TRAVERS SMITH

What's happening in Pensions

Issue 47 *July 2014*

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Finance Act 2014

The Finance Bill (see **WHiP Issues 45** and **46**) received Royal Assent on 17 July and is now the Finance Act 2014. The Act contains the legislation relating to the following changes on which we have previously reported:

- the transitional flexibilities that apply pending the April 2015 DC decumulation reforms, particularly regarding lump sums and drawdown (for details, see our briefing note **Budget 2014: Decumulation changes - immediate issues for trustees, WHiP Issue 46** and below);
- individual protection against the April 2014 reduction of the lifetime allowance (see **WHiP Issues 40** and **44**); and
- new HMRC scheme registration processes, designed to deter and detect pension liberation vehicles (see our briefing note **Pension Liberation: Issues for trustees**).

As we have reported previously, these changes have had legal effect for some time but only on an interim basis until now.

Finance Act 2014 (see sections 41 to 46 and schedules 5, 6 and 7):
http://www.legislation.gov.uk/ukpga/2014/26/enacted

DC decumulation flexibilities

Before April 2015

Following the March 2014 Budget announcements of DC decumulation flexibility (see **WHiP Issue 45**), the Government announced additional flexibilities in April 2014 regarding the timing of DC pension commencement lump sums (PCLSs), giving individuals who take PCLSs more time to decide what to do with the rest of their pension pots (see **WHiP Issue 46**). New provisions added to what is now the Finance Act 2014 reflect those announcements and include additional helpful provisions. HMRC has also updated its tax note *"Increasing pension flexibility"*.

Additional clauses and tax note:
http://www.publications.parliament.uk/pa/bills/cbill/2014-2015/0010/amend/financeaddednames.pdf

The legislation is complicated but the intention, as broadly summarised in the HMRC note, is as follows.

- *"where an intended PCLS is paid before 6 April 2015 in respect of a money purchase arrangement, the pension associated with the PCLS can commence up to 5 October 2015;*
- *where an intended PCLS is paid before 6 April 2015 in respect of a money purchase arrangement, the pension associated with the PCLS can be paid from a different scheme from that which paid the PCLS;*
- *where the associated pension is paid from a different scheme to the PCLS under the bullet point above, any right to a protected pension age or protected lump sum is preserved as part of the transfer;*
- *where an intended PCLS paid before 6 April 2015 in respect of a money purchase arrangement is repaid before 6 October 2015, the intended PCLS is treated for all tax purposes as if it had never been paid;*
- *where a member has received an intended PCLS before 27 March 2014, if they commute the uncrystallised expected pension to a lump sum under the trivial commutation or small pots rules then the intended PCLS will continue to be an authorised payment and tax free;*
- *where a member receives an intended PCLS in respect of a money purchase arrangement and dies before taking the expected pension under these transitional provisions, the PCLS will continue to be an authorised payment and tax free."*

Note that these provisions, unlike clauses in the original Finance Bill, did not have the force of law until the Finance Bill received Royal Assent last week (but they were then backdated to March 2014).

HMRC has published a new draft guidance note on the transitional flexibilities for DC benefits.

HMRC guidance:
http://www.hmrc.gov.uk/pensionschemes/pension-flexibility.pdf

Schemes that wish to allow members to take advantage of any of these flexibilities will need to consider whether their rules allow them to do so.

From April 2015
The Government has just announced more detail of how the DC decumulation flexibilities from 6 April 2015 and member guidance arrangements will operate. We will report in detail shortly.

Government announcement:
https://www.gov.uk/government/news/millions-guaranteed-the-right-to-free-and-impartial-guidance-on-their-new-pensions-choices

Scheme funding: new code of practice and other documents

TPR DB web page:
http://www.thepensionsregulator.gov.uk/doc-library/regulating-defined-benefit-pension-schemes.aspx

The Pensions Regulator has finalised its revised code of practice on DB scheme funding and published it alongside other documents including: a short guide to the code; the annual funding statement; the finalised DB regulatory strategy (which is new and not limited to scheme funding); and the finalised DB funding regulatory and enforcement policy.

The new code will take effect when it has been approved by Parliament but should be taken into account already. We covered the consultation proposals in **WHiP Issue 43**. We outline the key points from the final documents and the most significant changes below.

