SLAUGHTER AND MAY

Pensions and Employment: Pensions Bulletin

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Legal and regulatory developments in pensions

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There is no Employment bulletin this week

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For more information, or if you have a query in relation to any of the above items, please contact the person with whom you normally deal at Slaughter and May or Bridget Murphy.

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I. Watch list

The Watch List is a summary of some potentially important issues for pension schemes which we have identified and where time is running out (or has recently run out), with links to more detailed information. New or changed items are in **bold**.

No.	Topic	Deadline	Further information/action
1.	Reduction in annual allowance for high income individuals **Note:** Up to £80,000 annual allowance for tax year ending 5th April, 2016	Applies for tax years starting on or after 6th April, 2016	Summer Budget 2015 Supplement
2.	Severance payments and tapered annual allowance pitfall	From 6th April, 2016	Pensions Bulletin 16/06 2.1 Since 6th April, 2016, the £40,000 annual allowance for high income individuals is reduced by way of a taper to a minimum of £10,000 for those with income of £210,000 or more. 2.2 For the taper to apply, the individual must have UK taxable income in 2016/17 of : – £110,000 "threshold" income, and – £150,000 "adjusted" income. 2.3 Any taxable element of a termination package counts towards both threshold and adjusted income. A taxable termination payment could therefore catapult an individual over the £150,000 limit, resulting in a tax charge for the member on pension provision already made. 2.4 There may be scope for timing taxable termination payments to straddle tax years but care would be needed in view of anti-avoidance provisions. Termination procedures should be reviewed to build in a process to identify and manage this point.
3.	Reduction in Lifetime Allowance from £1.25 million to £1 million	6th April, 2016	Pensions Bulletin 15/19
4.	Members who intend to apply for Fixed Protection 2016 ("FP 2016") must have stopped accruing benefits	6th April, 2016	Pensions Bulletin 15/16
5.	Abolition of DB contracting-out: practicalities	6th April, 2016	Pensions Bulletin 15/16 5.1 Employers to notify affected employees of change in contracted-out status "at the earliest opportunity" and in any event by 6th May, 2016. 5.2 Schemes to notify affected members before, or as soon as possible after, 6th April, 2016 and in any event by 6th July, 2016. 5.3 Change template contracts of employment for new joiners to remove references to contracted-out employment. 5.4 Update, where applicable, pensions section of employee handbook to cover consequences of contracting-out ending.

No.	Topic	Deadline	Further information/action
6.	Abolition of DB contracting-out: Rule amendments needed Note: Statutory power to amend, retrospective to 6th April, 2016, expires on 5th April, 2017	6th April, 2016	If your scheme was contracted-out on 6th April, 2016 and currently has active members accruing benefits (and who continued to accrue benefits after 5th April, 2016 in the scheme), then your scheme will, more likely than not, require a rule amendment effective from 6th April, 2016 to prevent the inadvertent addition of an additional underpin to the accrued GMPs of those active members. See further Pensions Bulletin 16/03
7.	Abolition of DB contracting-out: Compliance with auto-enrolment requirements	6th April, 2016	If employer is using COSR as a "qualifying scheme" for auto-enrolment purposes, scheme will need to satisfy either: • "test scheme standard", or • alternative "cost of accruals" quality test if it is to continue as a "qualifying scheme". Pensions Bulletin 16/05
8.	Requirement to provide risk warnings when member provided with means of accessing DC benefits	6th April, 2016	Pensions Bulletin 16/04
9.	Put in place register of persons with significant control ("PSC") for trustee company where trustee is a corporate	6th April, 2016	Pensions Bulletin 16/03
10.	Ban on member-borne commissions in DC schemes used for auto-enrolment	5th July, 2016 at the latest	Trustees must notify "service providers" if the scheme is being used as a "qualifying scheme" for auto-enrolment purposes and some or all of the benefits are money purchase. Pensions Bulletin 16/04
11.	Cyclical re-enrolment	Within 6 month window by reference to third anniversary of employer's staging date	For example employers with a 2013 staging date must complete cyclical re-enrolment process between December 2015 and June 2016. Publication available to clients on request from usual pensions contact.
12.	First Chair's annual governance statement	Within 7 months of end of scheme year (for scheme years ending on or after 6th July, 2015)	For example, schemes with a 31st December year end must submit statement by 31st July, 2016. Client note dated June, 2015 available from Lynsey Richards.
13.	DC Code of Practice 13 on governance and administration takes effect	**28th July, 2016**	Schemes offering money purchase benefits (including money purchase AVCs, insofar as the legislation applies) must familiarise themselves with the revised Code.
14.	"Brexit"	Referendum held on 23rd June, 2016	Consider potential impact on pension schemes. Client publications available on Slaughter and May website
15.	Data protection: New Regulation	25th May, 2018	Pensions Bulletin 15/06

New Law

II. Brexit and pensions

A. Potential implications of Brexit

1. If you have not yet received a copy of our note on the potential implications of Brexit for UK occupational pension schemes, please contact Lynsey Richards.

