SLAUGHTER AND MAY

Pensions Bulletin

February 2020

Welcome to the February Pensions Bulletin from Slaughter and May. In this month's edition we cover the latest developments on the new Pensions Regulator's (**tPR's**) powers; the Pension Protection Fund's (**PPF's**) proposals for the next triennium with the change to Dun and Bradstreet; further news on RPI/CPI; tPR's response to its July, 2019 consultation on the future of trusteeship; and other developments to look out for.

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I. "Clearer, tougher, quicker": tPR powers, old and new.

TPR's "clearer, tougher, quicker" approach to use of its current powers in relation to DB schemes has been evident in reports of its recent enforcement activity. These powers are to be strengthened, and punitive sanctions introduced, in the Pension Schemes Bill that is currently making its way through Parliament. These new powers will give tPR greater flexibility than under the current tests to impose contributions. This, coupled with new civil and criminal sanctions, may have a significant impact on the way in which corporate and financial transactions involving a DB scheme are conducted, and more generally the role of tPR in funding negotiations.

The Pension Schemes Bill: The Bill, if enacted in its current form, will significantly bolster tPR's powers to protect DB schemes, making changes to the current contribution notice (CN) and notifiable events regimes alongside new criminal and civil sanctions. What we see as the potential implications for corporate transactions and management of DB liabilities were addressed in our October 2019 Bulletin.

Current enforcement activity: TPR's latest compliance and enforcement bulletin urges trustees to engage early with tPR during corporate transactions, highlighting a case where tPR deployed its event supervision and rapid response teams to engage with trustees. The engagement followed an announcement by the international parent company that it was closing its UK operations. TPR says it worked with the trustees to help them challenge the employer's proposals for the scheme.

Contribution notices issued against Dominic Chappell: A more detailed insight into the workings of tPR in relation to the exercise of its existing powers to issue contribution notices (CNs) is in the recent Determination Notice confirming CNs for over £9.5m issued to Dominic Chappell (DC) in connection with the sale of BHS in 2015.

CNs can be issued against any person connected with an employer, who was party to an act or failure to act which has detrimentally affected in a material way the likelihood of accrued scheme benefits being received (the "**material detriment test**"), and tPR is of the opinion that it is reasonable to issue the CN.

Although the tPR's Determination Panel concluded that the material detriment test was satisfied here on a quantitative basis (in that the sale of BHS to DC had resulted in less money being recoverable for the schemes in the subsequent liquidation than if BHS had entered insolvency at the time of the sale), it also considered that the test could be satisfied based on other, qualitative, factors, including that DC had:

- appointed persons with insufficient experience,
- failed to engage with the problems presented in a remotely timely or appropriate manner, and
- extracted value from the BHS business.

The amount of the CN was based on the amount "extracted" by DC from BHS, even though this fell short of the estimated detriment to the BHS Schemes. The amount extracted included:

- payments that were made, directly or indirectly, to DC, or which appeared to be for his or his family's benefit,
- payments to the directors of DC's company and BHS companies, and
- professional fees of £2.4m in respect of the sale. Although, in an ordinary commercial transaction, fees could have been met from the target company, there was never a realistic prospect that the post-sale BHS business would be sufficiently viable that the costs would be paid out of future profits.

On whether it was "reasonable" for the CNs to be issued, the Panel highlighted:

- DC's "reckless" approach to the transaction, which had taken place without adequate pensions due diligence,
- DC's failure properly to engage with the Schemes' trustees, and
- DC's pursuit of his aim to procure financial gain for himself and others with a reckless disregard for the position of the Schemes.

II. PPF Levy: Change in risk methodology spells bigger bills for bigger schemes

The Dun & Bradstreet (D&B) online portal for assessing employer insolvency risk is available via the PPF website. The PPF is encouraging employers and schemes to engage with their risk scores to ensure that any change is not due to incorrect information. Checking scores now will also enable schemes adversely affected by the PPF's proposed change in insolvency risk methodology to make their voices heard in the consultation, which concludes on 11 February.

The PPF has been consulting on revised methodology for calculating employer insolvency risk for the 2021/22 levy year following the appointment of D&B as insolvency risk provider in place of Experian.

The consultation reports that the current PPF scorecards are over or under-predicting the level of employer insolvencies. In particular Scorecard 1 (used for many of the largest employers) has been under-predicting insolvencies. Recalibration of the scorecards under the new methodology is likely to mean increased levies for larger employers, with corresponding decreases for some smaller entities and not-for-profits.

The first levy invoices to be calculated using the D&B methodology will be issued in Autumn 2020, based on insolvency risk scores from the **end of April 2020**.

