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Current issues

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Articles this month:

Regulator consults on the 'Future of Trusteeship & Governance'

A new consultation paper from the Pensions Regulator seeks views about the *Future of Trusteeship and Governance*.[1] It asks about ways to raise levels of trustee knowledge and understanding, the ideal composition of trustee boards, and how to remove barriers to consolidation for defined contribution schemes that cannot reach the required standards. Notably, it is the Regulator's ambition that, following the departure from the scene of those that are unable to improve sufficiently, each scheme will each have at least one professional trustee; but it is leery of the *'sole trustee*' model of governance for defined benefit schemes.

The initiative has been prompted in part by the EU's 'IORP II' Directive, under which the UK must (for the moment, at least) require that schemes '*have in place an effective system of governance*'.[2] In response, the Department for Work and Pensions (DWP) made Regulations obliging the Pensions Regulator to produce a new Code of Practice (replacing *Code of Practice No. 9: Internal Controls*) on the matters included in the Directive.[3]

The Regulator has concluded that, although most members of occupational pension schemes are in arrangements that meet expected standards, '*there remains a subset of disengaged trustees that are either unable or unwilling to take action to improve scheme governance*'. The problem is especially prevalent in smaller schemes. It admits that its *21st Century Trusteeship* campaign has not resulted in the desired improvements in this demographic sector.

As part of a general increase in its activity, more schemes can expect to be contacted by the Regulator. Defined contribution (DC) schemes that struggle to raise their standards will be encouraged to consider consolidation.[4] It has plans for a two-year programme of regulatory initiatives on investment governance, record-keeping, and the

[1] <www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/future-trusteeship-governance-consultation-july-2019.ashx>.
[2] *Directive (EU) 2016/2341 on the Activities and Supervision of Institutions for Occupational Retirement Provision*.
[3] The *Occupational Pension Schemes (Governance) (Amendment) Regulations 2018* (SI 2018 No. 1103).
[4] '*While some of broader principles of consolidation cut across DB and DC*', the consultation paper is focused upon DC schemes, noting that work on plans for supervision of commercial consolidators ('superfunds') for defined benefit schemes is ongoing.

processing of financial transactions; to be followed by campaigns about costs and charges, trustee knowledge and understanding, and public-sector administration.

The consultation paper asks:

- whether legislation should be changed to require trustees to acquire a minimum level of knowledge and understanding, perhaps through training or qualifications, with ongoing learning similar to the continuing professional development (CPD) requirements that apply in many areas of endeavour;
- if the TKU standards should be higher for professional trustees;
- whether the Regulator should concentrate on setting and communicating the standards for TKU, whilst leaving the actual provision of training to the market;
- whether there should be a requirement to report on activities intended to foster trustee diversity, and what role the industry should play in creating guidance materials;
- whether all schemes should, eventually, have a professional trustee;
- about the risks particular to the 'sole trustee' model under which a single individual effectively runs a defined benefit scheme, and how those risks can be managed; and
- about obstacles in the way of winding up DC schemes with valuable member guarantees as to, for example, annuity or growth rates.

Responses should be submitted by 24 September 2019.

The consultation paper is notable for the robustness of the Regulator's tone on certain issues. Readers may be surprised by the bluntly stated '*aspiration to see an accredited professional trustee on every board*', and they will be left with no doubts about its intention to push for consolidation as a remedy for persistently poor governance. At the other end of the enthusiasm scale, its wariness about sole trusteeship as a governance model for DB schemes is palpable.

Proposals for putting new trustee investment rules into pensions law, plus draft guidance

The Department for Work and Pensions (DWP) is consulting on proposals for placing new requirements for trustee oversight of investment consultancy and fiduciary management services, as imposed recently by the Competition and Markets Authority (CMA), on a statutory footing.[5] The Pensions Regulator has published draft guidance for trustees on how they should meet their obligations in this area.[6]

Background

As reported in *Current Issues* July 2019, the CMA has ordered certain remedies for problems that it identified in the markets for investment consultancy and fiduciary management services.[7] Amongst other things, the trustees of private-sector occupational pension schemes will be required to operate mandatory competitive tendering for fiduciary management services, and to set strategic objectives for their investment consultants, with effect from December 2019. They must also make regular statements about the extent of their compliance with the requirements. The Pensions Regulator is responsible for monitoring compliance.

[5] *Consultation on Delivering the Competition And Markets Authority (CMA) Recommendation for Trustee Oversight of Investment Consultants and Fiduciary Managers* <www.gov.uk/government/consultations/trustee-oversight-of-investment-consultants-and-fiduciary-managers>.
[6] *Draft Guidance Consultation (In Response to CMA Recommendation)* <www.thepensionsregulator.gov.uk/en/document-library/consultations/draft-guidance-consultation-in-response-to-cma-recommendation>.
[7] See *CMA Orders Changes To Investment Consultancy & Fiduciary Management*, <www.hymans.co.uk/media/uploads/Current_Issues_-_July_2019.pdf>.