   Short term issues to be addressed include:

   – (for DB and DC schemes) what, if anything, to say to members,

   – (for DB and DC schemes) whether it is necessary to review investment strategy/investment options, and

   – (for DB schemes) any impact on the strength of the employer covenant.

2. A statement on Brexit from the Pensions Regulator, published on 14th July, 2016, suggests areas that trustees could focus on in the short term (please see below).

3. The regulatory framework for pensions at EU level has been implemented in the UK largely by the Pensions Act 2004 and the Equality Act 2010. Assuming, following Brexit, that the UK no longer needs to comply with EU legislation, the UK Government may choose to repeal all or some of this implementing legislation.

4. But it would be surprising as a matter of principle if pension benefits accrued up to the date of repeal did not continue to be subject to the EU legislation in force at the time the benefits accrued (and future ECJ decisions relating to that legislation). It is an established Parliamentary convention, reflected in a key "rule of law" principle, that the applicable law is that which is in force at the time. In other words, a future Act of Parliament would, under this convention, not have retroactive effect to an earlier date than the date of the relevant Government Minister announcement to the House of Commons that the law is to be changed from the date of the announcement.

B. Pensions Regulator Statement on Brexit

The Regulator has issued a Statement on market volatility following the EU referendum, emphasising the need to take the long-term view.

It should be noted that the Pensions Regulator's Statements do not have the force of law and should be read in the context of the scheme's particular circumstances.

Key messages in the Statement are:

1. Defined Benefit trustees are urged to review their contingency plans and how they interact with current circumstances.

2. To consider the potential impact on covenant strength, trustees should consider how exposed their employer may be to the risks and opportunities which may come with the transition of trading relationships and potential changes to the wider economy, such as the strength of sterling and interest rates.

3. Trustees should continue to ensure that where deficit repair contributions were constrained to allow for investment in sustainable growth of the sponsor, that it continues to be used to strengthen the covenant to the scheme rather than being diverted away from the covenant (for example to pay dividends) - please see our next item "Dividends in the news".

4. Trustees should not be overly focused on short-term market movements, but should understand how this impacts on scheme funding plans and decision-making, including liquidity and cash flow management. Trustees should consider with their advisers the extent to which volatility and changing market conditions affect the longer-term view of expected risk and returns, and how this interacts with the scheme's funding plans and risk appetite. Scenario planning is suggested.

5. Where current conditions mean the scheme is exposed to an inappropriate level of risk, taking account of the employer covenant and other relevant factors, trustees should reconsider their investment strategy. Where trustees decide that action is needed, they should consider carefully the timing for implementation and be in a position to take action.

6. The Statement lists issues that trustees carrying out a valuation may wish to consider:

   - more sensitivity analysis to understand the potential impacts of different scenarios on the scheme and joining this analysis up with the sponsor's ability to provide support;
   - understanding the impact of those scenarios on the recovery plan and strategy to achieve long-term objectives;
   - reviewing contingency plans and how those interact with the current circumstances;
   - evaluating funding solutions which incorporate (for example) more contingent assets or conditional contributions with regular review periods; and
   - more regular and focused monitoring of the investment, funding and covenant.

7. For money purchase schemes, the Regulator says that trustees may consider it appropriate to make changes to the investments included in the scheme's default arrangement, or other investments offered to members. They should work with their providers and advisers to monitor developments and take steps to manage any emerging risks to the scheme, such as impacts on charges. The Regulator reminds DC scheme trustees that poor value for members is a key risk that trustee boards need to manage.

8. As regards member communications, the Regulator notes that members may be nervous about the impact of the leave vote on their pension savings and may contact trustees or their administrators for further information. Trustees should be prepared to explain to their members - clearly, and in plain English - the approach that they plan to take.

Press release

Comment (1): Responding to volatility in the markets is something that pension schemes will have had experience of in the past, although the prospect of Brexit is uncharted territory. The message that trustees should not react in a 'knee-jerk' fashion (broadly, the title of the press release) is to be expected. The continued message from the Regulator that deficit repair contributions should not be diverted to, say, dividends is in line with previous Regulator Statements. Overall, the message appears to be that trustees are expected to keep a closer eye than usual on the employer covenant and scheme investments, with scenario planning high on the agenda.

Comment (2): As regards member communications, trustees should take care that they do not expose themselves to the risk that members may bring a claim by reference to statements contained in such communications which overstate the position.

III. Dividends in the news

Research by Lane Clark & Peacock (*Accounting for pensions 2016*, issued on 16th August, 2016) has found that FTSE100 companies paid 5 times more in dividends than contributions to their defined benefit plans.

A point for company boards with defined benefit schemes in deficit to bear in mind when considering the rate of dividend to declare is that the Pensions Regulator has power to issue a 'contribution notice' under Section 38 of the Pensions Act 2004. The Regulator may issue a notice to an employer, or to someone connected or associated with the employer, requiring the recipient to pay a sum to the trustees of the pension scheme equal to an amount up to the scheme's Section 75 (or buy-out) deficit.

One of the circumstances in which a contribution notice may be issued is where an act or failure to act has detrimentally affected in a material way the likelihood of accrued scheme benefits being received.

