HYMANS ROBERTSON

Current issues

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Articles this month:

FCA Retirement Outcomes Review: proposed changes to rules and guidance

The Financial Conduct Authority (FCA) has come forward with proposed changes to its rules and guidance following completion of its Retirement Outcomes Review.[1] The Retirement Outcomes Review (ROR) looked at how the defined contribution (DC) retirement income market is evolving and to address any emerging issues. It focused on people who do not take regulated advice and who look to their pension provider or public sources for support and guidance around their retirement decisions. It concluded that competition is weak, few people switch away from their existing provider, many are poorly informed about their investments and whether they are suitable, and that charges might be too high in some cases.

Research findings

The 2015 Freedom and Choice reforms gave people more flexibility in how and when they can access their retirement savings. Members of DC schemes no longer have to purchase an annuity and they can draw income from their accumulated fund either using drawdown or by making a cash withdrawal (known as an uncrystallised funds pension lump sum). The ROR is about the drawdown market.

The FCA's research found that people who do not take advice struggle with their choice of provider, where to invest their drawdown pot and what level of income to take in retirement.

They found that around one in three people who recently commenced drawdown were unaware where their money was invested. Overall, thirty-three per cent of non-advised drawdown cases were wholly invested in cash, in some cases because providers are defaulting people into such funds. A wider mix of assets could significantly increase the income of a person planning to withdraw their drawdown pot over the long term.

The FCA is concerned about the lack of competition in the market and the implications this has for charges. Ninety-four per cent of people who did not take advice remained in the drawdown option with their existing provider compared to thirty-five per cent of individuals who took regulated advice. Non-advised drawdown management charges vary significantly—0.4% to 1.6% per annum—and, on average, are higher than accumulation charges,

[1] <www.fca.org.uk/publication/consultation/cp18-17.pdf>

some of which are capped at 0.75% p.a. Drawdown charges can also be complex and difficult to compare, which makes it hard for people to shop around for the best products. Despite this, and the current lack of product innovation, the FCA believes that the market will develop as drawdown pot sizes increase, and is prepared to give it more time to do so before it considers taking further action.

Consultation

The FCA is proposing a '*remedy package'* to address the problems that it has identified. This package aims to:

- protect consumers from poor outcomes;
- improve consumer engagement with their retirement income decisions; and
- increase competition between product providers.

Protecting consumers from poor outcomes

The FCA sets out a range of possible consumer-protection proposals for discussion. It proposes to require providers to offer a choice of three '*investment pathways*' to non-advised individuals. An investment pathway would be a '*ready-made investment solution'* that meets a broad objective corresponding to how a person might want to use their drawdown pot (the FCA is '*minded*' to prescribe these objectives); they would be mass-market products, and not intended to be '*optimal*' for non-advised individuals in every situation.

The description of an investment pathway and its risk profile would have to be clearly communicated to the individual. Providers would be free to offer other investments in addition to the pathways.

The FCA says that it is not minded to impose a charge cap on the investment pathways at this stage, nor across the drawdown market as a whole. Generally, it says that the market is still evolving and that the FCA has other ways of dealing with pricing issues. Moreover, it does not currently know the '*right*' price for investment pathways. However, it says that it expects providers '*to challenge themselves on the level of charges they impose on investment pathways, using the charge cap on default arrangements in accumulation of 0.75% as a point of reference*'. It proposes to review charges a year after the introduction of investment pathways; any problem will likely result in the introduction of a charge cap.

Views are also sought on whether the FCA should prevent people in drawdown from making investments in cash, or cash-like assets unless through choice. The FCA expects providers to address the cases of people already in drawdown who were automatically invested in cash and for whom that may not be in their long-term interests.

If the FCA takes these proposals forward it will consult on proposed rules in January 2019.

Improving consumer engagement

It is proposed that 'wake-up' packs are sent to people from age 50—earlier, if they request a retirement quote before then—and every 5 years thereafter until they have fully crystallised their pensions pots. These packs will include a single-page summary document and, depending on further consultation, retirement risk warnings. It will not be possible to include any marketing material in these packs.

The consultation refers to the FCA's responsibility under the *Financial Guidance and Claims Act 2018* to set the rules regarding, for example, what constitutes appropriate pensions guidance in the absence of regulated advice. The Act requires the FCA to consult with the new 'single financial guidance body', which has still to be set up.

