STEPHENSON HARWOOD
pensions law group

Snapshot

November/December 2021

- Restrictions on statutory transfers out
  From **30 November 2021** trustees have new obligations with respect to statutory transfers out. Unless a transfer is to a public service scheme, an authorised master trust or a collective defined contribution (**CDC**) scheme that has obtained authorisation, trustees must carry out additional due diligence checks before a transfer can proceed. If a 'red flag' (as set out in the legislation) is present, the trustees cannot proceed with the transfer. If there is an 'amber flag' (as set out in the legislation), the trustees cannot proceed with the transfer until the member has received scam advice from the Money and Pensions Service (**MaPS**). There are also new procedural requirements that trustees will have to comply with when considering statutory transfers out.

- Clarification of GMP conversion?
  There are some uncertainties about the current GMP conversion legislation which has resulted in reluctance to use this approach to achieve GMP equalisation. A Bill has been put forward to try and address these uncertainties. Whilst it is hoped the proposed changes will assist trustees in being able to use GMP conversion to achieve GMP equalisation, it is still likely to be some time before the Bill, and the corresponding secondary legislation that will follow, becomes law.

- Trustees to be asked for more information on asset allocations from 2023
  The Pensions Regulator (**Regulator**) will ask trustees of defined benefit (**DB**) pension schemes for more information about how they allocate their assets from 2023. It is expected that the additional data gathered from annual scheme returns will assist the Regulator in assessing the investment risk of schemes and support the Pension Protection Fund (**PPF**) in its levy calculation. The Regulator will request information at three levels of detail depending on a scheme's size, with more detailed information being required from larger schemes.

- The Pensions Ombudsman (**PO**) guidance on communicating with members
  The PO has produced guidance on best practice for communicating with members with the aim of reducing the number of complaints culminating in PO action.

- Serial rectification restoring the balance of powers back to the trustee from the employer
  In *Mitchells & Butlers Pensions Ltd v Mitchells & Butlers plc* the trustee argued that the scheme rules should be rectified to address an inadvertent change to the balance of powers in the pension increase and revaluation rule in 1996 which subsisted in later consolidations. The rectification claim was successful based upon evidence of a negative intention (i.e. the witnesses attested that they would have remembered an intention to change the balance of powers – they did not, so there could not have been one). The judge also made some obiter comments dealing with other arguments that could impact schemes with an amendment power that requires another party to be consulted before a valid amendment can be made.

Overview

Restrictions on statutory transfers out

Trustees should be aware that they have new obligations with respect to statutory transfers out from **30 November 2021.** The Occupational and Personal Pension Schemes (Conditions for Transfers) Regulations 2021 provide trustees with new obligations in a bid to protect members from transfers to scam arrangements. The regulations require further transfer due diligence checks from trustees before a transfer can be made and prevent transfers where 'red flags' are present. The regulations also require trustees to ensure that members receive scam advice from MaPS where certain warning signs are present.

Can the trustees agree to a transfer?

A transfer can proceed without any further checks to:

- A public service pension scheme.
- An authorised master trust on the Regulator's published list.
- A CDC scheme that has obtained authorisation.

Unless a transfer is to one of the above, trustees will need to consider if a red or amber flag is present. Where amber flags are present, members must take advice from MaPS before the transfer can occur. Where red flags are present, the transfer must be refused. The legislation sets out the various flags.

New procedural requirements

In addition to the new due diligence process to follow when deciding whether a statutory transfer can proceed, trustees will also need to take additional administrative steps, as follows:

- Within one month of a member's application for a statement of the cash equivalent or transfer, notify the member that their application will be assessed against the new requirements (unless the transfer is made within that period).
- Process member data for a new purpose and obtain new information to establish if a red or amber flag exists. Trustees will need to ensure that they comply with UK GDPR requirements and that members are aware of the additional data being collected, as well as the purpose for which their data is being used.
- Ensure they are aware of any member vulnerability and whether some people need more support than others from the trustees to avoid scams.
- Inform members of the progress of the application throughout the transfer process.
- Notify members of the trustees' decision.

