on the matter, but in practice they often concur.

EU law

The case is about the correct interpretation of Directive 2008/94/EC '*on the protection of employees in the event of the insolvency of their employer*'. Article 8 obliges member states to '*ensure that the necessary measures are taken to protect the interests*' of the employees (past and present) of an insolvent business with respect to their occupational pension rights.

The ECJ has previously said that member states need not necessarily provide for *full* protection of accrued rights, but that systems that resulted in members receiving less than half of their pensions were inadequate.[7] The main question that the ECJ has been asked in the current case is whether that means that *each individual member* must receive no less than 50 per cent of their scheme entitlement.

The PPF

The compensation provided by the PPF is constrained in several ways. A compensation cap—currently just over £39,000 a year for someone aged 65, but boosted for those with 21 or more years' service—applies to members who are under their scheme's normal pension age at the time of the sponsor's insolvency. On top of that, members in this category have their (capped) compensation cut back by a further 10 per cent. (By contrast, those who are *over* NPA when their employer goes bust are subject to neither the cap nor the 90-per-cent compensation level.) Finally, once compensation is in payment, the PPF will increase the element attributable to post-5 April 1997 service only, in line with inflation (Consumer Prices Index, currently) but subject to a maximum of 2.5 per cent in any year; no increases are paid in connection with benefits accrued prior to that date.

Facts of the case

The member at the heart of the case had around 27 years' service, ending in 1998, when he took early retirement at the age of 51. His pension was subject to generous, extra-statutory increases of at least three per cent per annum. His former employer became insolvent, and so entered a PPF assessment period, whilst he was still under his NPA. His scheme came out of the assessment period without being taken over by the PPF, because its assets were sufficient to buy out benefits at or above the PPF compensation level. However, schemes in that position must generally be wound up, and their trustees must (broadly speaking) secure PPF-level benefits as a first priority; the PPF's compensation rules can in that way effect members of schemes for which it does not assume responsibility. At the time of the PPF's assessment of his scheme, this member's compensation would have been around one-third of his scheme benefit entitlement; and because of the relative generosity of the scheme's increases, compared to the virtual absence of any entitlement to indexation under the PPF's rules (because his pensionable service was almost entirely rendered before 6 April 1997), the disparity is growing over time.

Advocate General's Opinion

The AG proposes that, correctly interpreted, EU law requires that every individual employee be entitled to compensation of at least 50 per cent of his or her pension entitlement. Moreover, the increases provided by

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[6] *Hampshire v Board of the Pension Protection Fund* (Case C-17/17).
[7] *Robins v Secretary of State for Work and Pensions* (Case C-278/05), and *Hogan v Ireland* (Case C-398/11).

institutions such as the PPF cannot be such that the compensation level falls below 50 per cent through the action of time. Finally, she says that individual scheme members should be able to rely on the EU legislation directly against ‘public’ bodies like the PPF, even if, as in this case, that will have repercussions outside of the PPF itself.

The implication seems to be that the PPF compensation cap will have to be revised to (at the very least) incorporate a 'floor' of 50 per cent of the person's scheme entitlement. That floor would have to be reassessed periodically, as a disparity between scheme and PPF increase policies might otherwise mean that a person's compensation level slips below the half-way mark after it begins to be paid.

Should the ECJ agree with the AG, the UK Government will have to reconsider the PPF’s compensation rules (which are set out in primary legislation). The number of members of failed schemes who stand to benefit directly from the introduction of a floor to their PPF compensation is likely to be relatively small. As this case itself demonstrates, however, the repercussions of such a decision would go further than just the payments out of the PPF: it could lead to reassessment of the protected liabilities of schemes that have gone through PPF assessment and come out the other side, and potentially increase the levies paid by other private-sector defined benefit schemes.

And Finally…

Abandon hope, all ye who Brexit here…

The European Commission (EC) recently issued a notice about the effect of Brexit on '*institutions for occupational retirement provision'*, or as we would call them, occupational pension schemes.[8] The gist of it is that the trustees and sponsors of any UK-based schemes that cover members working in other EU members states may need to approach the relevant authorities in those countries to ascertain the terms on which such cross-border activity can continue. Sort of 'It's my ball, so I'll decide if you can play', but in the sphere of international relations.

The bit that stood out for *AF* was the sentence '*The United Kingdom will then become a "third country".*' We couldn't help but think that the EC really, *really* wanted to drop a 'world' into the midst of the phrase in quotes…

If you have been affected by the issues raised by this story…

The following advice appeared on the GOV.UK Web site, under the heading '*Changes to form C1331 used to declare a pleasure craft (CIP8)*'[9]:

> '*When you arrive in the UK on a pleasure craft that has departed directly from a country outside the EU, the National Yachtline must be contacted.*'

As an inhabitant of an island nation, we suppose that *AF* shouldn't be so surprised, but… there's really a *National Yachtline*?

Who's got the keys to the DeLorean…?

Elsewhere in this 'ere news rag you'll find a serious (note, we didn't claim it was good) report on the Pensions Regulator's success in its pursuit of a financial support direction against ITV. *AF*'s analysis of the judgment was hindered by the cognitive dissonance brought on by his difficulty in believing that renting televisions was a thing that people did, once upon a time, juxtaposed with hazy recollections of visiting a high-street shop with his mum to pay the rental fees.

Which of today's companies will, twenty years hence, turn out to have had business strategies that elicit blank looks from anyone under 30? Somewhere, there's a rejected *Back To The Future* script in which Marty McFly tries to persuade a group of scornful company executives that by 2018 televisions are to be had in the local supermarket for less than the price of a cheap ticket to a Bon Jovi concert…

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[8] <https://ec.europa.eu/info/sites/info/files/180427-notice-withdrawal-uk-iorp_en.pdf>.
[9] <https://www.gov.uk/guidance/changes-to-form-c1331-used-to-declare-a-pleasure-craft-cip8>.