Wedlake Bell

THE PENSIONS COMPASS

MARCH 2019

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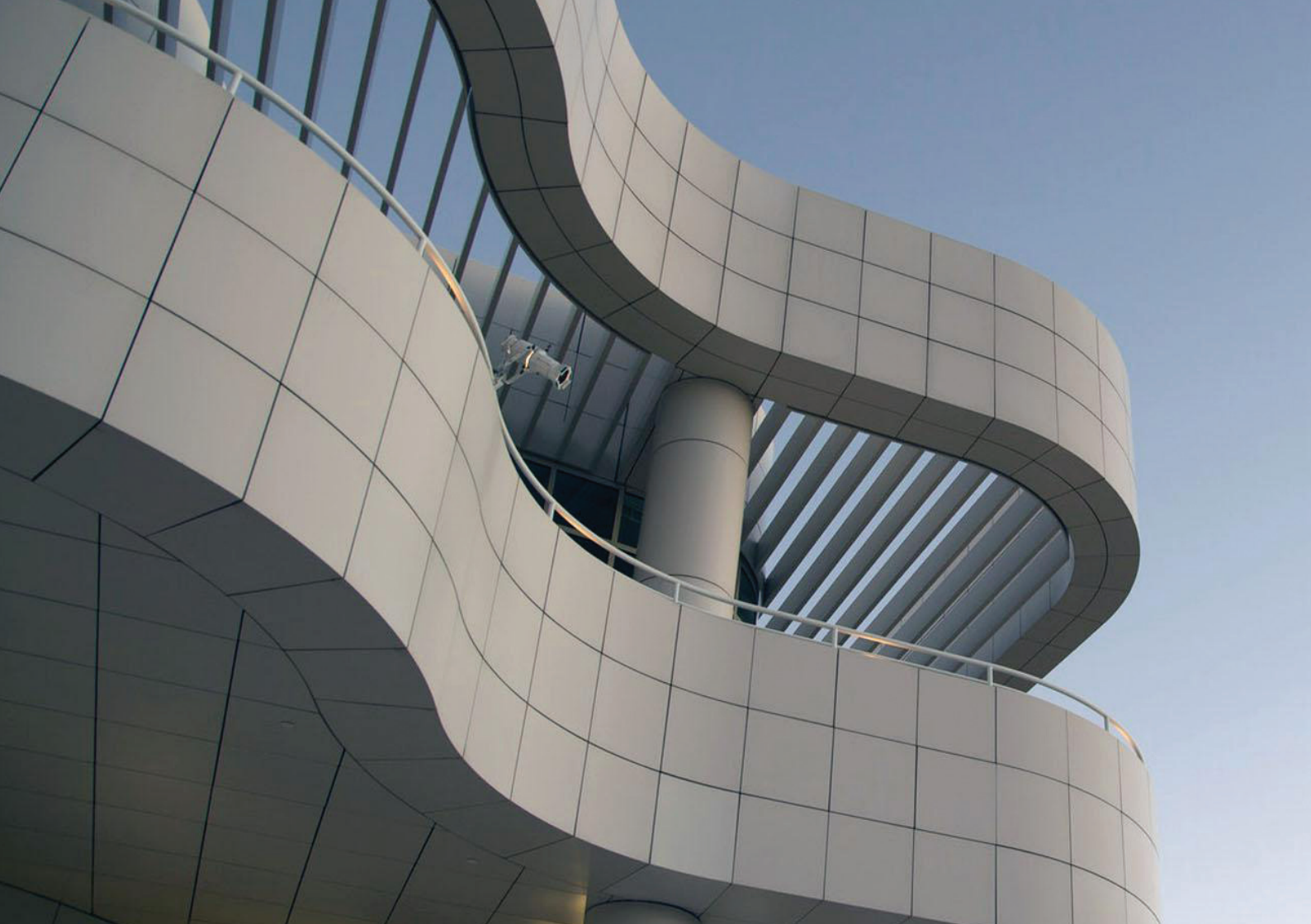