Code of practice
The revised code of practice takes account of (a) the Regulator's new statutory objective under the Pensions Act 2014 (effective from 14 July 2014) to "*minimise any adverse impact on the sustainable growth of an employer*" (see **WHiP Issue 46**) and (b) its current regulatory approach, which has developed significantly since the previous code was issued in February 2006.

There are nine principles of general application:

> *"**Working collaboratively**: Trustees and employers should work together in an open and transparent manner to reach funding solutions that recognise the needs of the scheme and the employer's plans for sustainable growth.*
>
> ***Managing risk**: Trustees should implement an approach which integrates the management of employer covenant, investment and funding risks; identifying, assessing, monitoring and addressing those risks effectively.*
>
> ***Taking risk**: Before trustees take funding or investment risk they should, in discussion with the employer, establish the employer's risk tolerance and assess the employer's ability to address a range of likely adverse outcomes over an*

appropriate period.

***Taking a long-term view**: Trustees' decisions should be consistent with their long-term funding and investment targets and their view of the employer covenant.*

***Proportionality**: Trustees should act proportionately in carrying out their functions given their scheme's size, complexity and level of risk.*

***Balance**: Trustees should seek an appropriate funding outcome that reflects a reasonable balance between the need to pay promised benefits and minimising any adverse impact on an employer's sustainable growth.*

***Well governed**: Trustees should adopt good governance standards in relation to the scheme's funding.*

***Fair treatment**: Trustees should seek to ensure that the scheme is treated fairly amongst competing demands on the employer in a manner consistent with its equivalent creditor status.*

***Reaching funding targets**: Having agreed an appropriate funding target, trustees should agree funding to eliminate any deficit over an appropriate period."*

The code is around 20 pages shorter than the consultation draft, with less repetition, and is more reflective of employer concerns than the consultation draft. There are the following key changes from the consultation draft.

- **Recovery periods**: The draft code said that shortfalls should be eliminated as quickly as employers could reasonably afford. The Regulator says it did not mean to suggest that recovery periods should be as short as possible. It now says that they should be of an "*appropriate period*", in view of the risks to the scheme and the impact on the employer(s) and taking account of the overall funding and security arrangements that are agreed.
- **Managing risk**: References in the draft code to "mitigating risks" have been changed to "managing risk". This is to make it clear that not all conceivable risks have to be covered, especially if there are associated rewards, and not all risks need to be dealt with immediately they crystallise. Trustees should concentrate on having adequate and flexible response strategies and contingency plans as part of their scheme governance arrangements.
- **Dividends**: The final code recognises that dividend payments are part of normal business activity and can be consistent with employers' plans for growth and trustees' aims to pay benefits in full. It notes, however, that trustees should scrutinise the employer's dividend policy if dividends are proposed at an unusual time or at an exceptionally high level, or if covenant strength is a concern.
- **Scrutiny of employer decisions**: The final code is clearer on the circumstances when trustees should scrutinise employer decisions, for example if an employer intends to prioritise investing in its business over addressing a scheme deficit.

In the following areas, messages from Regulator guidance or statements are now incorporated in the code, giving them greater force.

- The meaning of **"employer covenant"** has changed significantly since the 2006 code. Instead of being defined by an employer's willingness and ability to fund the scheme, it now takes account of situations where companies support schemes without being under a legal obligation to do so.
- Content from the Regulator's November 2013 **asset-backed contributions** (ABCs) guidance (see **WHiP Issue 43**) has been included.
- The code incorporates the gist of the Regulator's debateable October 2013 statement on the **"double counting" of employer debt payments and funding contributions** (see **WHiP Issue 43**).

Funding regulatory and enforcement policy
As originally proposed, the Regulator is dispensing with its old system of triggers based on schemes' technical provisions and recovery periods. Employers will be categorised by the Regulator into one of four covenant strength "segments" (strong to weak). That categorisation is used to focus on the appropriate steps that should be taken to improve or maintain scheme funding.

Respondents to the consultation had expressed concern that the proposed BFO (balanced funding outcome) could be seen as a new minimum funding standard that would encourage minimal funding, especially if schemes' advisers could work out the minimum that the Regulator would expect. The final policy document replaces the BFO with the FRI (funding risk indicator) and lists it as only one of a number of risk indicators.

Deliberately, minimal detail of how it will work has been published.

