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Current issues

June 2020

Articles this month:

Viral news

In what we hope will *not* become a regular feature, we provide a round-up of pension-related news relating to the COVID-19 pandemic.

Furlough scheme updates

The Government has announced a series of stepped changes to the Coronavirus Job Retention Scheme (CJRS, also known as the ‘furlough scheme’):[1]

- it is closing to new entrants—it seems that any employee who is not already in the CJRS but might need to be should be furloughed by 10 June 2020;
- from 1 July, furloughed employees will be allowed to work (and be remunerated by the employer) part-time—this is being called '*flexible furloughing*', and guidance will be published on 12 June;
- from 1 August, the CJRS will no longer cover employer National Insurance and pension contributions;
- from 1 September, it will only reimburse 70 per cent of pay (up to £2,190);
- from 1 October, it will only reimburse 60 per cent of pay (up to £1,875);
- it will end on 31 October 2020.

Eligibility for the CJRS is ordinarily dependent on employees having ceased all work for their employer. A Treasury Direction on the CJRS, published on 20 May, confirms (amongst other things) that an employee can still undertake work ‘*for the sole purpose of fulfilling their duties as a trustee*’ (or manager, or trustee director) of an occupational pension scheme without endangering their status as a furloughed employee.[2] The exception will not apply if the employer’s business is the provision of independent trustee services to occupational pension schemes.

DC scheme management and investment guidance updated

On 13 May the Regulator updated its defined contribution (DC) scheme management and investment COVID-19 guidance for trustees. The guidance now says that transfers from DC schemes are deemed to be '*core financial transactions*' so that it is '*very important*' to process them '*within a reasonable timeframe*' (subject to due diligence). Transfer activity should be monitored.

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[1] <www.gov.uk/government/news/chancellor-extends-self-employment-support-scheme-and-confirms-furlough-next-steps>.
[2] <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/886959/CJRS_DIRECTION_200bNo2___20_05_2020.pdf> See paragraphs. 6.10 to 6.12.

The guidance was updated again on 21 May to include a section explaining when the temporary closure of a fund and diversion of contributions to an alternative might lead to the creation of a 'default arrangement' for charge-cap purposes.

The Regulator believes that the only circumstances in which a default arrangement *would not* be created are if:

- members were made aware before they selected the original fund that contributions could be diverted to another fund in certain situations; *or*
- members consented in advance to diversion of contributions (the Regulator says trustees should consider taking advice before doing this).

A '*pragmatic approach*' to regulatory action is promised; however, the Regulator reminds trustees that it has no discretion over the imposition of fines for non-compliance with annual governance (Chair's) statement requirements.

DB funding

The Pensions Regulator has responded to recent calls for a re-think on the revision of the defined benefit (DB) funding Code.[3]

The first phase of consultation on the Code was launched at the beginning of March 2020 and seeks comments on the Regulator's proposed approach and underlying principles. The proposals include a twin-track route to valuation compliance, with the focus on a long-term objective. It puts the onus on trustees to demonstrate compliance and could lead to major overhauls in funding and recovery plans. The closing date for responses is currently 2 September 2020.[4]

The Regulator's blog says that calls have been made for it to revisit or abandon the consultation, the argument being '*that it was written in different, more benign, economic conditions and is now out of place*'. David Fairs, Executive Director of Regulatory Policy at the Regulator, has dismissed these claims and said that the consultation is principles-based, and the principles have not changed. The Regulator will, however, review the parameters of the low-dependency funding basis in light of market changes.

Auto-enrolment & DC pension contributions guidance clarified

The Pensions Regulator updated its *Automatic Enrolment & DC Pension Contributions: COVID-19 Guidance for Employers* on 6 May, to provide additional clarification on automatic enrolment duties for furloughed members of staff.[5] The guidance makes it clear that if the auto-enrolment criteria are satisfied, workers must be auto-enrolled or auto-re-enrolled, as the case may be; and that opt-ins should continue to be processed.