Draft legislation

The DWP is seeking views on draft Amendment Regulations designed to transpose those aspects of the CMA's Order into private sector pensions law, effective from 6 April 2020.[8] The proposed legislation replicates the CMA Order for the most part: in some cases, however, some defined terms have been translated where equivalent terminology already exists in pensions law, and there are slight differences in the application of the draft legislation to peripheral cases.

As expected by the CMA, trustees will be required to consider their statement of investment principles when setting objectives for their investment consultants. The objectives must be reviewed at least triennially, and after any substantial change in investment policy. Trustees will have to assess their consultant's performance against the objectives at least once a year. The DWP says in the consultation document that it expects trustees to set objectives that establish clear outcomes and timescales, are relevant and conducive to measurement, but it has not gone into that level of detail in the legislation.[9]

Provision is being made for trustees to report the extent of their compliance with the requirements in the scheme returns provided to the Regulator (this is done annually, through the online *Exchange* system). The DWP is taking the opportunity also to winnow out from the '*registrable information*' required by the return some details that it no longer considers necessary: namely, whether the scheme is a public service pension scheme or has the benefit of a Crown guarantee, and the nature of the business of its sponsoring employer(s).

The consultation period runs from 29 July to 2 September 2019.

Draft guidance

The CMA recommended that the Regulator produce guidance to help trustees meet the new obligations. The Regulator has now published that guidance in draft form for consultation purposes. Separate draft guides deal with

- how to competitively tender for a fiduciary manager;
- how to choose and monitor the performance of an investment consultant;
- how to set objectives for investment consultants and decide what services are required; and
- how to choose an appropriate investment governance model for a scheme.

Regulator expects review will lead to a single Code of Practice

The Pensions Regulator has announced that over the next year it will review its fifteen Codes of Practice and expects to combine them to form a single, shorter Code.[10] It intends to make the information '*quicker to find, use and update, so that trustees and managers of all types of scheme can be more responsive to changes in regulation*'.

The Regulator's initial focus will be on the Codes most affected by the expanded governance requirements that arise as part of the transposition of the IORP II Directive into UK law.[11] It will review Codes of Practice 9 (*Internal Controls*) and 13 (*Governance and Administration of Occupational Trust-based Schemes Providing Money Purchase Benefits*) first, as well as content from Codes of Practice 14 (*Governance and Administration of Public Service Pension Schemes*) and 15 (*Authorization and Supervision of Master Trusts*). Trustees and scheme managers will need to be able to demonstrate that they have an effective system of governance within twelve months of publication of the updated and consolidated Code.

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[8] In the consultation paper the DWP supports the conclusion that the Local Government Pension Scheme (LGPS) is within the scope of the Order in so far as it requires the setting of strategic objectives for investment consultants; however, the draft Amendment Regulations will not affect the LGPS, which is the responsibility of the Ministry of Housing, Communities and Local Government.

[9] The DWP's expectations correspond with the SMART criteria, which—as many readers will know—counsel that good objectives ought to be specific, measurable, attainable, relevant and time-bound. It is comforting to know that the Department is *au fait* with 1980s management theory.

[10] <www.thepensionsregulator.gov.uk/en/document-library/statements/single-code-of-practice-statement>.

[11] *Occupational Pension Schemes (Governance) (Amendment) Regulations 2018*. For more detail see *Current Issues* December 2018.

The Regulator is planning to hold a formal consultation later this year. In the interim, it will seek feedback on the proposed design and content of the new governance-focused Code.

It is not clear when the revised Code is expected to come into force, but our current understanding is spring 2020.

This will be a challenging exercise, especially with everything else the Regulator currently has on its 'to do' list, such as the new defined benefit funding code and its 'clearer, quicker and tougher' intervention regime.

Supreme Court denies Government's application for permission to appeal ruling

The Supreme Court has denied the Government's application for permission to appeal against a ruling that transitional protections made during the reform of the Judicial and Firefighters' pension schemes are discriminatory. An Employment Tribunal will now decide on the appropriate remedy for the discrimination. In a written statement the Government confirmed that the Court of Appeal's ruling affects all the main public service pension schemes.[12]

Public service pension scheme reform: a brief recap[13]

Broadly, the reform of public service pension schemes happened in 2012 and involved a shift away from final salary to career average revalued earnings for the future accrual of benefits. The reforms included the provision of transitional protections to ensure that active members within ten years of normal pension age (NPA) on 1 April 2012 were fully protected from the changes, effectively remaining entitled to accrue benefits on their existing terms until retirement. Active members between ten and fifteen years away from their NPAs received a less generous, tapered form of protection which involved limited periods of continued accrual under their existing schemes before being moved into the reformed schemes. Younger members received no protection other than retention of their accrued rights.