Those considering purchasing an annuity must be made aware of their potential eligibility for an enhanced annuity (that is to say, one that takes account of individual health or lifestyle factors). If eligible, after assessment by the provider, they must be provided with the highest quote on the open market for an enhanced annuity. It is proposed that providers must also provide information on the best rate in the open market if an individual requests an income-driven annuity quote (i.e. how much it would cost to purchase an annuity providing a specific level of income).

Increased competition between product providers

Providers would have to include certain information about their product along with the Key Features Illustration before people commence drawdown (or take an uncrystallised funds pension lump sum). This includes a one-year charge figure in pounds and pence.

Once in drawdown, annual information would have to be provided to remind people to review their investment pathway decision and their ability to switch if it is no longer appropriate for their circumstances.

Consultation arrangements

Responses to the consumer-protection proposals are due by 9 August 2018; responses to the remaining proposals should be submitted by 6 September 2018.

It is encouraging to see the FCA proposing that providers show the first-year charge in pounds and pence, thereby allowing people to compare charges on products across a number of providers. However, a comparison based solely on charges is too simplistic in this market, and other factors (e.g. investment performance) need to be taken into account.

Although the FCA has not explicitly proposed a charge cap for drawdown investment pathways at this stage—because it does not know what the 'right' charge is—its comments arguably point toward a figure of 0.75 per cent p.a. if they are introduced. Whether the 0.75 per cent p.a. charge cap for default accumulation funds is necessarily the 'right' charge cap for default decumulation funds is a moot point given the relative pot sizes and the other differences (e.g. administration requirements) between the two products.

People who do not take regulated advice need help understanding what a sustainable withdrawal rate is in order to avoid running out of money in their later years. It is common for them to significantly underestimate how long they might live, and they need help to understand and frame their income in the context of their actual life expectancy. Longevity risk is not being managed in current non-advised drawdown strategies.

Regulator updates chair's statement guide

The Pensions Regulator has produced an updated guide to the annual governance statements that must be produced for schemes with money purchase benefits, and signed by the chair of trustees (hence the usual abbreviation, 'chair's statements').[2] The guide complements the Regulator's *Code of Practice 13: Governance and administration of occupational trust-based schemes providing money-purchase benefits*.[3] The new version incorporates recent changes made by legislation.[4]

The guide sets out the legal requirements in relation to the chair's statement and how the Regulator expects trustees to meet them. It includes a detailed checklist for them to use and examples of good practice and common mistakes. As regards the latter, it seems that trustees often fail to include a copy of the complete statement of investment principles for the default arrangement, and will frequently assert that requirements were met rather than explaining how compliance was achieved. To improve the readability of the statement, the Regulator has also produced an example technical appendix that trustees can refer to rather than listing specific requirements in the statement itself.[5]

We are aware of trustees being sent penalty notices that were immediately cancelled, relating to chairs' statements for 2016, when the Regulator had issued little guidance on what should be covered. It is encouraging to see the Regulator now produce this level of guidance and support for trustees.

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[2] < www.thepensionsregulator.gov.uk/trustees/communicating-with-members-in-your-dc-scheme.aspx#s22192>.
[3] < www.thepensionsregulator.gov.uk/codes/code-governance-administration-occupational-dc-trust-based-schemes.aspx>.
[4] <www.hymans.co.uk/media/uploads/1804_Current_Issues.pdf>.
[5] <www.thepensionsregulator.gov.uk/docs/chair-statement-quick-guide-appendix.pdf>.

Ban on pensions cold calling: consultation

Her Majesty's Treasury (HMT) is consulting on draft regulations that will implement a ban on cold calling in relation to pensions.[6] Having already consulted on legislation, they describe this as a 'technical consultation' with the intention of seeking final views on the draft regulations to ensure they meet the policy objectives.

Policy objectives

The objective is to ban pensions cold calling. Exceptions will be made only where the call is from someone regulated by the Financial Conduct Authority or trustees or managers of occupational pension schemes regulated by The Pensions Regulator, and:

- the recipient has given specific consent to receive pensions marketing calls from the calling organisation; or
- the recipient has an existing client relationship with the caller and would expect to receive unsolicited calls.
- There is no intention to block legitimate calls, such as calls from the third-party administrator of an individual's pension scheme, which would not in any case constitute 'marketing'.