Impact?

There is no doubt that the policy intention behind these new regulations is admirable. Any steps which help reduce member risk to scams should be encouraged and applauded. It is perhaps inevitable that these additional protections come with additional work for trustees. Whilst the DWP has made clear that its intention is not, on the whole, to increase the due diligence burden on trustees, in reality it is difficult to see how this will not be the outcome.

For more information on this topic, including details of the red and amber flags, please see our briefing here.

Clarification of GMP conversion?

One way that trustees are seeking to resolve the GMP equalisation issue is to convert GMP benefits into other defined benefits using the conversion legislation.

However, there are a number of uncertainties surrounding the GMP conversion legislation that deterred trustees from using this approach. As a result, the Pension Schemes (Conversion of Guaranteed Minimum Pensions) Bill has been put forward to try and address these uncertainties. In particular, the Bill:

- confirms that GMP conversion applies to survivors as well as earners.
- provides for a power to set out in regulations the conditions that must be met in relation to survivors' benefits.
- replaces the requirement for employer consent to conversion with a power to set out in regulations the consent requirements. There were some concerns about what the employer consent requirement meant in, for example, multi-employer schemes and schemes where the employer no longer existed. It is hoped these concerns will be addressed in the regulations to be made under the new powers.
- removes the requirement to notify HMRC that conversion has taken place.

Draft legislation to clarify the conversion process is welcome and will hopefully assist trustees on their path to GMP equalisation. However, it is likely the Bill will not receive Royal Assent before next summer and secondary legislation will also be needed to fill in some of the detail. This is therefore not going to be the "quick fix" solution that some trustees had been hoping for.

Trustees to be asked for more information on asset allocations from 2023

The Regulator will ask trustees of DB pension schemes for more information about how they allocate their assets from 2023.

It is expected that the additional data gathered from annual scheme returns will assist the Regulator in assessing the investment risk of schemes and support the PPF in its levy calculation.

In response to a recent joint consultation with the PPF, the Regulator will request information at three levels of detail, depending on a scheme’s size. For smaller schemes (with liabilities of up to £30m), a basic level will be required while, for schemes with liabilities between £30m and

£1.5bn, more granular information will be requested. Information on the sensitivity of portfolios to investment stresses will be expected for schemes with liabilities of £1.5bn or more.

The Regulator's Executive Director of Regulatory Policy, David Fairs, commented: "*Protecting savers is our core priority and this additional data will give us a more detailed picture of how trustees are managing their members' investments. It will give us an improved overview of DB funding whilst also flagging any potential concerns about a particular scheme's approach to risk management*."

The Regulator noted that most of the 29 respondents to the joint consultation supported the proposals, particularly the need for schemes to provide more details on bonds (which make up around 70 per cent of DB pension scheme assets).

From 2023, scheme returns will ask for bonds to be shown split into investment grade and sub-investment grade and, for some schemes, by duration to capture more accurately the level of risk.

The Regulator believes that better risk assessment will result in companies reducing the mismatch between assets and liabilities and will help the Regulator focus on schemes where the greatest risks to savers remain. This, in turn, may result in fewer bad outcomes for savers.

The Regulator is in the process of developing the IT necessary to enable the implementation of a new scheme return from 2023.

Guidance on communicating with members

The PO has produced guidance on best practice for communicating with members, with the aim of reducing the number of complaints culminating in PO action. Misinformation was the third most complained about issue to the PO in 2020/21, making up about 12% of complaints.

The PO highlights that many member disputes and complaints stem from poor communication and/or customer service and can be resolved through engagement and education rather than the disputes process.

The PO has published some "top tips" for avoiding the PO alongside links to key guidance and relevant case studies. With regard to communicating with members, some of the PO's top tips include: listening to the member, using plain English and avoiding technical terms, managing expectations, apologising and accepting responsibility and avoiding delays.