The claims and judgments

Groups of judges and firefighters in the tapered- and no-protection categories brought claims against the Government on the basis that the transitional protections amounted to direct age-related discrimination, indirect race-based discrimination, and a breach of the equal pay legislation.

The judges were broadly successful in their initial Employment Tribunal claims and in the Government's subsequent appeal to the Employment Appeals Tribunal (EAT). The firefighters' claims were dismissed, at the first instance, but they appealed successfully to the EAT.

The Government then took the cases to the Court of Appeal. The Court of Appeal upheld the EAT's rulings that the transitional arrangements for judges and firefighters are discriminatory on grounds of age.[14] The claimants were also largely successful in their arguments about the other forms of discrimination. On 27 June 2019 the Supreme Court denied the Government permission to appeal the Court of Appeal's ruling.

Outcome

In its written statement the Government says that remedying the discrimination will add around £4bn per annum to scheme liabilities from 2015. Until the outcome of the Employment Tribunal is known, current planned improvements in member benefits following cost control reviews have been put on hold.[15] However, significant employer contribution increases, mainly due to a reduction in the discount rate used by the Government to assess

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[12] <www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2019-07-15/HCWS1725/>.

[13] For more information on the background to this case see *Current Issues* February 2019, <www.hymans.co.uk/news-and-insights/research-and-publications/publication/current-issues-february-2019/>.

[14] *Lord Chancellor v McCloud* [2018] EWCA Civ 2844

[15] For more information on the cost control mechanism see our Sixty Second Summary, *Caps, cycles and pain: public service pensions race continues* (October 2018) <www.hymans.co.uk/media/uploads/181031_60SS_Cost_cap_-_FINAL.pdf>.

the current value of public service pension liabilities, will go ahead in the unfunded schemes from April 2019 as planned..

Until the Employment Tribunal determines a remedy, the public service schemes will remain in a position of uncertainty over future benefit design and cost, which could be significant particularly in the unfunded schemes.

Revised DC investment governance guidance

The Pensions Regulator has revised its Investment Governance guidance for defined contribution (DC) schemes to reflect recent legislative requirements.[16]

Recent regulations require that, from October 2019, trustees revise their SIPs to set out their policies on: '*financially material considerations*'; the extent to which the views of members and beneficiaries are taken into account; and stewardship.[17] The SIPs will also need to be freely available online.[18] From October 2020, trustees will also need to update their SIPs to incorporate information about asset-management agreements and engagement polices. An annual implementation statement must be produced and be openly available. [19] The statement must set out the trustee's adherence to the investment policies and provide details of voting behavior.[20]

The updated guidance now incorporates these legislative changes and aims to provide further clarity in several areas. The Regulator gives examples of considerations trustees may want to take into account when determining whether financial considerations are material and explains what the Regulator expects from the stewardship policy. The Regulator also provides suggestions for the detail to be included in the implementation report.

Trustees of money purchase schemes will need to ensure they are familiar with the updated guidance and the Regulator's expectations before revising their SIPs to meet the new statutory requirements.

Regulator's DB funding analysis 2019

The Pensions Regulator has published its 2019 Scheme Funding Analysis for defined benefit (DB) and hybrid schemes, covering Tranche 12 schemes (those with valuation dates from 22 September 2016 to 21 September 2017).[21]

The central message of the report is that over the three-year period to 2016/17 the growth in scheme assets matched the increase in scheme liabilities resulting in a relatively unchanged average funding ratio on a technical provisions (i.e. the amount as calculated by the actuary required to meet the accrued benefits of the scheme) basis.

Other statistics of note include:

- that average annual deficit reduction contributions remained largely unchanged in the three years to 2016/17 (at 2.1 per cent of liabilities);
- the average length of time for recovery plans is 7.3 years;

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[16] <www.thepensionsregulator.gov.uk/en/media-hub/press-releases/new-guidance-published-for-dc-investments>.

[17] For more details please see,our Sixty Second Summary, *Clarifying and strengthening trustees' investment duties* (September 2018) <www.hymans.co.uk/news-and-insights/research-and-publications/publication/clarifying-and-strengthening-trustees-investment-duties/>.

[18] *The Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018, SI 2018 No.988.*

[19] *The Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019 SI 2019 No. 982.*

[20] For further information please see our Sixty Second Summary, *New investment rules for DB & DC schemes* (June 2019) <www.hymans.co.uk/news-and-insights/research-and-publications/publication/sixty-second-summary-new-investment-rules-for-db-dc-schemes/>.

[21] <www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/scheme-funding-analysis-2019>.

