SLAUGHTER AND MAY

Pensions Bulletin

July 2020

Welcome to the July 2020 Pensions Bulletin from Slaughter and May. In this month's edition, we analyse HM Revenue & Customs (HMRC) and industry guidance on equalising for the effects of guaranteed minimum pensions (GMP equalisation). We report on a significant European Court case on data transfers to the United States, which has broader implications for the transfer of data outside the EEA. We also cover the Pension Protection Fund's (PPF's) COVID-19 levy payment extension. We conclude with a look at two recent court cases: the latest decision in *Safeway v Newton* on equalisation of retirement ages and a successful application for rectification to remove the "hard-wiring" into the pension scheme rules of pension increases based on the Retail Prices Index (RPI).

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I. GMP equalisation: HMRC newsletter on lump sums and PASA guidance on data

In further tax guidance on GMP equalisation, HMRC have expressed the view that, in nearly all cases, lump sums already paid by pension schemes that did not take account of GMP equalisation, will be authorised payments. Any "top-up" payment made to reflect GMP equalisation is treated as a separate lump sum.

HMRC repeats that it is unable to provide any guidance on conversion.

PASA has also published further guidance on the data aspects involved in equalising GMPs. Trustees will need adviser input and, in particular, should ensure they take legal advice before making an approximation on data.

The second tranche of HMRC guidance on the tax implications of equalising for the effect of GMPs, covering lump sum payments, was issued on 16 July 2020. This follows on from the guidance on the "dual records" methods of equalising (see our March 2020 Pensions Bulletin).

The HMRC guidance is helpful confirmation that, in nearly all cases, past lump sum payments will not be treated by HMRC as unauthorised due to the decision, in the first *Lloyds* judgment in 2018, that schemes must equalise for the effects of GMPs. The main concern relating to past lump sum payments was whether a lump sum paid that did not take GMP equalisation into account met the authorised payment requirement that the lump sum extinguished the member's (or dependant's) rights. HMRC accepts that the later identification of further entitlement due to GMP equalisation does not prevent the condition having been met. HMRC takes the point in time at which the GMP equalisation benefit could reasonably have been known about to be once the scheme administrator adopts their chosen GMP equalisation methodology, so lump sums paid after the *Lloyds* judgment can fall within the guidance.

A "top-up" payment made to reflect GMP equalisation is treated by HMRC as a separate lump sum (not a correction of the original lump sum), and can be a different payment type. It is taxable in the tax year paid. The "small lump sums", with a limit of £10,000, will be a useful payment type to consider, including for any top-ups after death as, scheme rules permitting, they can be paid to any person (not just the original scheme member).

However, GMP equalisation benefits can cause the "value" limit for "trivial commutation lump sums" already paid to be breached, potentially turning these into unauthorised payments. (Note that "trivial commutation lump sums" are different from "small lump sums".) For this lump sum, the value of the member's total benefits across all registered schemes had to be less than a fixed amount on a nominated date, so in practice were rarely paid by schemes, due to the difficulties of verification of the member's broader pension benefit position.

HMRC repeats that it is unable to provide any guidance on conversion due to the wider issues raised by that method, and states that schemes wishing to use conversion should take their own advice on the tax implications. There are a number of issues that arise when trying to fit conversion within the existing tax rules.

The guidance does not comment on whether or not schemes should go back and top up lump sums already paid. It will be for schemes to determine whether or not this is required, and there may be helpful analogies to draw from the awaited judgment in the third *Lloyds* hearing on transfers.

The cross-industry GMP Equalisation Working Group of the Pensions Administration Standards Association (PASA) has published further, highly technical, guidance (July 2020), on the **data aspects** involved in equalising GMPs. It follows previous PASA guidance on methodology and scheme rectification (see our April 2020 Pensions Bulletin). The guidance identifies five key data areas that are important for schemes undertaking GMP equalisation:

- **Data required and availability:** the guidance sets out the potential data required and notes that some will not be readily available (or available at all), or the effort and expense required to obtain it may be disproportionately high in the context of the benefit uplift amounts.

- **Member groupings:** trustees should assess if all members will be dealt with in the same way; they could decide to deal first with data issues for those members for whom there is an earlier material impact. Alternatively, they may decide it is most cost effective to obtain all data at once.

- **Adviser input:** trustees will need to consult advisers on the data required, the impact of making assumptions or approximations and the availability of resource. Trustees need to decide which party will carry out the data related work and the process to be used for data cleansing.

