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Current issues

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Articles this month:

The CPIH in the RPI's clothing

The Retail Prices Index (RPI) is likely to change, no earlier than 2025, to become a virtual clone of the Consumer Prices Index variant that incorporates owner-occupiers' housing costs (the CPIH).

The RPI lost its 'National Statistic' badge in 2013, due to concerns about its shortcomings. Activities intended to improve its methodology essentially ceased, but doubts have been raised about whether that was the correct thing to do. In January 2019, the House of Lords Economic Affairs Committee published a report, *Measuring Inflation*, which recommended (amongst other things) that the Government give the consent necessary for the Office for National Statistics (ONS) to fix the problems with the Index.[1]

In March 2019, in answer to the Committee's call, the UK Statistics Authority (UKSA) advocated a course of action (which has only now been made public).[2] It proposed that the Government take steps toward the abolition of the RPI, including removing the ONS's statutory obligation to keep producing it. Recognizing that this would require primary legislation, and that there would be '*substantial implementation issues*', it proposed in the meantime to use the CPIH methodology to calculate the RPI so that, in effect, the RPI would be the CPIH under another name (at least initially). Until 2030, under a statutory provision concerned with the interests of certain index-linked gilt holders, that would require the consent of the Chancellor of the Exchequer; from 2030, when the relevant gilts reach maturity, the UKSA will be free to make the change (assuming it still wishes to do so) without the Chancellor's consent.

On 4 September, the Government responded to the Committee's recommendations and the UKSA's proposals.[3] Chancellor of the Exchequer Sajid Javid rejected the idea of ceasing publication of the RPI, and refused to consent to an alignment of the RPI with the CPIH before 2025, at the earliest. There will be a consultation exercise, beginning in January 2020, on whether the RPI should be made to conform with the CPIH sometime between 2025 and 2030.

A response will be published before 5 April 2020. The Government says that it has no plans to stop issuing RPI-linked gilts.

[1] https://publications.parliament.uk/pa/ld201719/ldselect/ldeconaf/246/246.pdf.
[2] https://www.statisticsauthority.gov.uk/wp-content/uploads/2025/09/190304_SirDavidNorgrove_to_Chancellor_Section21.pdf.
[3] https://www.gov.uk/government/publications/a-response-from-sajid-javid-to-sir-david-norgrove-on-uksas-proposed-reform-of-the-retail-prices-index-and-the-governments-response-to-the-house-of

Graphs of historical CPI and CPIH inflation rates look almost identical. When superimposed, it can be seen that each has been higher than the other at times, but the average rates of inflation under both measures are very similar. The RPI rate of inflation has generally exceeded those of both the CPI and the CPIH by a significant margin.

The CPIH is already the measure that one encounters first in the ONS's monthly Consumer Prices Inflation bulletins, and the Government has signaled its intention to adopt it as its own 'headline measure' in due course. We can probably expect it to take over the CPI's role in the setting of statutory minimum pension increases at some point. Schemes with rules based on the statutory increases will automatically follow suit; and it seems that, sooner or later, schemes that are locked into the RPI will also be moving to the CPIH in all but name. It will be interesting to see whether trustees who have some choice over the index used will feel motivated to make the change.

Following such a change, benefits that increase in line with the RPI would be expected to grow at a slower rate than would otherwise be the case. Although disappointing for pensioners, the resulting reduction in liabilities could be good for scheme funding levels; however, the effects on scheme assets will also have to be considered. Investment strategies, assumptions and benchmarks may need to be reviewed. The market reacted with a rather sharp reduction in the pricing of inflation, especially at the long end of the market.

GMP equalization update

Following the 2018 High Court ruling that pension schemes are required to equalize pension benefits for the effects of guaranteed minimum pensions (GMPs)[4], an industry working group has published a 'call to action' and guidance on equalizing for GMP; and the trustee of Lloyds pension scheme has requested further guidance from the Court.

Working Group publications

The cross-industry, GMP Equalization Working Group published a 'Call to Action' in July 2019 to provide information and guidance to (predominantly) scheme trustees and sponsors who are just beginning the GMP equalization process.[5] Whilst clarification is still required on some issues, the Working Group encourages trustees to start work in three areas: reconciliation and rectification, data-quality review, and ongoing transactions (for example retirements, deaths, transfers and commutations).