- 50 per cent of recovery plan end dates are unchanged or have been shortened since the last triennial valuations, with 10 per cent having been extended by more than six years;
- 11 per cent of schemes have a strong employer covenant, 46 per cent are tending to strong, 29 per cent are tending to weak and 14 per cent have a weak covenant;
- 13 per cent of schemes have less than 20 per cent of assets in return seeking investments, 24 per cent of schemes have 20 to 40 per cent in return seeking investments, 39 per cent of schemes have 40 to 60 per cent and 24 per cent of schemes have over 60 per cent in return seeking investments;
- 17 per cent of schemes have a contingent asset (with 70 per cent of these being guarantees);
- 23 per cent of schemes in this tranche are in surplus on a technical provisions funding basis; and
- the average funding level on a technical provisions funding basis is 89 per cent.

Court dismisses appeal against 'Box Clever' financial support directions

The Court of Appeal has dismissed, in unequivocal terms, an appeal against the Regulator's decision to issue financial support directions (FSDs) in the long-running 'Box Clever' case.[22] The judgment examines the implications of retrospection (all of the events on which the FSDs were based occurred before FSDs existed), questions about the connections between the scheme employers and the targets of the FSDs, and other matters relevant to the 'reasonableness' of the Regulator's decision.

Financial support directions

Since 6 April 2005, the Regulator has had the power to issue an FSD if it concludes that a defined benefit scheme's sponsor is '*insufficiently resourced*': that its value (on a prescribed basis) is less than half of the scheme's estimated buy-out deficit at a time when '*connected*' or '*associated*' companies have the wherewithal to make up the difference. The potential targets of the FSD are generally the sponsor and those connected or associated companies. The required financial support can take several forms. The targets must come up with a proposal that meets with the Regulator's approval.[23]

Box Clever

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. They would have benefited had the business been successful, but were insulated from the downside of a continued decline in the TV-rental market.

The new business established a DB scheme in 2001. Granada and Thorn had no funding obligations toward it. When Box Clever went into administrative receivership, in 2003, the scheme had a substantial funding deficit, which has grown since. 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 initial legal analysis of the jurisdiction issue was wrong, it refused to extend the same comfort to Granada.

The Regulator decided to issue financial support directions 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.

[22] Granada UK Rental & Retail Ltd and Others v The Pensions Regulator and Another [2019] EWCA Civ 1032.
[23] The Government intends to amend the legislation so that a renamed financial support *notice* will impose a specified form of financial support upon its target; see *Government Response to the Consultation on Protecting Defined Benefit Pension Schemes: A Stronger Pensions Regulator* (February 2019).

Litigation

The FSD targets appealed the Regulator's decision to the Upper Tribunal. It concluded that the Regulator was able to issue FSDs to the companies, and that its decision to do so was reasonable.[24] The targets appealed further, to the Court of Appeal.

Court of Appeal case

The appeal raised three main issues:

- Was the Regulator allowed to issue FSDs based on events that occurred before the FSD legislation came into being?
- Were the targets '*connected with or an associate of*' any of the scheme sponsors on 31 December 2009?
- Were the FSDs reasonable given that the joint venture arrangement was a reasonable commercial decision, that there was no element of fault or misconduct, and that the targets did not have the opportunity to apply for clearance (which came in at the same time as the FSD legislation)?

Decision

The Court dismissed all of the targets' grounds of appeal. It said that, given the purposes of the legislation, it was unlikely that Parliament had intended to limit the scope of the FSD power to future circumstances. The potential unfairness of a retrospective FSD was one of the considerations that the Regulator had to take into account. The Tribunal was entitled to find that the disadvantage created by retrospection was outweighed by other factors, and that a fair balance had been struck.

Having examined certain debenture terms, which covered the control of voting rights in the event of a default, and the legal effects of the appointment of administrative receivers, the Court concluded that the target companies were still associated (in statutory terms) with the scheme employers at the relevant time.

It also said that it was for the Regulator to decide on the weight to be given to relevant matters when deciding whether an FSD was '*reasonable*'. It was entitled to consider relationships as they existed in the past, and to take account of a benefit received in the past even if it had proved to be less valuable than expected or hoped (and even if that value was not susceptible to precise quantification). Whilst the Court agreed that retrospection '*must be regarded as weighing heavily against the imposition of an FSD*', that was the approach that had been taken. The Tribunal's distinction between 'fault' and 'responsibility' (it regarded the targets as having a high degree of *responsibility* for the failure of the joint venture, even though they were not at fault) was a valid one. There had been no error of law in its conclusion that the factors in favour of issuing FSDs outweighed those against.

Perhaps the Court's ringing endorsement of the Regulator's approach will now allow the parties to get on with the job of deciding what sort of financial support is appropriate in this case. Companies may draw some comfort from confirmation that retrospective effects should weigh heavily against the imposition of an FSD. Having said that, this litigation has gone on for so long that there cannot be many other cases in which the crucial events pre-date FSDs, so the point may be largely (aptly) one of historical interest. The Government plans to make the 'insufficiently resourced' test simpler.[25]

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[24] For more information on the Upper Tribunal's ruling see *Current Issues* June 2018 <www.hymans.co.uk/media/uploads/1806_Current_Issues.pdf>.

