Current issues

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Forfeiture, set-off & the Ombudsman's 'competence'

The High Court in England and Wales recently ruled on whether a purported forfeiture rule extinguished 'unclaimed' arrears after six years.[1] It also answered (however ephemerally) the question of whether the Pensions Ombudsman is able to settle disputes over the amounts of overpayments to members and the rates at which they can be recouped.

Background

It is the regrettably familiar tale of a scheme that was thought to have had its retirement ages equalized, following the *Barber* judgment, only for it later to emerge that the necessary formalities for amendment had not been fully observed. A similar problem occurred concerning a subsequent change in the benefit-accrual formula. In each case, the scheme was administered on the understanding that the changes announced had been properly made at the time, but it transpired that they were not in fact legally effective until years later.

That meant that benefits had been underpaid, so that members were entitled to and received arrears. However, there was a difference of opinion between the trustee and employer over the interpretation of a scheme rule, with the latter arguing that it resulted in forfeiture of sums six years after they fell due. If the employer's interpretation was correct, the trustees' failure to take account of the supposed forfeiture clause meant that members who received full payment of arrears had been overcompensated. Figures reported in the judgment suggest that the cost difference between the two viewpoints was almost £2m.

The rule in question said that,

> '*Notwithstanding* [rules about forfeiture of guaranteed minimum pensions] *if a benefit or instalment of benefits is not claimed by or on behalf of the person entitled to the benefit or instalment in accordance with these Rules within 6 years of its date of payment it shall be retained by the Trustees for the purposes of the Scheme.*'

It (and its predecessors in earlier trust deeds) appeared under the heading, '*Benefit forfeiture*'. However, the scheme rules themselves provided that headings were '*included for convenience*' and did not affect meaning. For that reason, and

[1] *CMG Pension Trustees Limited v CGI IT UK Limited* [2022] EWHC 2130 (Ch).

because court rulings in similar circumstances suggested that headings should not trump the ordinary understanding of the words used within a clause, the judge reached his decision without reliance on the heading.

Judgment

The judge concluded that the rule *did* constitute a forfeiture clause, despite not using the word explicitly, so that it extinguished entitlements to benefit shortfalls that were not claimed until more than six years after they fell due—even though the trustee did not inform the members about the shortfalls, and they had no other reasonable means of knowing about them. He said that forfeiture of a shortfall in a commutation lump sum had no effect upon (that is, neither increased nor decreased) future instalments of pension; and he thought that interest should be applied to the arrears at the rate of one per cent above the base rate.

The judge was also asked to rule on the implications of section 91(6) of the *Pensions Act 1995*. It says (in summary, and only so far as was relevant to the case) that trustees who want to recoup payments made in error from future pension instalments must give the member a certificate setting out the amount of the set-off, and its effect on the benefits; and that if the amount is disputed, the set-off cannot be applied without '*the order of a competent court*'.

He said that the dispute could either be over the total amount of the overpayment, or the amount to be deducted from each pension instalment, and that it was sufficient to obtain the court's declaration that there had been an overpayment and that the trustees are entitled to recoup the relevant sum from future instalments (rather than have the judge make an order for repayment). He also concluded that the Pensions Ombudsman *does not* count as a '*competent court*' for this purpose (the current Ombudsman, Anthony Arter, has put the case for his 'competence' in this regard in the past[2]). Part of his reasoning was that trustees cannot apply to the Ombudsman to enforce a set-off, and indeed that the Ombudsman has no direct power to enforce his own determinations.

Subject to the usual proviso that the decision was very dependent on the specific phrasing of and history behind the scheme rule, this judgment about the ins and outs of forfeiture clauses may be of interest to trustees who are liable for arrears or want to recoup overpayments. It seems, to a legal layperson, somewhat at odds with a June 2021 High Court decision, but the judge in this (August 2022) case was able to distinguish it, saying that 'the context and wording of the relevant clauses was different.'[3] The judge's thoughts on the (ahem) 'incompetence' of the Ombudsman in this context could have a bearing on how trustees go about recouping overpayments in contentious cases.

[2] *Factsheet: Recoupment in Overpayment Cases* <www.pensions-ombudsman.org.uk/publication/recoupment-overpayment-cases>. The Factsheet has been amended to note that it is currently being reviewed in light of this court decision.

