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NORTON ROSE FULBRIGHT

Essential pensions news

Updater

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Introduction

Essential Pensions News covers the latest pensions developments each month in an "at a glance" format.

The Queen's Speech 2016 – new Pensions Bill

Of general interest is the confirmation of a new Pensions Bill in the Queen's Speech. The Bill, which was not mentioned in the Queen's Parliamentary address but was included in supporting documentation, will provide protections for members of master trusts, remove barriers for those who wish to access their pension savings flexibly and restructure the delivery of financial guidance to consumers.

There is scant detail on the pensions aspects of the Government's proposed new Bill in the supporting documentation published by the Lord Chancellor's office, but the Bill's intended scope is outlined at pages 30-31 of the background notes linked here.

According to the background notes, the main aims of the Bill would be:

- providing better protections for members in Master Trust pension schemes including millions of automatically enrolled savers;
- capping early exit charges to ensure that excessive charges do not prevent occupational scheme members from taking advantage of pension freedoms; and
- providing more targeted support for consumers by restructuring the delivery of public financial guidance through the creation of two new bodies and directing more funding to the front line.

Comment

Master trusts are proving an essential part of the auto-enrolment landscape and can offer employers a streamlined solution to complying with their auto-enrolment duties. The wider industry has generally welcomed the intention to introduce new powers to regulate such arrangements, and safeguards are clearly required to protect members from vehicles which are set up hastily, potentially exposing savings to possible scams and dubious investments. Employers should ensure that they do adequate due diligence on the quality of any master trust before entrusting their employees' savings to such an arrangement.

However, we hope that legitimate concerns about the possible lack of good governance in some of the smaller master trusts, which have recently entered the market, does not lead to onerous governance requirements being imposed on those other master trusts which are well run and which are overseen by knowledgeable and diligent boards.

Capping exit fees for savers who wish to access their funds early under the new flexibilities is also a welcome proposal. Costs associated with accessing the pension freedoms should be limited to proportionate administration charges only. Penal exit charges are at odds with the policy intention of allowing savers flexible access to their funds.

The aim to provide public financial advice in a simpler and more efficient way is uncontroversial. Hopefully, the proposed amalgamation of the services currently offered by TPAS and Pension Wise will achieve this, together with the new debt and money guidance service to be provided by the successor to the Money Advice Service.

Consultation papers published on secondary annuity tax and regulatory framework

Of general interest is a further development of the new pensions flexibilities, as announced by the Government in the Budget 2015, to allow annuity holders to sell their policies to a third party in exchange for a lump sum. Originally planned to be effective in April 2016, this measure was then postponed for a year.

Now HM Revenue & Customs (HMRC), HM Treasury (HMT) and the Financial Conduct Authority (FCA) have each published a consultation paper on the secondary annuity market ahead of the proposed implementation date of April 2017. The consultation deadlines are:

- HMRC – 15 June 2016;
- HMT – 2 June 2016; and
- FCA – 21 June 2016.

HMRC – the tax framework

On 20 April 2016, HMRC published *Creating a secondary annuity market: tax framework* (26 pages) which sets out the proposals for new tax rules allowing individuals to assign or surrender their annuity for cash or for rights in an alternative pension savings vehicle. The new rules will allow such a transaction to be effected without being subject to an unauthorised payment charge. They will apply only where certain conditions are met and where, at the time of assignment or surrender, the person receiving the lump sum payment has reached age 55 (or such other protected pension age as may apply).

The new regime will allow members of both DB and DC schemes to assign or surrender annuities, with occupational scheme trustees being able to assign annuities that were bought in their (the trustees') name to the members themselves. This represents a significant change for DB scheme trustees, as in December 2015 in the response document to an earlier call for evidence, the Government stated that it then had no plans to extent the scope of the secondary annuity market to DB scheme annuities. It is unclear whether (and how) this might apply to bulk annuities held by DB schemes.

The Government has also confirmed that individuals will be able to assign or surrender annuities currently in payment that were purchased before 6 April 2006 (A Day).

The options

It is proposed that where an individual reaches his minimum pension age of 55, or a lower protected pension age if applicable, he will be able to:

- receive the sale proceeds as a lump sum paid directly to him (or his personal representatives). The lump sum would be taxed at the individual's marginal rate of income tax (and could result in the individual being pushed into a higher income tax bracket); or
- request that the annuity purchaser transfers the proceeds to a flexi-access drawdown fund in the individual's name. The fund would then be subject to the current tax rules for flexi-access drawdown funds; or
- use the funds to purchase a flexible annuity in the individual's own name. Such an annuity would then pay a varying income amount from one year to another, which would be taxable in the usual way.