[25] See *Government Response to the Consultation on Protecting Defined Benefit Pension Schemes: A Stronger Pensions Regulator* (February 2019).

Pension Charges Bill

A Private Member's Bill, the Pension Charges Bill 2017-19, has been introduced to Parliament under the 'Ten Minute Rule'. The Bill would '*require pension providers to publish standardized information on charges for pension products* [and] *make provision for a cap on such charges*'.

Sponsor of the Bill, Labour MP Angela Eagle, hopes that her changes will contribute to a significant reduction in the total cost of pension fund managements; achieve better value for money; and ensure that a larger proportion of pension savings will go to providing savers with a comfortable retirement.

The text of the Bill is being prepared and has not yet been published. A date for the next stage of the Bill's passage through Parliament (its Second Reading) has not yet been announced.

The Government has already made some progress into reducing pension product charges and improving charge transparency, though clearly there is more that can be done. Private Member's Bills rarely make it to the statute books, so it might be said that this Bill is unlikely to bring about changes in this area directly. Its purpose is probably to keep the issue alive and apply additional pressure on the Government for further reform.

EIOPA's opinions on governance and risk management of pension funds

The European Insurance and Occupational Pensions Authority (EIOPA) has published documents intended to assist 'National Competent Authorities' (like the UK's Pensions Regulator) oversee various governance-related aspects of the IORP II Directive.[26] They cover matters such as the own-risk assessments that occupational schemes will be expected to conduct, operational risks, and environmental, social and governance (ESG) risks.

The UK's implementation of IORP II is being accomplished mostly by way of a revised governance Code of Practice[27]. It is likely that the EIOPA's opinions will influence the Regulator's drafting.

PensionsEurope (a representative body), although welcoming the ongoing dialogue with EIOPA, considers that the opinions overstep EIOPA's remit.[28] It fears that if they are followed by national supervisory authorities they could result in prudential requirements being introduced '*through the back door*'.

It is understandable why PensionsEurope are concerned. In the EIOPA opinion on risk assessment and transparency it states that:

The common framework would ensure an objective and transparent view of the financial position of IORPs and it would provide a comprehensive view of the extent to which pension promises are supported by financial assets and the extent to which they rely on sponsor support, pension protection schemes and benefit reductions.

This bears striking resemblance to the '*holistic balance sheet*' concept (sometimes described as 'Solvency II by the back door') that the EIOPA was instructed to drop.[29] It will be interesting to see how closely the Pensions Regulator's governance Code of Practice follows the opinions.

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[26]< https://eiopa.europa.eu/Pages/News/EIOPA-issues-opinions-on-governance-and-risk-management-of-pension-funds.aspx>.
[27] See our article above, *Regulator expects review will lead to a single Code of Practice for more details.*
[28] <www.pensionseurope.eu/system/files/Press%20release%20-%20EIOPA%20opinions%20on%20IORP%20II%20implementation%20-%202019-07-11.pdf>.
[29]See Recital 77 of the IORP II Directive,< https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32016L2341>.

Joint statement on climate change

The Pensions Regulator, along with the Financial Conduct Authority, Financial Reporting Council and Prudential Regulation Authority, has published a statement acknowledging that climate change is a major issue and presents far-reaching financial risks to their respective mandates.[30]

As part of the statement Charles Counsell, Chief Executive of the Pensions Regulator, makes it clear that the Regulator will be increasingly focused on climate change:

> *Climate change is no longer simply a social responsibility issue. It is a core financial risk impacting broadly across business, the economy and markets. Climate change is a risk to long-term sustainability pension trustees need to consider when setting and implementing investment strategy, while many schemes are also supported by employers whose financial positions and prospects for growth are dependent on current and future policies and developments in relation to climate change. Tackling poor standards of governance and risk management in pensions are priorities for TPR and we welcome working together with other regulators to address these challenges for pension schemes.*

The Divorce, Dissolution and Separation Bill

The *Divorce, Dissolution and Separation Bill* would, assuming it becomes law, introduce changes to the legal processes for obtaining a divorce, dissolving a civil partnership and obtaining a judicial separation.[31] The reforms would remove the incentive under the current system that encourages one spouse or partner to make allegations about the other's conduct in order to expedite the divorce process.

The Bill would also make changes to some of the terminology used in relation to divorce proceedings. In particular, a 'decree nisi' would become a 'conditional order'; 'decree absolute' would become 'final order'; and the term 'applicant' would be used in place of 'petitioner'.

The changes would be brought into force by commencement order once the Bill receives Royal Assent. It should be noted that the main provisions will only affect England and Wales.