The ban will cover a wide range of activities that encourage individuals to access their pension savings—often resulting in unanticipated tax charges—in order to invest in inappropriate investments. Examples include offers of a free pension review, inducements to hold certain investments within a pension wrapper and inducements to transfer to another pension arrangement.

Enforcement

The Information Commissioner's Office (ICO) currently enforces restrictions on unsolicited electronic direct marketing and restrictions on direct marketing calls. It is proposed the ICO will also take responsibility for enforcing the ban on pensions cold calling. The Government does not intend to impose criminal sanctions on those in breach of the cold-calling ban as the FCA and other law enforcement agencies already have sufficient powers to tackle any fraudulent activity. The ICO's jurisdiction would not extend to firms located overseas unless they are calling on behalf of a UK company. Consumers would be able report instances of unlawful marketing directly to the ICO.

The consultation will close on 17 August 2018 and, subject to timetabling, the Government intends to lay the regulations before both Houses of Parliament in autumn 2018.

As the ICO's jurisdiction does not extend to overseas callers it remains to be seen how successful this ban on pensions cold calling will be in practice.

Select Committee report on collective defined contribution pensions

The House of Commons Work and Pensions Committee has published a report on collective defined contribution pension schemes.[7] The Committee calls on the Government to '*move quickly*' to allow the creation of the UK's first collective defined contribution (CDC) pension scheme, following the agreement between the Royal Mail and the Communication Workers Union.[8] The Committee says that '*this could transform the UK private pensions landscape*'.

The Committee launched an inquiry into CDC pension schemes in November 2017. Its broad scope was to find out if the introduction of CDC schemes could deliver benefits to savers and the wider economy compared to the other types of pension schemes; whether conversion to CDC could be an option for defined benefit (DB) schemes; and to assess all the regulatory, governance and industry issues associated with their introduction.

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[6] <www.gov.uk/government/consultations/ban-on-cold-calling-in-relation-to-pensions>.
[7] <https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/580/580.pdf>.
[8] *Current Issues* March 2018.

CDC pension schemes

In the Committee's view, CDC schemes have the advantage of a '*middle ground'* between DB schemes that are in decline and individual DC arrangements which, although growing fast under automatic enrolment, still require the individual to manage the investment and longevity risk. By contrast, CDC schemes offer the following advantages:

- retirement income is in the form of a 'target benefit';
- changes in the scheme funding position result in an adjustment to the target benefit rather than extra employer contributions;
- the risk pooling of a CDC scheme could result in higher and more stable benefits compared to individual DC arrangements;
- offering individuals more choice is consistent with the 'freedom and choice' reforms that were made in 2015; and
- this approach is already being used successfully in other countries such as Denmark and the Netherlands (although they recognise the problems some schemes in these countries faced after the financial crisis in 2008-09).

It sees CDC schemes offering the possibility of collective pension arrangements extending across industries, professions and to the self-employed.

The Committee recommends that CDC schemes should be governed by a board of trustees and authorised and supervised by the Pensions Regulator. It also recommends that the Government consults on the benefit-adjustment and risk-sharing policies (which would be key); the regime for transfers out of a CDC scheme; and whether CDC scheme trustees should have specific qualifications.

In its written evidence to the inquiry, the Government expressed its reluctance to provide for the creation of CDC schemes through the commencement of the Pensions Scheme Act 2015.[9] It made the point that this approach would be too disruptive and only one single company and union had expressed any substantial interest in CDC schemes to-date. However, the debate has moved on since then, to the less-onerous option of re-defining 'money purchase benefits' using regulations under the Pensions Act 2011. Judging by the DWP Minister's appearance in front of the Committee the Government is more receptive to that approach.

Further extension proposed to exemption from central clearing obligation

The European Commission is proposing to extend pension schemes' exemption from the obligation to clear over-the-counter derivative contracts through central counterparties.[10] However, the legislation allowing it to do so will not be in place until after the expiry of the current exemption. The relevant regulatory authorities have responded to this lamentable legislative lacuna by, in essence, indicating that technical breaches committed by schemes during the interim will be ignored.

The European Market Infrastructure Regulation (EMIR), the EU legislation about derivative contracts, allows a temporary exemption from the clearing obligation when derivatives are used by pension schemes for hedging purposes. This is in recognition of the difficulty that schemes would have in complying with the requirement to centrally clear trades; in particular, a portion of the collateral to cover potential losses must be in the form of cash.

