BE PREPARED: PENSION TRUSTEE ACTION PLAN FOR 2014

December 2013

Business planning is becoming more important than ever for pension plan trustees. In addition to standing agenda items, there are many new issues that will demand commitment of extra time and/or resources in the coming year. We highlight our "top ten" below, to help trustees plan for 2014.

1. DC or Not DC? That is the Question!

The new definition of money purchase benefits in the Pensions Act 2011 is scheduled to come into force on 6 April 2014 and will have retrospective effect from 1 January 1997. The new definition was introduced following the Supreme Court decision in *Bridge Trustees*[1]. In brief, the new definition provides that benefits will only be money purchase in nature if they are calculated solely by reference to the assets, meaning that the assets must always suffice to meet the liabilities. Many pension plan benefits that have previously been administered on the basis that they are money purchase may no longer fit the new definition (for example, where there is a guaranteed rate of return on investments or where money purchase benefits are converted into a scheme pension).

The retrospective nature of the change will cause particular problems for many pension plans including those that are in the process of winding-up. Following consultation, the Government will decide on the extent to which trustees and employers will be expected to unravel past actions and decisions in a number of specific areas including: winding up; employer debt; revaluation; indexation; the calculation of cash transfers; the Pension Protection Fund (including payment of the PPF levy, eligibility for PPF compensation, and valuations); and scheme funding.

Action will be needed where benefits (including benefits from Additional Voluntary Contribution arrangements) are affected by the new definition. Trustees should take legal advice to ascertain the effect on their pension plan.

1 *Houldsworth and another v Bridge Trustees Ltd and another*, 2011.

2. State Pension Reform – Understanding the Consequences

The Pensions Bill 2013/14 provides for the introduction of the single-tier state pension from 6 April 2016, the consequential abolition of contracting-out on the reference scheme test basis and an acceleration of the increase in state pension age (amongst many other things).

Many defined benefit pension plans are designed to integrate with state pension provision. Changes to the state pension system have a knock-on effect on the pension plan and these issues need to be identified and their impact assessed.

Some defined benefit pension plans provide a "bridging pension" to give a higher pension until the time members' state pensions are expected to come into payment, and a reduced amount thereafter, to achieve a more even level of pension income throughout retirement. Depending on the precise wording of the pension plan's rules, the increase in state pension age may mean that the bridging pension is paid for longer (creating an additional liability) or it may reduce before the member's state pension comes into payment (resulting in an unexpected drop in income for the member). It may be possible for the trustees to amend the rules but the options available will vary for each pension plan.

Trustees should assess the impact of state pension reform on their pension plan. Where the rules provide a bridging pension trustees are encouraged to seek legal advice on their options, as current and future bridging pensions may be impacted.

3. Pensions Liberation – Don't Get Stung!

Pensions liberation has plagued trustees in 2013. The requirement to act in the best interests of the beneficiaries does not sit comfortably with the duty to process a member's statutory transfer request, where liberation activity is suspected.

Material issued to date by the Pensions Regulator and HMRC can be described as "helpful" but does not provide trustees with a complete solution. Expect more developments in 2014 (including Pensions Ombudsman determinations that are likely to add a new dimension to the on-going saga).

Trustees need to be aware of the risks associated with processing, not processing, or delaying, member transfers. Trustees should ensure that their transfer procedures would stand up to scrutiny from the Pensions Regulator, the Pensions Ombudsman and the courts. Trustees should also be alert to developments that may influence their decisions on transfers and should take legal advice where liberation is suspected.

4. DC Compliance – the 31 Steps

We have witnessed an unprecedented amount of DC activity over the course of the last year, including work by the Association of British Insurers in the contract based arena and the market study on workplace DC arrangements undertaken by the Office of Fair Trading. It is now politically necessary (as well as generally desirable) for the Government to set high standards for DC pension provision, bearing in mind that most automatic enrolment solutions will be DC based.

Against this backdrop, the Pensions Regulator's Code of Practice on the governance and administration of occupational trust based DC pension plans came into force on 21 November 2013, and new guidance material was issued on the same date. All pension plans with a DC element are covered by the regulatory material including Additional Voluntary Contribution arrangements and the DC elements of hybrid plans.

The Regulator says that: "while trustees need to be familiar with the DC Code as a whole, we suggest they work through each section systematically". This is likely to require additional time and resources in 2014.

Trustees should assess how their DC arrangements (including Additional Voluntary Contribution plans) comply with the 31 quality features in the DC Code. We recommend that an action plan is put in place as soon as possible.