Pension scheme trustees should be prepared for a potential increase in divorce calculations following the Bill's enactment. Scheme documentation and member communications relating to pension sharing on divorce will also need to be reviewed to ensure they reflect the new terminology and scheme administrators will need to familiarize themselves with the changes.

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[30] <www.fca.org.uk/publication/documents/joint-statement-on-climate-change.pdf>.

[31] A factsheet summarising the main changes has also been published: <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/808613/divorce-bill-fact-sheet.pdf>.

Court judgments

'Capacity to marry' condition breached unmarried partner's human rights

The Court of Appeal has said that scheme rules contravened a surviving, unmarried partner's human rights where they prohibited payment of survivor's benefits to her because she remained married to another person (from whom she was long estranged).[32] The offending condition is common in public service schemes, and may be a feature of some private sector ones. However, the Court was critical of the defence mounted by the Government, and did not rule out the possibility that such a condition could be justified in other cases.

Facts

A member of the Armed Forces died, leaving an unmarried partner with whom he had lived for fifteen years. Under the rules of the scheme in question, death benefits would have been paid to her if she had been in a '*substantial and exclusive relationship*' with the deceased member, if they were not prevented from marrying, and if there was evidence of financial dependence or interdependence. She met the requirements save for the fact that she remained married to a man from whom she had been completely estranged for seventeen years, so that her relationship with the deceased did not meet the standard for 'exclusivity' as specified in the scheme rules, and she could not have married the member without first divorcing her existing husband. They had declared their intention to marry and made some enquiries towards her obtaining a divorce.

She complained that the rule discriminated against her contrary to Article 14 of the *European Convention on Human Rights*, which says that the rights and freedoms in the Convention are to be secured without discrimination, taken together with Article 1 of the First Protocol, which established the right to peaceful enjoyment of one's possessions.

The Government argued that the rule was necessary for consistency between married and unmarried persons, to prevent 'double recovery' by an unmarried partner who had a spouse who was also a member of a public service pension scheme, and to ensure that the scheme was affordable and administratively workable. It said that any discriminatory effect would be justified unless '*manifestly without reasonable foundation*'.

Judgment

The Court ruled in favour of the surviving partner. It deduced that the goal of that aspect of scheme was that those in stable and exclusive relationships should be in the same position, benefit-wise, whether married or not. Marriage to a third party could be relevant when considering whether the conditions of relationship exclusivity and financial dependence exist. However, the aim and the means of achieving it should not be confused. The exclusionary rule discriminated between the surviving partner and other partners of scheme members who are not married to the member or any other person.

The judges agreed that they had to start from the basis that the difference in treatment would be justified unless it was shown to be without reasonable foundation. However, their examination of the reasonableness of the foundation had to be '*proactive*': it was not persuaded that the claimed foundations for the discrimination were reasonable, so it would have been '*fanciful*' to conclude that they were nonetheless not manifestly unreasonable.

There was no evidence that the Government's points about double recovery and administration had played any part in the formulation of the rule. Whilst it was true that a person could not become the lawful spouse of the member whilst married to someone else, parity with that requirement for unmarried partners would be achieved by making eligibility for benefits conditional on demonstration that a substantial, exclusive and financially dependent relationship existed in practice. Preventing unmarried partners from claiming unless they comply with the preconditions for a lawful marriage '*impairs rather than promotes equality of treatment.*'

The Government had produced no evidence of the likely numbers of people who might otherwise benefit from 'double recovery' from public funds. In any case it could have been prevented more simply by requiring a claimant

[32] *Langford v Secretary of State for Defence* [2019] EWCA (Civ) 1271.

to show that any existing spouse is not a member of a public-sector scheme, so the imposition of the exclusionary rule was '*a sledgehammer to crack a nut*'. No evidence on costs and administrative convenience had been presented by the Government at the earlier stages in the litigation. The Court had rebuffed its attempts to introduce evidence late in the proceedings—and described the rejected material as being '*(with respect) sketchy*'.

The Court qualified its judgment by noting that the exercise of justifying the discriminatory effects of the exclusionary rule had not been properly undertaken by the Government in this case. It could not rule out the possibility of a different result in another case, if sufficient evidence were to be brought forward at the proper stage of the proceedings.

Leaving aside the glimmer of hope that the Court left the Government with (if only it can get its act together), it seems to us that a direction of travel has been signposted by this and other recent cases in which the Courts have struck down unnecessarily large obstacles in the path of claims by unmarried partners. We wonder how long it can be before we see challenges to other conditions common in the public sector, such as the rule in the Local Government Pension Scheme (LGPS) that unmarried partners must have been living together for at least two years at the time of the member's death. After all, if a member stepped into the path of a plummeting Steinway on his or her way out of the church or registry office, that Scheme would pay out automatically, with little to no enquiry about the details of the couple's prior relationship.

