Sackers

Pensions & Investment Litigation Briefing

June 2020

Sackers' Pensions & Investment Litigation team reviews recent case law and developments, examining the practical lessons for trustees and employers

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Abbreviations

CDC: Collective Defined Contribution

CPI: Consumer Prices Index

DB: Defined Benefit

DC: Defined Contribution

ESG: Environmental, social and corporate governance

FCA: Financial Conduct Authority

ONS: Office for National Statistics

PPF: Pension Protection Fund

RPI: Retail Prices Index

SMPI: Statutory Money Purchase Illustration

TKU: Trustee Knowledge and Understanding

TPAS: The Pensions Advisory Service

TPO: The Pensions Ombudsman

TPR: The Pensions Regulator

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Overview

"These are extraordinary times. But, as ever, pension schemes need to balance an ability to react to change with maintaining a long-term view.

On page 3, we look at some of the developments over recent weeks in light of the pandemic. Its impact has been widespread and significant, presenting various challenges for trustees and employers, including in relation to members' benefits. Our recent Hot Topic set out some practical tips and reminders to help you manage the issues that may arise from a spike in member complaints.

Our April webinar looked at TPR's view of the future of pensions, and how it is planning to get there. The regulator has repeatedly declared itself "clearer, quicker and tougher", and is now set to have some even more stringent new powers at its disposal. What will this mean for both trustees and employers? We run through some of the key points made at our webinar on pages 4-5.

Finally, we review a pair of recent cases on the perennially hot topic of RPI-CPI, which focus on the legal ability to switch away from RPI when increasing pensions in payment – see pages 6-7."

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In this issue

Current climate round-up

Since mid-March, various pensions bodies have issued guidance, statements and blogs aimed at updating trustees, employers, administrators and members, and guiding them through the current crisis:

TPR suspension of some of its regulatory initiatives

TPR DB funding and investment guidance and DC investment guidance

TPR update on its approach to reporting duties and enforcement activity during the pandemic, with detail of regulatory easements

After announcing in March that it would be "focusing on existing enquiries and complaints only", TPO started to accept new applications again – online and by email only

Industry-wide scam warnings – see below

TPR guidance on member communications – see below

Communicating with members to prevent scams and rushed decisions

Repeated warnings have been made by various pensions bodies (including TPR, TPAS, the FCA, PPF and Government ministers) about the prevalence of scams during this period, and against members rushing financial decisions. Schemes have been urged to "exercise extreme caution" and to report concerns to ScamSmart.

In late April, TPR issued specific guidance addressing steps schemes should take in relation to communicating with members during these "uncertain times". It asks that "for the foreseeable future" a template letter (prepared jointly by TPR, the FCA and TPAS) should be sent to any DB members requesting a transfer to a DC arrangement, setting out points they should consider before making a decision and where they should go for impartial guidance.

In terms of DC investments and market volatility, TPR notes that falls in the markets and individual fund values may prompt members to switch investments (crystallising their losses), discourage them from saving, and make them especially vulnerable to scams that promise better returns. TPR again advises trustees to highlight certain points in any upcoming communication (such as an SMPI), including the need to think carefully and consider getting investment advice before switching funds in the current market.

The impact of COVID-19 on member complaints

Schemes' administration systems and turnaround times will be coming under scrutiny both during the pandemic and in its wake, for example in relation to transfers and benefit payments. Members will expect their schemes to have adapted to new guidance, technologies and processes, whilst remaining robust against scamming activity and protecting members' personal data. We are already seeing COVID-period complaints coming through.

TPR 2020 – webinar highlights

Whilst TPR has been dealing with business-as-unusual over recent weeks, schemes must still have an eye to maintaining compliance and managing risk generally. And in the current climate, it is vital that levels of governance do not slip. For example, when considering an employer request to defer deficit contributions, robust decision making and record keeping will be imperative.

In our April webinar, we looked at TPR's recent approach to supervision and enforcement, and shared our thinking on what might be expected in this new decade. We set out some of the highlights and key messages here.

Supervision and governance

What now?

The last two years have seen important work delivered by TPR in the governance arena, as it aims to drive up standards of trusteeship (both lay and professional) across all schemes, to target smaller schemes where they are perhaps less well engaged or under-resourced, and to encourage consolidation. Whilst aiming to be as clear as possible as to the standards it expects, it also acknowledges the need to balance member protection with employer sustainability.

A fundamental element of TPR's ongoing "21st century trusteeship" campaign targeted improved governance. Where schemes fail to meet their basic duties, TPR vows to take action. It looks for trustees to have the right levels of knowledge and understanding, with a balanced and diverse board that can understand and challenge advice, and has a clear decision-making process.

Schemes need to show they are getting the basics right – ensuring they are administered and managed in accordance with the rules and with the law. Can you demonstrate that the systems, practices and policies your scheme has in place achieve that?