Other risk indicators include (among other things) the risks posed by the scheme's investment strategy; mortality assumptions; back end loading of recovery plan contributions; lower contributions than under the last recovery plan; actions that have weakened the employer covenant; reliance on investment outperformance; scheme governance issues; and use of ABCs.

The Regulator will take into account the following factors when deciding whether to engage with the scheme:

- the position of the scheme compared to the risk indicators;
- the size of the scheme's liabilities;
- the potential complexity and resource intensity of engagement compared to the impact and value that can be added; and
- the overall resources available to the Regulator.

Annual funding statement
This statement is directed at schemes with valuation dates between 22 September 2013 and 21 September 2014 ("Tranche 9 schemes"). It expects schemes to take account of the new code of practice as far as it is reasonable to do so, but accepts that schemes with valuations already at a developed stage may not be able to take full account of it.

Key points include the following:

- Most schemes with an increased deficit should be able to manage the impact through appropriate use of the flexibilities available in the funding regime.
- Continuing low interest rates mean that schemes may need to plan for longer periods of low yields than previously expected.
- Trustees will be expected to be able to show how they have taken an integrated approach to risk management and a proportionate approach to assessing the employer covenant.

Pension Protection Fund: Proposed new pension protection levy regime

Press release:
http://www.pensionprotectionfund.org.uk/News/Pages/details.aspx?itemID=366

The PPF has consulted on proposed changes to the pension protection levy regime for the three years 2015/16 to 2017/18. Most of the impact will be in the area of insolvency scores, connected to the replacement of Dun & Bradstreet (D&B) with Experian. There are also, however, important changes affecting "last man standing" schemes, schemes with parent company guarantees, and schemes with asset-backed contribution arrangements.

Insolvency scores
Experian has developed a PPF-specific "scorecard" model for determining employer insolvency risk scores. It focuses on financial information (disregarding D&B factors such as geographical location and make-up of the board) and on employers who have DB pension schemes (which are typically different from those which do not).

There will be eight or ten bands. Scores will be collected and averaged annually. For 2015/16, however, they will be collected and averaged over the six month period from 31 October 2014 to 31 March 2015 (the short period will allow schemes to check information and scores before they start to count).

Details of how the insolvency scores will be calculated will be in the PPF Board's annual determination (this contrasts with D&B's opaque approach): a draft appendix has been published with the consultation. An online portal allows trustees (and will later allow employers) to check insolvency scores and the data held. It also allows the impact of future changes (eg, new company accounts) to be modelled in advance. Trustees can register to receive emails when an insolvency score changes.

For companies that have a credit rating, the PPF is considering using that instead of the Experian insolvency score: credit ratings may be more reliable for large, complex organisations. The model also does not work well for not-for-profit organisations: the PPF is considering different arrangements and which organisations would be covered.

Up to 50% more schemes will see a levy reduction than will see an increase but increases will generally be larger than reductions. About 600 (or 10%) of schemes will pay £50,000 or more extra; 200 will pay more than £200,000 extra. About 20% of schemes will see their employer insolvency risk treble. The PPF is suggesting that it could cap increases to schemes' insolvency scores at 200%.

Guarantees
The Experian model is expected to reduce the need for parent company guarantees because it takes more account of group finances than D&B's model. The guarantor's

insolvency risk (but not its insolvency risk as an employer, if it is one) will be calculated taking account of the fact that it has given the guarantee. Trustees will have to certify a "realisable recovery" amount which they are confident could be recovered in circumstances of insolvency and the certification wording will be changed to the following:

> *"The trustees, having made reasonable enquiry into the financial position of each certified guarantor, are reasonably satisfied that each certified guarantor, as at the date of the certificate, could meet in full the Realisable Recovery certified, having taken account of the likely impact of the immediate insolvency of all of the relevant employers."*

"Last man standing" schemes
At present, "last man standing" schemes (ie, schemes where there is no segregation of assets when an employer ceases participation) qualify for a 10% levy discount. This discount will be replaced by a scheme structure factor discount of anything between 0% and 10%. Schemes where most of the members are with one employer will receive a smaller discount than those where there is a more even spread.

The PPF is also concerned about schemes being classified incorrectly as "last man standing". It is therefore considering requiring trustees to confirm that they have reached their conclusion based on legal advice.