Each option would be subject to its own conditions which, once satisfied, would mean that the sums paid were authorised payments.

The transfer proceeds under option 2, or used to purchase a flexible annuity under option 3, would not:

- be subject to income tax;
- count towards the individual's annual or lifetime allowances;
- trigger entitlement to a tax free lump sum; or
- be eligible for pensions tax relief.

The rights must be assigned in their entirety to a single buyer in order to fall within the unauthorised payment override. Similarly, the buyer must pay a single lump sum to purchase the annuity, not a series of payments, to fall within the new rules. In most circumstances, individuals who assign or surrender an annuity will be subject to the reduced money purchase annual allowance in relation to any future pension contributions.

Where an annuity has been assigned, the Government proposes that the annuity payments will be treated as trading income, investment income, or other income in the hands of the purchaser, depending on the purchaser's business. If a registered pension scheme were to purchase annuity income, it is indicated that income from these annuities would not be taxable.

The consultation closes on 15 June 2016.

HMT – consultation on draft secondary legislation relating to secondary annuity market

On 21 April 2016, HMT published a consultation document (9 pages) on the draft legislation to be introduced relating ion of a secondary market for annuities.

The document sets out and seeks views on draft secondary legislation to create three new specified activities in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the RAO) that will apply to any person wishing to operate in the new secondary market for annuities. These are entering into a regulated annuity assignment agreement as a purchaser, entering into a regulated annuity buy back agreement as an annuity provider, and regulated annuity broking.

In addition, HMT is consulting on its intention to amend:

- The Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001 to allow appointed representatives, acting under the responsibility of an authorised principal, to be exempt from the requirement to be authorised to act as intermediaries in the secondary market and for the buying back of annuities.

- The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the FPO) to ensure that unauthorised persons are prevented from engaging in financial promotions relating to investment activity on the secondary annuities market.

- The Financial Services and Markets Act 2000 (Carrying on Regulated Activities By Way Of Business) Order 2001 to make clear that those buying rights to annuity income streams in this market will always be deemed to be doing so by way of business, and will therefore always be subject to the requirement to be authorised or exempt under the Financial Services and Markets Act 2000 (FSMA) and the RAO.

To ensure that the secondary market is competitive and access is not restricted to UK-only firms, HMT also proposes to apply the overseas exemption in article 72 of the RAO to both purchasers and intermediaries, provided that at least one other party to the transaction is an FCA-authorised firm. HMT explains that the above legislative changes are intended to make it easier for the FCA to apply specific, tailored rules for UK firms participating in the secondary annuities market.

The deadline for responses to the proposals and comments on the draft secondary legislation is 2 June 2016.

FCA consultation – the new rules for the secondary annuity market

On 21 April 2016, the FCA published a consultation paper *Secondary annuity market – proposed rules and guidance* (CP16/12 – 112 pages), setting out its proposals for governance of the secondary annuity market that is due to be launched by the Government in April 2017.

CP16/12 sets out the proposals that will apply to the three new dedicated regulated activities for the secondary annuity market (of buying annuity incomes, buying back annuity income, and acting as a market intermediary) on which HM Treasury is consulting on draft legislation.

The proposed changes to the FCA Handbook are set out in a draft Secondary Annuities Market Instrument 2016 in Annex 2 of CP16/12. They are intended to provide additional protections to support the seller throughout their customer journey if they decide to sell their annuity income. Key proposals relate to disclosure, the presentation of offers, restrictions on charging, and compensation and prudential arrangements.

The FCA confirms that where the proposals change the Financial Ombudsman Service (FOS) voluntary jurisdiction, CP16/12 should be treated as being issued jointly by the FCA and FOS.

The FCA intends to publish final rules and guidance in a policy statement later in 2016, with a view to the rules coming into effect as soon as they are made, which it expects to be in Autumn 2016. However, some proposals will only come into effect once the government has made the related legislative changes.

The consultation period ends on 21 June 2016.