[3] *Punter Southall Governance Services Limited v Jonathan Hazlett* [2021] EWHC 1652 (Ch).

Small pots working group reports

The Small Pots Co-ordination Group (an industry group established by the Pensions and Lifetime Savings Association and Association of British Insurers, with support from the Department for Work and Pensions) has issued a report exploring three potential solutions to deal with the proliferation of small, deferred pension pots in the automatic enrolment (AE) workplace pension market.[4]

Possible solutions

Three models have been suggested as having merit for dealing with small pension pots.

Pot follows member

This is where a member's deferred pot automatically moves with them to their new employer's scheme (with the option for the member to opt out) as they change jobs.

Multiple default consolidators

Under this model, pots deferred for a specific period of time, below a certain value and of a specified 'type', would be automatically transferred to one of a number of 'pot consolidators'. Single consolidator schemes have been ruled out due to the disruption that they would cause to the pensions market.

Member exchange

Members with a small, inactive pot in one master trust and an active pot in another master trust are identified and the small, inactive pot is transferred into the active scheme. Three large master trusts have been investigating this model, and a pilot member-exchange project is planned, though it is noted that there are significant legal hurdles that would need to be overcome for it to represent a viable solution.

Next steps

The report states that a combination of the three models may be the best approach and that legislation would be needed to ensure that the solution(s) were effective. The Group will now undertake further analysis to determine which model or combination of models will provide the best outcomes for savers. The analysis is to include research on consumer preferences, the costs entaild, and the potential for reducing the number of small pension pots. It will also need to consider how the ultimate solution will affect the structure and sustainability of the pensions market.

It is clear that the issue of reducing the number of small pots is a complicated one and that more research will be needed before the final solution is found.

ARGA-ments over future funding

The Financial Reporting Council (FRC) has published proposals on how the new regulator, the Audit, Reporting and Governance Authority (ARGA) should be funded.[5, 6] The proposals set out the funding model, and the groups that should fund each of ARGA's regulatory activities.

This consultation follows the Government's response to its consultation on *Restoring Trust in Audit and Corporate Governance*, which set out its plan to provide ARGA with statutory powers to allow them to raise a levy.[7] Following the consultation, the FRC expects to consult on the finer details of the proposed levy arrangements. The results of which will be contained within a Rule Book.

The consultation closes to comments on 21 October 2022.

The proposal is that the levy will be set in a way that sees market participants meet the costs of ARGA's regulatory functions. In addition, ARGA's annual funding requirements will be based on the budget set for each of its regulatory responsibilities, defined as 'activity blocks'. The cost of funding these activity blocks will be allocated to market participants who will then be grouped into distinctive 'funding groups'. The funding groups will then be charged a levy that is calculated

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[4] <www.abi.org.uk/globalassets/files/publications/public/lts/2022/small-pots-co-ordination-group-spring-2022-report.pdf>.
[5] <www.frc.org.uk/news/july-2022/consultation-on-funding-the-audit,-reporting-and-g>.
[6] <www.frc.org.uk/getattachment/bc0650d0-bd8d-408e-a791-621cbd2ced68/-;.aspx>.
[7] <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1079594/restoring-trust-in-audit-and-corporate-governance-govt-response.pdf>.

based on the regulatory activities that are directly related to their group. There will also be additional charges to cover items such as overheads that will be proportionally allocated to each group. The method of calculating the levies payable by individual participants will vary, and is likely to be calculated based on one or more of the following factors: fee income, size of membership, market capitalisation, or annual turnover. The FRC has acknowledged that some bodies may fall into more than one category and this will be taken into account when setting levies.

It is anticipated that most of the entities that currently contribute to the FRC's funding would also be subject to ARGA's statutory levies. However, there will be a small number that will not be required to pay the new levies, such as alternative investment market (AIM) companies and public sector bodies that do not meet the definition of a PIE (public interest bodies). The following market participants are anticipated to cover the majority share of ARGA's funding requirements:

- Auditors of PIEs;
- Recognised supervisory bodies (RSBs);
- Recognised qualifying bodies (RQBs);
- Accountancy professional bodies;
- Listed companies, large private companies, and other entities falling within the definition of PIEs;
- Institutional investors;
- The Institute and Faculty of Actuaries; and,
- Beneficiaries of actuarial regulation, such as insurers, large pension schemes, and large funeral plans.