And when dealing with TPR and its requests – whilst remaining alert to relevant time limits – keep in mind that complexities relating to legal privilege and commercial confidentiality may apply, and take advice.

What next?

- Responding to its consultation on the future of trusteeship and governance, TPR noted that it intends to update its Toolkit to clarify its expectations and to drive up standards of trusteeship.
- TPR hopes to consult specifically on revisions to its TKU code in the early part of 2021. However, its forthcoming single web-based code of practice will form the foundation for its TKU project. The new single code was expected to be published for consultation during the first half of this year, but as with many things, Coronavirus has meant a delay, with no revised date set yet.
- ESG-related amendments were made to the Pension Schemes Bill during the committee stages, and are due to apply to both DB and DC schemes, with the detail in regulations. Our ESG and climate change for pension funds briefing considers the proposals.

Scheme funding and enforcement

Although during the pandemic period TPR promises to be "reasonable, pragmatic and proportionate", its mantra of "clearer, quicker and tougher" has not been abandoned, as it continues to pledge to hold those who are "not meeting their obligations towards pensions savers" to account.

Numerous schemes are already under TPR's one-to-one supervision programme, based on their size, risk profile and previous engagements with the regulator. TPR's "harder" powers are also being exercised more frequently – we are seeing disclosure requests and improvement notices issued, and trustee suspension and prohibition powers used.

TPR's 2019 Annual DB Funding Statement set out the direction of travel, flagging the continued roll out of the "new regulatory model". This focused on the development of long-term funding targets (and associated journey plans); key risks and actions for schemes; and ensuring the equitable treatment of the scheme. The recent 2020 funding statement followed in the same vein – against the backdrop of the pandemic – having a firmer focus on collaboration between trustees and employers, with TPR clear on what it expects to see from schemes.

TPR's increasing supervision and enforcement is set to grow further over the next year or two.

- The new provisions in the Pension Schemes Bill (currently progressing through Parliament, but slowed by the pandemic) seek to reinforce TPR's message of the importance of clear and long-term plans for funding, with a raft of new powers for the regulator. Greater transparency of corporate events will also be required, and will be enforced against a backdrop of potentially onerous penalties and criminal offences. See our December Briefing for a summary of the proposed powers.
- TPR's forthcoming revised DB code is intended to address the new statutory funding requirements, as well as its evolving approach to regulating DB funding. As with other things, the deadline for responding to the first stage of the two-part consultation has been pushed back, and the second stage is now to be published next year. TPR does not expect the new code to come into force "until late 2021 at the earliest". Whether the pandemic will cause any reassessment of the messaging remains to be seen.

DC, including master trusts

No longer the "new kid on the block", DC schemes make up an increasingly large proportion of the UK's pension scene (with the rise of automatic enrolment, decline of DB, and the arrival of master trusts). It now accounts for over £100 billion of assets and approximately 35 million members. Increased regulation in this area can hardly be surprising then.

Key risk areas include governance (notably, chair's statements), communications (including on costs and charges), investment and administration (for example, core financial transactions) – essentially, operational concerns. DC regulation is a day-to-day issue.

In recent years, we have seen improvement notices used by TPR to address concerns with the systems and processes underpinning DC schemes, and penalties issued for governance failings. Master trusts, of course, have their own additional layers of legislative requirements, with CDC likely to follow this model when it finally arrives.

- In the near-term, the Pensions Schemes Bill is also set to bring in changes impacting DC schemes, including dashboard-related disclosure requirements and restrictions on the right to statutory transfers. As previously noted, it is also set to introduce powers requiring schemes to publish climate change related risk information and to ensure effective governance regarding the effects of climate change.
- And as DC membership numbers rise, in coming years there is only likely to be a sharper spotlight on the adequacy and performance of DC schemes from regulators, member pressure groups, and government initiatives. This could focus not only on the operation of such schemes, but also on investment options and, ultimately, the benefits that they provide to members in retirement.

RPI-CPI cases

A couple of recent High Court decisions have looked at the ever-hot topic of attempted moves between RPI and CPI – an area that leads to both conflict between trustees and employers, and to ongoing member complaints.

Ove Arup & Partners International Ltd vs Trustees of the Arup UK Pension Scheme

Background

In this case, the Court was asked to rule on the construction of an increase rule and, in particular, the scope to permit a move away from the use of RPI when increasing pensions in payment. Sackers acted for the trustees of the Arup UK Pension Scheme ("the Scheme").

The relevant rule read: "*If the composition of the Index* [defined in the rules as RPI] *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.*"

Judgment

Has RPI been replaced?

The short answer is no.