5. GMPs – Some Benefits Are More Equal Than Others

In April 2013 the Department for Work and Pensions issued its interim response to the consultation issued in January 2012 on equalising scheme benefits for the effect of Guaranteed Minimum Pensions arising from contracted-out membership between 17 May 1990 and 5 April 1997. It was announced that the regulations would be temporarily delayed, but the Government's position regarding the requirement to equalise is unchanged: "The Government is in no doubt that the draft regulations merely reflect the outcome of recent judgements in European case law, and will be laid in the future."

The DWP's draft equalisation methodology issued in January 2012 was widely criticised and this will not proceed to a final version. The DWP has taken time to consider other suggestions put forward as part of the consultation response and we anticipate the next instalment early in 2014.

Equalising for the effect of GMPs is an outstanding issue for many DB pension plans due to the lack of certainty on how to progress. However, trustees should prepare themselves to take action in the coming year.

6. Disclosure – Made Simples![2]

The Disclosure of Information Regulations are being updated with effect from 6 April 2014. The requirements for occupational pension plans and personal pension plans have been harmonised and brought together under a single statutory instrument.

Most of the changes are optional – for example, trustees will be able to simplify some of the information that is provided to new members (if they wish), and trustees of DC plans can amend the assumptions used in statutory money purchase illustrations to make these more relevant to member circumstances.

However, it will be compulsory for trustees of DC pension plans to provide specific information to members who are, or will be, invested in "lifestyling" funds. This should be built into the information supplied to new and prospective members. Existing members should be given this information when the regulations come into force, unless it has been previously supplied. There is also a requirement to provide lifestyling information within 5-15 years of a member's target retirement date.

Trustees of pension plans that offer lifestyling should check whether the information given to new and existing members satisfies the new disclosure requirements applying from 6 April 2014. Trustees should consider the content and timing of the information that is to be provided to members within 5-15 years of their target retirement date.

7. Refunds – Going… Going… (Not Quite) Gone…

In 2011, the DWP announced its intention to abolish short service refunds of contributions from DC trust based arrangements, as this works against the Government's efforts to encourage the accumulation of pensions savings.

The Pensions Bill 2013/14 provides that refunds will be abolished for members with more than 30 days of qualifying service and this will apply to individuals who join a pension plan after the date that the legislation comes into force. The Pensions Minister previously stated that this provision would come into force from April 2014; although this implementation date has not been confirmed.

Trustees of pension plans that were contracted out on the protected rights basis before April 2012 may still be grappling with the complexities of refunding former protected rights pension pots. We had hoped that this issue would be clarified during 2013… and we will keep this hope alive in 2014…

Trustees of DC plans should be prepared to make changes to administrative procedures and new member communications if it is confirmed that short service refunds will be abolished in April 2014. Trustees who are considering extinguishing former protected rights entitlements by paying a refund of contributions should take legal advice.

8. Same Sex Marriages – Uncertainty Remains

The Marriage (Same Sex Couples) Act 2013 received Royal Assent on 17 July 2013, with the Government predicting that the first same sex wedding could take place "by as early as Summer 2014".

From a pensions perspective, spouses in same sex marriages will be treated the same as civil partners as regards survivors' benefits. As such, occupational pension plans will be allowed to rely on an exemption in the Equality Act 2010 to restrict the survivors' benefits provided to spouses in same sex marriages to periods of service from 5 December 2005 (although different rules apply in respect of contracted-out benefits). Trustees should note that this exemption has been subject to recent legal challenge.

The Act requires the Secretary of State to review differences in the survivors' benefits provided by occupational pension plans for opposite and same sex spouses/civil partners. A report on the outcome of the review must be published before 1 July 2014 and may lead to changes to the exemption referred to above.

Trustees should understand the survivors' benefits provided by their pension plan. Where different survivor benefits are provided for opposite and same sex spouses/civil partners, trustees should be aware of recent challenges and the forthcoming review. Questions around survivors' entitlements should be handled with care.

---

2 Please forgive our grammatical inaccuracy – we like the meerkat advertisements!

9. Personal Data Security Breaches – Avoiding Them!

Trustees and their service providers deal with substantial amounts of personal member data. The Information Commissioner's Office (ICO) has made it clear, in public statements and in the sanctions it imposes, that it regards data security breaches as extremely serious. The sanctions that the ICO can impose include substantial monetary penalties or requiring formal undertakings, both of which it publicises under its "name and shame" policy. These penalties have also been imposed where the breach was by the data controller's contractor and could increase significantly if draft European legislation comes into force.

As data controllers, trustees need to check their own security measures, especially if they or their employees are allowed to access data using their own laptop or other devices. Trustees should make sure that their security measures keep pace with fast moving technology and changes in working practices. Unless properly secured, such data access can be the weak link in the trustees' security defences.