INTRODUCTION

We're now at the end of the first quarter of 2019, and for many, at the end of the financial year. Brexit continues to rule the headlines and be a source of frustration for many, thankfully there is plenty going on in the world of pensions to help distract us from what feels like the never ending uncertainty of Brexit! We are very happy to welcome Anna Giles into our team for the next six months as a trainee, hopefully some of you will get the opportunity to meet her over the coming months (whilst she gets a reprieve in this month's Pensions Compass you can expect to hear from her on a juicy pensions topic in our May edition of Pensions Compass).

Clive and Katie's article "DB recklessness offence could catch worst employers" was published in Pensions Expert earlier this month, the article can be accessed ***here***.

In our March edition of Pensions Compass 2019 we cover:

- **Clive's Ready Reckoner** – a helpful summary of the latest developments from the courts, government and Pensions Regulator;
- **The Pension Regulator's Annual Statement for 2019** – Justin gives us his views on the Statement and what the take-home messages are for trustees and employers;
- **Master trusts** – Katie reports on how the authorisation process is going;
- **Pensions and estate planning update** – Clive and Caroline Miller from our Private Client team provide a really useful ***podcast*** update on how pensions can be used as part of estate planning; and
- **Loss of protection against the Lifetime Allowance** – I consider a recent First Tier Tribunal decision which may give hope to individuals who have lost fixed protection.

As mentioned in our last edition of ***Pensions Compass***, the minimum contribution required under auto-enrolment is increasing to 8% on 6 April 2019. Hopefully you're all up to date on this but if you have any questions, for example – what are you meant to tell members? How does this interact with salary sacrifice arrangements? Please get in touch!

As ever, we love to receive feedback from our Pensions Compass recipients, do you have views about what you would like to see more of? Or less of!? Do you like our new podcast series? I will look forward to hearing any comments you may have!

We hope you enjoy this edition of the Pensions Compass.

If you have any questions regarding any of these topics please do get in touch.

For further details on these matters or any other pensions related queries, please contact a member of the Pensions and Employee Benefits team.

Alison Hills, Partner and Editor-in-Chief

PENSIONS READY RECKONER

PARLIAMENT		
Recent Legislation	**Date**	**Effect**
Financial Guidance and Claims Act	Enacted 10 January 2018	The Single Financial Guidance Body combines the Money Advice Service, Pensions Advisory Service and Pensions Wise. Framework into force **1 January 2019**.
Privacy and Electronic Regulations, Statutory Instrument No. 1396 of 2018	Regulations made 19 December 2018, came into force on 9 January 2019	Ban on unsolicited direct marketing calls relating to pensions.
Disclosure Regulations	Into force 6 April 2018	In addition, the regulations relating to money purchase occupational pension schemes publishing charges and transaction information about *pooled funds* to members came into force on **6 April 2019**.
Finance Act 2019	12 February 2019	In relation to pensions, the Finance Act widens the definition of beneficiary for life assurance arrangements and QROPs with effect from 6 April 2019.
Auto-Enrolment Regulations	Into force 6 April 2018	In addition to changes already implemented, the employer's full contribution rate of 3% of band qualifying earnings comes into force on **6 April 2019**, taking the *total* minimum contribution up to 8%.