The Call to Action stresses the need for collaborative working, identifying scheme-specific issues, and project planning and management. It also contains a checklist of actions that might be useful when preparing for the GMP equalization project.

Following on from the Call to Action, the Working Group published guidance outlining methods that schemes could use to equalize for the sex-based inequalities of GMPs and sets out ways for schemes to deal with common issues that may arise.[6]

Later this year, the Working Group intends to publish briefings concentrating on data, affected transactions, tax and the reconciliation and rectification of GMPs.

Lloyds return to court

The trustee of the Lloyds pension schemes has announced that they are to go back to court to receive guidance on the extent to which the trustees are required to revisit past transfers out of the schemes.[7] Although the question had formed part of the initial application to the Court, the judge did not rule on the matter.

The court hearing is expected to take place in late April or early May 2020.

For schemes that have not yet taken action on GMP equalization, the guidance provides a useful, high-level overview of the things they need to consider. For trustees who have already begun the equalization project there may be some comfort that the approaches being adopted are in line with the range of positions across the industry.

Schemes who have wind-up or buy-out exercises under way should be aware that the Lloyds hearing has the potential to delay proceedings.

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[4] *Lloyds Banking Group Pensions Trustees Limited v Lloyds Bank PLC and Others* [2018] EWHC 2839 (Ch). For details of the judgement see our 60 Second Summaries, *Judge says GMP eqialization is obligatory* (October 2018) <www.hymans.co.uk/media/uploads/1810_lloyds_judgment_(gmp_equalization)_60SNS.pdf> , and *GMP equalization conversion route clarified* (December 2018) <www.hymans.co.uk/media/uploads/1812_lloyds_supplementary_judgment.pdf>.

[5] <www.pasa-uk.com/sites/default/files/releases/PRESS%20RELEASE%20-%20PASA%20Call%20to%20Action%20FINAL%2016%20JULY%202019%20%5B1%5D.pdf >.

[6]< www.pasa-uk.com/sites/default/files/releases/Equalising%20for%20the%20Effects%20of%20GMPS%20September%202019%20FINAL.pdf>.

[7] <www.lloydsbankinggrouppensions.com/trustee_message_august#>.

Stewardship & governance changes: new guidance issued

The Department for Work and Pensions (DWP) has published a 'fact sheet' about changes it made recently to the information that trustees must disclose in statements of investment principles (SIPs) and elsewhere, in connection with the EU's re-vamped Shareholder Rights Directive (SRD II).[8] The new rules cover the engagement policies and investment-governance arrangements of private-sector occupational pension scheme, and are being phased in, beginning in 1 October 2019.

For more details about the changes see our June 2019 Sixty Second Summary, *New investment rules for DB & DC schemes.*[9] A broad synopsis of the new requirements, together with related amendments made in September 2018, is given in the following table, which indicates when the changes begin to have effect for different types of scheme.

	1/10/2019	1/10/2020	1/10/2021
DB & DC	State (in SIP) policies on financially material considerations, non-financial matters, and stewardship	State (in SIP) policies on arrangements with asset managers and extended stewardship/engagement activities (capital structure, conflicts, other stakeholders)	
DB		Publish SIP online Prepare implementation statement about (extended) stewardship/engagement activities	Publish implementation statement about (extended) stewardship/engagement activities online
DC	Publish SIP online (and advertise in annual benefit statements)	Prepare implementation statement and publish online	Expand implementation statement to cover extended stewardship/engagement activities (capital structure, conflicts, other stakeholders)

We noted in *Current Issues* August 2019 that the Pensions Regulator had updated its *Investment Governance* guidance for money purchase schemes in light of the legislative developments discussed above.[10] It has now completed a revision of *DB Investment* too; incorporating the changes '*involved significant rewriting of various sections throughout the* Investment Governance *and* Investing to Fund DB Schemes *portions of the guidance*.'[11]

[8] *Shareholder Rights Directive II Fact Sheet* <www.gov.uk/government/publications/workplace-pension-scheme-shareholder-rights-directive-ii-fact-sheet/shareholder-rights-directive-ii-fact-sheet>.
[9] <www.hymans.co.uk/insights/research-and-publications/publication/sixty-second-summary-new-investment-rules-for-db-dc-schemes/>.
[10] <www.hymans.co.uk/insights/research-and-publications/publication/current-issues-august-2019/>.
[11] <www.thepensionsregulator.gov.uk/en/document-library/regulatory-guidance/db-investment>.