TPR publishes fifth annual DB funding statement expecting greater employer contributions where there is "sufficient affordability"

Of interest to DB schemes is the Pensions Regulator's (TPR's) fifth annual funding statement which confirms that most schemes with effective valuation dates between 22 September 2015 and 21 September 2016 (Tranche 11) will see a greater than expected increase in their funding deficits. Despite this, TPR expects trustees to seek higher employer contributions where there is evidence of "sufficient affordability".

The funding statement notes that overall investment performance in the last three years has been good, but yields on long-dated gilts have fallen and market expectations are for interest rates to remain lower for longer and to revert to lower long-term levels. Despite this, TPR expects trustees to seek higher employer contributions to enable schemes to meet their recovery plan end dates where there is evidence that there is "sufficient affordability".

TPR continues to emphasise the importance of knowing the strength of the employer covenant, having a sound risk management framework and that scheme trustees and employers should work collaboratively in their funding discussions.

Valuation process

Tranche 11 schemes currently undertaking the valuation process would last have done so in 2013, before the concept of integrated risk management (IRM) applied.

TPR emphasises that trustees of Tranche 11 schemes must ensure that they finalise the valuation itself, statement of funding principles, recovery plan and schedule of contributions within 15 months after the effective date of the valuation. TPR expects schemes to comply with this deadline, and where there may be difficulty meeting it, trustees are urged to contact TPR at an early stage. As usual, TPR highlights that a clear understanding of the employer covenant, a framework for integrated risk management and the trustees, advisers and employers working collaboratively in an open and transparent manner remain fundamental to the funding process.

Accompanying the statement is a more detailed quantitative analysis document of the expected positions of Tranche 11 DB schemes. This is used to inform TPR's approach and its message to trustees and employers in the annual funding statement.

Funding position and employer contributions

Although most major asset classes have performed well over the last three years, long-dated gilt yields have fallen and the market is expecting interest rates to remain lower for longer before reverting to lower long-term levels. TPR notes this is likely to have a negative impact on the medium and long-term returns for various asset classes, and many schemes will have larger funding deficits than previously predicted. Recovery plans may therefore need reviewing.

However, TPR's quantitative analysis confirms that for the majority of Tranche 11 sponsors, there has been an increase in reported profits. TPR expects trustees to ask for higher employer contributions if these are affordable and unlikely to have a "material impact" on the employer's sustainable growth plans and where there is "sufficient affordability".

Market volatility

TPR acknowledges that there has been significant financial market volatility recently, particularly at the start of 2016, partly attributable to the upcoming EU referendum. While such volatility may have a material impact on scheme funding, trustees are urged to take a longer-term view of expected risk and returns as a key part of an effective integrated risk management framework.

Mortality assumptions

An important part of the valuation process is a scheme's assessment of its "technical provisions", requiring assumptions to be made about the possible future impact of certain factors. TPR notes that part of the trustees' considerations will be on possible changes in the mortality rate, as this determines the length of time for which pensions are expected to be paid. Many schemes use the most recent version of the Continuous Mortality Investigation (CMI) to set their assumptions. TPR notes that CMI 2015 produces life expectancies that are lower than the 2014 version, and trustees should take advice and on whether it is appropriate to update to CMI 2015, if this change is seen as a possible future trend.

DC flexibility

Members of DB schemes may elect to transfer their accrued DB rights to a DC scheme in order to take advantage of the flexibilities. For trustees considering making adjustments to their assumptions where there is a likely increase in the number of individual transfers out, TPR states that such decisions must be evidence-based.

Comment

The funding statement is likely to be greeted with concern by employers, as TPR's expectation of increased contributions could be very adverse for them. TPR is of the view that there has been a general improvement in profitability in scheme sponsors since 2006, and accordingly, that most employers can now afford to increase contributions to keep their recovery plans on track. However, here is a wide range of performance across different industries and many employers may not be able to afford higher contributions in the current climate of a potential Brexit and economic uncertainty.

We will shortly be publishing an in-depth briefing on the funding statement.

View the 2016 funding statement.

View TPR's quantitative analysis document.

TPR publishes its 2016-19 corporate plan confirming focus on auto-enrolment and master trusts

Of general interest is the publication by TPR of its corporate plan for 2016-2019, setting out its priorities for the next three years. Of the key areas it identifies as the focus of its operational approach to "educate, enable and enforce", auto-enrolment and master trusts are identified as the most significant.