Proposed Legislation	Date	
Civil Partnerships Registration etc. Bill	Unknown	This Bill is progressing through Parliament. Amongst other matters the Bill provides for opposite sex couples to enter into a civil partnership.
Divorce (Financial Provision) Bill	Unknown	The Bill aims to introduce as a fair starting point the equal division of all property and pensions acquired by the couple **after** marriage. This Bill is still progressing (slowly) through Parliament.
Pensions Bill?	Unknown	At some point it seems some legislative changes may be needed to facilitate conversion of GMPs into non-GMP pension, to complete the existing framework legislation.
DWP - Consultation on Collective Defined Benefit Schemes ("**CDCs**")	6 November 2018	It is intended that CDCs will enable employers to provide a third type of pension provision between DB and DC schemes. Timing of any new legislation to permit this is uncertain due to BREXIT.
DWP – Strengthening TPR's powers	January 2019	Following its Consultation in 2018, Government has announced it intends to introduce two new criminal offences (including an offence of harming schemes by wilful neglect on the part of their sponsors/their Directors) as well as legislation to strengthen TPR's powers of investigation and inspection. Due to BREXIT the timing of this new legislation is unclear.

FROM THE COURTS

Topic	Recent decisions
Amending scheme rules *Coats UK v Styles* High Court, 14 January 2019	Whilst this decision related to changes to the Scheme's indexation and revaluation provisions, interestingly the High Court has decided that an otherwise invalid Amending Deed, was validated by treating it as an exercise of the trustees' unilateral power to amend schemes under Section 68 Pensions Act 1995.
'Privileged' correspondence *Briggs v Clay* High Court, 25 February 2019	Be careful what you write in correspondence! This High Court decision, involving a negligence action against deeds prepared by actuarial advisers, examines the extent to which correspondence between the parties is admissible in a subsequent negligent action. Key point – marking correspondence "without prejudice" does not necessarily shield it from later scrutiny.
Joint Venture Agreement – extent to which 'unforeseen' pension liabilities can be recovered from the parties to a joint venture *Spirit Energy v Marathon Oil* Court of Appeal, 17 January 2019	Be careful what you write in correspondence! This High Court decision, involving a negligence action against deeds prepared by actuarial advisers, examines the extent to which correspondence between the parties is admissible in a subsequent negligent action. Key point – marking correspondence "without prejudice" does not necessarily shield it from later scrutiny.

FORTHCOMING COURT DECISIONS

Topic	Effect
Discrimination – equalisation of women's state pension ages *Robinson v Secretary of State* High Court, 5 and 6 June 2019	Challenge to Government methodology for increasing State Pension Age for women from 60 to 65 over the period April 2010 to November 2018 (originally to November 2020).
Sex equality *Safeway v Newton* Reference to CJEU	Validity of method of equalising pension benefits – domestic UK law v EU law (referred by Court of Appeal on 5 October 2018 to the CJEU). The Advocate General's Opinion to the CJEU was delivered on 28 March 2019, the CJEU's judgment is now likely within six months.
Proper exercise of Trustee powers *British Airways Trustees v British Airways* Supreme Court, 2019	Issue: whether the BA Trustees acted properly in awarding discretionary pension increases. The Trustees won in the High Court in May 2017, lost by 2 to 1 in the Court of Appeal in July 2018 and their appeal will be heard in the Supreme Court on 3 and 4 July 2019. An extremely important case on the legal powers of trustees.
Overpayments of pension and their recovery *Burgess v BIC UK* Court of Appeal, 6 and 7 February 2019	The Court of Appeal judgment has been reserved and will be given at a later date. The case concerns the validity of pension increases, and the law relating to the recovery of invalid increases paid.
TPR's Financial Support Directions *Granada v TPR – Box Clever case* Court of Appeal, 13 May 2019	Query, the extent of TPR's powers to issue Financial Support Directions in the context of joint venture corporate structures.

Clive Weber, Partner – Pensions & Employee Benefits Team
Please contact Clive with any queries on this Ready Reckoner

TPR: 2019 ANNUAL FUNDING STATEMENT

Earlier this month the Pensions Regulator ("tPR") released its 2019 Annual Funding Statement (the "Statement") for defined benefit pension schemes. Its intended target – trustees and sponsoring employers who are undertaking triennial valuations between 22 September 2018 and 21 September 2019. However, in our view (as will become clear) it does no harm for all schemes and sponsoring employers to be taking heed of tPR's latest thinking.