Pension bodies FAQ document

The Pension Protection Fund, Financial Services Compensation Schemes, Money and Pensions Service, Pensions Regulator, Financial Conduct Authority and the Pensions Ombudsman have jointly produced a document called '*COVID-19 & Your Pension: Where to Get Help*', to answer some frequently asked questions from scheme members.[6]

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[3] <blog.thepensionsregulator.gov.uk/2020/05/18/db-funding-code-its-a-matter-of-principle>.

[4] See *Current Issues* April 2020 for more details, <www.hymans.co.uk/insights/research-and-publications/publication/pensions-investments-round-up-april-2020>.

[5] <www.thepensionsregulator.gov.uk/en/covid-19-coronavirus-what-you-need-to-consider/automatic-enrolment-and-pension-contributions-covid-19-guidance-for-employers>.

[6] <www.ppf.co.uk/sites/default/files/file-2020-05/COVID-19-and-your-pension.pdf>.

Guidance on Transfers

The Regulator has published a blog post on its website summarizing and bringing together the various pieces of guidance that it has issued on the subject of transfers, to DB and DC trustees, and to scheme members.[7]

Work and Pensions Committee questions Pensions Regulator

On 19 May, the House of Commons Work and Pensions Committee had a Microsoft Teams session to question decision makers at the Regulator on its response to the COVID-19 crisis.[8]

The Committee quizzed the Regulator's representatives about the effect the pandemic had had on auto-enrolment, DB scheme deficits and the action being taken to protect pension scheme members from scams. The Regulator drew attention to the various guidance documents that it has produced for trustees and employers during the crisis and its more flexible approach it is taking to various infractions.

LGPS 'no boycotts' investment guidance deemed excessive

The UK's Supreme Court has ruled that the Government exceeded its statutory remit when it warned Local Government Pension Scheme (LGPS) administering authorities not to use their investment powers in ways that were at odds with official foreign and defence policies.[9]

Background

The legislation governing the management and investment of LGPS funds was replaced in 2016.[10] Each administering authority is required to formulate an investment strategy covering several matters, including '*the authority's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realization of investments*'. The investment strategy must be in accordance with Government guidance.[11]

The guidance issued in 2016 adopted the Law Commission's criteria for investment decisions based on non-financial considerations: it should not involve risk of significant financial detriment to the fund, and there should be good reason to think that scheme members would support the decision.[12] Controversially, the guidance said that it was '*inappropriate*' for administering authorities to use pensions policies to '*pursue boycotts, divestment and sanctions against foreign nations and UK defence industries… other than where formal legal sanctions, embargoes and restrictions have been put in place by the Government.*' This was summarized as advice that administering authorities '*Should not pursue policies that are contrary to UK foreign policy or UK defence policy*'.

Case history

That aspect of the guidance was challenged by an organization that campaigns against Israeli occupation of disputed territories in the Middle East, and by a local government (and LGPS member) employee who has a senior role in the organization. Their claim for judicial review was initially successful, in 2017, when a High Court judge ruled that the guidance was unlawful. The Government removed the offending passages and reissued it, but also appealed against the decision. In 2018 the Court of Appeal overturned the High Court ruling. The campaigners appealed to the Supreme Court.

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[7] <blog.thepensionsregulator.gov.uk/2020/05/26/covid-19-transfer-your-attention>.

[8] <www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/news-parliament-2017/pensions-regulator-evidence-19-21/>.

[9] *R (on the application of Palestine Solidarity Campaign Ltd and another) v Secretary of State for Housing, Communities and Local Government* [2020] UKSC 16.

[10] The *Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016* (SI 2016 No. 946).

[11] At the time the responsible department was the Department for Communities and Local Government; it became the Ministry for Housing, Communities and Local Government in 2018.

[12] *Fiduciary Duties of Investment Intermediaries* (2014) (Law Comm No. 350).

Judgment

The Supreme Court has, by a 3:2 majority, allowed the appeal and restored the original judge's order saying that the guidance was unlawful.

Parliament had conferred on the Government the power to issue guidance to which administering authorities must adhere. The Court had to analyse the words used in the legislation to identify the purpose of the power and therefore its scope. In this case the words used, in their context, all pointed toward the conclusion that the aim was to identify the procedures and strategy that administering authorities should adopt when discharging their functions.