Asset-backed contributions
Employer asset-backed contribution arrangements (ABCs) will be treated more like Type B contingent assets (ie, security over cash, UK real estate or securities). The PPF is concerned that ABCs, which are often included in levy valuations as assets worth the net present value (NPV) of the expected contributions (regardless of what the asset itself might be worth), can allow a levy reduction that is disproportionate to the risk reduction.

Controversially, the PPF intends only to give credit for UK real estate ABCs. Trustees will have to certify the ABC value on a specified basis. Broadly the value will be the lower of (a) the NPV of the expected contributions and (b) the asset's value in the event of a sale in circumstances of insolvency. Annual certification will be required. Deficit reduction certificates will now need to exclude ABC contributions.

Pension Schemes Bill: defined ambition etc

Pension Schemes Bill:
http://services.parliament.uk/bills/2014-15/pensionschemes/documents.html

Consultation response:
https://www.gov.uk/government/consultations/reshaping-workplace-pensions-for-future-generations

The Government has published the Pension Schemes Bill and the response to its consultation on options for reshaping workplace pensions (see **WHiP Issue 43**). The Bill is the first step to achieving the following:

- categorising schemes (or parts thereof) for certain purposes as "defined benefits schemes" (with a "full pensions promise"), "shared risk schemes" (with a less than full "pensions promise"), or "defined contributions schemes" (with no "pensions promise");
- enabling DC schemes to operate with a guarantee element (and become shared risk schemes): the "pension income builder" option, under which part of the contributions secures a nominal deferred annuity each year and the rest is invested, is most favoured by the Government of the four options on which it consulted;
- enabling "collective benefit" schemes as a form of shared risk scheme, ie, collective DC schemes, which have pooled investments (rather than individual accounts) and targeted benefits;
- allowing personal pension schemes to provide benefits other than pure money purchase benefits; and
- preventing transfers from unfunded public service DB schemes into DC arrangements.

The Bill amends certain pieces of legislation in respect of **shared risk schemes** (also known as "defined ambition" schemes). That legislation includes preservation (30 day vesting periods will apply to "non-salary related benefits", as defined, rather than just to pure money purchase benefits), the application of revaluation methods (with a new "default method" for shared risk schemes of treating deferreds the same as actives), and the calculation and guaranteeing of transfer values.

Collective benefit schemes will be exempted from the indexation, automatic transfer, scheme funding and employer debt legislation and will not be eligible for the PPF. There will be specific legislation for them on disclosure of information, contributions (payment schedules will be required), investment strategy, valuations and transfer values. Section 67 of the Pensions Act 1995 will provide that conversion of DB benefits to collective benefits is a "protected modification" requiring member consent.

The consultation response confirms that no steps are to be taken to ease the statutory requirements for **DB schemes**, ie, none of the consultation proposals, such as removing the indexation requirement for future accruals, are going to be taken forward. This is explained as being due to a lack of interest in the proposals unless accrued rights were also covered, which the Government firmly rejects.

There should not be any impact on most existing DB or DC schemes but existing schemes which are "shared risk" (eg, cash balance schemes and schemes which apply longevity adjustment factors) will need to consider how they are affected. Schemes which follow the rules for hybrid schemes in the automatic enrolment legislation will need to check whether they will be "shared risk schemes" after that legislation is amended.

The Government announced the Bill as giving consumers and industry what they want. It neglected to mention, however, that the consultation closed before the Budget announcements on DC flexibility were made (see **WHiP Issue 45**). There is very little mention of those changes: the consultation response simply notes that the DWP will continue to work with the Treasury and HMRC to decide how collective DC and shared risk schemes will be treated for tax purposes.

Pensions liberation: Pensions Ombudsman

Announcement:
http://www.pensions-ombudsman.org.uk/news/

The Pensions Ombudsman has announced a delay in the issuing of determinations of the numerous pension liberation complaints that are before him: "*it is unlikely they will be published before July*". It is thought that most of the complaints relate to transfer requests denied by trustees.

VAT

HMRC Brief:
http://www.hmrc.gov.uk/briefs/vat/brief2214.htm

HMRC has issued a new Brief 22/14, following its February 2014 Brief 06/14 about VAT charged on fees for pension scheme fund management and administration services. See **WHiP Issue 44** for the background to this.

Brief 06/14 was widely criticised for being inconsistent with the spirit of the European Court's decision in *PPG Holdings BV* on VAT paid for services provided to a DB scheme (see **WHiP Issue 41**). The Court has also subsequently given its decision in *ATP Pension Services* on VAT paid for services provided to a DC scheme (see **WHiP Issue 45**).