The Statement sets out specific guidance on how to approach a valuation, tPR's view on some topical issues (see below) along with what trustees and sponsoring employers alike can expect from tPR over the coming year.

Oh, and it also mentions the dreaded "B" word (Brexit!), although this is more of a passing reference to tPR's statement of 24 January 2019 which outlined Brexit-related steps that trustees and employers should be taking or at least thinking about. Like the rest of the population, tPR is monitoring Brexit developments and will issue further guidance if necessary.

Key points to come out of the Statement include:

Long Term Funding Targets ("LTFT")

Trustees and sponsoring employers are encouraged to agree a clear strategy to reach a defined long term goal which balances/aligns the "holy trinity" of investment risk, scheme funding and covenant support over time. tPR calls this a LTFT and sees it as a journey plan/flight path which should go beyond full funding on a technical provisions basis. This thinking (currently best practice) is in line with the Government's March 2018 white paper "Protecting defined benefit pension schemes" and is likely to become a compulsory requirement for all schemes. Formulating a long term destination now, in anticipation of this requirement being introduced is being actively encouraged.

Balancing Risks

As well as focusing on the "holy trinity" of risks mentioned above (investment, scheme funding and covenant support), trustees are encouraged to broaden their horizons in terms of integrated risk management. Scheme maturity attracts the spotlight as a particular area needing attention. As more members become pensioners, the benefits paid out increase as a proportion of scheme assets or liabilities and this can put a different complexion on the risks. These should be managed, especially investment volatility.

tPR has also pointed out that it does not assess the appropriateness of schemes' technical provisions or discount rates based on predetermined relationships to gilt yields or other indices. Instead emphasis is placed on judging their suitability on the risks in their funding and investment strategies and how trustees appear to manage them.

The Statement actually includes a useful risk matrix for use by trustees in assessing where their scheme sits and what tPR expects in terms of the three risk areas. The matrix has 10 distinct groups or categories of scheme, each of which applies different expectations re. the three risk areas.

DB Funding Code of Practice

tPR remains on course to review and update the existing (published July 2014) DB funding code of practice by the end of the year. Consultation will begin in summer 2019 on various options for a revised funding framework followed by consultation on the new draft code itself.

Equitable Treatment

tPR remains concerned by the inequitable treatment DB pension schemes are receiving when compared to other creditors of sponsoring employers (i.e. shareholders). In particular, tPR remains concerned about the disparity between dividend growth and stable deficit recovery contributions ("DRCs") as highlighted by recent high profile corporate failures where payments to shareholders were excessive compared to DRCs.

The Statement details the key principles behind tPR's expectations as follows:

- where dividends and other shareholder distributions exceed DRCs, tPR expects strong funding targets and recovery plans to be relatively short;
- if the employer is tending to weak or weak, tPR expects DRCs to be larger than shareholder distributions unless the recovery plan is short and funding targets strong; and
- if the employer is weak and unable to support the scheme, tPR expects the payment of shareholder distributions to have ceased.

Long Recovery Plans

tPR intends to contact a number of schemes ahead of their 2019 valuations where existing recovery plans are considered unacceptably long. The schemes to be selected for this engagement will cover the whole spectrum of covenant strengths.

Other Interventions

tPR will continue to engage with other schemes during 2019 and not just those in a valuation cycle. Schemes will come under close scrutiny if there are concerns over funding and investment plans in the context of their covenant and scheme profile.

Trustees and employers: (i) should be fully prepared to justify their approach with evidence of robust negotiations having taken place; and (ii) need to be fully aware of tPR's guidance set out in the Statement and wider funding materials.

Late Valuations

Trustees are expected to start their valuation process in good time and to follow a project plan that leaves sufficient time for advice, analysis and negotiation with the sponsoring employer. Trustees are reminded that they should not agree an inappropriate valuation merely because the statutory deadline is approaching or has been missed. Interestingly, tPR encourages trustees to make contact if they are pushed to do so by the employer or a third party.

tPR Powers

tPR uses the Statement to remind readers of its wide ranging powers which include: directing how a scheme's technical powers should be calculated; how any deficit should be funded; one to one supervision; improvement notices; penalties; and anti-avoidance investigations.