- **Consistency and efficiency:** trustees should consider the potential need for decisions on data to be consistent with other similar decisions (for example, in relation to general *Barber* equalisation and GMP reconciliation and rectification projects).

- **Calculation options:** the post-16 May 1990 GMP (and non-GMP) elements for the opposite sex will need to be calculated. The option chosen for doing this will depend on the data available, the benefit structure and the profile of the affected members. These will be decisions for trustees, sometimes in conjunction with the employer, and in most cases requiring input from advisers.

II. European Court invalidates the EU-US Privacy Shield for international data transfers

In Data Protection Commissioner Ireland v Facebook Ireland and Maximillian Schrems, the European Court has invalidated the EU-US Privacy Shield framework for personal data transfers to the US. Pension scheme trustees and sponsors who rely on the EU-US Privacy Shield for international transfers of personal data will need to assess what their next steps should be to remain compliant.

In addition, while the Court confirmed that the EU standard contractual clauses (SCCs) can provide a lawful framework for international transfers of personal data, the Court's comments that transfers pursuant to the SCCs should be suspended or stopped if the protection required by EU law cannot be ensured in the recipient country, may create potential problems for transfers of data outside the EEA (apart from the US) where trustees are relying on SCCs. SCCs are issued by the European Commission in order to provide sufficient safeguards for data transferred outside the EU or EEA.

The European Court called into question the protections granted to personal data in the context of the US national security and intelligence services. US domestic law on the use of personal data by public authorities does not, in the Court's view, provide protections that are essentially equivalent to those required under EU law. Given these issues, the Court ruled that the EU-US Privacy Shield was invalid.

The Court confirmed the validity and sufficiency of the EU SCCs (one of a limited number of mechanisms by which organisations in the EU can transfer personal data to countries outside the EEA). However, it went on to say that transfers of personal data pursuant to the SCCs can (and should) be suspended or stopped entirely if the protection for personal data required by EU law cannot be ensured in the recipient country. It is up to the data exporter and recipient to determine, before any data transfer, whether the level of protection in the third country is sufficient to enable compliance with the SCCs. The Court also reiterated the fact that national data protection authorities have an obligation to intervene to suspend data transfers where the SCCs cannot be complied with in the recipient jurisdiction.

The Information Commissioner's Office (ICO) has confirmed that it is currently reviewing its guidance on the EU-US Privacy Shield and SCCs. The ICO's advice to organisations who are currently using the

Privacy Shield framework for data transfers to the US is to continue to do so until new ICO guidance becomes available, but organisations should not to start to use the Privacy Shield during this period.

The European Data Protection Board, which brings together EU privacy enforcers, has published a document to say it will provide more guidance to EU-based data exporters on the use of data-transfer tools, including SCCs. There are other mechanisms for lawful transfers, such as binding corporate rules (BCRs) and other derogations in the GDPR. The EU body said it is looking into what kind of "supplementary measures", whether legal, technical or organisational, could be put in place so that companies could continue to rely on SCCs or BCRs for data transfers outside of the EU.

III. PPF COVID-19 levy payment extension

The PPF has announced that levy payers struggling to pay due to COVID-19 will be given up to 90 days to pay the levy without incurring an interest charge. Trustees will need to complete an impact notification form once they have received their invoice.

On 7 July 2020, the PPF made an announcement about a COVID-19 levy payment extension, giving PPF levy payers who are struggling to pay due to coronavirus up to 90 days (instead of 28 days) to pay without incurring interest. There is also a reminder that a payment plan may be available to spread the cost of the levy. The Help paying your levy page explains that the legislation does not allow the PPF to extend the invoice payment terms, but it can waive interest charged for late payment. Guidance on applying for extension terms explains that trustees should submit the COVID-19 impact notification form within 28 days of (but not before) receiving the levy invoice. The PPF will consider the trustees' explanation of how COVID-19 has negatively affected the scheme or the employer's business and the PPF may ask for supporting evidence. Their "policy intent" is that, if payment is made within 90 days, the interest on late payment will be waived.

The PPF has also announced that it will now send electronic copies of invoices, in addition to paper copies (until schemes opt out of receiving paper copies).