The Government had, however, '*insinuated into the guidance something entirely different*'. That was '*an attempt to enforce the Government's foreign and defence policies … even when the tests… for reaching a potential investment decision by reference to non-financial considerations have … been met*'. Power to direct *how* administering authorities should go about making investment decisions based on non-financial factors did not include power to direct *what* investments should not be made.

There is speculation that the Secretary of State was '*emboldened*' to exceed his powers by misconceptions about administering authorities' roles in investment decisions and the ownership of LGPS funds. The administrators are quasi-trustees acting in the best interests of their members, not (as the Government argued) part of the machinery of state, discharging conventional local government functions; and the funds represent local government employees', not public, money.

Dissenting voices

A very different view was taken by two of the five Supreme Court judges. They said that the LGPS is liable to be identified with the British State, so it is important for the Government to be able to exercise control over the generation of perceptions about the attitude of the State. They saw nothing in the legislation to indicate that the coverage of the guidance was limited in that way that their colleagues thought. Funding for the LGPS was provided by the State and underwritten by it, giving it a legitimate interest in how the money is managed. The purposes of the legislation included working out the role of central government in relation to the Scheme, balancing the public interest with that of members, and establishing suitable governance. They rejected the view that the guidance purported to tell administering authorities what investments they must hold, and said that it reflected and articulated the legitimate role of central government in relation to public service pension schemes.

The divergence of opinion within the Court makes for a fascinating discussion about the limits of the exercise of executive power. The judgment is also notable for the (seemingly unanimous) endorsement of the Law Commission's views on the relevance of non-financial considerations in investment decision-making.

The campaigners' victory may be short-lived. In background notes to the Queen's Speech the Government announced its intention to fulfill a Conservative Party election manifesto pledge by legislating to prevent public institutions (probably including LGPS administering authorities) from '*imposing their own approach or views about international relations*'.[13]

[13] <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/853886/Queen_s_Speech_December_2019_-_background_briefing_notes.pdf>.

Late A-day protection notifications: reasonable excuses & excessive delays

A scheme member who relied on an adviser to protect pre-6 April 2006 pension rights had a reasonable excuse for applying late, but tarried too long doing something about it.[14] As a consequence, he was not entitled to the protection, and stands liable to pay substantial tax charges when the funds are crystallized.

Legislative background

When the lifetime allowance came into force on 6 April 2006 ('A-day'), members with large accumulated pension entitlements had the opportunity to protect themselves against the associated tax charge. To do so, they were expected to give notice of their intention to rely on the protection (there were two forms: 'primary' and 'enhanced'), in the appropriate form, by 5 April 2009. However, Her Majesty's Revenue and Customs (HMRC) was obliged to consider a late submission provided the person '*had a reasonable excuse*' and gave notice '*without reasonable delay*' after the excuse ceased to apply.[15] Upon receipt of a valid notification, HMRC would issue a certificate to the applicant.

Facts

The member in the case at hand had more than £5m in a self-invested personal pension (SIPP) at A-day. He considered himself a '*well-informed amateur as to pensions*', and learned about the lifetime allowance in 2006. Soon after, he instructed his long-time financial adviser to notify HMRC of his intention to rely upon enhanced protection. They agreed that the member would sign the uncompleted application form, which would be largely filled out by the adviser, who would then send it to the scheme provider to add the fund value and finally forward it to HMRC. The adviser confirmed that the completed form had been despatched. However, no certificate was ever sent, and the applicant was unaware that he should have received one, even though it was explained within the notes that came with the form.

The member's original adviser left the firm in late 2014. In 2015, his successor made enquiries with HMRC, which searched its systems and informed him that no notification had been received or certificate issued. The new adviser delayed telling the member until he had completed his own investigation (which included enlisting the help of the old adviser's personal assistant to conduct a search of the advising firm's office).

It was thus not until October 2015 that the member learned about the problem. He immediately instructed a solicitor specializing in professional negligence claims. It was not until April 2016 that he was advised about the possibility of submitting a late notification. His solicitor asked HMRC about it in August, and was told in October to submit the required form. This was done in December 2016. The application was rejected on the basis that the member had not established that he had a reasonable excuse for late submission and had notified HMRC without reasonable delay once that excuse fell away.