Paying "excessive" dividends could fall within the scope of actions caught by Section 38. The Pensions Regulator's guidance on clearance states that employers and trustees should assess whether the employer covenant has been weakened to such a degree than an 'event' could be considered materially detrimental to the ability of the scheme to meet its liabilities. The guidance refers to a return of capital, such as a dividend payment, as an example of an event. The Regulator holds this view because paying dividends could impact on the ability of the employer to meet its ongoing funding commitments to the scheme if the employer's cash flow or balance sheet are affected.

However, the Clearance guidance expressly refers to special dividends, implying that regular dividends would not be relevant to the material detriment test. This is supported in the Regulator's Material Detriment Test Guidance, which states that the test would not be relevant where:

> "*Company A is trading profitably and the associated pension scheme has a deficit which is being addressed by an appropriate recovery plan. As part of the recovery plan directors make a routine annual dividend payment to shareholders in the normal course of business*".

The guidance only sets out illustrative examples, however, and "*should not be considered as setting precedents*". This is designed to ensure that shareholders are not placed at a disadvantage when compared with lenders of debt. The guidance recognises that companies need to be able to provide their shareholders with a reasonable rate of return on equity capital.

Also of relevance is the requirement in the legislation for the Regulator to consider a range of factors when deciding whether the material detriment test is met. Factors include the effect of the act or failure to act on the value of the scheme assets or liabilities and the extent to which any person is likely to be able to discharge their obligations to the scheme. There is also a defence under the legislation. The defence is that the person in question:

- considered the extent to which the scheme might be detrimentally affected,
- took all reasonable steps to minimise or eliminate that detriment, and
- it was reasonable for that person to conclude that the act or failure would not detrimentally affect in a material way the likelihood of accrued scheme benefits being received.

IV. BHS report

1. A joint report by the Work and Pensions Committee and Business, Innovation and Skills Committee regarding the problems currently faced by BHS was published on 25 July, 2016.

2. The report identifies the actions of Sir Philip Green in relation to the BHS pension scheme as contributing "substantially" to BHS's predicament. As a result, the report suggests that Sir Philip Green has a moral duty to make a large financial contribution to the pension schemes, which have a significant level of deficit.

3. Deficits were identified in the pension schemes some time ago, resulting in a 23-year recovery plan for the main scheme in 2013. The PPF assessment period for the schemes began in March 2016, followed in April 2016 by the employer's entry into administration.

4. The Pensions Regulator continues to investigate the way in which BHS was run and, in particular, its sale to Retail Acquisitions Limited for £1 in 2015.

5. The Regulator's shortcomings were also identified in the report, which describes the body as "reactive and [it] can be slow-moving". The Regulator's call for stronger requirements for employers to cooperate and provide information to trustees and the Regulator, and its assertion that the current mechanisms are inflexible, were noted in the report, however.

   Comment (1): The joint report is of interest to the wider pension community because the findings have led to an invitation for written submissions on:

   - DB pensions regulation,
   - the role of trustees and
   - affordability for the employer (please see the item below).

   Comment (2): It would not be entirely surprising if the inquiry into defined benefit pension schemes results in changes to legislation. The negative experience of a high-profile pension scheme has resulted in wide-ranging changes to legislation in the past. Although the circumstances were entirely different, the experiences of the Mirror Group Pension Fund resulted in the Pensions Act 1995.

   Comment (3): It seems likely that the Regulator's powers will be strengthened to improve its ability to behave more proactively. The Regulator's Chief Executive, Lesley Titcomb, has been quoted in the press (*Financial Times – 12 August, 2016*) as saying that the Regulator should be given greater powers to block deals, suggesting that clearance should be sought on an obligatory basis where the pension scheme is underfunded. While such a step might result in a lower PPF levy charge, the impact on mergers and acquisitions may not be so widely welcomed.

   Comment (4): The Pensions Regulator already has very wide-ranging powers under the Pensions Act 2004 to issue financial support directions and contribution notices. It is to be hoped that the Government's response will result in a considered course of action, avoiding knee-jerk legislation, conflating a distress sale (where the outturn for the pension scheme would have been the same in all material respects – whether or not the sale had gone through) with a further extension of regulatory intervention powers.

V. Defined benefit schemes - call for submissions

1. The Work and Pensions Committee has called for written submissions on the regulation of defined benefit pension schemes.

2. The deadline for submissions is 23 September, 2016.

3. The Committee invites written submissions addressing one or more of the following issues:

   3.1 Defined benefit (DB) pensions regulation by the Pensions Regulator, including:

   - the adequacy of regulatory powers, including anti-avoidance provisions;
   - the application of those powers, including in specific cases other than BHS;
   - the level and prioritisation of resources;

- whether a greater emphasis on supervision and pro-active regulation would be appropriate;
- whether specific additional measures for private companies or companies with complex and multi-national group structures are required;
- the pre-clearance system, including whether it is adequate for particular transactions including the disposal of companies with DB schemes;
- powers relating to scheme recovery plans; and
- the impact of the Regulator's approach on commercial decision-making and the operation of employers.

3.2 The Pension Protection Fund, including:

- the sustainability of the PPF; and
- the fairness of the PPF levy system and its impact on businesses and scheme members.