The current exemption is set to expire on 16 August 2018. It was initially set to expire on 16 August 2015, but the legislation allowed it to be extended by up to three years to give central counterparties more time to come up with a viable technical solution to the problem, such as developing the systems necessary for them to be able to accept non-cash assets as collateral. As no solutions have been developed to-date, the Commission proposes to amend the EMIR to generally extend the temporary exemption for two years, with the option to extend it by a further year.

[9] <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/work-and-pensions-committee/collective-defined-contribution-pension-schemes/written/77698.html>.
[10] <www.europarl.europa.eu/news/en/press-room/20180607IPR05253/revised-rules-for-otc-derivatives>.

For small schemes, which do not present the same risks as larger schemes, it proposes to extend the temporary exemption for three years, with the option to extend it by a further two years.

The European Securities and Markets Authority (ESMA) issued a statement on 3 July 2018 indicating that it does not expect the relevant EMIR amendments to be made before the temporary exemption expires, on 16 August 2018.[11] To address this timing gap, ESMA expects national competent authorities to '*prioritise their supervisory actions towards entities that are expected to be exempted again in a relatively short period of time, and to generally apply their risk-based supervisory powers in their day-to-day enforcement of applicable legislation in a proportionate manner'.*

On 6 July 2018, the Financial Conduct Authority issued its own statement confirming that 'we will not require pension schemes arrangements and their counterparties to start putting processes in place to clear derivatives for which they are currently exempt from clearing under EMIR during such timing gap' but they 'continue to recognise that the clearing of derivatives is a prudent risk management tool'.[12]

Reforms proposed for investment consultancy & fiduciary management

The Competition and Markets Authority has published a report detailing the decisions it has reached, provisionally, on the basis of its market investigation into the investment consultancy and fiduciary management sector.[13] The report makes a number of proposals intended to increase competition in this sector and help trustees assess and compare firms, especially in the fiduciary management market.

Provisional findings

The Competition and Markets Authority (CMA) started its market investigation in September 2017 following a reference from the Financial Conduct Authority (FCA)[14]. Its provisional conclusion is that neither the investment consultancy market nor the fiduciary management market is highly concentrated, with a sufficient number of providers in both markets, and that barriers to entry are not high. However, in both markets it has identified weaknesses that lead to potential adverse effects on competition in the sector.

The CMA seeks feedback on its provisional decision report by 24 August 2018. The statutory deadline for the publication of its *final* report is 13 March 2019.

Fiduciary management

The CMA's more serious concerns were found in the fiduciary management market. They are that:

- many scheme trustees do not shop around when first moving into fiduciary management;
- a lack of clear and comparable information on performance and fees that will help trustees make a good choice when picking a fiduciary manager or assessing their existing one;
- firms that offer both investment consultancy and fiduciary management enjoy an incumbency advantage when selling fiduciary management to their existing consultancy clients;
- investment consultants steer their customers to their own fiduciary management service making it less likely that they shop around; and
- it can be very costly and time-consuming to switch fiduciary manager.

[11] <www.esma.europa.eu/sites/default/files/library/esma70-151-1462_communication_on_clearing_obligation_for_pension_scheme_arrangements_0.pdf>.
[12] <www.fca.org.uk/markets/emir>.
[13] <https://assets.publishing.service.gov.uk/media/5b4f4db2e5274a730e4e273b/investment_consultants_market_investigation_provisional_decision_report.pdf>.
[14] <www.gov.uk/government/news/cma-launches-market-investigation-into-investment-consultants>.

Investment consultants

It found that the following factors weaken the competitive pressure on investment consultancy firms:

- there are low levels of engagement on investment matters by some trustees, especially in defined contribution and smaller schemes; and
- as with fiduciary management, there is not enough information on the quality of investment consultancy services for trustees to judge whether or not they are getting a good deal.

Proposals

The CMA proposes a number of changes to address these provisional findings:

- trustees selecting their first fiduciary manager must run a competitive tender and those that have appointed a fiduciary manager without going through a tendering process must put the role out to tender within five years[15];
- so that trustees have the information they need to make meaningful comparisons between different providers, fiduciary managers must provide disaggregated information on fees, greater information on costs, and how they have performed for other clients;
- adoption of common standards for reporting on performance by both investment consultancy and fiduciary management firms;
- trustees will be required to set strategic objectives with their investment consultants and the consultant should report on progress in meeting these periodically;
- the Pensions Regulator should provide new guidance for trustees on how to choose and scrutinise providers; and
- the Government should broaden the FCA's regulatory scope to include the main activities of investment consultants and fiduciary managers.