Economic and market outlook

TPR notes that the UK economy has been slowly recovering from the financial crisis of 2008 and the ensuing recession. It is recognised that the environment remains challenging for many businesses, with much depending on the specific sectors in which firms operate. In such an environment, good governance and administration are essential if members are to receive value for money in their pension investments.

Since 2009, membership of DC schemes has almost tripled to over 7 million, with the growth split between master trusts (71 per cent) and other DC-only schemes (29 per cent). As a result, members are increasingly in a handful of schemes, with 55 per cent of DC members in the four largest master trusts.

TPR's focus

Key priorities are listed below, and TPR notes they will be continually reviewed and updated over the course of the next three years.

- **Auto-enrolment** – TPR acknowledges that currently 90 per cent of small and micro-employers who were due to implement auto-enrolment have done so. However, concerns remain that the smallest employers will either comply late or not at all. Successful implementation of auto-enrolment is therefore TPR's top priority over the next three years. TPR intends to strengthen its compliance and enforcement capability to deal with the volume of employers reaching their staging dates.

- **Master trusts** – TPR's priority will be to "Protect consumers from poorly governed master trusts". It will work with the Institute of Chartered Accountants in England and Wales to develop a revised version of the master trust framework. Its concern is that the failure of a large master trust, which has no sponsoring employer to support it, could result in members having to fund the trust's future administration in order to access their pension savings from the master trust "as a result of its disorderly exit from the market". TPR intends to examine the risks associated with master trusts to see what it can do to mitigate these risks.

  It is also engaging with the Financial Conduct Authority (FCA) and the government to identify "unmitigated risks" to members and agree the required safeguarding steps. Where it has concerns on governance and administration, TPR will engage directly with the master trust to check the skills and experience of the managers involved and the sustainability of their business model.

- **Effective regulation of DB schemes** – TPR will continue its risk-based approach to achieve appropriate funding outcomes through case interventions, and guidance via the annual funding statement.

- **Effective regulation of public sector schemes** – TPR aims to identify risks in key areas such as record keeping, internal controls and communications in public sector schemes. It will drive improvements to historical governance issues and performance by tailoring its educational tools to this specific audience.

- **Maintain confidence in pensions** – TPR will continue to combat pension scams and is currently leading Project Bloom, a taskforce including the government, other regulators, financial services bodies and criminal justice agencies. It will continue to raise awareness with trustees and members via its "Scorpion" campaign. Where necessary, TPR will use its powers to protect members and their benefits.

- **Improve the quality of scheme governance** – TPR intends to set out what effective and contemporary trusteeship looks like, and to develop tools and guidance to support trustees. This will include forcing schemes to provide TPR with timely and accurate information. Action will be taken on non-compliance with the DC requirements for a chair's statement, implementing charge controls and banning member-borne commission fees.

- **Extension of TPR's regulatory influence** – TPR will produce clear messages and will engage on policy issues and the development of appropriate standards. Its communications strategy will support trustees and employers through a continued education programme. Relationships with key government partners will be strengthened.

- **Increase in member engagement with pensions** – TPR will focus on improving savers' understanding of pensions, facilitating the creation of a pensions dashboard in partnership with the FCA and others. The pension freedoms will be supported by helping the industry to focus on appropriate member guidance and advice, and effective transfer mechanisms.

- **Effectiveness and efficiency** – TPR will focus on its own staff, instilling its vision and values at every level of the organisation. It will use data, information and technology to improve its performance through better segmentation of schemes, communications and data collection mechanisms. Existing TPR capabilities will be enhanced through upgraded IT systems and website development.

The figures included in the report shows an increase in the budget for 2016-17 of £15.4 million against the 2015-16 forecast spend. The main reasons for this increase are:

- salary costs of higher staff levels to support auto-enrolment, and the linked IT changes

- IT and infrastructure investment

- outsourced costs associated with the increase in number of employers required to comply with auto-enrolment and other IT costs held back from 2015-16.

However, costs in the final year covered by the Plan (2018-19) will reflect a reduction of almost 320 million in comparison to 2017-18 as the IT and infrastructure investment programme reduces to a lower annual cost.

View the Corporate Plan.

TPR updates 2016 DC scheme return form

Of interest to trustees and administrators of occupational schemes providing DC benefits is the updating by TPR of its scheme return form.