Administrator should have been aware of pension tax rules

The High Court has held that the administrator of a pension scheme should have been aware of tax rules about the re-employment of members who are able to retire before reaching the age of 55.[33] It was therefore liable for negligent misstatement when it told the retiring members that they would be eligible for tax-free lump sums, when in actuality its own, near-immediate re-employment of those members made the lump sums (and the associated annual pension payments) unauthorized member payments.

Tax rules

Generally, members of registered pension schemes cannot take their benefits before the '*normal minimum pension age*' (NMPA) of 55 years. Pensions and lump sums received prior to the NMPA are deemed to be unauthorized member payments and attract penal tax charges. In some circumstances, however, transitional provisions that were put in place when the current pensions tax legislation took effect, on 6 April 2006, allow members to retain their rights to receive benefits earlier than the NMPA. Those members are said to have '*protected pension ages*'. One condition, broadly summarized, of the transitionally protected right to retire before NMPA is that that the members must not then be re-employed by a sponsoring employer of the scheme. There are exceptions, though, one of which applies so long as there is a gap in employment of at least a month, and the member's new job is '*materially different in nature*' from the pre-retirement employment.

Facts

The members in question were police officers from two different forces who retired from service at their protected pension ages, but were almost immediately re-employed in various civilian capacities by their respective police authorities. They complained to the Pensions Ombudsman that the relevant police authorities and chief constables had breached their duties toward members by failing to advise or inform them about the tax consequences of re-employment in this fashion. The Ombudsman dismissed the complaints, so the members appealed to the High Court.

The case was complicated somewhat by the roles and responsibilities of the participants. Police officers are officers of the Crown, not employees of the police authority. However, the relationship between chief constable and police officer is considered to be closely analogous to that of employer and employee. The body responsible for

[33] *Corsham and Others v Police and Crime Commissioner for Essex and Another; Hazell and Another v Chief Constable of Avon and Somerset Police* [2019] EWHC 1776 (Ch).

administration of the Police Pension Scheme in a particular area was at the time in question the police authority for that area, but that has since changed.

Judgment

In the Court's judgment, the two police authorities, in their capacity as scheme administrators, ought to have known of the relevant tax provisions. However, there were different outcomes in the cases against the authorities because of disparities in the availability of evidence about what they in fact knew.

One authority said that it was unaware of the one-month rule for re-employment in a different capacity until it received a December 2011 Police Federation circular that highlighted the issue. The judge said that he found that '*a remarkable proposition*' and that it seemed '*wholly improbable that nobody at the relevant bodies had informed themselves*' of the changes, as would have been '*virtually impossible to administer the schemes after A-Day* [6 April 2006, when the pensions tax system was reformed] *unless one had educated oneself properly as to the new provisions*'.

Despite knowing its officers' retirement dates and that it had offered to re-employ them within one month of those dates, it told them that their lump sums would be tax-free. It knew the relevant facts which, combined with the knowledge of pensions tax law that it should have had, would have led to the realization that payments made were unauthorized (and that it was itself liable for scheme sanction charges as a result). This met the tests for negligent misstatement. The judge said that the police authority was not entitled to assume that members would obtain independent advice on the matter, and that they did not act unreasonably by failing to obtain such advice.

The first police authority was accordingly held to have breached its duty of care to the members. A disclaimer in the correspondence with members about the estimated amounts of the quoted benefits, and saying that the decision to commute pension to lump sum was a personal choice, were not effective to disclaim responsibility for the misinformation about the tax-free nature of the lump sums. The members had reasonably relied on the (mis)statements and would have acted differently if they had been given accurate information. The authority was liable to the members for their losses suffered through the penal tax charges that applied.

In the case of the other police authority, the judge did not have specific evidence about the dates when re-employment was offered, when re-employment commenced, and when the members were told about their pension entitlements. He thought it highly likely that, if he did have such evidence, it would lead him to the same conclusion. He said that if the police authority accepted that similar findings of fact were appropriate in its case, the same finding on breach of duty of care would apply. Otherwise, the matter would be remitted to the Pensions Ombudsman to explore the facts and apply the legal principles in the judgment to them.

As regards the complaints against the chief constables, the Court held that they were not liable for the adverse tax consequences suffered by the members. The *Scally* ruling, which established that in some narrow circumstances an employer is under an implied duty to take positive steps to inform its employees about valuable pension rights of which they are unaware, did not apply in this case. There was no right arising from their quasi-employment of which the members were unaware; what they were unaware of were the tax consequences of their near-immediate re-employment by the police authorities, and those consequences were external to the relationship with the chief constables (who, it was noted, were not at the time involved in scheme administration or the members' re-employment).