An indication of the levy amount that is likely to be applied to each the proposed funding groups will be published by the FRC following this consultation.

We welcome the FRC's consultation on ARGAs proposed levies. However, as this consultation is high-level it is likely to be quite some time before the finer details of the proposed funding model are known.

There is currently a levy that funds the FRC's responsibilities in connection with the actuarial profession, and is paid by defined benefit and defined contribution schemes with 5,000 members or more. Payment is strictly speaking discretionary, but there is an as-yet-unused statutory power for the Government to make it obligatory if voluntary compliance is not forthcoming. It remains to be seen whether the new arrangements will abandon the carrot in favour of the stick.

Regulator lays out expectations on sponsor refinancing

The Pension Regulator has published a blog setting out its expectations for trustees and sponsoring employers in relation to refinancing in the current economic situation.[8]

David Friars, Executive Director of Regulatory Policy, Analysis and Advice, notes that the post-pandemic return to something approaching normality will see the resumption of more traditional refinancing and the negotiation of new facilities to meet debt obligations. The blog contains a reminder of the areas that could have material impact on the employer covenant. In summary, the Regulator expects trustees to engage with sponsor management well ahead of any potential refinancing, and understand the effects of (and seek to mitigate any detriment arising from)—

- changes in cost of debt,
- changes in debt type,
- any resulting subordination in priority on insolvency,
- financial/restrictive covenants, and
- changes in lender.

The blog is on the one hand a reprise of familiar notes about the sorts of things that trustees and employers should consider in connection with corporate activities. On the other, it is perhaps noteworthy for the seeming shift of focus from headline-grabbing events like mergers and acquisitions towards more-routine transactions.

[8] <blog.thepensionsregulator.gov.uk/2022/08/10/refinancing-in-the-current-economic-climate-our-expectations-of-trustees-and-sponsoring-employers/#more-2061>.

Pension bodies' annual reports

The Pensions Regulator, Pensions Ombudsman, and the Pension Protection Fund (PPF) have recently published their annual reports and accounts for 2021/22.

The Pensions Regulator

The Pensions Regulator's report highlights its continued focus on savers, particularly its initiatives to ensure value for defined contribution savers; and the stakeholder panels that it has established to help it better understand the needs of the regulated community.[9]

The Regulator also reports that:

- auto-enrolment regulation has returned to 'business as usual' following the pandemic, with most employers meeting their duties;
- the regulatory initiative for employers in distress (in which the Regulator contacted the trustees of '*hundreds*' of schemes about possible pandemic-related weakening of their employer covenants) has been successful, with almost 75 per cent of those contacted feeling that its intervention enabled constructive discussions with their sponsors (over 40 per cent said they took action because of the communication, and more than 10 per cent said the scheme's financial security increased as a result); and
- ten of its 'key performance indicators' were met during the year, three were almost met, and the remaining one (completing the second phase of consulting on the principles for the revised defined benefit funding code) was missed by a significant margin.[10]

Pensions Ombudsman

The Pensions Ombudsman's report notes that there was an 8 per cent increase in the number of complaints closed in 2021/22, despite an 11.7 per cent increase in complaints.[11] Seventy-four per cent of cases were closed within 12 months, exceeding the Ombudsman's target of 70 per cent. The Ombudsman hopes that the increase in funding allocated to it will enable it to reduce waiting times further.

As in previous years the most popular subjects for complaints remain transfers, retirement benefits and misquotes or misinformation. The Ombudsman draws attention to the marked increase in complaints about the non-payment of contributions to pension schemes (up by 6.4 per cent since last year), which it notes may be due to economic strains caused by the COVID-19 pandemic.

PPF

The PPF reports that its financial position is stronger than last year, with its funding ratio up to 137.9 per cent (from 127.3 per cent) and a funding reserve of £11.7 billion.[12] It also notes the improved funding of the schemes that it protects. As a result of the funding improvements the PPF states that '*assuming our funding position remains robust over the next three-year period, our expectation remains that we will look to reduce how much levy we collect in keeping with our long-stated intention*.'[13]

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[9] <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1090757/the-pensions-regulator-annual-report-and-accounts-2021-to-2022.pdf>.