TPR sends out annual scheme return notices to DC schemes with 12 or more members, while DC schemes with fewer than 12 members are only obliged to complete a scheme return every three years. Several new questions have been added for 2016:

- **Executive pensions.** New question 7 asks whether a scheme is an executive pension scheme, meaning a scheme with a single employer which is a company and also sole trustee, where the members are current or former directors of the company and include at least a third of the current directors. The significance is that an executive pension scheme is exempt from certain governance-related measures introduced in April 2015, such as the charges cap and the requirement to provide an annual chair's statement.

- **Benefit details.** New question 9.8 asks whether a scheme with 12 or more members includes provision for a guaranteed minimum income for members or dependants receiving a drawdown pension directly from the scheme.

- **Chair's statement.** New question 11 asks whether the scheme has produced an annual chair's statement within seven months of the end of the scheme year. The question does not have to be answered if the scheme is exempt from the requirement to produce a chair's statement.

In addition, several of the existing questions have been re-worded. These include question 12 (regarding the name of the chair) and question 10 (regarding the charges cap). Also, the existing questions 21.2 and 21.3 regarding whether a scheme has been used to meet an employer's auto-enrolment duties since 6 April 2015 (including in relation to existing members) now apply to all sizes of DC scheme.

TPR will start sending out the revised return to DC schemes in July 2016.

View further information from TPR on the scheme return here.

HMRC publishes pension schemes newsletter no. 78

On 17 May 2016, HMRC published the latest issue of its pension schemes newsletter. The key contents are summarised below.

- **Secondary annuities market:** – HMRC is to schedule discussion sessions with a range of stakeholders on the consultation relating to the creation of a secondary annuities market;

- **Tapered annual allowance (TAA)** – confirmation that a scheme administrator is required to provide a standard pension savings statement for 2016/17 onwards to a member only if that member's pension input for that scheme exceeds the general untapered allowance (currently £40,000) rather than if it exceeds the member's personal tapered allowance. The current position is therefore unchanged.

- **Scheme pays** – for 2016/17 onwards, individuals subject to the TAA are not prevented from using scheme pays provided that:

  - their annual allowance charge (from all accrual) for the tax year exceeds £2,000; and
  - their pension input amount for the scheme for the tax year exceeds the general untapered annual allowance (currently £40,000).

- **Lifetime allowance (LTA)** – the latest versions of the forms required by those applying for IP2016 and FP2016 are appended to the newsletter. The newsletter also provides helpful assurances for scheme administrators relating to members relying on either of these protections using the interim application process.

- **UFPLS payments** – confirmation that the entitlement to an UFPLS payment arises immediately before (and not at any time before) the lump sum is paid. This means an UFPLS paid on or after 6 April 2016 triggers a BCE on the date it is actually paid, and the amount crystallised is tested against the LTA in force on the date of payment.

- **Serious ill-health lump sums** – the new Finance Bill 2016 extends the circumstances in which a serious ill-health lump sum may be taken. Currently, even where the other criteria are met, a serious ill-health lump sum may not be taken where any of the other benefits have previously been accessed. Once the new Finance Bill is in force, those who have accessed part of their pension will be able to take a serious ill-health lump sum from their remaining uncrystallised funds.

View the newsletter.

The end of DB contracting-out and the effect on employees' NICs

Of interest to all employers sponsoring schemes formerly contracted-out on a salary-related basis are queries we have received relating to the employee information to be provided regarding possible changes in the level of their National Insurance contributions (NICs).

HMRC has also published the latest edition of its Countdown Bulletin, which details further practical issues of interest for such employers.

Clients have raised queries relating to the abolition of DB contracting-out and the potential knock-on effect on the level of employees' NICs in circumstances where the scheme's sponsoring employer decides not to absorb the increased NI costs itself.

There is no legal obligation on employers to notify employees of changes to the rates of NICs or tax payable where the employee's contract of employment states that "salary is payable subject to statutory deductions". Nevertheless, it is good practice for the employer to keep employees informed of such changes in any member communications relating to the contracted-out status of the pension scheme.

However, where information relating to contracting-out has been provided to employees as part of the written statement setting out the basic terms of employment (a requirement under section 1 of the Employment Rights Act 1996), there is an obligation for the employer to provide a written statement to the employee about any subsequent changes. Thus, if an employer had provided contracting-out information in the section 1 statement, it should then notify the employee in writing of any change in NI contributions following contracting-out abolition. There is no financial remedy though for an employee who has an incomplete or inaccurate section1 statement.