IV Equalisation: Court of Appeal decides that UK domestic law was effective to close *Barber* window from 1 January 1996

A further case relating to the equalisation of retirement ages in the Safeway pension scheme. The Court of Appeal's decision offers a limited concession for schemes with open Barber windows on 1 January 1996. A valid rule amendment under UK domestic law, made between 1 January 1996 and 6 April 1997 (when Section 67 of the Pensions Act 1995 was introduced), could have retrospective effect to level down benefits from an earlier date. If (as in Safeway) the amendment purported to take effect from a date before 1 January 1996, the Barber window is treated as having closed on 1 January 1996.

The background was a previous decision of the Court of Appeal, confirming that equalisation of retirement ages could only be effected by a deed of amendment, not by written announcement (see our Pensions Bulletin dated 13 October 2017). The Court referred to the European Court the question of whether a retrospective equalisation amendment which "levelled down" benefits was prohibited by European law (Article 119 of the Treaty of Rome). In October 2019, the European Court confirmed that retirement ages could only be equalised from the date of the 1996 deed, even though, under domestic law, the amendment would have been valid from the date stated in the announcement. The final issue left over was whether Section 62 of the Pensions Act 1995 operated to close the scheme's *Barber* window.

The Court of Appeal has decided that Section 62 was effective to close the scheme's *Barber* window from 1 January 1996, when it came into force. From this date, a member's right to enforce the equal treatment principle was no longer provided by Article 119 but, instead, by UK domestic law under Section 62, so it was from this date that Article 119's prohibition against retrospectivity fell away and the 1996 deed was allowed to operate.

Two facts were key to this decision – the scheme's power of amendment expressly permitted retrospective amendments and the purported amendment pre-dated Section 67 of the Pensions Act 1995 coming into force, which would have prevented the amendment. Given the overall liabilities for the scheme in this case, the financial implications of the savings for the period from 1 January to 2 May 1996 were significant.

V High Court allows rectification to remove RPI hard-wiring in pension increase rules

The High Court decision in Univar UK Ltd v Smith could, in some cases, increase the possibility of being able to rectify drafting errors in pension scheme documentation. On a practical level it highlights the importance of both trustees and sponsors agreeing to a schedule of changes as evidence as to what was intended in the drafting of any amending deed.

The High Court, in *Univar UK Ltd v Smith*, granted rectification in a case involving the inadvertent hard-wiring of RPI into a scheme's pension increase rules. The scheme's 2008 deed and rules were intended to be a consolidation. The previous deed and rules had provided for increases to pensions in payment and revaluation of pensions in deferment to be calculated on the statutory basis. On its face, the 2008 deed and rules made changes to the pension increase provisions, including that increases were to be calculated by reference to RPI rather than by reference to the statutory rate. As a result, members continued to be entitled to RPI-based increases even after the statutory regime had switched to providing CPI-based increases.

Univar's legal advisers had highlighted the changes to be made in the 2008 deed and rules in a "schedule of changes" presented to the trustees before it was executed. That schedule included a reference to the pension increase rules, but only to the reduction in the statutory cap from 5% to 2.5%.

Univar applied for rectification of the pension increase provisions. They argued that the 2008 deed and rules mistakenly wrote the then statutory regime, calculated by reference to RPI, into the rules of the scheme, thereby failing to reflect the common intention of the company and the trustees that they would continue to increase benefits by whatever the statute required from time to time.

The High Court granted rectification. Univar had established that, although they and the trustees were well aware of the actual words used, neither of them intended the pension increase and revaluation rules to have the legal effect they did. The oral and documentary evidence established that the company and trustees intended that no change of substance would be made unless it was included on the schedule of changes. The change from the statutory basis to RPI hard-wiring was not identified on the schedule. The Judge commented that the absence of discussion of an important change by the parties can in an appropriate case itself be evidence that the parties did not intend it. The Judge also gave weight to the fact that Univar's former legal advisers had admitted that they had not been instructed to draft the pension increase rules in the way they were drafted.

This was a more nuanced rectification claim than many previous ones, because the words used in the deed and rules did reflect the actual practice of the scheme at the date it was executed, based on the statutory regime then in force. The key points highlighted by the decision are:

- The importance of getting evidence from all witnesses when a mistake is identified, in order to demonstrate the subjective collective intent. The Court noted that it had the benefit of almost all the relevant contemporaneous documentation as well as oral evidence from over a dozen witnesses, including individuals who had been involved on behalf of the company and trustees and the legal advisers who had drafted the 2008 deed.

- The significance of the schedule of changes – the fact that the RPI hardwiring did not appear on the schedule of changes agreed by both employer and trustees was evidence that is was not intended.

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