This ruling is in many ways particular to the unusual circumstances of police service, but the imputation of tax knowledge to the administrator and the discussion of the implied duty to inform employees are perhaps of wider interest. The police authority had, or should have had, all of the necessary information available to it to realize that the members would foreseeably suffer adverse tax consequences as a result of misleading communications. The judge was quite critical of the Pensions Ombudsman's handling of the complaints, which may now, in part, be sent back to the Ombudsman for further consideration.

Same-sex spouses in public sector to have parity with widows

The Government has confirmed how the public service pension schemes will be amended in response to a July 2017 Supreme Court judgment in which it was held that the same-sex spouse of a deceased scheme member was entitled to death benefits based on the whole of the member's service.[34]

Guy Opperman (who remains Parliamentary Under Secretary of State for Pensions & Financial Inclusion) announced that, in the public sector, surviving same-sex spouses and civil partners will, in the majority of cases, receive benefits equivalent to those received by widows in opposite sex marriages. Government departments will consult on and take forward the necessary scheme changes as soon as possible. Opperman said that private sector scheme trustees should obtain advice on how to comply with the judgment.

The statement also represents the Government's response to the 2014 *Review of Survivor Benefits in Occupational Pension Schemes*. It has decided against making other changes to the pensions legislation to retrospectively equalize survivors' benefits. Opperman said that '*While this means that the differences in survivor benefits for accruals in past periods will remain for some, these will work their way out of the system in time.*'

At some point someone is bound to challenge rules that discriminate against opposite-sex widowers in terms of the service that counts when determining their survivors' benefits. The Government baulked at the estimated £2.9bn cost to the public sector of full equalization.

HMRC newsletters

Her Majesty's Revenue and Customs (HMRC) has published *Pension Schemes Newsletter 112* and *Countdown Bulletin 47*. [35]

Pension Schemes Newsletter 112 includes information for administrators of relief-at-source schemes, updated flexible payments statistics, and some reminders about annual allowance pensions savings statements. It also sets out how members should account for annual allowance charges in their tax returns (with pointers towards HMRC's online annual allowance calculator and guidance).

Countdown Bulletin 47 provides updates on the financial reconciliation exercise (whereby any contracting-out-related debts owed by schemes, or refunds owed by HMRC, will be calculated and notified). It states that HMRC expects to start posting invoices to schemes with unpaid State Scheme Premiums around 15 August, sending refund letters around 23 September, and refund cheques by 28 October. Breakdowns of final scheme bills will begin to be available online (via the Shared Workspace e-room) from 15 August (HMRC notes that this could mean that the breakdown of the bill is available before the final bill arrives in the post).

Schemes that receive bills will have until 17 October to pay them. Where bills are not paid, liability for guaranteed minimum pensions (GMPs) for some or all scheme members will be re-instated in the scheme without further notice, and will appear in the final lists that are issued by HMRC in late 2019.

The Bulletin also reminds administrators that schemes with total bills of less than £1,000 will be written off, as will any debt that is over 6 years old at 8 August 2019.[36]

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[34] *Walker v Innospec: Supreme Court Judgment and Response to the Survivor Benefits Review* (Written Statement HCWS1690) https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2019-07-04/HCWS1690/.

[35] *Pension Schemes Newsletter 112*, <www.gov.uk/government/publications/pension-schemes-newsletter-112-july-2019/pension-schemes-newsletter-112-july-2019> and *Countdown Bulletin 47*, <www.gov.uk/government/publications/countdown-bulletin-47-august-2019/countdown-bulletin-47-august-2019>.

[36] This was initially announced in Countdown Bulletin 44, <www.gov.uk/government/publications/countdown-bulletin-44-march-2019/countdown-bulletin-44-march-2019>.

Pensions Regulator launches re-enrolment tool

The Pensions Regulator has launched a new tool to assist employers comply with their automatic re-enrolment duties.[37]

The automatic enrolment legislation requires that employers re-enrol any '*eligible jobholders*'[38] into a '*qualifying scheme*'[39] every three years. The employer must then re-submit their declaration of compliance to the Regulator to demonstrate how they have met their duties.

The tool is intended to simplify the re-enrolment process for employers, ensuring that they continue to meet their obligations.

[37] <www.thepensionsregulator.gov.uk/en/media-hub/press-releases/re-enrolment-made-simpler>.
[38] An eligible jobholder is an employee aged between 22 and State pension age to whom gross annual earnings of more than £10,000 (the '*earnings trigger*') are paid.
[39] A pension scheme that meets, or exceeds, the relevant statutory qualify requirements.

And Finally…

The leading judgment in the *Langford* case, discussed in the *Court judgments* section of this edition of *Current Issues*, quoted a fellow judge's observation that use of '*MWRF*' as an abbreviation of '*manifestly without reasonable foundation*' is '*hard to escape*'. To *AF*, it readily brought to mind the disgruntled noise made by a hungry cat—a sound which is also, we can attest, hard to escape…