The proposals appear to have a greater impact on fiduciary managers than investment consultants although the initial reaction from both groups has been broadly welcoming. The CMA is not proposing the sort of radical shake-up of the market that had been mooted at some points during the process, and the industry will be well placed to deal with its proposed changes.

Mandatory competitive tendering for schemes considering a move to fiduciary management is a sensible step in the right direction. Ensuring that there is independent advice on selection and appointment of a fiduciary manager would be another.

Encouraging competition within investment consultants is also important. However, the CMA notes that in its view the five-yearly switching rate of 27 per cent does not raise major concerns. It also notes that the cost of switching is not acting as a barrier. Given the availability of independent trustees and expert procurement firms, most schemes do have the resources to assess investment consultants and in its analysis the CMA reports that 75 per cent of schemes not changing advisers are happy with the service they receive, the quality of advice and the relationship.

More transparent material around the value that investment consultants are adding can help trustees, and it is encouraging to see that trustees will be required to set their investment consultants strategic objectives and firms must report against them. We already help clients set strategic objectives and are very happy to be measured against them. It should be standard practice. The CMA recognises that the material and measures must reflect the long-term nature of the decisions and the relationship. A focus on short-term measures would lead to an industry focused on short-term advice, which would go against the key principles set out in the 2001 Myners Review.

[15] We note that in its online summary of the Report, the CMA suggests that competitive tendering should be required after *seven* years: <www.gov.uk/government/publications/investment-consultancy-market-investigation-summary-of-provisional-findings/serving-uk-pension-schemes-better-provisional-findings-from-the-cmas-investigation-into-investment-consultancy>.

Trustees' role was to manage, not design, scheme

The Court of Appeal has invalidated a unilateral decision by pension scheme trustees to give themselves power to grant discretionary increases, which they used to partially offset the effects of the switch from the RPI to the CPI as the basis for statutory increases.[16] The Court held (by a 2:1 majority) that they had used their amendment power for an improper purpose, having arrogated to themselves the responsibility for designing the scheme, when their role under the trust deed was to manage and administer it.

Background

The defined benefit scheme at the heart of the case was closed to new members in 1984, in preparation for the privatization of the sponsoring employer in 1987. At the time of its 31 March 2012 actuarial valuation it had a deficit of £680m on its scheme-specific funding basis, and £1.538bn on a buy-out basis.

As a legacy of state ownership, the scheme's rules provided for pensions in payment to increase annually in accordance with the Pensions Increase (Review) Orders made by Her Majesty's Treasury in connection with public sector pensions. Historically, the basis for the Orders was the Retail Prices Index (RPI), but in June 2010 the Government announced that they would thereafter be based upon the Consumer Prices Index (CPI).

By a unanimous decision, taken in 2011, the trustees amended the scheme rules to give themselves the power to award discretionary increases on top of the CPI-based increases set by the Orders. The new discretionary-increase power was likewise to be exercised without the need for employer consent, but was subject to the agreement of at least two-thirds of the trustees, and procurement of appropriate professional advice. They used their discretion for the first time in 2013, to award pensioners an additional 0.2 percentage-point increase (representing half the gap between the CPI and RPI at the time), with effect from 1 December 2013.

The employer challenged the validity of both the rule amendment and the awarded increase. The High Court ruled in the trustees' favour. (For more of the background facts and details of the High Court's decision, see *Current Issues* June 2017.[17])

Scheme rules

The trust deed described the trustees' role: it was to '*manage and administer the scheme*'. They were generally empowered '*to perform all acts incidental or conducive to such management and administration*' and '*to the attainment of the objects of the scheme*'. They had specific power to amend or add to the scheme, if a two-thirds supermajority resolved to do so, and provided that the amendment did not (amongst other things) '*have the effect of changing the purposes of the scheme*'.

Judgment

The judgment of the majority of the Court was that the trustees' use of the scheme amendment rule to introduce the discretionary increase power, and their exercise of that purported power, were for purposes contrary to those of the scheme. The decisions were, therefore, invalid.