3.3 The role and powers of pension scheme trustees.

3.4 Relationships between the Regulator, PPF, trustees and sponsoring employers.

3.5 The balance between meeting pension obligations and ensuring the ongoing viability of sponsoring employers, including:

- the Regulator's objective to "minimise any adverse impact on the sustainable growth of an employer";
- whether the current framework is generating inter-generationally fair outcomes; and
- whether the current wider environment, including very low interest rates, warrants an exceptional approach.

4. Submission of views is invited through the Pension Protection Fund and Pensions Regulator inquiry page.

Comment: The experiences of British Steel and BHS have received sustained media attention. The BHS inquiry has now led to the call for submissions on DB scheme regulation, the role of trustees and affordability for the employer. The Government is already considering options in relation to the latter. For example, the possibility of offering very large schemes (with over 100,000 members) the option of transferring members without consent to a new scheme with lower pension increases and lower revaluation has been expressly mooted in the DWP's British Steel consultation published in May, 2016 (Pensions Bulletin 16/08).

VI. DC Code and guides finalised

1. The revised Code of Practice on DC governance and administration came into force on 28th July, 2016. The Code applies to schemes offering money purchase benefits (including money purchase AVCs, insofar as the legislation applies).
2. Also published by the Regulator is a self-assessment tool to help such trustees measure their scheme against the Code's standards.
3. Links to the Code, accompanying 'how-to' guides and self-assessment tool are contained in the Regulator's press release.

4. A further link in the press release relates to the finalised DC compliance and enforcement policy of the Regulator. A consultation on the draft revisions was launched in March, 2016, intended to cover the new requirements of the Charges and Governance regulations 2015.

VII. Auto-enrolment contributions transitional period extension

1. The Employers' Duties (Implementation) (Amendment) Regulations 2016 extend the transitional periods during which minimum contribution levels for jobholders who are auto-enrolled in an occupational or personal DC qualifying scheme are being phased in. The extension aligns the transitional periods with the start of the tax year.

2. The changes will come into force on 1st October, 2016.

3. The first transitional period will run from an employer's staging date until 5th April, 2018. In this period, total contributions must equal at least 2% of a jobholder's qualifying earnings in a relevant pay reference period, of which the employer must contribute at least 1%.

4. The second transitional period will run from 6th April, 2018 to 5th April, 2019. In this period, total contributions must equal at least 5% of a jobholder's qualifying earnings in a relevant pay reference period, of which the employer must contribute at least 2%.

5. The amending regulations also clarify that the transitional period for DB and hybrid schemes will end on 30th September, 2017.

VIII. Data protection latest

1. Having previously failed to agree the adequacy of the EU-US Privacy Shield in May, the Article 31 Committee, which is responsible for EU data protection, has now approved the final version of the Privacy Shield. On 12th July, 2016, the European Commission **adopted** an adequacy decision approving the Privacy Shield framework for EU-US personal data transfers in a commercial context.

2. The new regime will replace the 'Safe Harbor' regime. The US Department of Commerce began accepting Privacy Shield self-certifications from US companies on 1 August, 2016. The Department of Commerce has also **launched** a new website that provides individuals and companies with additional information regarding the EU-US Privacy Shield, including information about complying with, and self-certifying to, the Privacy Shield's principles. In addition, it has published a **guide** on "How to Join Privacy Shield".

IX. IORP II finalised

1. The **final IORP II wording** has been published.

2. The formal adoption of IORP II by the European Parliament is expected in October 2016.

3. A few points to note:

   3.1 As already widely reported, solvency based funding has been dropped from the Directive wording and the 6-year post-implementation review will not cover solvency.

   3.2 Cross border schemes will be able to run deficits accompanied by recovery plans.

   3.3 The wording clarifies that IORPs will not become cross border schemes just because they happen to have beneficiaries in another member state.

3.4 Schemes must comply with the new Own Risk Assessment at least every 3 years, or following any significant change to the scheme's risk profile. The Assessment would need to cover the scheme's risks, conflicts of interest and environmental and social and governance factors, among other issues.

Comment: Brexit calls into question how relevant IORP II will be to UK pensions. The expectation is that the Directive will be approved later this year by the European Parliament. The Directive would come into force 20 days after publication in the Official Journal, following which there is a 24-month deadline for transposition into national law. There is therefore a real possibility that the UK may still be in the European Union by that deadline, depending on progress made on negotiations for withdrawal.

X. NEST consultation

1. The DWP has issued a consultation on the future of NEST. The consultation (dated 7th July, 2016) closes on 28th September, 2016 and seeks to consider how NEST might evolve to respond to wider pension reforms.

2. The consultation notes that NEST's Order and Rules were written to reflect the legislation in 2010, which was prior to the introduction of the pension freedoms.

3. Options under consideration include:

   3.1 allowing NEST to provide more flexible decumulation services for its members; and

   3.2 whether there is a case for expanding the opportunities for individuals, employers and other schemes to access NEST's services (for example, by allowing employers to use NEST for contractual enrolment or allowing employers not already using NEST for auto-enrolment to use NEST as the destination for a bulk transfer).

