ALLEN & OVERY

10 December 2018

Pensions: what's new this week

Welcome to your weekly update from the Allen & Overy Pensions team, bringing you up to speed on all the latest legal and regulatory developments in the world of occupational pensions.

Lloyds case: guidance on conversion | DB funding/dividends: TPR threatens use of powers | Brexit: new draft pensions regulations | Pensions dashboards: new report and consultation | Auto-enrolment: earnings trigger 2019/20 | Purple Book 2018 | RPI/CPI: BT appeal dismissed | Patient capital guide launched | Master trust update | Transfers: FCA releases key findings on advice

Lloyds case: guidance on conversion

The High Court has handed down a short supplementary judgment to its earlier decision that trustees are obliged to equalise for the effect of unequal guaranteed minimum pensions (for more information about the case and details of the various possible methods of equalisation, see our briefing Equalising pensions for GMPs? High Court says 'yes'). We are acting for the Trustee in this case.

The new judgment includes some further guidance on Method D2 (GMP conversion), which the judge concluded could be used with sponsor consent.

Mr Justice Morgan has now clarified (with reference to the terms of the order between the parties), that for the purposes of Method D2, it is not necessary to first equalise benefits in accordance with Method C2 (which is a year-on-year comparison method). He also stated that it is for the actuary (not the court) to determine the actuarial equivalents of the unequalised pensions, and that he would not make any ruling as to what assumptions the actuary should make about interest or discount rates or other matters (and that the interest rate used for Method C2 was not intended to bind an actuary in relation to Method D2).

DB funding/dividends: TPR threatens use of powers

A new regulatory intervention report by the Pensions Regulator (TPR) provides useful insights on its approach where a scheme is in deficit but the employer is paying (or intends to pay) substantial dividends to shareholders.

In 2015, the trustee and Southern Water agreed a valuation (as at March 2013) which TPR had previously stated did not comply with the statutory framework. TPR considered that higher deficit repair contributions (DRCs) were affordable, that the recovery plan was too long, and that there was potential for members to be treated unfairly in comparison to shareholders (the company went on to pay dividends of GBP190 million in 2016 and 2017). TPR subsequently issued a Warning Notice in relation to the use of its statutory funding powers and opened an investigation into whether the payment of dividends gave it grounds to use its Contribution Notice powers.

TPR ultimately ceased its regulatory action and anti-avoidance investigation, focusing instead on agreeing an appropriate 2016 valuation. This resulted in significantly increased DRCs over a shorter period, additional contributions to cover an increase in the deficit after the valuation date, and a dividend sharing mechanism. Under that mechanism, if external dividends in excess of an agreed threshold are paid outside of the group to shareholders, DRCs are accelerated.

TPR has stated that where employers are paying substantial dividends (illustrating that higher DRCs are affordable), it will seek short recovery plans and other mechanisms to ensure that schemes are treated fairly – fair treatment was one of the messages in TPR's annual funding statement earlier this year (WNTW, 9 April 2018). TPR's press release is available here.

Brexit: new draft pensions regulations

The government has laid before Parliament a revised version of draft regulations which would make changes to numerous pieces of pensions legislation in the event that there is no withdrawal agreement between the UK and the EU. The government has withdrawn the earlier version of the regulations (WNTW, 29 October 2018). The draft regulations must be approved by both Houses of Parliament.

The government is proposing to make changes to requirements for scheme investments – under the current Investment Regulations, scheme assets must be predominantly assets traded on 'regulated markets'. The original draft regulations proposed to restrict this to 'UK regulated markets'. Following industry feedback, the government has revised the proposed amendments so that the regulated markets on which scheme assets must be predominantly traded include markets outside the UK. The new explanatory memorandum confirms that it is not the government's policy intention that pension schemes may need to disinvest from overseas regulated markets as a result of the changes.

For news on other Brexit-related developments, visit www.allenovery.com/Brexit.

Pensions dashboards: new report and consultation

The government has released a feasibility report on pensions dashboards, together with a related consultation. It expects that a dashboard facilitated by the Single Financial Guidance Body (SFGB) will be introduced from 2019/20, with other commercial dashboards to appear over time.

