SLAUGHTER AND MAY

Pensions Bulletin

29 March 2019 / Issue 03

Legal and regulatory developments in pensions

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For more information, or if you have a query in relation to any of the above items, please contact the person with whom you normally deal at Slaughter and May or Bridget Murphy

New law

I. Government supports investment management changes announced by CMA

1. Trustees will face new duties regarding their relationship with their investment consultants and fiduciary managers, including mandatory tendering where over 20% of scheme assets are delegated to a fiduciary manager, and a requirement to set objectives for their investment consultants.

2. The Government plans to press ahead with recommendations outlined in the recent CMA report on investment management (to read more about the CMA's report, please see Pensions Bulletin 19/02).

3. In its response (of 12th March, 2019), the Government confirms that it intends to produce draft regulations for consultation in 2019, with the aim that the changes will be brought into force in 2020.

4. The DWP is to make legislation to enable the Pensions Regulator '*to oversee the duties on trustees … We will introduce DWP regulations which put the CMA's remedies, insofar as they apply to trustees, into the main body of pensions law*'.

5. The response also mentions that the Regulator will engage with industry stakeholders and the CMA '*over the coming months*' to develop trustee guidance about the new requirements, with a consultation on the guidance planned for Summer 2019.

6. As regards the CMA's recommendation that the FCA's regulatory perimeter be extended to cover investment consultants' activities, the Government plans to consider this and '*consult in due course*'.

II. SFGB to be renamed

1. Scheme literature will need to be amended so that members are signposted to the Money and Pensions Service, the new name[1] for the Single Financial Guidance Body from 6th April, 2019.

2. The Single Financial Guidance Body was established under the Financial Guidance and Claims Act 2018 and started operating in January, 2019. In addition to its guidance role, the Government wants the body to host any future non-commercial dashboard (to read about the dashboards consultation, please see Pensions Bulletin 18/17).

Cases

III. Court confirms fiduciary duty not owed by trustees to employer

The High Court has confirmed that trustees do not owe a fiduciary duty to employers, concluding that trustees may have regard to the employer's interests but those interests are subordinate where they conflict with beneficiaries' interests.

A. Facts

1. KeyMed made a number of allegations against the defendants, who had held senior managerial posts in KeyMed at the relevant time. They were trustees of the main KeyMed scheme and later established an Executive pension scheme, of which they were also trustees.

2. KeyMed alleged that the defendants had breached a range of duties (including various directors' duties

[1] The name change is being made by the Financial Guidance and Claims Act 2018 (Naming and Consequential Amendments) Regulations 2019 (SI 2019/383).

set out in Sections 170-177 of the Companies Act 2006) by:

2.1 setting up the Executive scheme and amending it to remove the young spouse benefit reduction;

2.2 removing the old tax regime Inland Revenue limit on indexing pensions in payment in the main pension scheme; and

2.3 adopting 'unduly conservative' funding and investment strategies for the main and Executive schemes (the investment strategy had shifted from a 40% equities and 60% gilts allocation to one where the investment profile was gilts and cash).

B. Decision

1. KeyMed's allegations were rejected by the court.

2. Trustees do not owe a fiduciary duty to employers. The primary duty of trustees is owed to the beneficiaries. The fact that a trustee may consider the interests of an employer (*Merchant Navy Ratings*) does not mean that a duty is owed to the employer. Asplin J in *Merchant Navy* was saying that it would not be improper to consider other interests if the primary duty to beneficiaries is respected.

   Comment: The primary beneficiaries are the scheme's members and their survivors. Most pension scheme trust deeds provide for any surplus arising on a winding-up to be repaid to the employer, making the employer a residual beneficiary.

3. Trustees are entitled to have regard to the employer's interests, but where those interests conflict with the interests of beneficiaries, the employer's interests are subordinate.

4. Trustees need to balance the competing interests of members and employers but a fiduciary should only serve one master. The divided loyalty of a trustee was profoundly undesirable. The law will not go out of its way to create conflicts.

   Comment: The Pensions Regulator's statutory objectives recognise that it must balance competing interests too, those being the need to protect benefits and the PPF, and the need to minimise any adverse impact on the sustainable growth of the employer.

5. The conservative funding and investment strategies were entirely reasonable for the trustees to adopt for both the members and for KeyMed. The strategies very materially reduced the risk that KeyMed would be called upon to inject significant payments into the schemes at some point in the future. KeyMed knew and approved of the strategies. It can be quite proper, however, to adopt a riskier investment strategy '*provided the scheme employer and the trustees are comfortable with this level of risk*'.

   Comment: The Regulator expects trustees to implement integrated risk management, by balancing the employer covenant, investment, and funding risks. More generally, trustees must exercise their powers for a proper purpose and in line with their constitutional function under the scheme trust deed and rules (*British Airways - Court of Appeal* - please see Pensions Bulletin 18/12).

6. The decisions to establish the Executive scheme and remove the IR limit and young spouse reduction were honestly and properly made. The Executive scheme was set up to address the fact that high earners' benefits would be capped if the main scheme were to enter the PPF at some point in the future. The Inland Revenue limit cap on indexing pensions in payment was retained after A-Day by the main scheme trustees and KeyMed '*unconsciously*'. As regards the removal of the young spouse reduction, the parties to the amending deed understood that

document and knew that one of the defendants was planning to remarry someone to whom the reduction would otherwise apply.