Minor surgery prescribed for doctors' annual allowance ills

The Government is consulting on plans to amend the rules of the NHS Pension Scheme in England and Wales to address the effect of the tapered annual allowance on highly paid clinicians.[12] An extension of proposals aired in July but withdrawn just over a fortnight later, they would give those members most at risk of annual allowance charges the ability to tailor their accrual levels.

In April 2016 the Government imposed a mechanism by which the £40,000 annual allowance tapers off, by £1 for every £2 of '*adjusted income*' over £150,000, down to £10,000 for those with adjusted income of £210,000 or more.[13] It applies only to those with '*threshold incomes*' exceeding £110,000.[14]

Concerns have arisen that the taper is deterring senior doctors from taking on extra paid (but typically non-pensionable) work, with evidence that it is having an adverse effect on NHS efficiency. Some doctors are opting out of the NHSPS, losing death-in-service and ill-health cover.

On 22 July 2019, the Department of Health and Social Care published proposals to allow NHSPS members to choose, at the start of a tax year, to reduce their accrual and contributions rates by 50 per cent. Death-in-service cover, survivor benefits and ill-health pensions would have continued to be provided in full. The consultation period was to have continued until 14 October, but instead, on 7 August, it was announced that the July consultation had been withdrawn pending a new consultation on options for permitting greater flexibility.[15] It was also declared that Her Majesty's Treasury would review the operation of the tapered annual allowance in so far as it affects the delivery of public services.

Clinicians who anticipate that they might incur an annual allowance charge will be able to opt, before the start of the scheme year, to reduce their accrual rate to a fraction of the normal level; and then review that decision near the end of the scheme year when they are more able to estimate their total earnings. Death-in-service and ill-health cover will be maintained. The available options for the accrual rate would rise in ten-percentage-point steps from ten to ninety per cent of the full rate (the Government is not presently inclined to provide a zero or almost-zero accrual option).

So, for example, a doctor could decide to cut his or her accrual rate for the coming year to ten per cent of the norm. As a result, he or she would pay just ten per cent of the usual contribution. The NHS employer's contribution toward the cost of accrual will be similarly reduced, but its total contribution will add up to more than ten per cent of the full amount because of the costs of providing ancillary benefits (such as death-in-service cover) and paying down any past-service deficit.

If, toward the end of the year, the doctor discovers that he or she has scope to accrue additional pension benefits without incurring an annual allowance charge, the chosen accrual rate can be retrospectively increased, upon payment of member and employer contribution arrears (it seems there will be no option to revise accrual downward).

When clinicians have taken up the option to reduce their accrual rates, their employers will be able to convert the unused employer contributions into extra remuneration at the year-end. The terms upon which such a payment can be made are to be explained when the Government announces the outcome of the consultation exercise.

A future consultation exercise may cover options for spreading over several years any increases to pensionable earnings arising from large one-off pay increases.

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[12] *NHS Pension Scheme: increased flexibility* https://www.gov.uk/government/consultations/nhs-pension-scheme-increased-flexibility.
[13] Adjusted income is, broadly, net taxable income plus the annual allowance pension input amount for the tax year.
[14] Threshold income is, broadly, net taxable income.
[15] https://www.gov.uk/government/news/nhs-pensions-for-senior-clinicians-new-changes-announced-to-improve-care.

The Government is also considering changing the method by which NHSPS members' benefits are reduced when the scheme administrator pays annual allowance charges on their behalf ('scheme pays'). In summary, rather than waiting until the member's retirement before converting the tax charge, plus interest thereon, into a pension deduction, the member's accrued pension would be reduced when the tax is paid. The change is not expected to be financially advantageous to NHSPS members (quite the opposite); instead, it is hoped that it would give members a better appreciation of the consequences of using the 'scheme pays' facility when they are choosing how to pay the charge.

The consultation period ends on 1 November 2019. It is expected that any resulting changes will be in place for the 2020/21 tax year; however, the Government hopes to be able to provide member information and an annual allowance modeller by the end of 2019. Guidance has already been provided to NHS employers about measures that they can take to support staff during the current financial year.[16]

The annual allowance taper is widely considered to be bad medicine; the DHSC's proposals seek to reduce the symptoms rather than removing the cause of the ailment. Only the Treasury can provide a cure. *[Ed: that's enough of the cheesy medical puns.]*

The taper's effects on NHS waiting lists and patient care have understandably taken the limelight, but the Forces Pension Society has highlighted the existence of similar issues for army medics and other serving members of the Armed Forces.[17] Employers in the private sector will generally have come up with their own workarounds by now, but will no doubt also follow these proceedings with interest.