Comment (1): It is not entirely surprising that NEST wishes to reassess its role in a fast-changing pensions environment. It will be interesting to see the response to consultation as an indicator of how much appetite there is outside of NEST for that master trust to change further.

Comment (2): The consultation notes the wider trend of other master trusts considering the possibility of making at least one decumulation option available. However, there is also the acknowledgment that early exit charges (in line to be banned or limited) currently pose a barrier for many people.

Tax

XI. VAT and pension schemes latest

1. HMRC's existing practice on VAT and pension schemes will end on 31st December, 2016. Therefore, from 1st January, 2017, various existing favourable practices will no longer apply, including:

   – the "30:70 split" (under which an employer can, generally, recover 30% of the VAT borne on pension fund management services), and

   – the ability of an employer to recover VAT borne on administration services supplied to the pension scheme trustee.

2. We have written a note on the latest position, examining a number of possible structures that allow an employer to preserve and, in some cases, even enhance, its pensions-related VAT recover.

3. This note is available to clients. If you would like to receive a copy of our note, please contact Lynsey Richards.

Cases

XII. Civil partnerships and retroactivity - AG Opinion

A. Overview

The Advocate General (AG) has taken the view (on 30th June, 2016) that reducing a survivor's pension where the marriage or civil partnership took place after the member reached age 60 amounted to sexual orientation discrimination, age discrimination and discrimination arising from the combined effect of age and sexual orientation.

B. Facts

1. The case of *Parris v Trinity College Dublin* is before the Irish Labour Court, which has referred questions to the CJEU. The case relates to a requirement in the scheme rules that pension payable to a spouse or civil partner of a member would be reduced if the marriage or civil partnership was entered into on or after the member reached age 60. The aim of the requirement was to reduce the likelihood of death-bed marriages being entered into in order to receive a survivor's pension.

2. Dr Parris entered into a civil partnership in the UK when he was 63 (in 2009) and that civil partnership was recognised in 2011 in Ireland, when Irish law first allowed civil partnership to be given recognition.

3. The questions referred to the CJEU ask whether:

   3.1 The age 60 cut-off date amounts to discrimination on the grounds of sexual orientation under the Equal Treatment Directive, since civil partnerships were not possible in the UK and not recognised in Ireland until after Dr Parris had reached age 60.

   3.2 If sexual orientation discrimination has not taken place, did the age 60 cut off amount to age discrimination.

   3.3 If not, did the combined effect of Dr Parris's age and sexual orientation mean that discrimination arose in this case.

C. Decision

1. The AG has expressed the view that the age 60 limit amounted to indirect sexual orientation discrimination, since the scheme rule operated to the detriment of a group of employees born before 1951 who were unable to enter into a civil partnership before age 60. The discrimination was not justified by a legitimate aim using appropriate and necessary means. Avoiding 'death-bed marriages' in this way was "extremely drastic".

2. Restricting the Equal Treatment Directive (2000/78) to accrual after a particular date would have required an express provision to that effect. However, no such special provision had been made. Nor had any such limit had been imposed by case-law relating to occupational pension schemes covered by the Directive (as was done in the *Barber* ruling in relation to Article 119 of the EEC Treaty, for example). Citing the *Maruko* and *Romer* rulings, the AG noted that the CJEU had already declared the Directive to be applicable to survivors' pensions where any contributions or reference periods predated the entry into force of the Directive. Although claims could not be made under the Directive for payments in respect of periods

predating the time limit for transposing the Directive, "*a future survivor's pension... is unaffected by that principle because such recognition is concerned only with future pension scheme payments, even though the calculation of those payments is based on periods of service completed or contributions made in the past*".

3. The AG rejected the argument that a finding of sexual orientation discrimination would result in conferring retroactive effect on civil partnerships in Ireland. The AG considered that a prospective benefit was being claimed here, with the claimant and his partner "defending themselves against a term...which was laid down in the past but discriminates against them today".

4. The AG also concluded that the fact that Dr Parris' pension entitlements were based almost entirely on periods of service completed before the Directive came into effect did not prevent those rights from being subject to the principle of equal treatment under the Directive. It was settled law that while a new law did not apply to "legal situations that have arisen and become definitive under the old law", it did apply to their "future effects, and to new legal situations".

5. Given the finding on sexual orientation discrimination, the AG did not have to answer the other two questions but decided to anyway.

6. Regarding question (2) about direct age discrimination, the AG found that this was the case here and that it was not justified.

7. While noting that the CJEU had yet to rule on discrimination arising by virtue of a combination of factors, the AG concluded that indirect discrimination arose as a result of Dr Parris's combined age and sexual orientation. Combining more than one ground may increase the likelihood of prejudice, as was the case here.

C-443/15 AG Opinion - Parris v Trinity College Dublin and Others

Comment (1): Advocate General Opinions are not binding but can sometimes be an indication of how the CJEU will rule on a case before it.

Comment (2): The two most notable aspects of this Opinion relate to retroactivity and the ability to combine factors when arguing that discrimination has taken place.

On retroactivity, the O'Brien ruling in the Supreme Court was due to hear that appeal on 7 July, 2016 and the outcome of that appeal will be closely watched, particularly in view of the *Parris* litigation.