KeyMed (Medical & Industrial Equipment) Ltd v (1) Hillman (2) Woodford - High Court - Smith J

Points in practice

IV. Regulator's Scheme Funding Statement

1. Those involved in running DB schemes should take note of the Pensions Regulator's Funding Statement for 2019. The Statement is not legally binding but schemes will need to take it into account. Although it generates action points for DB schemes with valuation dates between 22 September 2018 and 21 September 2019, schemes not scheduled to have a valuation within that timeline should still be aware of the Statement's contents as it shows the Regulator's direction of travel.

2. The current Code of Practice continues to apply, although a consultation on revisions to the Code is planned for Summer 2019.

3. The Statement urges DB schemes to:

   3.1 **Look at the long term** - The Regulator considers it best practice for schemes to have a long-term funding target, such as buy-out, which is agreed with the employer. It wants schemes to provide evidence that investment and funding strategies are aligned with that target and achieved by a journey plan which will '*look beyond becoming fully funded on a TPs [technical provisions] basis*'.

   Comment: The Regulator is taking its cue from the 2018 White Paper, which envisaged DB schemes having to appoint a Chair who would set out the scheme's long-term financial destination in a statement submitted with each triennial valuation.

   3.2 **Establish which group their scheme belongs to** - There are a number of tables contained in the Funding Statement. The tables group schemes according to their employer covenant strength, funding position, and maturity characteristics. The Regulator's expectations (on covenant, investment, and funding) are different for each scheme group.

   3.3 **Keep a paper trail of negotiations** - The Regulator wants trustees to have evidence of their '*robust negotiations*' with the employer. This evidence would typically take the form of correspondence and any covenant advice, where appropriate.

   Comment: In our experience, more schemes are being contacted by the Regulator and its expectations of evidence of negotiations with the employer are higher. This appears to be the Regulator's next stage of proactive engagement.

   3.4 **Be aware of the Regulator's line on dividend negotiations** - The Regulator plans to increase its intervention levels where it considers that a scheme may not have been treated fairly. For example, if dividends paid out by the employer exceed deficit repair contributions then the Regulator expects to see a strong funding target and the recovery plan to be '*relatively short*'.

   Comment: This reflects the Regulator's increasing preoccupation with dividends paid by employers sponsoring schemes in deficit (as evidenced in its 2018 and 2017 Funding Statements).

   3.5 **Focus on the length of the scheme's recovery plan** - If the Regulator thinks that the recovery plan's length is '*unacceptably long*' (when measured against scheme maturity and the employer's covenant strength) then it is likely to intervene ahead of the scheme's next valuation. The Regulator says that the median recovery plan length is 7 years so it considers that schemes with strong covenants should generally have significantly shorter plan lengths.

3.6 **Get the scheme valuation right** - The Regulator says that it wants the best outcome for the scheme, rather than a valuation agreed under pressure to meet the statutory deadline. If the deadline cannot be met trustees will need to tell the Regulator in good time. The Regulator has power to impose a penalty for late submission but it may choose not to if trustees have taken all reasonable steps to finalise the valuation.

V. Regulator comments on DB transfers-out and restructuring recommendations

1. The Pensions Regulator has commented[2] on recommendations put forward in an independent review which focused, principally, on scheme restructuring exercises. To read more about the review please see Pensions Bulletin 19/01.

2. The Regulator confirms that it is:

2.1 reviewing its existing guidance for DB to DC transfers;

2.2 working to create new online guidance (including templates) for trustees to help them communicate with members on a restructuring, or other event that may trigger them to consider future membership of a DB scheme;

2.3 checking the legislative and regulatory requirements with the DWP and HM Treasury '*to ensure that digital communications can be used properly and effectively as part of trustees' communications plans*'; and

2.4 concerned about the recommendation that members who would clearly be better off in the new scheme following a restructuring should be defaulted into that scheme.

VI. Regulator's report on pre-pack

1. A Regulatory Intervention report issued by the Pensions Regulator reminds those considering a pre-pack administration that it will investigate whether there are grounds for it to take anti-avoidance action where the pre-pack results in the withdrawal of employer support from a DB scheme, particularly where there is an association between the new owners and the previous owners or other stakeholders.

Comment: As well as the possibility of an investigation being carried out by the Pensions Regulator, employers should be mindful of the PPF's guidance on pre-packs, outlining steps it may take if it finds that the trustees or PPF have not been included in 'meaningful consultation' at an early stage.

2. In this instance, the Regulator confirmed that it would not take any action in relation to the pre-pack sale of Johnston Press.

3. Johnston Press went into administration in November 2018, 2 days before a deficit repair contribution ('**DRC**') of £885,000 fell due under the schedule of contributions. The DB pension scheme had a £305 million buy-out deficit.