[16] <www.nhsemployers.org/case-studies-and-resources/2019/09/nhs-pensions-tax-guidance>.

[17] *Financial Times*, *Army Pensions Watchdog Wades Into Taper Tax Battle* (16 August 2019); *Armed Forces Caught In Pensions Tax Trap* (26 August 2019).

Fixed protection loss via auto-enrolment not employer/scheme's fault

The Pensions Ombudsman has rejected a complaint from a scheme member who was not warned that automatic enrolment could jeopardize his lifetime allowance protection.[18] Neither his employer nor the scheme manager was obliged to advise him of such matters, especially as they were unaware that he had accumulated substantial pension rights in his previous career.

Background

The Finance Act 2004 limited the total value of the pension rights that a person could accumulate before incurring extra tax charges. Called the *lifetime allowance*, it was set at £1.5m for the tax year 2006/07, and rose steadily to £1.8m by 2010/11, before being pruned back to £1.5m for 2012/13, £1.25m for 2014/15, and £1m for 2016/17. It has begun to rise again under a statutory indexation formula introduced in 2016, so that it is now £1.055m (we will know the 2020/21 figure when the Consumer Prices Index statistics for September 2019 are released).

In association with the 2012 cutback, the Government allowed people to apply for a form of protection through which they could retain a lifetime allowance of £1.8m. It is known as '*fixed protection*' or '*fixed protection 2012*' (FP12), to distinguish it from the transitional provisions introduced alongside subsequent lifetime allowance decreases. Crucially, a member's FP12 is lost if there is '*benefit accrual*' (broadly, money purchase contributions or increases to defined benefits) after 5 April 2012.

Facts

The complainant built up substantial pension rights prior to 6 April 2012, and gave notice to Her Majesty's Revenue and Customs of his intention to rely upon FP12. He took up a new position in October 2015. His appointment letter had said that he would be automatically enrolled into a pension scheme, but explained how he could opt out; had he done so, he would have been treated for all purposes as though enrolment had not occurred, so there would have been no benefit accrual to trigger cessation of FP12. Although he was directed to information about the scheme, neither it nor the appointment letter warned that fixed protection could be lost as a result of auto-enrolment.

It was not until April 2018 that he realized, through discussion with his independent financial adviser (IFA), that he had cancelled his FP12 by accruing benefits in the scheme. He asked for his membership to be unwound, saying that he had not been warned about the consequences of auto-enrolment, but also admitting that he would have spotted the problem earlier if he had properly examined his pay-slips. He was informed that it was no longer possible to undo his auto-enrolment.

He complained to both his employer and the scheme manager using its internal dispute resolution procedure. They said in summary that he had been provided with the information required by law, that his tax affairs were his own responsibility, and that there was no provision for the sort of retrospective opting out that he desired.

He complained to the Pensions Ombudsman.

Determination

The Ombudsman rejected the complaint. Neither the employer nor the scheme manager was expected to include warnings about lifetime allowance protections in routine auto-enrolment information. There are few instances in which scheme membership could be expected to have negative consequences. They had no way of knowing that he had acquired substantial pension rights in the course of a past career. Although the employer now recommends that people seek appropriate financial advice when taking up similar roles, that did not mean that the guidance given to the member was in breach of statutory requirements. He should have ascertained the correct position much sooner than he did.

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[18] *Mr T [PO-23961]* <www.pensions-ombudsman.org.uk/wp-content/uploads/PO-23691.pdf>. We pity the fool who makes an A-Team joke in response to the Ombudsman's choice of pseudonym.

The Ombudsman drew the member's attention to the *Hymanson* ruling, by which HMRC was required to reinstate the FP12 of someone who had lost it as a result of accidental benefit accrual.[19]

It seems as though the Ombudsman threw the complainant a lifeline at the last moment. However, there were some singular aspects to Hymanson, and it is unclear as yet how magnanimous HMRC will be in interpreting and applying the ruling to other cases of its kind.

[19] *Hymanson v HMRC* [2018] UKFTT 667 (TC). See *Current Issues* December 2018.

