Sackers

Pensions litigation briefing

December 2022

Sackers' pensions litigation team reviews recent case law and developments, examining the practical lessons for trustees and employers

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Abbreviations

CPI: Consumer Prices Index

CPIH: CPI including owner occupier's housing costs

DB: Defined benefit

DC: Defined contribution

GMP: Guaranteed minimum pensions

HMT: HM Treasury

PSIG: Pensions Scams Industry Group

RPI: Retail Prices Index

TPO: The Pensions Ombudsman

TPR: The Pensions Regulator

UKSA: UK Statistic's Authority

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Overview

"Welcome

What we've seen over recent months is turmoil, uncertainty and a financial squeeze, and we expect that this is likely to last for some time to come.

A key factor is a rate of inflation not seen for decades and indeed never experienced by some of our colleagues in their lifetime.

In this briefing we look at the impact of high inflation on member complaints and areas of scheme decision-making that could be challenged. We also look at a judicial review case which challenged the future change to align RPI with CPIH from 2030.

In what seems like the blink of an eye, we're also nearly a year into managing the new transfer conditions, which seem for the most part to have bedded in successfully to schemes' transfer processes. We use the anniversary as a timely reminder of transfer due diligence requirements and what points schemes can take away from a couple of TPO cases.

We kick off this briefing with a look at the work of TPO in the latest financial year and what he's seeing and saying about member complaints that have been addressed by his team. And there's a new Pensions Ombudsman to welcome and we're all keen to see how he picks up the baton when he starts in the role early next year.

Finally, seasons greeting to all and warmest wishes for 2023."

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In this issue

Pensions Ombudsman update

TPO published its annual report and account for 2021/22 back in July, with some interesting facts and figures.

The number of complaints received by TPO continues to increase, with over 6,000 complaints received over the 2021/22 year. This is a 18.3% increase in demand since 2018/19 and TPO expects this upward trend to continue over the next three years as people joining pension schemes through automatic enrolment become increasingly aware of pension issues.

What do the complaints relate to?

The top 10 issues complained about has remained the same for the last three years. However, the order has varied. For example, in 2021/22 TPO saw an increase in complaints about non-payment of contributions, which could be attributable to the "financial turbulence" as a result of the COVID-19 pandemic.

13.1%	11.0%	11.0%	10.8%	7.9%
transfers	retirement benefits	misquote/ misinformation	contributions	administration

Source: Subject matter of closed pension complaints (top 5), from The Pensions Ombudsman Annual Report and Account 2021-22

Outcome of TPO formal determinations

65%	17.5%	17.5%
not upheld	partially upheld	upheld

Source: The Pensions Ombudsman Annual Report and Account 2021-22

What's next for TPO?

TPO also published its Corporate Plan 2022-2025 over the summer. Key priorities over the next three years include:

- reducing "unacceptably long" waiting times
- continuing the "critical" work of the Pensions Dishonesty Unit (which investigates cases where there is alleged dishonesty by trustees), including securing funding for 2023/24 and 2024/25
- working with the industry to raise standards in dispute resolution.

All change at the top!

Dominic Harris has been confirmed as the new Pensions Ombudsman. He will take on the new appointment from 16 January 2023, replacing the current Pensions Ombudsman, Anthony Arter, who has been in place since May 2015. Anthony is not out of the action for long, as he's recently been appointed as a member of TPR's Determinations Panel.

High inflation: potential member complaints

Cost of living increases have reached levels unprecedented in recent history. The 12-month CPI rate has been 9% or above since April 2022. It reached just over 11% in October, estimated to be the highest figure since around 1981. High inflation has wide implications for pension schemes and, as is always the case when there is a decision to be made or discretion to consider, there is the potential for member complaints to arise.

Discretionary increases to pensions in payment

DB pensions usually increase annually at a level broadly in line with inflation, but the amount of increase is typically capped, and will often vary depending on when the benefit was accrued. When statutory minimum annual increases for pensions in payment were first introduced on 6 April 1997, they were based on inflation capped at 5%. And for benefits built up since 6 April 2009, increases are currently capped at 2.5%. Pensions in excess of GMP earned before April 1997 do not benefit from any statutory increases. Up until now, these caps have not generally gained much attention due to relatively low and consistent inflation.

Scheme rules can provide for pension increases in excess of the statutory minimum and will often contain powers to grant discretionary pension increases. Although the approach taken will vary on a scheme-by-scheme basis, in the current high inflation environment, employers and trustees may look (or be expected by members to look) at whether it would be appropriate to use these powers.