The Court of Appeal in *O'Brien*, in contrast to the AG's Opinion in *Parris*, concluded, based on a rigorous analysis of the *Maruko* and *Romer* CJEU decisions, that pension rights attributable to a particular period of service were acquired definitively during that period of service. There was, therefore, a gradual accrual of vested rights. The legal situation created by the period of service was definitively fixed on expiry of that period of service.

Combining more than one factor to create a claim for discrimination where each individual factor alone would not succeed appears to be a new approach to discrimination law. If adopted, such an approach may make it harder for employers to defend themselves against such claims.

XIII. PPF compensation and the Insolvency Directive – provisional ruling

A. Overview

The Court of Appeal provisionally ruled, on 28th July, 2016, that the rules for calculating PPF compensation breach the Insolvency Directive requirement set out in Article 8.

B. Facts

1. The claimant was 58 years old when his employer (T&N) became insolvent. Normal pension age under the scheme was 62 and the claimant's pension was reduced by 67%. The claimant argued that Article 8, as interpreted in the cases of *Robins* and *Hogan* (please see below) meant that each employee should be guaranteed at least half of their benefits under the occupational pension scheme.

2. Article 8 says:

   > "*Member States shall ensure that the necessary measures are taken to protect the interests of employees and of persons having already left the employer's undertaking or business at the date of the onset of the employer's insolvency in respect of rights conferring on them immediate or prospective entitlement to old-age benefits, including survivors' benefits, under supplementary occupational or inter-occupational pension schemes outside the national statutory social security schemes.*"

3. The Court of Appeal has referred questions to the EU Court of Justice so the issues raised have not been ruled on definitively at this stage.

4. Obstacles to reaching a 50% level of provision for every individual under the PPF compensation rules were identified as:

   – the cap on compensation for individuals who have not reached normal pension age when the employer becomes insolvent; and

   – restricted indexation provision.

C. Decision

1. The High Court rejected the claim, accepting the PPF's argument that the *Robins* ruling meant that a breach of Article 8 would require very considerable numbers of employees to have suffered significant reductions in their pension.

2. The Court of Appeal, however, took the view that *Hogan* confirmed that the minimum level of protection (50%) was of universal, and therefore individual, application. The position was not completely clear, however, and therefore a reference has been made to the EU Court of Justice.

3. Also referred to the E U Court of Justice was the question of whether Article 8 of the Insolvency Directive has direct effect and is therefore capable of being enforced directly in the English courts.

Hampshire v The Board of the Pension Protection Fund

Comment (1): There is no clarity yet on the points raised, although the Court of Appeal's preliminary view is to be noted. If it transpires that PPF compensation has not been compliant with the Directive, and the enforcement aspect of such a ruling is such that the UK Government must take steps, changes would need to be made to the Pensions Act 2004.

Comment (2): The UK's pension compensation arrangements in the event of insolvency are:

- the PPF, for schemes that commenced winding up on or after 6th April, 2005 and
- of less relevance, the Financial Assistance Scheme, for schemes that commenced winding up between 1st January, 1997 and 5th April, 2005.

Comment (3): The EU Court of Justice rulings in recent years on this issue (the Irish 2013 ***Hogan*** case (C-398/11) and the earlier 2007 ***Robins*** case (C-278/05)) have meant that the PPF has felt able to continue paying compensation without making changes to its calculation rules.

The ECJ ruled in Robins that although Article 8 did not require accrued pension rights to be funded in full on the insolvency of the sponsoring employer, a loss of more than 50% of a member's contractual entitlement would normally involve an infringement. The protection afforded by the UK's Financial Assistance Scheme, providing less than 50% of benefits for some members, was incompatible with Article 8. As a consequence, the UK Government extended the FAS to provide 90% of "core" pension rights, subject to a cap.

The *Hogan* case was brought by Irish workers. The Irish Government had chosen to ignore the *Robins* decision. The ruling in that case was not indicative of what the position in England and Wales might be.

The High Court in *Independent Trustee Services Limited v. Hope* (Pensions Bulletin 09/20) noted that, in relation to members of the Ilford Pension Scheme who stood to lose more than 50% of their pension if their scheme entered the PPF, "a loss of 50% of a member's contractual entitlement would normally infringe Article 8". This would be relevant only if the scheme in due course entered the PPF, at which point the affected members could challenge the level of compensation on the grounds that the UK had failed properly to implement Article 8.

XIV. Replacing the principal employer; pension increase correction - High Court ruling

A. Overview

The High Court has examined (on 27th June, 2016) a scheme's attempts to change its principal employer and correct an error regarding pension increases.

B. Facts

1. The Trust Deed and Rules were replaced in 1995 with a fresh document executed by Viavi (the existing employer) and the trustees. There was some uncertainty about whether the principal employer had changed, however, to a new employer, Wandel & Goltermann Management Limited. The uncertainty arose because later documents stated or implied that Wandel became the new principal employer with effect from 30 September, 1994. By the time of the trial, however, documents became available showing that Wandel became the holding company of Viavi on 30 September, 1994 but was not even admitted to the scheme as an employer until 1996. Viavi had continued to fulfil the role of principal employer until at least 1997, when it appointed two new trustees.