The Southern Water case is mentioned as an example of tPR intervening in a situation where there was an imbalance between DRCs and dividends paid in 2016 and 2017. The eventual settlement reached involved Southern Water contributing an additional £50m to its pension scheme and the introduction of an equitable dividend sharing mechanism for the future.

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At 22 pages the Statement is longer than those issued in the previous three years. The long term journey plan/flight path has never been so important and in challenging market conditions, covenant, scheme funding and investment obviously need close monitoring. A collegiate, joined up approach from trustees and sponsoring employers is also promoted as being the order of the day and one of the optimal conditions for a scheme to be able to pay promised benefits.

The high profile corporate failures referred to in the Statement obviously brought with them a certain amount of criticism of tPR's role and function, hence the reason why dividend returns and equitable treatment features prominently as things that need to be monitored. We suspect also that the gentle reminder of tPR's powers is more than that – in our view the gloves are off and one can expect a significant flexing of muscles where schemes are not following the spirit of tPR's guidelines.

Justin McGilloway
Partner and Head of Pensions & Employee Benefits Team

WILLIS TOWERS WATSON'S LIFESIGHT BECOMES FIRST MASTER TRUST AUTHORISED UNDER TPR'S NEW REGIME

LifeSight is the first master trust to be authorised by TPR's master trust authorisation and supervision regime which began on 1 October 2018 (see Alison's ***article*** on the introduction of this new regime in September 2018). The authorisation process requires schemes to outline how they meet required standards in aspects such as level of reserves and the qualifications of the individuals running the scheme.

The window for master trust authorisation applications runs to the end of March 2019 (a deadline which can be extended for six weeks but only if the scheme can show a good reason for the delay). As at 6 March, the Pensions Regulator had received only 13 applications for authorisation compared to the 74 master trusts which were registered with the Regulator at the end of 2018. TPR will be expecting a rush of applications before the end of the month, but a large portion of schemes are also choosing to drop out of the market with benefits transferred in bulk elsewhere. At 6 March, 39 schemes had either exited the market or notified TPR of a trigger event to exit.
The authorisation regime was introduced to ensure protections for members of master trusts that are equivalent to those in other types of pension schemes. Master trusts will need to have:

- fit and proper individuals involved in the running of the scheme, meeting the standard of honesty, integrity and knowledge appropriate to their role;
- sufficient robust IT systems and processes in place to effectively govern the scheme;
- continuity planning, with a strategy that TPR finds credible;
- a scheme funder (a company or partnership) which only carries out activities relating directly to master trusts and which can show clear evidence that it is able to financially support the master trust; and
- financial sustainability, with a business plan setting out expected activities, growth and sources of funding.

In our view, the authorisation regime improves options for members and employers in the busy DC marketplace and we expect to see an increase in transfers to master trusts in the coming months and years.

Katie Whitford, Solicitor – Pensions & Employee Benefits Team

HOPE FOR THOSE WHO HAVE LOST HMRC PROTECTION AGAINST THE LIFETIME ALLOWANCE

The Lifetime Allowance was introduced on 6 April 2016 and since then it has applied to the total of all the tax-free pension savings an individual has, including the value of pensions promised through any defined benefit schemes. Note that the State pension is not counted against the Lifetime Allowance. At that time the Lifetime Allowance was £1,500,000.

Individuals are tested against the Lifetime Allowance when a benefit crystalisation event occurs. There are 12 such events, including death and becoming entitled to receive a scheme pension. A tax charge (of up to 55% –albeit the way the charge applies depends on whether you receive the money from your pension as a lump sum or as part of regular retirement income) is levied on the value of the payouts from the individual's pension pot(s), including the value of the payouts from any defined benefit schemes, that exceeds the lifetime allowance.