The government's approach is to establish an industry-led delivery group headed by the SFGB which will determine the final detailed model for the dashboard (in line with a number of principles set out in the report). It envisages that industry should begin to voluntarily supply data to the SFGB-hosted dashboard from 2019, with State Pension data being integrated in future. It expects that the majority of schemes will be onboarded within three to four years from the first dashboards becoming publicly available. The government intends to legislate to provide that pension schemes must provide data via a dashboard (where the individual has given consent), although it is considering whether some types of schemes should be exempted. It also proposes that pension schemes will be legally required to provide data to a single 'pension finder service', which will be run on a non-profit basis.

The government considers that the dashboards project should be largely funded by industry (including the pension finder service and the non-commercial dashboard hosted by the SFGB); there may be funding available via existing industry levies, but some costs may fall on schemes.

The consultation closes on 28 January 2019. The government is also running a number of stakeholder engagement events in December, and if you wish to receive dashboard-related communications, you can request to be added to the stakeholder mailing list by emailing pensionsdashboard@dwp.gsi.gov.uk.

Auto-enrolment: earnings trigger 2019/20

The government has announced that it intends the earnings trigger for auto-enrolment to remain unchanged at GBP10,000 for 2019/20. The lower and upper limits of the qualifying earnings band would remain aligned with National Insurance thresholds, and be set at GBP6,136 (increased from GBP6,032) and GBP50,000 (increased from GBP46,350).

Purple Book 2018

The PPF has published the 2018 edition of the Purple Book, which contains its assessment of the risk profile of UK defined benefit pension schemes. The data shows that the number of schemes open to new members is stable, but schemes that are already closed to new members continue to move to closing to future benefit accrual. The proportion of fully-closed schemes rose to 41 per cent in 2018 (39 per cent in 2017).

RPI/CPI: BT appeal dismissed

The Court of Appeal has unanimously dismissed an appeal by BT plc in relation to the ability to change the index used to calculate pension increases under the BT Pension Scheme: *BT plc v BT Pension Scheme Trustees Ltd anor*. The decision is the latest in a line of cases which illustrate that the ability to switch from RPI depends on the precise wording of the scheme rules in question.

In January 2018, the High Court held that the test for changing the index, as set out in the rules, had not been met – the 'trigger' for a decision to change index in the 2016 Rules was whether RPI had ceased to be published or become inappropriate. The question of whether RPI had become inappropriate was an objective one (the rules did not confer a power on BT to decide this), and the judge concluded that RPI had not become inappropriate (see WNTW, 29 January 2018).

The Court of Appeal held that the issue of whether RPI had become inappropriate for the purposes of the 2016 Rules was an objective state of affairs, which was inevitably fact sensitive and, in the event of a dispute, was to be determined by the courts. It also refused to interfere with the judge's decision that RPI had not become inappropriate for the purposes of the 2016 Rules. The court's review was limited to whether the judge had legitimate and proper grounds for reaching his decision, rather than reconsidering the issue afresh, and it concluded that the judge was entitled to form the view that RPI had not become inappropriate on the evidence before him. The court declined to comment on the issue of whether a failure to exercise a power to change index within a reasonable time would cause it to lapse, on the basis that it was unnecessary to do so.

Patient capital guide launched

The PLSA has released a guide to patient capital and illiquid investment. This follows support for investment in patient capital in the 2018 Budget and updated DB and DC investment guidance from TPR, which address patient capital and social impact investment (WNTW, 5 November 2018). The PLSA guide contains case studies, tips and checklists to assist trustees.

Master trust update

TPR's latest figures on the master trust market show that to date, only one master trust has applied for authorisation (though other applications are understood to be in preparation). No additional master trusts have exited the market.

Transfers: FCA releases key findings on advice

The Financial Conduct Authority (FCA) has released its key findings from recent work on pension transfer advice. In particular, the FCA is very concerned about suitability rates – too many firms are not consistently providing suitable advice on transfers, and the FCA is planning a wide-ranging programme of activity on transfers next year. It expects advisers to start from the position that a pension transfer is not suitable (but recognises that there are occasions when it is in the member's best interests to transfer). The FCA also released new rules and guidance on transfers last month (WNTW, 8 October 2018).

Contact information

Helen Powell
PSL Counsel, London
0203 088 4827
helen.powell@allenovery.com

Ruth Emsden
PSL, London
0203 088 4507
ruth.emsden@allenovery.com