The prevailing opinion, having considered the terms of the trust deed and the relevant case law, was that '*the function of the trustees* [was] *to manage and administer the scheme; not to design it.*' Use of a power in a way that alters '*the constitutional balance*' risked breaching the '*proper purpose principle*', which says that a discretionary power conferred on trustees, however widely expressed, must not be exercised for an improper purpose. It was not the case that '*the trustees can do whatever they like so long as their ultimate purpose is to provide pensions.*'

[16] *British Airways PLC v Airways Pension Scheme Trustee Ltd* [2018] EWCA Civ 1533.
[17] <www.hymans.co.uk/news-and-insights/research-and-publications/publication/current-issues-june-2017/>.

The true purpose of the amendment rule was to '*give the trustees a wide power to … make those changes which may be required by the exigencies of commercial life.*' It was never intended to permit them to impose discretionary increases upon the employer.

The suggestion that the majority's conclusion '*emasculates* [the amendment power] *and reduces the trustees to little more than a cypher*' was rejected as '*mere polemic*'. As one judge put it, the trustees' stated role

'*does not preclude them from making decisions that have financial repercussions for the employer … But there is nothing to suggest that the power of amendment was intended to give the trustees the right to remodel the balance of powers between themselves and the employer.*' In practice, '*the trustees are arrogating to themselves the responsibility for* designing *as opposed to managing and administering the scheme, in circumstances in which (a) the fund is in deficit and (b) the employer would be required to make additional contributions not for the purpose of funding benefits already promised but for funding additional benefits decided upon by the trustees. That is not the trustees' constitutional function under the trust deed.*'

The concurring judgment said that the addition of the discretionary increase power '*resulted in a scheme with a different overall purpose, in which the trustees effectively added the role of paymaster to their existing responsibilities as managers and administrators.*'

The dissenting judge was concerned that the trustees would be placed '*in a position of complete uncertainty about the scope of their powers*', and that the proper purposes principle was being used in a novel fashion. One of his colleagues responded that in this case '*it is the actions of the trustees that are novel, not the application of the rule.*' It was not enough that the trustees' decisions were subject to safeguards such as the need for a supermajority and actuarial advice: the question was '*not whether the brakes were working but whether the journey itself is permitted.*'

The circumstances of this judgment are somewhat unusual, but if it remains standing the comments about trustees' role might be raised during other discussions about the 'constitutional balance' in defined benefit schemes. We understand that there is likely to be a further appeal, to the Supreme Court.

Proposed changes to PPF rules around benefits from transfers

The Department for Work and Pensions plans to amend the Pension Protection Fund legislation to negate a 2017 High Court judgment.[18] The direct effect of the Court's ruling was to require the PPF to treat fixed pensions arising from transfers separately from pensions accrued 'in scheme', thereby reducing the impact of the compensation cap for some members; but the DWP has identified other, unintended consequences of the decision.

The consultation period ran from 3 July 2018 until 24 July 2018.

Beaton v The Board of the Pension Protection Fund[19]

In *Beaton*, the High Court said that a fixed pension awarded by a scheme to a member in connection with an inward transfer was not '*attributable to his pensionable service*' under that scheme. The ruling meant that legislation requiring the aggregation of certain benefits before application of the PPF compensation cap was ineffective in such cases, in contrast to examples where members are credited with additional, notional periods of service in return for transfers.

Proposals

The DWP says that the PPF's practice of treating fixed pensions like notional service was in tune with its policy intention. It also points out that the phrase '*attributable to … pensionable service*' occurs elsewhere in the PPF compensation rules, in contexts in which the Court's interpretation would be detrimental to the recipient of the

[18] <www.gov.uk/government/consultations/changes-to-the-pension-protection-fund-ppf-compensation-regulations>.
[19] [2017] EWHC 2623 (Ch).

compensation. Most notably, it could exclude fixed pensions from consideration when survivors' benefits, revaluation of deferred benefits, and increases to benefits in payment are calculated.

The Government is therefore proposing to amend the PPF legislation to ensure that fixed pensions derived from transfers are treated as though attributable to pensionable service when compensation is calculated.

As well as increasing PPF costs, the judgment would have resulted in incongruous treatment of transferred benefits, depending on whether a fixed pension was awarded or the member was credited with extra service. On that basis, and in light of the possibility of other, unintended consequences of the decision—the judge did acknowledge the existence of 'anomalies', but felt bound to apply the normal and conventional meaning of the language—the proposals seem sensible.