Also, trustees are required by the Data Protection Act, whenever they appoint "processors", to do upfront and on-going checks into the security measures their processors take, and to incorporate into their written contracts commitments to comply with those measures. Some security measures, such as encryption of the hard drives of laptops, are mandatory. If trustees fail to take the appropriate measures and a data breach occurs, the trustees will be liable, both to affected individuals and to the ICO, and may well not be able to recover their losses from their processors.

The ICO has recently changed its guidance, stating that professional service providers who are required to act in accordance with externally imposed standards should be treated as joint data controllers with the trustees. This is definitely the case for actuaries, and may well apply to at least some of the services of auditors.

Trustees should:

- *review their own security measures including any access permitted via private devices, to check they meet the ICO's standards*
- *review the security measures of their service providers and the provisions of the agreements with them, to check that they meet the ICO's standards*
- *strengthen any measures/agreements that fall short of the ICO's standards*
- *revise agreements with actuaries to reflect their joint data controller status*

It is also vital to be able to respond swiftly to data breaches – trustees should have processes in place.

10. Trustee Training – Keep up to Speed

We have witnessed many pensions developments in 2013 and we anticipate many more in 2014; it would therefore be remiss of us to end this list without mentioning the importance for all trustees to remain up to date on the issues that may impact on their pension plan. The Pensions Regulator's online trustee toolkit provides essential learning but, in our view, trustees should not underestimate the value of roundtable discussions, training and workshops that are tailored for their pension plan.

Trustees who want to demonstrate their level of knowledge may wish to consider sitting the PMI's Award in Pension Trusteeship (DB/DC or DC only). We are the only law firm recognised by the PMI for our APT revision and exam course.

Trustees should also ensure that developments affecting their pension plan are assessed as part of their risk management process.

Ensure that sufficient time is allocated to consideration of current issues at trustee meetings. Consider individual and group training needs in the light of recent and future pensions developments. Always consider the impact of developments from a risk management perspective and update the risk register.

Quick Fire Round-up…

…of other issues for 2014 not covered in our top ten.

- As highlighted in the recent decision in the Court of Appeal involving *Olympic Airlines*[3], foreign liquidation does not count as a qualifying insolvency event for the purposes of the PPF entry regulations. *Trustees of DB pension plans with overseas sponsoring employers should be alert to this potential exposure.*
- The Pensions Regulator's new statutory objective: "to minimise any adverse impact on the sustainable growth of an employer" when exercising its scheme funding duties, is scheduled to come into force in 2014, as is the new "funding defined benefits" Code of Practice. *Trustees undergoing actuarial valuations should be aware of the Regulator's stance on scheme funding.*
- The debate is still ongoing on the extent to which pension plans can reclaim VAT on investment management services. *Trustees who are unsure about the position for their pension plan are advised to discuss this with their investment manager or legal adviser.*
- There will be a flurry of automatic enrolment activity as the new duties apply to medium-sized employers and some smaller employers in 2014, creating a potential "capacity crunch". *Trustees should be prepared to engage with employers.*
- The Lifetime Allowance will reduce to £1.25 million from tax year 2014/15 and the Annual Allowance (AA) will reduce from £50,000 to £40,000. The reduction in the AA will lead to an increase in the number of pension savings statements that need to be provided automatically and an increase in "scheme pays" applications in due course. *Trustees to note this and ensure that procedures are in place.*

3 *Olympic Airlines SA Pension & Life Assurance Scheme v Olympic Airlines SA, 2013.*

- During 2014 we are expecting more details on:
  - Automatic transfers.
  - The abolition of DB contracting-out.
  - Defined ambition pensions.
  - European legislative proposals on governance, transparency and reporting requirements.
  - Potential issues around Scottish independence.
  - PPF levy rules applying for the 3 years from 2015/16.
  - The impact of the PPF's future change of insolvency provider from D&B to Experian.
  - The future shape of the DC market! Lots more to come following the recommendations from the Office of Fair Trading and the DWP's call for evidence on quality standards in DC workplace pensions.

Trustees should keep up to date on the issues that are of relevance to their pension plan.

Further Information

Please contact any of the partners listed below or your usual contact in the Pensions Practice Group for more information on any of the subjects covered in this communication.

Catherine McKenna
Partner, Leeds
T +44 113 284 7045
E catherine.mckenna@squiresanders.com

Anthea Whitton
Partner, Leeds
T +44 113 284 7364
E anthea.whitton@squiresanders.com

Wendy Hunter
Partner, London
T +44 20 7655 1119
E wendy.hunter@squiresanders.com

Matthew Giles
Partner, Birmingham
T +44 121 222 3296
E matthew.giles@squiresanders.com

Charmian Johnson
Partner, Manchester
T +44 161 830 5047
E charmian.johnson@squiresanders.com

11628/12/13