Regulator's Compliance and Enforcement Bulletin

In its most recent *Compliance and Enforcement Quarterly Bulletin*, the Pensions Regulator notes that it has, for the first time, appointed an independent trustee to a scheme due to a lack of competence amongst the existing trustees.[20]

An independent trustee was appointed after the existing trustees persistently failed to respond to the Regulator's governance concerns. It was apparent to the Regulator that the trustees either did not have sufficient knowledge and understanding or they were not using it. The Determination Panel concluded that the trustees' unwillingness to address the issues identified and their lack of engagement with the Regulator showed '*systemic failures justifying the appointment*'.

This is contrasted with a case study in the same Bulletin in which the Regulator's intervention did not end with use of its formal powers. In this case, the Regulator was concerned that the trustees were overly reliant on their advisers (as they were unable to answer questions about their recovery plan directly), had conflicts of interest, and did not have the necessary knowledge and understanding to challenge their advisers' decisions, where appropriate. Here the trustees responded to the Regulator's concerns by introducing a conflicts policy (and, in the case of one conflicted trustee, by resigning), undertaking training (with annual reviews to identify gaps in their knowledge), and committing to holding regular, minuted trustee meetings. As a result of the trustees' positive engagement, the Regulator did not need to exercise its powers.

The Bulletin also reports that there are now 35 schemes subject to 'one to one supervision'. The intention is that this will be extended to more than 100 schemes over the financial year. The Regulator stresses that '*including a scheme in One to One supervision does not mean we believe it is failing to meet our expectations. We build strong ongoing relationships with these schemes regardless of whether they trigger our traditional risk indicators*'.

The Regulator continues to ramp up its focus on 'trustee knowledge and understanding' (TKU) and in its July 2019 consultation floated the idea of mandatory qualifications and minimum ongoing training hours for all trustees.[21] Whilst we see this as unnecessary, it is vital that trustees ensure they are sufficiently knowledgeable and confident to oversee their scheme. This is not only in the interests of good governance but in being well prepared should the Regulator come calling.

We suggest that as a minimum an annual training and skills audit is conducted in tandem with the board's annual effectiveness review. This will then feed into ongoing annual training plans. Defined contribution scheme 'Chair's statements' already need to include a detailed summary of a board's TKU activity and it is likely that when Chair's statements are introduced for defined benefit schemes they will too.

[20] <www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/compliance-and-enforcement-quarterly-bulletin-april-to-june-2019.ashx>.

[21] See our article in *Current Issues* August 2019 for more details, <www.hymans.co.uk/insights/research-and-publications/publication/current-issues-august-2019/>.

(Another) new Secretary of State

Therese Coffey was appointed Secretary of State for Work and Pensions on 8 September 2019, following Amber Rudd's resignation. Guy Opperman remains in his role as Parliamentary Under Secretary of State for Pensions and Financial Inclusion.

And Finally…

Some researchers have shrugged off (in fine Gallic fashion) the calumnies cast upon Frenchwoman Jeanne Calment's longevity record.[22]

Readers may recall the scurrilous aspersion that the person who died on 4 August 1997 was not Jeanne Calment, who would by then have attained the near-biblical age of 122 years and 165 days, but her daughter Yvonne Billot-Calment, who was thought to have died in 1934. The theory went that it was actually *Jeanne* who succumbed to pleurisy in the same year that a man with a toothbrush moustache became Germany's Reich Chancellor (it wasn't Charlie Chaplin[23]), and that Yvonne had assumed her mother's identity as a tax dodge.

The French (and Danish—oh, and Swiss too, but they're basically French aren't they?) researchers counter that the historical records are consistent with Calment's claim, and also that a cake with 122 candles isn't as statistically implausible as the j'accusers made out.

The allegations were made by a pair of Russian ne'er-do-wells (well, an assistant professor of gerontology and a maths PhD), so they were particularly inflammatory, given that Tsar Alexander I's refusal to abide by the terms of the Treaty of Tilsit and the ignominies of Napoleon I's retreat from Moscow in 1812 are so fresh in France's collective memory (even if they weren't—quite—witnessed by any of her citizens)…

[22] Jean-Marie Robine, Michel Allard, François R Herrmann, Bernard Jeune, *The real facts supporting Jeanne Calment as the oldest ever human*, The Journals of Gerontology: Series A, <doi.org/10.1093/gerona/glz198>.
[23] Or Oliver Hardy.