The lifetime allowance, is currently £1,030,000 and will increase to £1,055,000 for the tax year 2019/2020 (an increase which is in line with the rise in the Consumer Prices Index this year).

It is true that the Lifetime Allowance only affects a limited number of people. However, some reports we have read suggest that many savers in the middle of their working lives could actually be on track to breach the allowance without investing another penny – apparently a 30 year old with a pension pot of £360,000 could already be on track to breach the lifetime allowance by the age of 67. As pensions are normally a long term commitment, what might appear modest today could exceed the lifetime allowance by the time you want to take your benefits.

The introduction of and subsequent reductions to the Lifetime Allowance posed a problem for pensions savers who already had pension savings in excess of the newly introduced limit. As a result HMRC protections were offered to such people. In order to achieve protection against the Lifetime Allowance the individual must make a successful application to HMRC, which in turn needs to be granted. At which time a certificate will be issued to the individual. There have been various different types of protection available since the Lifetime Allowance was introduced:

- Primary Protection
- Enhanced Protection
- Fixed Protection 2012
- Individual Protection 2014
- Fixed Protection 2014
- Individual Protection 2016
- Fixed Protection 2016

The only two which are currently available are:

- Individual Protection 2016
- Fixed Protection 2016

It's not the end of the story once protection has been granted though. Protection can be lost. The Money Advice Service website states that *"The protection rules are complicated. And the ways in which the protection can be lost differ depending on whether your retirement income (including lump sums) is provided from a defined contribution, or a defined benefit pension scheme"*. Indeed, simply being admitted to an auto-enrolment compliant scheme would be sufficient for someone to lose their HMRC protection. It's easy to see how some people accidentally lose their protection. This was the subject of a recent appeal to the First Tear Tribunal by Mr Hymanson. Mr Hymanson was granted fixed protection in 2012. However, he failed to stop monthly direct debits to two of his pension schemes until April 2015. His certificate of protection was consequently revoked by HMRC as he had failed to satisfy the conditions of paragraph 14, Schedule 18 of the Finance Act 2011 by accruing further benefits in a registered pension scheme.

Mr Hymanson claimed this was a simple mistake and those payments should be set aside as though they had not been paid. HMRC did not accept this argument, resulting in Mr Hymanson's appeal to the First Tier Tribunal.