III. RPI v CPI: Two cases and a Government consultation

Two recent cases illustrate the courts' reluctance - in the case of the two schemes in question - to allow flexibility to change the measure of inflation. The index that applies to pension increases and/or revaluation depends on the wording of the scheme rules.

At the same time, the UK Statistics' Authority proposal to align RPI with CPIH, a consultation which is expected to be published alongside the Budget on 11 March 2020, may have a significant impact on those schemes using RPI as a measure of inflation. Although any change is not expected to take place until 2025 at the earliest.

In *Britvic plc v Britvic Pensions Ltd* (17 January 2020), the High Court held that the scheme rule dealing with increases to DB pensions paid from the Britvic Pension Plan had to be interpreted so that members received an increase calculated by reference to RPI, with a discretion on the part of the principal employer to award a higher (but not lower) rate. The reference in the rules to "*or any other rate decided by the principal employer*" meant only some other **higher** rate.

In *Re Atos UK 2011 Pension Scheme*, the High Court decided that a definition of RPI in the scheme's 2011 rules should be construed as still referring to RPI. The Court rejected the employer's argument that, once it had become apparent that RPI was no longer an accurate measure of price inflation, the definition had to be interpreted as referring to another index.

The decisions confirm that whether scheme rules allow selection of an index other than RPI is a matter of construction of the wording and that each case depends on its facts. In both cases, the High Court took into account evidence of the history of the schemes.

IV. Future of trusteeship: gradual rather than dramatic change

TPR's response to its July, 2019 consultation on the future of trusteeship and governance reveals a number of smaller measures, but without the more dramatic steps some in the pensions industry had anticipated. There are plans for a new Code of Practice on TKU and minimum hours of trustee training, but there will be no requirement to report on diversity of the trustee body/board or to appoint a professional trustee, and it will continue to be permissible to have a sole trustee.

The consultation covered a wide variety of topics, including trustee knowledge and understanding (TKU), whether it should be mandatory to have a professional trustee, the possible prohibition of sole trustees, the diversity of trustee boards, and encouragement of the consolidation of DC schemes.

TKU: There will be no legislative change but tPR says it will review and update its Code of Practice to reflect changing expectations of trustees. It says that the updated Code will include an indicative number of hours of learning. Consultation on the revised Code is expected to be early 2021. In terms of demonstrating TKU compliance, tPR plans on running a "regulatory initiative", by which it will contact a large number of schemes about how TKU is assessed and engage with those that have not adequately addressed the risk of non-compliance.

Governance: There will be no requirement to report on diversity of trustee boards (although an industry working group will be set up to drive improvement in this area), nor will schemes have to have a professional trustee. Sole trustees will be permitted but remain a concern to tPR. An industry code will address this by providing best practice on sole trusteeship.

DC consolidation: There is little by way of further assistance to DC schemes, particularly those which provide a form of guarantee to members. No guidance is to be offered by tPR for those schemes looking to wind up with guarantees (although further DWP guidance is expected on this), and an option requiring Nest to take on schemes with guarantees was rejected.

V. Looking ahead

Charles Counsell, tPR's CEO, has revealed tPR's priorities for 2020:

- to publish its formal response to consultation on the **future of trusteeship and governance** (as covered in item IV above);
- to consult on a revised **DB Funding Code** in March 2020. The proposal is for employers to follow a "fast track" prescribed route or a more "bespoke" approach, with the latter subject to greater regulatory scrutiny. The first consultation in March will focus on funding principles, to be followed later in the year by consultation on the detail of the new Code; and
- to continue to work with other regulators on an authorisation and supervision framework for DB superfunds.

  This suggests that the proposed legislative framework for DB consolidators is some way off. We await the response to the 2018 consultation (which was expected last December) and note that there is nothing in the Pension Schemes Bill on the issue.

On the requirement, from October 2020, for trustees to produce an implementation report outlining how they have acted on the investment policies in their SIPs, Charles Counsell comments that: "*These statements are not mere tick box exercises – we expect trustees to provide us with details of how they have considered environmental and social governance*".

Separately, Guy Opperman, Pensions Minister, confirmed that the Government intends to release what he describes as "*game-changing*" guidance for pension schemes on climate-related disclosures in March. This follows the introduction in October 2019 of new ESG disclosure requirements.

Other developments in prospect are:

- the Budget on 11 March, where we may see proposals in relation to the annual allowance taper, to alleviate the impact on senior NHS practitioners, and the RPI consultation referred to above, and
- the supplemental decision in ***Lloyds***, on the impact of past transfers out on the duty to equalise benefits to reflect unequal GMPs, expected in late April/early May (although the judgment could be issued several months after that).

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