On a related note, the most recent issue of HMRC's Countdown Bulletin was published on 23 May 2016 and sets out information on various scheme administrative matters relating to the abolition of DB contracting-out, including the online GMP checker facility, the scheme reconciliation service and pensions forums which HMRC is considering holding in September 2016.

View Countdown Bulletin no. 17.

Bank of England and Financial Services Act 2016

On 4 May 2016, the Bank of England and Financial Services Bill 2015-16 received Royal Assent, becoming the Bank of England and Financial Services Act 2016.

Of most relevance to pensions are the following provisions:

- an extension of the services of Pension Wise (or its successor) to offer guidance to annuity holders considering selling the income from their annuities to a third party; and
- the introduction of a ban on specified charges being imposed on members of pension schemes who take, convert or transfer pension benefits after they have reached normal pension age but before their expected retirement date.

Certain parts of the Act came into force on Royal Assent, but the majority of its provisions will come into force on dates to be specified by HM Treasury in regulations.

On 13 May 2016, the Bank of England and Financial Services Act 2016 (Commencement No 2) Regulations 2016 were published, and brought into section 32 of the Bank of England and Financial Services Act 2016.

Section 32 amends section 333A of the Financial Services and Markets Act 2000 to expand the scope of Pension Wise so that it can offer guidance to annuity holders considering selling the income from their annuities to a third party.

Mrs X (PO-4280): pension scheme merger – no-worse-off guarantee could be validly removed for future service

Of particular interest to DB schemes is the Pensions Ombudman's (PO's) determination that on the closing of the final salary section of an occupational pension scheme and the removal, in relation to future service, of a guarantee that benefits received would be at least as good as those in the original scheme was not invalid. In addition, under the guarantee, which still applied to frozen benefits in the closed final salary section, the member was not entitled to more generous benefits set out in a 1985 scheme booklet that conflicted with the original scheme's trust deed and rules.

Summary

The PO has dismissed a complaint by a member whose original scheme was merged with the Kingfisher Pension Scheme (KPS) in 1988, following which the employer guarantee was included in the KPS governing rules. In 2012, when the final salary section closed to future accrual, Mrs X became a deferred member of the section, entitling her to a less generous accrual rate under the original scheme's rules. The PO held that:

- the KPS rules permitted such a modification, which was not a regulated modification for regulatory purposes, and that neither the employer nor the KPS trustee had acted in a manner that was inconsistent with their duties in those roles;
- any argument based on contract by virtue of the guarantee or on legitimate expectation was unfounded;
- the 1985 scheme booklet, which contained a disclaimer, did not confer any express legal rights over those in the trust deed and rules; and
- no employment contract established a contractual right to the higher level of benefit. Arguments based on estoppel, change of position or a reasonable and continued expectation also failed.

Facts

Mrs X was employed by B&Q plc (a subsidiary of Kingfisher plc) and from 1985 was a member of the final salary B&Q (Retail) Limited Retirement Benefits Scheme (the B&Q Scheme). Under the scheme rules, active members with 20 years or more pensionable service were entitled to a full pension of two-thirds of final salary at normal pension age. Benefits for deferred members were calculated as for incapacity, with a maximum of one-sixtieth of final salary for each year of service (up to a maximum of forty years). The 1985 scheme booklet stated that a member's pension would be in proportion to his final salary at the rate of forty-sixtieths for 20 or more years' service. It did not distinguish the position of deferred members, unlike the 1986 booklet which followed it. It also stated that "[i]n the event of any discrepancy between [the] booklet and the Trust Deed and Rules, the latter will prevail".

In February 1988, the B&Q Scheme merged with the existing KPS, another final salary scheme. Transferring B&Q scheme members were informed that under a B&Q guarantee (the Guarantee) their benefits on retirement at normal retirement age would "be at least as good as those which would then have been paid under the B&Q Scheme".

Following consultation with members, Kingfisher closed the final salary section of the KPS to future accrual by deed of amendment under "Project Kendall", with effect from 30 June 2012 (the Kendall Date). Affected members, including Mrs X, joined the existing KPS money purchase section on improved terms for future service without the benefit of the Guarantee. At the same time they became deferred members of the final salary section, where the Guarantee continued to apply. By this time, Mrs X had more than 20 years' service but was not entitled to a full pension of two-thirds of her final salary pension at the normal retirement age since, as a result of the 2012 deed of amendment, she was treated as a deferred member.