The employer argued that "functional replacement" (ie that CPI was now regarded as the main measure of consumer price inflation) was sufficient for RPI to be replaced within the meaning of the rule. However, the judge (Cooke HHJ) dismissed this, continuing the trend of cases that have resisted arguments to move away from RPI despite the widespread criticism of it as an index. RPI can only be replaced by the body responsible for its publication (currently, the ONS). In order to be replaced it must be discontinued by that body, and another index introduced or declared to operate in its place.

Effect of the change in the composition of RPI

The parties agreed that the adjustment made by the ONS in 2017 to the way in which housing costs were reflected in RPI was a change in the composition of RPI. The question was whether this change in composition "opened the gateway" and gave the trustees power to select an alternative index for increases.

The judge ruled that, whilst "change in the composition" should be interpreted widely, the provision was aimed at circumstances in which the trustees decided that a change in its composition meant that it would not be fair and reasonable to use the unadjusted increase in the relevant index over the reference period.

The judge found that it could not be a reasonable construction of the provision to conclude that a change in the composition opened the gateway to grant the trustees an unrestrained power to make any changes to calculation they saw fit. Furthermore, it did not give them the right to select an alternative index (it allowed adjustment, not replacement).

Timing of changes

The case also examined the "lookback" period for making adjustments to calculations. The judge ruled that the trustees had the power to make adjustments to take account of changes in the composition only since the most recent set of rules was introduced. In essence, the execution of a definitive deed resets the clock.

The Company has been granted permission to appeal.

RPI-CPI cases cont.

Carr v Thales Pension Trustees Ltd (High Court, 22 April 2020)

Background

In this case (not connected to the 2017 *Thales* case, which concerned different rules), Nugee J rejected an employer's appeal against an earlier TPO determination.

In December 2019, TPO had upheld a complaint by a pensioner member (Mr Carr) of the Thales UK Pension Scheme ("the Scheme") relating to the rate of increases to be applied to his pension in payment. Thales UK Ltd ("Thales"), the principal employer of the Scheme, appealed against the determination.

The relevant rule stated that pensions in payment would be increased annually by: "[Limb 1] *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* [Limb 2] *as specified by order under Section 2 of Schedule 3 of the Pension Schemes Act*".

When the rule was drafted in 2000, the relevant statutory order for the purpose of Limb 2 (our numbering) under the Pension Schemes Act 1993 ("PSA93") specified RPI. But in 2011 the two limbs of the rule became inconsistent, with the Government's move to CPI for indexation and revaluation purposes.

In 2016, on advice, the trustee moved to using CPI for increases with retrospective effect. Mr Carr complained to TPO, arguing that the rules hard-coded RPI. TPO upheld the complaint (in doing so, overturning an earlier adjudicator's decision), on the basis that the "ordinary and natural" meaning of the rule should mean the use of RPI.

Judgment

The High Court dismissed Thales' appeal.

Nugee J concluded that the difficulty in construction in this case was not caused by any ambiguity in the words used, as the rule was "perfectly comprehensible in itself". Rather that, since the Government's move to CPI in 2011, the two limbs of the rule were inconsistent. In order to resolve this inconsistency, Nugee J turned to construction.

Following *Barnardo's*, it was appropriate for the Court to give weight to textual analysis. The "natural and ordinary reading" of the rule gave "primacy" to Limb 1. Limb 1 was "detailed, clear, and unambiguous"; it was "complete by itself and [did] not need further exposition". Limb 2 was designed to describe an attribute of the rate in Limb 1 (ie that it would be specified in the appropriate revaluation order), and not "to set up a competing rival rate".

In Nugee's judgment, therefore, TPO "came to the right conclusion on the question of construction" and so the appeal was dismissed.

Summary

The cases again demonstrate that everything rests on the specific wording of a set of rules. Schemes with the same provisions can read the judgments across to their rules (subject to the any future appeals). However, they demonstrate the difficulties in attempting to move away from RPI.

Schemes considering such issues should take advice on the interpretation of their rules, and on the arguments that would be relevant, from a trustee or employer perspective, in considering how to approach changes in the composition of the RPI as an index. Whilst the precise rule that is being applied will vary, certain points of principle will apply across cases.

At the general level, these cases add to the body of case law which show the restrictive approach of the Court in attempting to move away from RPI in circumstances where the power to allow that is less than explicit. The Court has repeatedly stressed (in a number of cases) that RPI has not been replaced and anything less than discontinuance will not suffice. It seems unlikely that the tide will turn.

Contact

Our market leading Pensions & Investment Litigation team is consistently ranked in the top tier by both Chambers UK and the Legal 500. Our "respected team of pension litigators" (Chambers UK 2020) is experienced in handling cases before TPR, the High Court and TPO, and acts for both claimants and respondents in all forms of pensions and investment litigation.

Sackers is the UK's leading commercial law firm for pension scheme trustees, employers and providers. Over 60 lawyers focus on pensions and its related areas. For more information on any of the articles in this briefing, please get in touch with Peter or any of the team below, or your usual Sackers' contact.

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