The new Brief says that HMRC is considering the *ATP* case and representations made by industry bodies about its response to the *PPG* case. Further guidance will be issued in the autumn on how the two judgments will inform HMRC policy and there will be a transitional period for schemes to make changes to their VAT arrangements. In the meantime, businesses may continue to use the transitional arrangements outlined in Brief 06/14 beyond the six month time limit stated there.

The new Brief gives email and postal addresses for trustees or employers to file protective claims for recovery of overpaid VAT.

Redefining "money purchase benefits"

Commencement

Commencement order:
http://www.legislation.gov.uk/uksi/2014/1683/made

Section 29 of the Pensions Act 2011 will come into force on 24 July 2014, redefining "money purchase benefits" retrospectively (but see below) in pensions legislation to include (broadly) only benefits in respect of which no deficit can arise. See **WHiP Issue 46** for details of the effect on schemes.

Regulations now split in two

Regulations:
http://www.legislation.gov.uk/uksi/2014/1711/made

Draft regulations (subject to Parliamentary approval):
http://www.legislation.gov.uk/ukdsi/2014/9780111116647

Due to a procedural error, the draft regulations (see **WHiP Issue 46**) limiting the retrospective effect of the redefinition of "money purchase benefits" have been withdrawn, split in two and reissued. There should be no impact on the effect of the combined regulations.

The regulations containing most of the exceptions to the new definition take effect immediately after section 29 comes into force (see above). At the time of writing, the other set of regulations (which mainly concerns cash balance benefits) is still awaiting Parliament's approval.

Consultation web page:
https://www.gov.uk/government/consultations/definition-of-money-purchase-benefits-in-occupational-pension-schemes

The May 2014 consultation response (see **WHiP Issue 46**) has been revised and reissued to reflect the split regulations.

PPF requirement for out-of-cycle valuations

PPF press release:
http://www.pensionprotectionfund.org.uk/News/Pages/details.aspx?itemID=365

The PPF has consulted on proposals for requiring out-of-cycle valuations for schemes that are already required to file valuations, because they provide DB benefits, but which also provide benefits that will cease to be within the definition of "money purchase benefits".

It proposes to call for out-of-cycle section 179 valuations to be submitted by 5pm on 31 March 2015. They will be required where (a) the valuation that would otherwise be on the Pensions Regulator's Exchange system at that time does not take account of the new definition and (b) the impact is material. A material impact is where, as at the date of the last valuation, the new definition results in a change to the scheme's surplus or deficit that is more than 10% in relative terms and more than £5 million in absolute terms (valued on the PPF basis).

Law Commission report: "Fiduciary duties of investment intermediaries"

Law Commission report:
http://lawcommission.justice.gov.uk/areas/fiduciary_duties.htm

The Law Commission has issued a long report on the application of fiduciary duties to those who invest on behalf of others, focusing particularly on pension scheme trustees. The Commission decided against recommending codifying the law in this area, to avoid unhelpful rigidity. It notes that the law is already flexible enough to allow trustees to take into account considerations other than financial returns. A point that is stressed is that the existing law does not require trustees to maximise returns in the short-term at the expense of risks over the longer term.

Accompanying the report is Law Commission guidance: *"Is it always about the money? Pension trustees' duties when setting an investment strategy"*. This covers, among other things, questions of when investment taking account of "ESG" (Environment, Social and Governance) factors may be appropriate. The Commission encourages circulation of the guidance and asks the Pensions Regulator to include it in its Trustee Toolkit and later in a code of practice (and the FCA to give similar guidance to independent governance committees of contract-based schemes).

The guidance says that under the existing law to trustees may take account of any financial factor which is relevant to investment performance. These include risks to a company's long-term sustainability, such as ESG factors. Indeed, trustees, should take account of such factors when they are or may be financially material. Non-financial factors (which might include factors typically labelled as "ethical") may be taken into account if two tests are met:

> *"(1) trustees should have good reason to think that scheme members would share the concern; and*
>
> *(2) the decision should not involve a risk of significant financial detriment to the fund."*

The distinction between financial and non-financial factors is illustrated by reference to the example of the tobacco industry.