Serial rectification restoring the balance of powers back to the trustee from the employer

In *Mitchells & Butlers Pensions Ltd v Mitchells & Butlers plc*, the Trustee sought rectification of a pensions increase and revaluation rule which was erroneously introduced into the governing documents of the M&B scheme in 1996 and was maintained in the 2002 and 2006 consolidations. The rule introduced in 1996 provided:

The rate of increase is the percentage increase in the Retail Price Index during the year ending the previous 31st May but subject to a maximum increase of five per cent. per year compound ***(or any other rate decided by the Principal Employer)*** [emphasis added].

The effect of the wording in bold (which was also considered recently in the *Britvic* case in the Court of Appeal) was to grant the sponsoring employer an unfettered power to set both the rate and inflationary index for pension increases and revaluation of benefits in deferment. Prior to 1996, the Trustee had the power to choose the inflationary index.

The Trustee argued that the change in the balance of powers was unintended and a mistake. The Trustee was successful in its claim, with each of the 1996, 2002 and 2006 deeds being successfully rectified to remove the sponsoring employer's power and to reinstate the Trustee's previous control over the selection of inflationary index.

For a successful rectification the Court requires convincing evidence - but for serial rectification of deeds across an extensive period, like in this case, that burden is all the stronger. The Trustee successfully cleared the hurdle, however. 19 witness statements were adduced, with 16 witnesses giving oral evidence. The evidence relied upon was the absence of intention for the change to be made to the balance of powers and that decision makers believed there was a guaranteed rate based on RPI with a cap of 5%.

The case demonstrates that RPI/CPI disputes are alive and kicking, despite the upcoming changes to CPIH. It is also relatively rare to see a trustee acting in a representative role (without a separate representative beneficiary) and arguing for rectification (which is usually argued for by the sponsoring employer).

The other arguments in the case, whilst obiter due to the success of the Trustee's primary case, do make this judgment more than just a "typical" rectification. Notably:

- ***Improper consultation with the actuary*** - The Trustee was successful in arguing that the scheme actuary had not been properly consulted about the introduction of the new employer power in 1996. Consultation was a condition of the power of amendment being exercised. The Judge agreed, noting that the change had not been drawn to the actuary's attention, and, in fact, there was a reference to "no change to the balance of powers" in the information provided to the actuary. Therefore, even if rectification had not been successful, the rule was not properly introduced in accordance with the power of amendment.

  The case therefore emphasises that, where an amendment rule requires consultation (in this case with the actuary), that consultation must be properly carried out. Simply providing the documentation without directing the recipient to the provision being changed and/or asking the right question may not be enough for genuine consultation. Those with references to consultation in their scheme rules will want to consider this case and take advice as to what they should be providing to the consultee.

- ***Bona fide purchaser for value without notice*** - The principal employer also argued, unsuccessfully, that its accession as principal employer (in place of the original employer entity which was party to the 1996 and 2002 deeds) meant that rectification should not be allowed on the basis that the principal employer was a bona fide purchaser for value without notice. This argument had not been deployed in a pensions case before. However, the Judge did not consider that a purchase took place (instead it was a group reorganisation with no new money coming in from the outside) and there were other elements of the transaction which did not satisfy the test (including continuity of directors and the witness testimony from those involved at the time). Also, the principal employer's accession was specifically to 'assume its position' and was therefore a matter of substitution not property rights. Nevertheless, it would be interesting to see if the bona fide purchase for value argument could apply in future in a pensions context where, for example, a differently worded accession deed is used or where new money is coming in for a purchase.

Contacts

CHRIS EDWARDS-EARL

SENIOR ASSOCIATE, Pensions

T: +44 20 7809 2113

E: chris.edwards-earl@shlegal.com

GRAHAM WRIGHTSON

PARTNER, Pensions

T: +44 20 7809 2557

E: Graham.wrightson@shlegal.com