Members who retain final salary link after accrual ends not 'in pensionable service'

Employees whose benefits continued to be calculated by reference to the salaries they earned in an employment after their pension scheme closed to accrual were not '*active*' members, according to a recent High Court ruling.[20] The judgment was an important one for the sponsors of the scheme, because it meant that none of them would become liable to pay a 'section 75' debt merely by ceasing to employ any members.

Employer debts

Section 75 of the *Pensions Act 1995* forms the basis for the 'debt on the employer' rules for defined benefit pension schemes. They specify various circumstances in which participating employers are required to make good any deficiency in their scheme's assets. One such case is where a sponsor of a multi-employer defined benefits scheme ceases to employ '*active*' members at a time when the scheme is otherwise open to accrual, so that an '*employment-cessation event'* is deemed to have occurred. If at that time there happens to be a shortfall in the scheme's assets, measured against the costs of buying out the members' benefits with an insurance company, the employer in question becomes liable to pay its share of the deficit. If, by contrast, accrual stops for all of a scheme's participating employers, simultaneously, it becomes a 'frozen scheme', and there is no automatic requirement to calculate and deal with the employer debt.

The statutory definition of '*active member*' is '*a person who is in pensionable service under the scheme*'; and '*pensionable service*' means '*service in any description or category of employment to which the scheme relates which qualifies the member (on the assumption that it continues for the appropriate period) for pension or other benefits under the scheme*'.

Facts of the case

The judgment concerned a final salary pension scheme that had been amended to stop benefit accrual. However, the scheme rules had been interpreted as preventing any amendment from severing the link to final salary. Consequently, the amendments had created a new category of membership for those who remained in the employment of a scheme sponsor after the closure date. The pensions of '*employed deferred*' members were subject to an underpin that entitled them to have their benefits increased in line with their salaries, if that was more valuable than statutory revaluation in deferment.

The scheme's principal employer asked the Court to confirm that, despite the final salary link, the scheme had no active member and was frozen.

Judgment

The judge concluded that the members in question were not in pensionable service, because their post-closure-date service did not qualify them for further pension rights; instead it simply quantified the rights that they had

[20] *G4S Plc v G4S Trustees Limited & Another (In the Matter of the G4S Pension Scheme)* [2018] EWHC 1749 (Ch).

already earned. Hence, the members had ceased to be in pensionable service on the closure date, and the scheme had at that time become a frozen scheme for employer-debt purposes.

This DB scheme is by no means alone in having been closed to future accrual, but with the retention of a link to final salary. The Court's judgment will be welcomed by sponsoring employers who would otherwise be at risk of potentially eye-watering buy-out debt demands merely because of ordinary staff changes.

Gender recognition & State pensionable age

The UK contravened EU legislation when it required a transgender woman to annul her marriage to her wife in order to claim her State pension from the same age as other women.[21]

The challenge to UK law was brought by a person who was born male, in 1948, has been married since 1974, and underwent a transition to female during the 1990s. State pensionable age for someone born in 1948 is 60 for a woman and 65 in the case of a man (the process of equalizing SPAs began with women born on 6 April 1950). In order to receive her State pension at that age, in 2008, she needed a 'full' gender recognition certificate (GRC); but she could not obtain such a certificate without having her marriage annulled (this being around six years before same-sex marriage was permitted in the UK). She met all of the other criteria (physical, social and psychological) for a full GRC. She and her wife had religious reasons for not annulling their marriage.

The UK Government argued that matters of civil status fell within its competence. The Court agreed but said that the exercise of that competence was subject to the principle of non-discrimination on grounds of sex, which extended to discrimination arising from gender reassignment. The UK legislation involved less-favourable treatment of someone who changed gender after marrying, compared to a married person who retained his or her birth gender, which could amount to direct discrimination. The UK Government argued that those cases were not wholly comparable, because—at the time in question—a person who had been female from birth could not be married to another woman, but a transgender woman could end up in a same-sex marriage. It said that the purpose of the marriage-annulment condition had been to ensure that same-sex marriages, which were not permitted then, did not come about indirectly in this way. The Court disagreed. It said that the Government's argument made marital status the decisive element in determining comparability, whereas marital status was not otherwise relevant to eligibility for the State pension in question. The legislation was directly discriminatory on grounds of sex, and therefore unlawful.