The member appealed to the First-tier Tribunal (Tax).

Decision

The judge concluded that the member had a reasonable excuse for the late notification, but that he delayed action for too long once he discovered that his original application had not been processed successfully.

It was an objective test that took into account the taxpayer's experience, attributes and circumstances, with the burden of proof on the member. It was reasonable for him (a highly experienced businessman who was well-informed about pensions matters) to rely on professional advice. There was no reason to doubt that the financial adviser and the scheme provider could, between them, arrange protection for him. It was also reasonable for him to sign the declaration on the incomplete form and leave them to fill in the details; the judge noted that, as a non-specialist, the member would have been reliant on his advisers for the accuracy of the technical aspects in any event. It was not unreasonable for him to rely on the scheme provider to send the form to HMRC (even if there

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[14] *Ketley v The Commissioners for Her Majesty's Revenue and Customs* [2020] UKFTT 00161 (TC).

[15] Regulation 12 of the *Registered Pension Schemes (Enhanced Lifetime Allowance) Regulations 2006* (SI 2006 No. 131).

might have been better ways of accomplishing the task), or to have expected the adviser to read the notes to the form, so that he did not need to read them himself.

There was no evidence that the member took a '*passive stance*' (as HMRC had argued). He had asked periodically for updates and was assured that everything was in order.

The judge considered that the delay in this case lasted ten months: from October 2015, when the member discovered that he was unprotected, until August 2016, when his new adviser wrote to HMRC to ask it to accept a late notification. The judge felt that the member, a financially aware, retired businessman, who was conscious of the implications of having no protection, had not taken the steps that a reasonable taxpayer would. The delay had been caused by him directing his advisers solely toward the professional negligence question; he did not (whether himself or through the advisers) investigate whether the pensions legislation contained a remedy. Had he done so the ability to make a late application would have become apparent much earlier. Delays by HMRC in responding were not relevant: whilst they might be '*a source of significant frustration*', it was not a comparative exercise.

It is reassuring to know that the courts will not fault a member for relying upon expert advice in such cases; but one must act promptly once it is discovered that the steps that one has understandably delegated to others have not in fact been successfully undertaken.

RPI-to-CPI judgments

As if to prove that the world is still turning on its axis, despite any indications to the contrary, the courts have continued to produce rulings on the vagaries of pension scheme indexation rules.

RPI increases required despite contradiction in rules

In April 2020, the High Court endorsed the Pensions Ombudsman's conclusion that the Retail Prices Index (RPI) had been 'hardwired' into a scheme's increase rule, so that a purported switch to the Consumer Prices Index (CPI) had been invalid.[16]

Facts

The rule in question provided for increases to pensions in payment to be in line with—

> '*the percentage increase in the retail prices index over the year ending 30 September in the calendar year prior to that in which the increase is due to take place subject to a maximum of 5 per cent*',

but immediately followed that up with the words—

> '*as specified by order under Section 2 of Schedule 3 of the Pension Schemes Act*'.

The second 'limb' to the rule refers to the annual statutory instrument that declares schemes' minimum obligations with respect to the revaluation of deferred pensions and, by extension, the limited price indexation of pensions in payment.

When drafted, in 2000, the two limbs to the rule would have been harmonious: the statutory Revaluation Orders were based on the RPI, and were capped at five per cent per annum. However, the cap was reduced to 2.5 per cent for statutory increases to pensions accrued after 5 April 2005, and for statutory revaluation of deferred benefits accrued after 5 April 2009; and from 2010 onward the Orders were based on the Consumer Prices Index (CPI), under which measure the rate of inflation is typically lower.

The scheme's trustee initially continued to increase pensions by reference to the RPI (the Pensions Ombudsman was critical of their initial failure to disclose that the decision was based on legal advice). In 2016, though, it

[16] *Carr v Thales Pension Trustees Ltd and Another* [2020] EWHC 949 (Ch).

decided (based on a newly obtained legal opinion) that the second limb of the increase rule ought to have had effect, and switched to CPI-based increases. It did not attempt to recover the 'overpayments' purportedly made to its pensioners, but did freeze their pensions until CPI-based inflationary increases made on the 'correct' basis had caught up with them.