Mrs X complained to the PO on two issues:

- **The amendment issue.** The closure of the KPS final salary section to future accrual, rendering her a deferred member of that section, and the removal of the Guarantee for post-Kendall Date service were invalid. She claimed that the consultation was flawed and ignored members' expectations while failing to explain the consequences of the changes; and
- **The calculation issue.** The Guarantee had been incorrectly interpreted in relation to her pre-Kendall Date service and the 1985 booklet should in fact apply to her. In particular, she submitted that it was an express contractual term of her employment contract as a new starter that the 1985 booklet method would apply. She claimed that she had a

> reasonable and continued expectation that her entitlement was as advised in 1985 and had received no communications about the 1986 booklet. She had been told by a previous head of group pensions that her annual statements did not reflect her protected position under the Guarantee, as the employer wanted to keep this advantage low key.

Among other things, the employer and the trustee (the respondents) submitted that annual benefits statements received by Mrs X showed correct deferred benefits that were significantly less that the two-thirds pension to which she claimed she was entitled.

Mrs X's case was selected as the lead complaint from three complaints on these issues made to the PO to date. Additionally, there are around 100 other potentially affected members.

Determination

The PO dismissed the complaint.

On the amendment issue, the PO said that if a modification of a scheme's deed and rules was not a statutory regulated modification and there was power to make the modification in the scheme rules, and making the modification would be a proper use of that power, then "the trustees or the employer, or both, whoever can validly exercise that power, may make the modification".

The amendments were not a regulated modification under section 67 (of the Pensions Act 1995) since by freezing Mrs X's existing benefits they did not replace them with money purchase benefits; nor were her subsisting rights adversely affected by becoming a deferred member. The PO noted that in Stena v MNRPF [2011], the Court of Appeal stated that "the starting point in relation to powers to amend pension schemes is that they should be given a broad interpretation" and emphasised the importance of not fettering amendment powers. He concluded that in Mrs X's case it was clearly within the scope of the amendment power to make the alterations.

In exercising their powers, employers and trustees must also act in a manner consistent with their duties in those roles. An employer must not, without reasonable and proper cause, act in a way "calculated or likely to destroy or seriously damage the relationship of confidence and trust between employer and employee". There had been a 60-day consultation, as required under the relevant regulations, and although members' expectations were relevant, the respondents were entitled to take their own interests and the future operation of the KPS into account. Noting that TPR had investigated the consultation process and concluded there was no case to answer, the PO held that the respondents' decision was neither irrational nor perverse.

The PO also concluded that Mrs X had no enforceable right to higher benefits in relation to post-Kendall Date service by virtue of the Guarantee, partly because Mrs X did not need to consent to the transfer. Similarly, although Mrs X had a legitimate expectation that the Guarantee would not be unpredictably removed, this did not extend to continued benefit accrual after the KPS was restructured. There was no suggestion that the Guarantee could never be amended and it was taken into account when calculating Mrs X's deferred benefits for pre-Kendall Date service.

On the calculation issue, Mrs X argued that under the Guarantee the calculation method in the 1985 booklet should apply although it conflicted with the B&Q Scheme rules as it did not distinguish deferred members. However, it is a well-established legal principle that explanatory material provided to scheme members does not generally override the trust deed and rules. The disclaimer in the 1985 booklet made this clear and also stated that the company "reserve[d] the right to terminate or amend the scheme at any time". Therefore, the

1985 booklet did not confer any express legal rights over those in the trust deed and rules. Nor did any employment contract provided establish a contractual right to the higher level of benefit.

In addition, the PO noted the precedent in existing case law that there could be no reliance on statements inconsistent with the trust deed in order to establish an estoppel.

On the question of any reasonable and continued expectation regarding Mrs X's entitlement to receive two-thirds of her final salary pension (following the IBM case), the PO was not satisfied that the head of pensions would have told her to ignore her annual statements. Nor was he satisfied that she could have reasonably believed this was the case, especially given her various roles within the company. More generally, it was not reasonable of Mrs X to rely on the 1985 booklet in isolation, given the other conflicting information she had received.