Reform on the cards

Coincidentally, the Government launched a consultation exercise about reform of the *Gender Recognition Act 2004* in July 2018.[22] It seeks to explore ways of making it easier for transgender people to gain legal recognition, noting that the current criteria are felt to be bureaucratic, expensive and intrusive.

The world, or at least UK legislation, has moved on from the position that existed when this transgender woman reached State pensionable age: since the passage of the Marriage (Same Sex Couples) Act 2013, a married person can have a change of gender legally recognized without having to annul his or her marriage. The judgment is most directly relevant to similarly historical cases.

In the area of occupational pensions, our understanding is that there are some remaining questions over the legal implications of a change of gender. Generally, the effect of a full gender recognition certificate is that the person's gender becomes for all purposes the acquired gender, but that does not affect things that happened before the certificate is issued. The Gender Recognition Act 2004 deals explicitly only with guaranteed minimum pension (GMP), where the effect of a GRC is that there is no change to the accrued benefit (which was built up in accordance with the person's birth sex), but the payment date becomes the one that is relevant to the acquired

[21] *MB v Secretary of State for Work and Pensions* (Case C-451/16).
[22] <www.gov.uk/government/consultations/reform-of-the-gender-recognition-act-2004>.

sex. The low numbers of people seeking GRCs have meant that most schemes will not have had to confront the uncertainties. The move to make the process less intrusive and bureaucratic might change that.

HMRC newsletters

Her Majesty's Revenue and Customs (HMRC) has published several updates since the last edition of *Current Issues*.

Pension Schemes Newsletter 100

The topics covered in this Newsletter include the operation of the new Manage and Register Pension Schemes Service; the information HMRC will provide to a transferring scheme's administrator(s) about the receiving scheme's registration status; the imminent re-release of the annual allowance calculator; and confirmation that the current PAYE treatment of flexible pension drawdown payments will remain place (although HMRC will keep this under review).[23]

Countdown Bulletin 35

Finally, HMRC has published the latest Bulletin in a series designed to deal with the aftermath of the abolition of contracting out.[24] It points out that there are '*no plans at this time*' to extend the December 2018 deadline for the closure of the Scheme Reconciliation Service.

[23] <www.gov.uk/government/publications/pension-schemes-newsletter-100-june-2018/pension-schemes-newsletter-100-june-2018>.
[24] <www.gov.uk/government/publications/countdown-bulletin-35-june-2018/countdown-bulletin-35-june-2018>.

And Finally…

If the *Old Age Pensions Act, 1908* were a person, it could have had its *seventh* congratulatory letter from the Queen* on 1 August 2018, 110 years after the date on which her great-grandpappy signed off on it. We thought we would mark the occasion with some brief highlights so that readers might appreciate how UK pensions—and the bounds of acceptable statutory language—have changed since.

> **On the basis that one is eligible for one's first regal missive of felicitation on one's 100th birthday, a second on the 105th (anything in between being entirely unremarkable), and one per birthday thereafter.*[25]

The Act provided for the payment of up to five shillings a week to British subjects who reached the age of 70, from the beginning of 1909, subject to means-testing (those with '*yearly means*' in excess of thirty-one pounds ten shillings were ineligible) and residency conditions.

Claims for old-age pensions and questions about eligibility were determined in the first instance by a local pension committee appointed by the relevant borough, district or county council. Anyone found to have fibbed in his or her application could be sentenced to up to six months imprisonment ('*with hard labour*') as well as having to repay any pension received.

Claimants would be disqualified if they

- were in receipt of '*poor relief*';
- had '*habitually failed to work*' so as to provide for themselves and their dependants;
- were committed to an asylum under the *Lunacy Act, 1890* or as a '*criminal lunatic*' [insert Donald Trump joke here];
- were '*being maintained in any place as a pauper*'; or
- were convicted criminals (whilst they were in prison and for ten years thereafter).

Additionally, the courts were given discretion to disqualify, for up to ten years, people who were liable to be detained under the *Inebriates Act, 1898*—we promise we're not making these titles up—but only where they were aged sixty or more at the time of conviction.

Perhaps that last qualification was inserted by Members of the Parliament who did not wish to be disadvantaged by their own youthful indiscretions…

[25] <www.gov.uk/get-birthday-anniversary-message-from-queen>.