One of the scheme's members, a pensioner and former trustee director, complained to the Pensions Ombudsman, saying that the trustee should have continued to use the RPI. The Ombudsman agreed. The trustee and the scheme's principal employer appealed to the High Court against that determination.

Judgment

The Court upheld the Pensions Ombudsman's ruling. Its task was to decide which of the two limbs of the scheme's pensions-increase rule had primacy when they had become inconsistent. Although there was nothing to clearly and unambiguously signal which limb had been regarded as pre-eminent by the person who drafted the rule, the judge thought that '*the natural and ordinary reading*' gave primacy to the first part. He confessed that it was

> '*not always easy to articulate with precision why one reading of a disputed phrase seems more natural and ordinary than another, as the way in which language strikes a reader as having a natural and ordinary meaning is an accumulation of experience of how language is ordinarily used*',

but nevertheless went on to try to explain his conclusion. In terms of grammatical structure, he thought that the effect of the rule was to say that '*The* [increase] *rate shall be X, and here is some more information about X*' (i.e. where to find it). On that basis, even when the described rate could no longer be found in the Revaluation Orders (as indicated in Limb 2), it did not detract from the fact that it had been specified in detail in Limb 1.

He saw no grounds for departure from that '*natural and ordinary*' interpretation. The principal employer had argued against a construction that meant that Limb 2 served no practical purpose, but the judge thought that the only thing that could be deduced from it was that the draughtsperson had not appreciated that the two limbs might one day come into conflict.

As is invariably the case with RPI-to-CPI disputes, the specific wording of the scheme's increase rule was all-important, making it hard to generalize the judgment. The judge's explanation seems eminently reasonable, but the sums of money that are typically at stake will continue to make it worthwhile for sponsors to try their luck in court.

RPI composition changed, but switch to CPI not justified

In May 2020, the High Court ruled that the demotion of the Retail Prices Index (RPI) and elevation of the Consumer Prices Index (CPI)—and subsequently the CPIH—in its stead as the official measure of inflation did not amount to 'functional replacement'.[17] Moreover, whilst the composition of the RPI had changed at times, the effects were not so as to justify a switch to another index.

Facts

The scheme rule at issue in this case said that:

> '*If the composition of the* [Retail Prices] *Index changes or the Index is replaced by another similar index, the Trustees, after obtaining the Actuary's advice, may make such adjustments to any calculations using the Index (or any replacement index) as they consider to be fair and reasonable.*'

Argument

The principal employer contended that the RPI has been '*replaced*' for the purposes of the scheme rule, even though it is still being published, because it is no longer the UK's official measure of inflation. This was

[17] *Ove Arup and Partners International Ltd v Trustees of the Arup UK Pension Scheme* [2020] EWHC 1064 (Ch).

characterized as a '*functional*' replacement. Alternatively, it asked the Court to rule on whether certain changes that had been made to the RPI, between 2010 and 2017, counted as a change in its '*composition*'. It wanted the Court to declare that the trustees were able (or obliged) to use the CPI or CPIH instead, or to adjust their calculations to achieve a similar effect.

Judgment

The Court concluded that—

- the sort of '*replacement*' envisaged by the rule drafter could only mean replacement by the Office for National Statistics in conjunction with the discontinuation of the RPI;
- in such circumstances the trustees would have had to base their increases thereafter on the replacement index, subject to the power to make adjustments;
- *'composition*' had a wide meaning (it extended to any change in data or methodology) and the trustees had to use their judgement when deciding whether any changes justify adjustments and what adjustments would be fair and reasonable;
- it was unlikely that any particular time horizon had been intended for the exercise of the power to adjust after a change in composition, but the clock had effectively been reset whenever a new set of scheme rules had been adopted (so the trustees could not now look back beyond the date of the latest set of rules);
- the change made in 2017 to the way in which housing costs were incorporated into the RPI was a change in composition that *in principle* triggered the power to make adjustments, coming as it did after the adoption of the current set of scheme rules in 2013; and
- the nature of the adjustments must be fair and reasonable considering the effects of the change in composition, so that the 2017 change in relation to housing-cost data could not justify a switch from the RPI to another index.