Lessons to learn from TPO

Although the current environment of high inflation is unusual in recent times, trustees have still had to consider whether to award discretionary increases on pensions in payment and some of those decisions have ended up with TPO.

Mr T (PO-17701)

Mr T complained that discretionary increases had not been applied to the pre-April 1997 element of his pension since 2009. The power to award discretionary increases was held jointly by the sponsoring employer and the trustees.

The sponsoring employer took into account a number of factors when considering whether to agree to any discretionary increases, including that the discretionary increases would only be provided to a limited number of members (ie those with benefits that built up prior to April 1997) and the financial impact the increases would have on the scheme, at a time when the scheme was in deficit.

TPO did not uphold Mr T's complaint, noting that the scheme was in deficit and that the employer's "first responsibility" is to reduce the deficit in order to provide security for the payment of the members' existing benefits. The employer, therefore, had not "erred in the exercise of its discretion" and the trustees had done nothing wrong.

Mr W T (PO-1203)

The facts in this case were similar to those of Mr T above – the sponsoring employer and trustees had a joint power to apply discretionary pension increases to pensions in relation to pensionable service before April 1997. These discretionary increases had been consistently given from 1988 to 2009 but the employer and trustees decided not to grant them in 2010. An affected member complained on various grounds, but the deputy TPO did not uphold the complaint, noting that:

- the fact that the benefit was granted in the past cannot on its own said to give rise to a future expectation
- the fact that the scheme had a significant deficit "cannot be ignored"
- even if the employer covenant is strong, that does not mean that the employer should commit a disproportionate amount of resources to the scheme – it will have many other financial commitments
- it is permissible for different groups of members to be subject to differing sets of rules covering the same period of accrual (eg in relation to pre-April 1997 service, one group having a right to a fixed increase and another group having discretionary increases only).

High inflation: potential member complaints cont.

Factors to consider when deciding whether to increase pensions

Taking account of the legal test, if trustees and employers are considering whether to exercise a power to increase pensions in payment, relevant factors to consider include:

- ✓ the scope of the relevant powers under the scheme rules, including who holds the power (employer, or trustees, or both) and any restrictions on its use
- ✓ any inflation protection provided under the scheme rules and legislation
- ✓ the scheme's current funding position, as well as the impact on that position and security of members' benefits as a whole
- ✓ whether additional contributions would be required to meet the cost of any increases, and
- ✓ the impact of cost of living rises on the scheme's particular membership.

Crystallising discretions in a buy-out – can a member complain?

In the current inflationary climate, members may be particularly sensitive about any changes, whether to their pensions or via appointments of external third parties. The recent experience of transfer values going down markedly during 2022 is an example where members have been suspicious of a new administrator or actuary looking to cut costs for commercial reasons.

A similar example arises with schemes which buy-out benefits with an insurer. In a buy-out, any pension increases will be crystallised in the contractual terms agreed with the insurer, ie with no power to grant discretionary pension increases.

Members whose benefits are bought out may consider their position is weakened if their scheme rules contained a power to grant discretionary increases. The loss of discretion could lead to members challenging the decision to buy-out. Pensioners may even consider that employers who are paternalistic, or who could afford to pay discretionary increases or, indeed, who may be likely to face political pressure to look after their pensioners in periods of high inflation, are a better bet against inflation when compared with the third party insurer.

While the prospects of a successful challenge to these sorts of decision is low, members may feel their employers and trustees are acting unfairly at a time when pensions are being squeezed and that more should be done to assist them during the current financial crisis. Class actions or multiple complaints can be time-consuming and disruptive for schemes, as well as reputationally damaging if enough affected pensioners look to mount a challenge.

Timing… is everything

This period of high inflation will have other implications for pension schemes. For example:

- in DB schemes, early retirement calculation methods may need to be reviewed more frequently to ensure they remain appropriate in a changing environment, and to ensure that trustees are complying with their legal (preservation) duties in relation to the value of "short service" benefits
- in DC schemes, trustees should consider how inflation levels impact on the performance of the default fund and any investment pathways offered, and whether any changes may be needed to the range of self-select funds.

In any situation where there is a change to benefits (whether early retirement factors, commutation factors or DC investment options), thought will be needed as to when and how to communicate this to members.

Inflation: changing the composition of RPI

The High Court has recently delivered its judgment in the application made to seek judicial review of the proposed change to how RPI is to be calculated. The proposed change to RPI came about as a result of HMT's and the UKSA's decision to change the methodology and data sources for calculating RPI by aligning these with CPIH with effect from 2030.

Why does this matter to pension schemes?

The parties seeking judicial review were the BT, Ford and Marks & Spencer pension schemes. Each is a large holder of index-linked gilts, the value of which would be impacted by the proposed change. Currently RPI produces an estimate of inflation about 1% higher than CPIH.