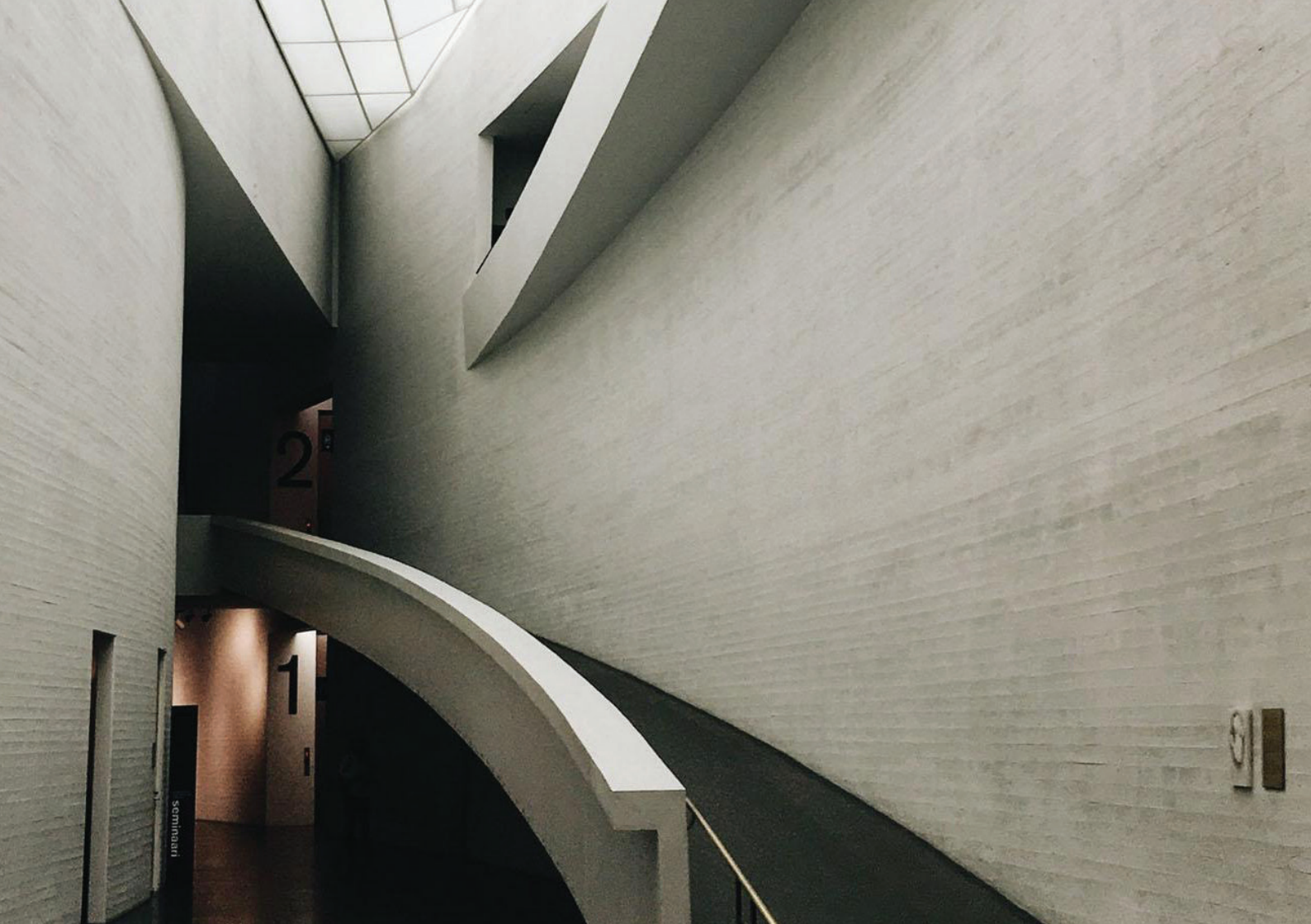
In considering the relevant issues the First Tier Tribunal referenced the principle established in Pitt v Holt that a voluntary disposition (in this instance a voluntary payment of contributions to the schemes) could be set aside on the grounds of mistake provided such action would be appropriate in the circumstances. In order to rely on this principle it is necessary to evidence that the mistake was the cause of the disposition and the gravity of the mistake must be considered.

The facts of this case seem to play a large role in the conclusion. In this instance the additional contributions paid by Mr Hymanson added up to just £7,000, whereas the loss he faced as a result of losing the fixed protection was estimated to be in the region of £50,000. Had he realised the consequences it is inevitable that he would have stopped the direct debit payments to the pension schemes. The First Tier Tribunal commented that it was "clearly a totally disproportionate loss of tax". The First Tier Tribunal concluded, based on the equitable maxim that "that which should be done should be treated as having been done", that the High Court, if the case were escalated to it, would order for rescission of the contributions and reinstatement of the fixed protection.

Of particular interest was the statement by HMRC that they would have been prepared to rescind the pension payments in the event that they had been paid erroneously by a bank (contrary to the individual's instructions) but had not considered whether rescission would be a proper course of action in the event of a mistake by the pension scheme member.

We expect there are many other individuals who have lost their Lifetime Allowance protection as a result of mistaken payments to pension schemes, and that there will be many more cases brought against HMRC for different circumstances which have led to protection being lost.

Alison Hills, Partner – Pensions & Employee Benefits Team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