Comment

This is a very interesting determination as "no-worse-off guarantees" have often been used in the past in circumstances where schemes are merged. However, as the risks in offering such guarantees have become more apparent, their popularity has dwindled. The main issue is usually whether there is a provision to amend or terminate the guarantee at a future date, as there was in this case. The answer depends on the wording of the guarantee, whether or not it is incorporated into the scheme rules, and other surrounding circumstances. In this instance, the PO seems to have concluded the guarantee did not confer an enforceable right, and that even if it did, that right could in any event be amended or terminated. It is unclear whether there will be an appeal, but it is conceivable that a Court could have a different view.

High Court: security of benefits not a factor for actuary when giving certificate for transfer without consent

The High Court has confirmed that a scheme actuary should not take into account the security of benefits in a receiving scheme when giving a certificate on a bulk transfer without consent.

The trustees of the Halcrow Pension Scheme (HPS) submitted a Part 8 application to seek the Court's declaration in respect of the pensions aspects of a restructuring of the scheme's principal employer. The case related to "Project Galaxy", a proposed restructuring of the benefits under the HPS with more than 3,000 members and a solvency deficit of £600 million. The employer was an old established engineering consultancy which was in financial difficulties, with a USA parent which had indicated that it would provide no further support.

Project Galaxy sought to transfer the assets and liabilities of the scheme to a new scheme, known as "HPS2". The benefits would be the same as in the HPS other than in respect of future increases to pensions in payment and deferment, which would drop to the statutory level. However, under HPS2, the benefits would be no worse than, and in most cases better than, benefits in the PPF. There were several advantages to the proposed restructuring in that there would be no insolvency of the sponsoring employer, no contagion to the USA parent company, the members would be better off (in most cases) than they would have been in the PPF and HSP2 would enjoy a parental guarantee of £120m and £5.5 annual contributions. In addition, there would be an 18-year recovery plan, meaning the scheme would be de-risked by 2043.

Due to the commercial sensitivity of the restructuring the transfer needed to be done without the members' consent. This required an actuarial certificate under the Preservation of Benefit regulations confirming that the transfer credits in HPS2 were "broadly, no less favourable than the rights to be transferred".

A key point in this case was the trustees' argument that when determining whether the transfer credits in HPS2 were "broadly no less favourable" the actuary should take into consideration the security of the benefits in each of the schemes and therefore, the likelihood of the benefits being paid. This was important in this case as there was a high likelihood that if the transfer did not go ahead the employer would go into insolvency and HPS would enter the PPF. However, the employer submitted that the correct approach was that the actuary may take into account a variety of factors which he considers relevant, including the security of benefits, but was not under an obligation to do so. The representative beneficiary and TPR submitted that the assessment required the comparison of benefits in the two schemes and that the security of the benefits was not relevant.

Asplin J held "with some reluctance" that there was no ground for the trustees' construction of the relevant regulation. Properly construed, the actuary's assessment did not include the security of benefits as a factor to be taken into account, irrespective of whether or not the transferring scheme was winding up. The judge held that "had it been intended that such a factor be taken into account, the regulations would have said so".

Privacy restrictions meant that the decision in this case, although dated 18 December 2015, was only published on 3 May 2016.

Comment

Much of the argument in this case centred on the wording in the actuary's certificate and whether account could be taken of the future security of benefits.

Asplin J indicated that she would have blessed the trustees' decision to carry out Project Galaxy as a reasonable and proper one, but held with regret that it was not permissible under the Preservation Regulations. She rejected the trustees' and the employer's that the Regulations required or permitted the scheme actuary to take into account the security of benefits when deciding whether the members could be transferred without consent.

Project Galaxy was a "win-win" proposal for an employer with a weak covenant and large scheme deficit, as it would be relieved of onerous pension liabilities, and saved from insolvency. In addition the scheme members would be better off than in the PPF. However, there was a note of warning that there would have to be rigorous scrutiny by trustees of any employer assertion that it would become insolvent without such restructuring of its pension liabilities. Care must be taken that such an exercise is not an opportunity for an employer simply to offload its pension responsibilities on the PPF. The trustees in this case though were recognised by the Court to have been extremely conscientious and had been advised that HSP2 was sustainable.

Although an alternative rescue solution had been expected in an announcement shortly after the publication of the judgment, there are now suggestions that negotiations are continuing and we will report further once a decision is reached.

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