2. A deed of amendment executed in 1999 was signed by Wandel, which had gone on to act as principal employer from then onwards. Viavi was not a party to this deed.

3. Two subsequent deeds were also examined by the court. One of those deeds was a 2001 deed of rectification, concerning a drafting error regarding pension increases post-5th April 1997. The other deed was a 2002 deed of novation attempting to give the change of principal employer retrospective effect to 1994.

C. Decision

1. The court looked at the wording of the various deeds and concluded that the principal employer change was effected by the 1999 deed.

2. As regards the drafting error concerning pension increases, the attempt to correct the position retrospectively was blocked by Section 67 of the Pensions Act 1995.

3. The case turns on its facts but there are some points of wider application.

3.1 Formality

The court held that where formalities are not prescribed under a scheme rule (in this case, regarding a change of principal employer) then a formality (such as a change having to be in writing) need not be implied. The court held that the rules could not be interpreted in a way that would require written consent.

The rules were a "carefully drawn professional document" and that pointed away from any conclusion that the draftsman overlooked an obvious term.

The court asked whether the deed lacked business coherence without the implied term. "*Best practice is one thing; necessity another. Terms are not lightly to be implied into complex and carefully drawn agreements.*"

The court noted that there was no need to refer expressly to a power to amend rules in order to exercise the power.

3.2 Retrospectivity

Previous cases (such as *PNPF Trust Company Ltd v Taylor*) support the use of retrospective powers where necessary for good scheme administration. But substituting the principal employer here retrospectively would invalidate acts that were valid when done and validate acts of the new principal employer which were invalid when done. This would pose "*an obvious danger that history would be at risk of being re-written with consequences for the scheme, such as rendering trustee appointments/removals void and thus impacting on trustee actions in the period in question.*"

3.3 Wholly owned subsidiary

The judge noted that the absence of the outgoing principal employer's actual or deemed consent could mean that the replacement of the principal employer was not effective. However, the outgoing employer was a wholly owned subsidiary of the new principal employer and, following the case of *Re Duomatic*, the parent company could take decisions on behalf of its subsidiary without the latter having to pass a resolution. The interests of both companies were different but not necessarily conflicting.

Shannan v Viavi Solutions UK Ltd

Comment (1): As regards the attempt to correct an error regarding pension increases,

the question of whether estoppel arose has been reserved for future proceedings.

Comment (2): It is important to be sure that any appointments, removals or amendments in relation to a scheme have been carried out effectively. Ineffective attempts to make those kinds of changes are likely to create significant problems down the line.

XV. Ill health early retirement delay - Ombudsman ruling

A. Overview

The Deputy Ombudsman has upheld (on 2nd June, 2016) a complaint that a delay of 12 months in reaching a decision on ill health early retirement should not have taken place.

B. Facts

The complainant (L) was a member of the Arriva Trains Wales section of the Railways Pension Scheme. The pensions committee rejected an application for ill health early retirement from L. L then used the internal disputes resolution procedure and the committee decided to defer its stage 2 decision under the IDRP for 12 months, as it felt that L had not tried all reasonable treatment options. One year later the incapacity pension was granted, backdated to when L left work 2 years previously but subject to a review in 2 years' time. L complained about the 12-month delay.

C. Decision

The Deputy Ombudsman agreed with L that the delay should not have taken place. The committee's reasoning and views were the same at the end of the 12-month delay as they were at the start. Simple interest was awarded on the benefits that would have been paid had there been no delay, plus £750 for distress and inconvenience.

Mr L - PO-6365

Comment: Decisions in relation to pension benefits should be made in a timely manner, although it is important that the body reaching the decision does so only once it has the relevant facts and has given the matter full consideration. Trustees in particular must ensure that when exercising their powers they must do so in accordance with trust law, taking account of relevant factors and not irrelevant factors, for example.

XVI. Pensions liberation - liability for scheme sanction charge discharged

A. Overview

The First Tier Tribunal has ruled (on 30th June, 2016) that Sippchoice Ltd, an administrator of a pension liberation scheme, should not have to pay a scheme sanction charge in respect of unauthorised payments.

B. Facts

1. Scheme administrators may apply to HMRC for the discharge of its liability to a scheme sanction charge under the Finance Act 2004. The ground for doing this is:

    '(a) the scheme administrator reasonably believed that the unauthorised payment was not a scheme chargeable payment, and

    (b) in all the circumstances of the case, it would not be just and reasonable for the scheme administrator to be liable to the scheme sanction charge in respect of the unauthorised payment.'

2. The majority of this SIPP's members have been assessed by HMRC for the unauthorised

payments charge, giving rise to a number of appeals which have yet to be heard.

3. The pension liberation scheme operated as follows:

Step One: The Member transferred his/her pension savings to the SIPP.

Step Two: At the request of the Member, Sippchoice invested the Member's pension savings in shares in Imperium Enterprises Limited 5 ("Imperium").

Step Three: Imperium lent the funds to BOH Investments Limited ("BOH").