> *"Withdrawing from tobacco because the risk of litigation makes it a bad long-term investment is based on a financial factor. Withdrawing from tobacco because it is wrong to be associated with a product which kills people is based on a non-financial factor."*

The Commission's key recommendations are as follows:

- The investment regulations' requirements for trustees to invest "*in the best interests of the beneficiaries*" and in a manner "calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole" only apply to schemes with 100 or more members. The regulations should be amended to apply them to all schemes. Trust law already applies these duties and exempting trustees of smaller schemes may wrongly suggest to them that they do not have the same duties as trustees of larger schemes.
- The requirement in the same regulations for trustees to include in their statement of investment principles a statement of their policy on social, environmental or ethical considerations should be reviewed to ensure that the requirement reflects all the non-financial factors that trustees may take into account.
- The Government should review whether trustees should be required to state their policy (if any) on stewardship, including whether they intend to engage with companies or exercise voting rights and, if so, how.
- As part of the Government's proposed review in 2017 of the DC default fund charge cap (see **WHiP Issue 45**), which does not cover transaction charges, it should consider whether the design of the cap incentivises trading over long-term investment and, if so, what measures can be taken to reduce the effect.
- Independent governance committees of contract-based schemes should have a statutory duty to act with reasonable care and skill in members' interests. Pension providers should also be required to indemnify committee members for liabilities they incur in the course of their duties.
- There should not be a formal review of the regulation of investment consultants. If they give only generic advice, they are not within the scope of the FCA's powers and so are unregulated. This lack of regulation is anomalous, so the Government should

actively monitor this area.

- There should not be a review of stock lending practices but intermediaries' fees should be more transparent. This should be considered by the Government in 2017 alongside the default fund charge cap (see above).

Civil partners and same sex spouses

Government report:
https://www.gov.uk/government/publications/occupational-pension-schemes-review-of-survivor-benefits

Report on fully equal treatment

The Government has reported, as required under the Marriage (Same Sex Couples) Act 2013, on its review of the inequalities in survivor benefits in occupational pension schemes.

The report notes that giving civil partners and same sex spouses fully retrospective survivor benefits in public service schemes would mean treating them better than male opposite sex spouses, which could lead to legal challenges. (Most public service pension schemes pay spouses' pensions to male opposite sex spouses based only on accruals since 6 April 1988 but exceed the legal minimum and pay civil partners and same sex spouses benefits based on accruals since 6 April 1988 (rather than just from 5 December 2005).)

The key findings were as follows (all figures exclude additional administration and adviser costs).

- Treating civil partners and same sex spouses the same as opposite sex widows would cost around £80 million for public service schemes.
- The cost of removing all inequality (including sex discrimination as well as sexual orientation discrimination) in spouses' and civil partners' benefits in public service pension schemes would be around £2.9 billion, with £1 billion payable immediately. For the private sector the equivalent cost would be around £0.4 billion.

The Government will be considering the matter "*very carefully*" before making a decision on whether the law should be changed. It seems very likely that it will not make a decision before the outcome of the pending appeal to the Court of Appeal in *Walker v Innospec* (see **WHiP Issue 45** for the EAT decision). See our briefing note **Same sex marriage** for details of the issues that arise in this area.

Consultation response:
https://www.gov.uk/government/consultations/consultation-on-the-future-of-civil-partnership-in-england-and-wales

Civil partnerships

The Government has responded to its consultation on the future of civil partnerships following the introduction of same sex marriage. The response announces that civil partners will be able to convert their relationship to a marriage from December 2014. Given a lack of consensus on whether and how to change the civil partnership regime, the Government will not be making any changes.

Pensions Ombudsman determinations

Determination:
http://www.pensions-ombudsman.org.uk/determinations/docs/2014/jun/po-2066.doc

Recovery of overpayments

The Deputy Pensions Ombudsman has issued a determination in favour of a complainant concerning a disputed attempt to recover overpayments. It covers the change of position defence, limitation periods and attempted recovery from future instalments.

Mr Clift retired under the British Coal scheme (later merged into the Industry Wide Scheme) in 1998 and was in receipt of an ill health pension. In June 1999, the trustees discovered a calculation error. His future pension instalments were corrected and the trustees sought repayment of overpaid lump. They later decided against recovery, having accepted that he had bought a conservatory, thereby changing his financial position in reliance on the lump sum payment. In 2011, another error was discovered. The trustees reduced his future instalments and suggested a five year repayment plan of £46.59 a month, further reducing future instalments. Mr Clift objected.