Lower expected returns due to RPI coming down would reduce the value of their assets.

The impact of the long term reduction of 1% in RPI from 2030 onwards was said to be around £90 billion – £100 billion.

At an individual member level, it was also estimated that lower RPI would reduce payments amounting to around 4% – 9% of their lifetime benefits, with women experiencing a greater reduction on average due to longer average life expectancy.

What else is RPI used for?

RPI is used for a wide variety of social and economic purposes in addition to providing index-linked gilts and pensions. There were always going to be winners and losers from the change. Other uses include:

- annual increases to train fares and utility charges
- annual adjustments of tax thresholds
- interest rates on student loans.

What did the Court decide?

The Court rejected the claim for judicial review. It found that the UKSA has the authority to amend RPI in the way envisaged and had properly assessed the rationale for the change, ie maintaining RPI's statistical quality and its fitness for purpose to be used as an index for measuring inflation.

In addition, HMT had followed a proper process of consideration and consultation when making its decisions, both to allow the change from 2030 and also for deciding not to compensate holders of index-linked gilts. The Judge also commented that the fact that no change would be permitted until 2030 was in fact favourable to holders.

The Court finally held that RPI will still continue to be published and so selecting an alternative index to pay interest to index-linked gilt holders would be unnecessary.

What does the decision mean?

The pension schemes have not sought to appeal the decision and the time limit for anyone else to challenge the decision has expired.

Politically or economically speaking, there remains the possibility that the proposed change may be further amended or even shelved between now and 2030. However, given the general acceptance of the need to change the methodology and data sources for calculating RPI, it seems most likely that RPI will now align with CPIH with effect from 2030.

However, the current turmoil and unpredictability in the markets could create some impetus for further lobbying. And what the future will actually hold for the rate or make-up of CPIH will be of much interest and source for debate in times to come – but that's a debate for another day!

Transfers regime: one year on

Regulations came into force on 30 November 2021, which introduced significant changes to the statutory transfer regime, with the aim of empowering trustees to stop suspicious transfers.

We are now nearly a year on, with well-oiled processes now in place to reflect the new regime. However, there are a couple of areas in particular where the policy intent has not necessarily been clearly reflected in the wording of the legislation. Trustees have been grappling with how to meet their legal obligations whilst also ensuring that they are processing transfers in a timely manner.

Whilst TPO is yet to make a formal determination in respect of the new regime, he's considered several recently under the old regime. We take a high level look at a couple of these determinations and what trustees can take away from them.

Mr R (PO-28951)

Mr R transferred from his personal pension scheme with ReAssure to the Optimum Retirement Benefits Plan in July 2016. Mr R was concerned that his assets may be lost due to fraud and complained about the level of due diligence carried out in respect of his transfer.

TPO did not uphold Mr R's complaint, noting that matters "cannot be viewed with the benefit of hindsight" and that it "is the circumstances at the time of the transfer" that are key. In this case, ReAssure acted in line with the PSIG's 2015 publication "Combating Pensions Scams – a Code of Good Practice" that was in force at the time of the transfer. As such, although it has since transpired that the transfers were not in Mr R's best interests, ReAssure didn't fail in its due diligence obligations at the time of the transfer.

Mr S (PO-11134)

TPO directed the Ministry of Defence ("MoD") to reinstate Mr S as a member of the Armed Forces Pension Scheme ("AFPS"), as it found that Mr S did not have a statutory right to transfer, which MoD would have identified had it undertaken adequate checks.

Since, on the facts of the case, he had no statutory right to transfer and as the AFPS did not have the facility under its rules to make a discretionary transfer payment upon Mr S's request, the payment of the transfer value was void.

This determination serves as a timely reminder that TPO expects administrators to update their processes promptly to reflect any change in industry guidance or legislation. This is generally within one month but "each case will be assessed on its own merits".

Key takeaway

Trustees should liaise with their administrators to ensure their processes are regularly reviewed and updated to reflect both legislative changes and changes in best practice.

What complaints are schemes seeing in practice?

We are seeing a variety of member complaints relating to transfers. The key complaints we see cropping up include those in relation to:

- delays to transfer due to audit checks on questionnaires
- the large amount of paperwork required to transfer
- perceived slow and clunky processes (generally from members looking to consolidate multiple pension pots, who can compare different schemes / administrators' processes)
- whether a red or amber flag exists or not (eg is a cash-back offer an incentive to a transfer request?)
- whether trustees should allow a discretionary transfer to be granted to avoid the alleged rigidity of legislative processes.

Contact

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