Step Four: BOH funded a subsidiary, SKW Investments Limited ("SKW") by way of a share subscription.

Step Five: SKW made a loan ("the Loan") to the Member. The Loan was of up to 25% of the value of the Member's savings with the SIPP and was expressed to be repayable out of the Member's pension derived from the SIPP.

C. Decision

1. The Tribunal noted that Sippchoice's directors did investigate whether there was a 'simple' pension liberation scheme operated through Imperium but they did not appreciate that a more sophisticated scheme might be in operation. Imperium's apparently innocent financial assets (loans to BOH) were in fact a mask for an investment by BOH in a subsidiary (SKW) which would be the vehicle for lending funds to Members. The Tribunal considered that Sippchoice were behaving reasonably because the evidence did not disclose circumstances which would have indicated to them that a more sophisticated scheme was being operated. Sippchoice were deliberately misinformed by Imperium and BOH.

2. The Tribunal considered whether Sippchoice realistically had means at its disposal to learn of the connection between the investments by members in Imperium shares and unauthorised payments being made, and concluded that it did not. Sippchoice made suitable enquiries of Imperium and was deliberately misinformed by them. The Tribunal also decided that the circumstances of the case did not show that the only reasonable explanation of the investments in Imperium was that they were connected with the making of unauthorised payments.

3. The Tribunal therefore ruled that limbs (a) and (b) of the discharge test were satisfied.

Sippchoice Limited v HMRC

Comment: Scheme administrators can perhaps take some comfort from this ruling. The Tribunal appears minded to view inquiries focused on more simple versions of pension liberation to be reasonable where the circumstances do not indicate that a more sophisticated scheme is in operation. The fact that the administrator was deliberately misinformed by those engaging in pension liberation also would have inclined the Tribunal towards ruling in the administrator's favour.

Points in Practice

XVII. Halcrow Section 89 report published

1. The Regulator has published a Regulatory Intervention Report (dated July, 2016) regarding the Halcrow scheme. This scheme was the subject of the *Pollock v Reed* case (Pensions Bulletin 16/06), in which the High Court rejected an attempt to transfer members without consent to a new scheme providing lower levels of revaluation and pension increases.

2. A regulated apportionment arrangement (RAA) has been agreed. The RAA will result in a cash injection of £80million to the scheme, plus an equity stake in the sponsoring employer (Halcrow Group Limited) of between 25% and 45%.

3. Members will have the option of transferring to a new scheme offering lower benefits than the existing scheme but worth £10million more than the level of PPF compensation that would otherwise have been available. Members choosing not to take this option will remain in the scheme and then enter the PPF.

4. In respect of the new scheme the following has been agreed:

   – The US parent (CH2M HILL) will provide a £50million guarantee.

   – The first recovery plan will not exceed 8 years.

   – Any inter-company loan payments between the sponsoring employer and the US parent will rank below contributions to the new scheme for up to 8 years. This appeared to be of particular significance in the Regulator's acceptance of an equity stake below the 33% minimum that is usually required in the context of an RAA.

   – The new scheme will be eligible for PPF entry. However, there is a plan to de-risk the new scheme's investment strategy 'over a reasonable timescale'.

5. Regarding the Regulator's decision to allow a successor scheme to continue, the report says:

   "*In some exceptional cases we may consider it reasonable for a scheme (or successor scheme) to continue. This assessment is likely to require a considerable level of independent analysis to be obtained by the trustees. In the rare event that continuation is acceptable, such as with HGL, we will expect trustees to manage the residual risk to the PPF to ensure that a fair balance between members and PPF levy-payers is maintained. This may require restrictions over future behaviour or appropriate protections being put in place. It is also important that members are involved, are given a choice, and are not transferred without their consent…. We would expect members and the PPF to be treated equitably with all other creditors and shareholders, which may include them compromising some or all of their rights.*"

Comment (1): It is surprising that this issue got as far as the High Court. Our advice has always been that security in the receiving scheme is not an issue for the actuary but is something to be taken into account by the trustees in considering the propriety of the transfer.

Comment (2): The terms of the RAA appear to be tougher, from the employer's perspective, than the deal put before the High Court. Aside from the financial protections put in place by the RAA, the consent of members will now be required before transferring them to the new scheme, in contrast to the proposal considered by the court.

XVIII. PPF levy data corrections

The PPF has published a document outlining the key principles that it will apply when considering a levy data correction request from schemes and advisers. The PPF warn that they will not routinely allow data corrections because of the time and resource required at their end in doing so.

Factors considered include:

- The timing of the correction request;
- Where responsibility for the error lies;
- The likely impact on the levy; and
- The extent to which the scheme has taken or planned steps to prevent another mistake.

Comment: Employers should already have in place procedures for data errors to be spotted quickly and for steps to be taken to prevent future errors occurring. Other circumstances may mean that a levy data correction will not be granted by the PPF, but having those measures in place would increase the likelihood of a correction being allowed.

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If you would like to find out more about our Pensions and Employment Group or require advice on a pensions, employment or employee benefits matters, please contact **Jonathan Fenn** jonathan.fenn@slaughterandmay.com or your usual Slaughter and May adviser.

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