- Mr Clift complained that the same change of position defence, based on the purchase of the conservatory, applied. The Deputy Pensions Ombudsman agreed that it did.
- Mr Clift argued that the trustees were out of time under the Limitation Act 1980 to claim any more than six years of overpayments, on the basis that they should have noticed the error in 2009 when the first mistake was spotted. The trustees argued that it was the previous scheme's error that they had mirrored and that a reasonably diligent trustee could not have discovered the error before 2011. The Deputy Ombudsman determined that:

  > *"In my view, a 'reasonably diligent' trustee should have a sound knowledge of the provisions of the Rules and understand fully how they are applied in practice. … In my view the Trustees should carry out checks or audits on a regular basis to avoid such errors."*

She held that this would have been in 1998 or 1999 and so the trustees could only recover overpayments made at the earliest six years before they notified Mr Clift in 2011.

- Mr Clift argued that the trustees were in breach of section 91 of Pensions Act 1995 in offsetting disputed sums against his pension. This section provides that sums purportedly owed to the scheme cannot be set off against benefit payments if the recipient disputes the amount owed. The Deputy Ombudsman agreed that there was a breach. This is the first occasion of which we are aware when the Ombudsman (or here the Deputy) has accepted this argument based on section 91 in relation to a disputed set-off applied after 2005 (when section 91 was amended). The Ombudsman had previously treated overpayments as early payments of future instalments and rejected claims that a set-off was being applied.

Draft clearly and take care when using FAQs

The Pensions Ombudsman has determined that transfer documentation issued by a pension provider was misleading to a lay reader and that information given in an FAQs section of an information pack could not be relied on if the member had not read that section.

Determination:
http://www.pensions-ombudsman.org.uk/determinations/docs/2014/apr/po-623.doc

Mr Gregory was a member of the DC section of the Mott MacDonald Pension Scheme ("MMPS"), managed by Friends Life. The employer closed this and arranged instead a group personal pension, also with Friends Life. An option to transfer pension pots was made and Mr Gregory took it up.

Under the MMPS, Mr Gregory had 80% of his accumulated funds as at December 2011 invested in a UK equities fund. The other 20% of the accumulated funds and all contributions made thereafter were invested in a cash fund. When he transferred to the GPP, Friends Life sent him various pieces of information, as follows.

- A membership confirmation statement showed his "Investment choice/default" as cash and asked him to check the details and notify Friends Life if anything was incorrect.
- A transfer information pack said that *"Your transfer value must be invested in exactly the same funds and investment proportions as your existing contributions"*.
- The FAQs section of the transfer information pack said *"Your transfer payment will be invested in the same funds as your regular GPP contributions"*.
- A transfer form said *"Your transfer value must be invested in exactly the same funds (and investment proportions) and follow the same lifetime investment programme as your existing policy"*.

Friends Life processed Mr Gregory's transfer and invested all the transferred funds in cash. Mr Gregory immediately asked it to change the investments back to what they had been and claimed compensation for his losses, which were mainly disinvestment and reinvestment charges. Friends Life argued that it had told him what would happen to his transfer payment and they had done what they had said they would do.

The Ombudsman determined as follows.

- When the transfer pack referred to *"your existing contributions"*, it would not necessarily have been clear to a person such as Mr Gregory with an accumulated pension pot that this meant only the contributions currently being made. It could just as easily have meant the contributions already made.
- The FAQs section includes the clearest statement of what would be done. *"However, it is contained in the section of the documents that would not necessarily have been read. FAQs are there in case of questions that the reader may have, not to be read in detail as a way of finding information for the first time. Mr Gregory did not in fact read it and I find that Friends Life cannot rely on it."*
- The transfer form was not clear. The "policy" referred to was probably meant to mean the policy of insurance under the GPP but it could have been intended to mean the policy for investing future contributions. But a lay person making a transfer would more probably have read it to be a reference to the MMPS.

The information was therefore misleading and this was maladministration. Mr Gregory's actions when he discovered what had happened satisfied the Ombudsman that he would have chosen to stay with the existing investment split if he had been properly informed. (This was not an option that was offered but he could have achieved more or less the same result by changing his regular contribution investment choice for a month and then changing it back.)