The judge downplayed the relevance of the 'numerous' judgments about the interpretation of other schemes' indexation rules, on the grounds that they establish no general principles and their particular contexts are decisive. In other words, to give the old chestnut yet another airing, it's a rules lottery out there.

Insolvency-law changes might affect DB schemes

The *Corporate Insolvency and Governance Bill 2019-21* aims to help businesses avoid insolvency during the current period of economic uncertainty.

It makes provision for a 20-business-day moratorium (extensible to 40 business days) during which creditors will be unable to enforce debts, crystallize charges, or instigate corporate wind-up proceedings.[18] The company itself will be subject to restrictions on its ability to obtain credit, grant security, enter into certain market contracts, settle debts or dispose of property during the moratorium. All of this will be subject to supervision by a '*monitor*' (an insolvency practitioner) and in some cases the courts.

There will be a new sort of court-sanctioned restructuring plan that will be capable of overriding the wishes of any dissenting creditors who are unlikely to be financially disadvantaged. There are also temporary suspensions on the ability of creditors to use statutory demands as the basis for winding up proceedings if the pandemic has prevented a company from paying its debts, and on the 'wrongful trading' rules. Both suspensions last till the end of June 2020.

All of this will potentially affect the position of defined benefit (DB) pension scheme trustees as creditors; and not necessarily in a good way. It might, however, mean that more of them emerge from the crisis with a solvent sponsor than would be the case otherwise.

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[18] https://services.parliament.uk/Bills/2019-21/corporateinsolvencyandgovernance.html.

HMRC updates May 2020)

Pensions Schemes Newsletter 120

Her Majesty's Revenue and Customs (HMRC) has published the May 2020 edition of its pensions newsletter.[19] It announces some temporary changes to processes as a result of COVID-19, explains how to raise queries with HMRC's Pension Schemes Services, and contains a reminder for administrators about the deadline for their relief-at-source annual returns.

Countdown Bulletin 53

The most recent *Countdown Bulletin* says that HMRC now plans to have issued all of its final data cuts from the Scheme Reconciliation Service exercise by the end of July 2020 (subject to '*changing departmental priorities*').[20] It also explains the incidence of differences between the guaranteed minimum pensions (GMPs) shown on final data cuts and those obtained through HMRC's online GMP checker service. In summary, the GMP from the GMP checker service is considered accurate at the time of checking whereas that shown in the final cut may now be out of date.

[19] <www.gov.uk/government/publications/pension-schemes-newsletter-120-may-2020/pension-schemes-newsletter-120-may-2020>.
[20] <www.gov.uk/government/publications/countdown-bulletin-53-may-2020/countdown-bulletin-53-may-2020>.

And Finally…

The Work and Pensions Committee's video chat session with senior Pensions Regulator peeps [*see Viral News*] will strike a chord for those of us WFH (working from home, rather than having the week from Hell, or weeping for humanity). There must be few of us left who aren't wearily familiar with conversations punctuated with '*Uh… are you still there? Hello? Hell-oo-ooo… Nope, we appear to have lost her*' interludes and choruses of '*You're still on mute!*'

However, there's a strange moment when Sir Desmond Swayne MP—the unfortunate chap caught on camera having forty winks behind Ken Clarke during a Parliamentary debate—appears to address the Regulator's David Fairs as '*Comrade*'. It's possible that it was a jocularly irreverant reference to Labour's Stephen Timms, who is the Committee's Chair, but *AF* wonders instead whether Swayne and Fairs may have been colleagues in the past. In any case it's probably just as well that we don't have a Senator Joseph McCarthy searching fervidly for evidence of 'reds under the beds'…

Also in this month's edition [*see Insolvency law changes affect DB schemes*] we have the news that the Government is creating a new type of restructuring arrangement for companies in dire straits (although the ones getting Money For Nothing presumably won't need it). Disappointingly, the legislation does not actually contain the delightful tongue-twister '*cross-class cram down*', which was used in all of the commentary that *AF* read. For hours (OK, seconds) of lockdown fun, try saying that one three times, quickly…