[10] It is *still* missing, largely as a consequence of the delay to the Department for Work and Pensions' consultation-draft Funding and Investment Strategy Regulations, published in late July 2022.

[11] <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1090752/pensions-ombudsman-and-pension-protection-fund-ombudsman-annual-report-and-accounts-2021-2022.pdf>.

[12] <www.ppf.co.uk/sites/default/files/2022-07/ARA%20202122%20FINAL%20web%20accessible%20PDF.pdf>.

[13] See our article '*PPF announces plans for levy redesign*' in Current Issues August 2022.

Members only: auto-enrolling younger & increasing contributions

A Private Member's Bill that would cast the automatic-enrolment net more widely has returned for a second attempt at getting into the statute books. Its prospects are currently uncertain.

Last month, we mentioned the *Pensions Dashboards (Prohibition of Indemnification) Bill,* a Private Member's Bill brought forward by Mary Robinson MP.[14] There is *another* pensions-related Private Member's Bill doing the rounds in this (2022/23) session of Parliament. The *Pensions (Extension of Automatic Enrolment) Bill* is sponsored by Richard Holden MP, under the Ten-Minute Rule (a reference to the maximum duration of the speech that the MP makes in support of the proposed legislation). It would extend the scope of auto-enrolment to jobholders aged 18 and above (it currently applies from age 22) and lower the floor of the qualifying earnings band (which currently extends from £6,240 to £50,270) to £0, so that contributions become payable on the first pound of a jobholder's earnings.

This is Holden's second bite at the cherry, having tabled a similar Private Member's Bill (and giving substantially the same speech) in the previous (2021/22) Parliamentary session. That session ended before any progress could be made on the matter, so the Bill lapsed. Unlike Mary Robinson's Bill, it is unclear whether Holden's reintroduced legislation is fully backed by the Government this time around, even though he thanked the Pensions Minister, Guy Opperman, for being 'supportive'. Opperman indicated last session, with reference to the unsuccessful first attempt to pass the Bill, that the Government might consider supporting such legislation.[15] It would fulfil a commitment made following a 2017 review of the auto-enrolment rules, at which time the Government suggested that the changes would be made 'in the mid-2020s.'[16] According to Holden's speech in Parliament, the Bill would allow the Secretary of State for Work and Pensions to bring the changes into force using regulations, 'when... the time is right.'[17]

HMRC newsletters: August 2022

Pension Schemes Newsletter 142[18] has articles on—

- relief at source;
- normal minimum pension age (pointing readers to updates to the *Pensions Tax Manual* about the transition to age 57 in 2028);
- migrating schemes from *Pension Schemes Online* to *Managing Pension Schemes*;
- Accounting for Tax returns for quarters from 1 April 2020 onwards (to be done through *Managing Pension Schemes*); and,
- the Regulator's new scam-combatting strategy.

[14] *Dashing towards dashboards deadlines*, *Current Issues* August 2022. The Bill, which had its Second Reading in the House of Commons on 15 July 2022, would forbid trustees who are fined for failure to comply with the forthcoming pensions dashboards obligations from reimbursing themselves from scheme assets. Attempting to do so would be a criminal offence, punishable by up to two years in jail and an unlimited fine.

[15] <hansard.parliament.uk/Commons/2022-02-25/debates/52A3D985-D7D7-48E6-87F4-15F5F1958C6E/PensionSchemes(ConversionOfGuaranteedMinimumPensions)Bill#contribution-E4201B91-1AB3-4EA7-9701-8DCFB0254250>.

[16] *Automatic Enrolment Review 2017: Maintaining the Momentum*.

[17] <hansard.parliament.uk/commons/2022-07-20/debates/3548E215-AB0B-4DBB-8D02-4AACA94105F2/Pensions(ExtensionOfAutomaticEnrolment)#contribution-9793FE0C-FF56-4BE9-902C-23897D4B1C85>.

[18] <www.gov.uk/government/publications/pension-schemes-newsletter-142-august-2022/newsletter-142-august-2022>.

And Finally…

The Data Privacy Network sent *AF* an email inviting us to participate in a '*Live online data breach event*'.[19] Although we're quite sure that we know what it meant, we feel like we'll have to conduct a data protection impact assessment before supplying any personal information on the event booking page.

[19] <dpnetwork.org.uk/events/data-breaches-assessing-the-risks/>.