Statutory holiday pay may have to take account of commission payments

Case report:
http://www.bailii.org/eu/cases/EUECJ/2014/C53912.html

The European Court has held, in *Lock v British Gas Trading Ltd*, that the EU Working Time Directive precludes UK national legislation from calculating statutory holiday pay based purely on basic salary for a worker who is remunerated partly by commission. In these circumstances, EU law requires that statutory holiday pay should include an element in respect of commission. Otherwise, the worker might be deterred from taking annual leave, which would be contrary to the directive's purpose.

There could be an impact on pension schemes where pensionable pay includes commission (and/or other variable payments) that is/are not paid or included in pensionable pay calculations for periods of annual leave. We now await the Employment Tribunal's decision on whether UK law, interpreted in the light of the directive's requirements, requires statutory holiday pay to take account of commission.

Automatic enrolment

LLP member was a worker

Case report:
http://www.bailii.org/uk/cases/UKSC/2014/32.html

The Supreme Court has held that an LLP member was a worker and so benefited from certain statutory employment rights and protections. This decision also affects LLPs' automatic enrolment duties.

The case concerned a junior equity "partner" (actually an LLP member) at a law firm who brought a whistleblowing unfair dismissal claim against the firm (*Clyde & Co LLP and another v Bates van Winkelhof*). She could only proceed with the whistleblowing claim if she was a worker. The Supreme Court unanimously held that she was. She met the two key conditions, in that she had a contract with the firm to perform work personally and the firm was not a client or customer of hers. The Court disagreed with the Court of Appeal's ruling that the concept of "worker" involves an element of control and subordination in the relationship. It also overruled the finding that provisions of the Limited Partnership Act 2000 prevented a member of an LLP from being a worker.

Whilst the Supreme Court did not consider pensions, the automatic enrolment obligations under the Pensions Act 2008 apply in respect of workers. The definition for these purposes is effectively the same. The obligation to enrol only applies to workers who have earnings (as defined) above the trigger level. "Earnings" for these purposes means *"salary, wages, commission, bonuses and overtime"* as well as certain other statutory payments (such as sick pay and maternity and paternity pay). It will not always be clear whether all or any of an LLP member's remuneration falls within the statutory definition of earnings. It is also unclear whether changes effective from April 2014 in the current Finance Bill, under which salaried members of LLPs might be treated as employees for tax purposes, could affect the characterisation of a LLP member's income for the purposes of automatic enrolment.

Even if a worker has no relevant earnings, the LLP still has a duty to provide prescribed information to its workers about pensions within a certain period of the new duties applying and to provide access to a pension arrangement on request. If an LLP member worker subsequently received any income categorised as earnings (eg, a bonus), this could trigger an enrolment duty (or opt-in right) at that point.

Pensions Regulator: registration is now "declaration of compliance"

Announcement:
http://www.thepensionsregulator.gov.uk/docs/declaration-of-compliance-changes.pdf

The Regulator has renamed registration as *"declaration of compliance"* and will adopt the new term in its literature. It says that the new term resonates more strongly with small businesses.

Public sector outsourcing: "Fair Deal"

GAD announcement:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/325462/_STT032__Changes_to_passport_certificate_system.pdf

The Government Actuary's Department (GAD) has announced changes to the "passport" system of certifying broad comparability of a private sector contractor's pension scheme with a public service pension scheme. The changes are being made in light of the changes to the "Fair Deal" policy (see **WHiP Issue 42**) under which contractors are able to participate in public service schemes rather than having to offer a broadly comparable scheme. This considerably reduces the need for passports.

The changes, effective from 1 July 2014, replace the existing two tier approach of interim and final passport certificates with a new single tier system. The new single tier passport certificates will normally be valid for a maximum of two years. GAD will not review scheme documentation and the requirement for an independent legal review is discontinued. Contractors will be asked to give an undertaking in relation to the updating of scheme documentation.

Existing passports that were still in force will remain in force after these changes. "One-off" certificates, relating to a particular transaction, are still an option.

A separate document has been published outlining for the first time the actuarial assumptions used for broad comparability assessments.

Actuarial assumptions:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/325463/_STT031__Actuarial_assumptions_for_broad_comparability_assessments.pdf

This and previous issues of WHiP can be found on our website **here**.

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If you wish to discuss any points arising from this note, please speak to your usual contact in the Travers Smith Pensions team or to one of the Pensions partners: Paul Stannard, Peter Esam, Philip Stear, Susie Daykin and Daniel Gerring.

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