4. Johnston Press had initially approached the Regulator and the PPF about the possibility of a Regulated Apportionment Arrangement, but the proposal did not satisfy the PPF's guidance and so was dropped. A formal sale process had been run prior to the administration, but the bids for the business (excluding the pension scheme) were rejected because they were worth less than the

[2] in a letter (dated 28/02/19) from the Pensions Regulator's Chief Executive (Lesley Titcomb) to the Work and Pensions Committee

outstanding value of the bonds. The bondholders then agreed to buy the business and assets via a pre-pack.

5. The Regulator considered whether:

   5.1 there was any viable alternative to the administration,

   5.2 the timing had been engineered to avoid the DRC,

   5.3 there were any acts before administration requiring further scrutiny, and

   5.4 there was a case to support a Financial Support Direction or Contribution Notice.

6. The Regulator found no evidence to suggest that the insolvency was avoidable, that the administration was planned to circumvent payment of the DRC, or that there were any acts before the administration worthy of further investigation.

Watch List

The Watch List is a summary of some potentially important issues for pension schemes which we have identified and where time is running out (or has recently run out), with links to more detailed information. New or changed items are in **bold**.

No.	Topic	Deadline	Further information/action
1.	Put in place register of persons with significant control ("PSC") for trustee company where trustee is a corporate	6th April, 2016 and ongoing requirement	Pensions Bulletin 16/03
2.	Ban on member-borne commissions in DC schemes used for auto-enrolment	5th July, 2016 at the latest and ongoing requirement	Trustees must notify "service providers" if the scheme is being used as a "qualifying scheme" for auto-enrolment purposes and some or all of the benefits are money purchase. Pensions Bulletin 16/04.
3.	Money purchase annual allowance, which applies to individuals who have flexibly accessed their money purchase pot on or after 6th April, 2015, has dropped from £10,000 to £4,000 under Finance (No.2) Act 2017	Retroactive effect from 6th April, 2017	Member communications should include a warning note about this, highlighting the retroactive effect.
4.	GMP equalisation		
4.1	Part 8 action brought by female staff, trustee and Lloyds Trade Union	15th May, 2017	We will continue to monitor developments in this litigation, which has implications for all schemes with GMPs accrued in the period 17th May, 1990 to 5th April, 1997.
		Judgment published	26th October, 2018 Pensions Bulletin 18/15 Pensions Bulletin 18/17
		Clarificatory judgment published	
4.2	Government response **to** consultation on GMP equalisation published	13th March, 2017	Pensions Bulletin 17/7
5.	HMRC's existing practice on VAT and pension schemes to continue indefinitely		Employers should consider taking steps to preserve, or even enhance, their pensions-related VAT cover. Pensions Bulletin 17/18
6.	DC bulk transfers without member consent: introduction of easements	6th April, 2018	Pensions Bulletin 17/18 Pensions Bulletin 18/05 Pensions Bulletin 18/08
7.	Bulk transfers of contracted-out rights without consent: introduction of easements	6th April, 2018	Pensions Bulletin 18/01 Pensions Bulletin 18/05
8.	Deferred debt arrangements became available	6th April, 2018	Pensions Bulletin 18/05
9.	Disclosure of costs, charges and investments - new requirements	Mostly in force 6th April, 2018	Pensions Bulletin 18/05
	Chair's statement and website must publish costs and charges information	Within 7 months of scheme year end falling on or after 6th April, 2018	

No.	Topic	Deadline	Further information/action
10.	Auto-enrolment total minimum DC contributions increase to 5% (of which minimum employer contribution of 2%)	6th April, 2018 to 5th April, 2019	
11.	Data protection: New Regulation: EU General Data Protection Regulation in force	25th May, 2018	Pensions Bulletin 16/05 Employment Bulletin 16/15 As data controllers, trustees need to ensure that compliance with the EU General Data Protection Regulation is achieved. A compliance checklist for trustees is available to clients from their usual Slaughter and May contact.
12.	Existing EMIR exemption extension for pension scheme arrangements ended	16th August, 2018	Pensions Bulletin 17/01 Pensions Bulletin 18/12
	EU Parliament confirms further extension of pensions exemption, with further extensions possible	12th June, 2018	Pensions Bulletin 18/10
13.	CJEU decides PPF compensation must equal at least 50% of each recipient's benefit (*Hampshire - Case C-17/17*)	6th September, 2018	Pensions Bulletin 18/13
14.	Master trusts new authorisation and supervision regime introduced	1st October, 2018	Pensions Bulletin 18/12 Pensions Bulletin 18/13 (note: SI later re-issued as SI 2018/1030)
15.	IORP II transposition deadline	12th January, 2019	Pensions Bulletin 16/11
16.	Auto-enrolment total minimum DC contributions will increase to 8% (of which minimum employer contribution of 3%)	6th April, 2019 onwards	
17.	Trustees must ensure Statement of Investment Principles meets new requirements on ESG and stewardship	Most requirements to be met by 1st October, 2019	Pensions Bulletin 18/13
18.	Pensions Regulator consultation on draft DB Funding Code of Practice expected	Autumn 2019	

If you would like to find out more about our Pensions and Employment Group or require advice on a pensions, employment or employee benefits matters, please contact Jonathan Fenn or your usual Slaughter and May adviser.