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UK: PENSIONS UPDATE – DECEMBER 2020

1. LLOYD'S – PAST TRANSFERS TO BE REVISITED

The Lloyds[1] judgment on revisiting transfers-out for GMP equalisation was handed down recently. This was a follow-on from the judgment in October 2018 (which confirmed schemes have to equalise benefits for the effects of GMPs[2]) and specifically looked at (i) whether the equalisation obligation applies in relation to past transfers-out; and (ii) if so, what this looks like and whether there are any time limitations which apply.

Some key points to note:

Statutory transfers	It's clear from the judgment that there is, in principle, an obligation for statutory transfers (i.e. those implemented in exercise of a member's statutory CETV right), to revisit and pay a top-up payment (to include interest) to the receiving scheme. However, there remains a question mark over how proactive trustees need to be in doing this.
Non-statutory transfers	For non-statutory transfers (i.e. transfers under the scheme rules which weren't in exercise of a member's statutory CETV right), whether or not the need to revisit and pay a top-up arises, in principle, will depend to some extent on the wording of the scheme's transfer rule(s) pursuant to which those transfers were made.
'Mirror-image' bulk transfers	For "mirror-image" bulk transfers (where the rights of the members under the receiving scheme are the same as the rights under the transferring scheme) it was agreed that these transfers were valid and effective and no further top-up payments fell to be made.

Key issues

1. Lloyds - past transfers to be revisited
2. Pension Schemes Bill 2019-21 Progresses
3. CJEU gives United Biscuits judgment
4. Mandatory climate-related disclosures within 5 years
5. General Levy consultation
6. PPF Consultation & Response: new levy rules for 2021/22
7. TPR publishes superfund guidance
8. Encouraging member engagement with Pension Wise
9. Receipt of personal data from the EU
10. ESMA publishes second report on pension scheme clearing solutions
11. CMA compliance statement submission
12. Government response to consultation on retained EU case law
13. PAC & Rothesay insurance business transfer
14. On the horizon

[1] Lloyds Banking Group Pensions Trustees Limited v Lloyds Bank plc & ors [2020] EWCh 3135 (Ch)

[2] See our UK Pensions Update: Special Edition (October 2018): High Court Confirms Schemes Must Equalise GMPs

What is the obligation?	The obligation is to make a top-up payment to the receiving scheme, which should include a sum representing interest on the shortfall over the period from the original payment date to the date the shortfall is made good at 1% above base rate.
How far back should trustees go?	The judge concluded that the 6 year limitation under the Limitation Act 1980 doesn't apply here and while it would still be worth checking specific scheme rules on the point, most are likely to have standard limitation wording and so are unlikely to provide help on this point.

In terms of next steps, it's unlikely that there will be a change of direction following Brexit since the judge's focus was on domestic rather than EU law. However, it is not yet known whether this judgment finally closes the chapter on the long-running GMP equalisation case, or whether there could be an appeal or further supplementary hearings ahead (noting that there were a couple of points which the judge left unanswered e.g. exactly what should happen where the transferring member is no longer a beneficiary of the receiving scheme e.g. because they have made an onward transfer-out).

2. PENSION SCHEMES BILL 2019-21 PROGRESSES

The Pension Schemes Bill 2019-21 (the **Bill**) had its report stage and third reading in the House of Commons on 16 November 2020. The Bill will now return to the House of Lords for consideration, although a date has yet to be set. There have not been any significant amendments to the Bill as part of its passage through Parliament.

However, the Pensions Regulator (**TPR**) has confirmed that the criminal offences in the Bill are not intended to work retrospectively, and are to catch behaviour which occurs after the Bill comes into force (this will hopefully be confirmed when the regulations to be made under the Bill are provided). TPR's guidance on the criminal offences setting out how it expects to use its new powers (and consultation on such guidance) is now not expected until after the Bill gains Royal Assent.

3. CJEU GIVES UNITED BISCUITS JUDGMENT

The Court of Justice of the European Union (**CJEU**) has handed down its judgment in the case of United Biscuits (Pension Trustees) Limited v Commissioners for HMRC regarding whether trustees of occupational pension schemes that use third party investment management companies to administer their pension schemes must pay value added tax (VAT) on the service or are exempt under Article 135(1)(a) of Council Directive 2006/1121EC (the VAT Directive).

The CJEU ruled that Article 135(1)(a) of the VAT Directive on the common system of value added tax must be interpreted as meaning that investment fund management services supplied for an occupational pension scheme, which do not provide any indemnity from risk, cannot be classified as 'insurance transactions', within the meaning of that provision, and thus do not fall within the VAT exemption laid down in that provision in favour of such transactions. The case will now return to the Court of Appeal.

4. MANDATORY CLIMATE-RELATED FINANCIAL DISCLOSURES WITHIN 5 YEARS

On 9 November 2020 HM Treasury published an interim report on, and accompanying roadmap for, achieving mandatory climate-related financial disclosure requirements across a range of organisations (including occupational and personal pension schemes) over the next 5 years (with a significant portion of mandatory requirements to be in place within the next 3 years).

For occupational pension schemes, the roadmap summarises the requirements and timelines consulted on by the DWP between August and October 2020 (see our UK: Pensions Update – September 2020 for further details) which proposes to introduce new regulations to require trustees to assess and report on the financial risks of climate change within their investment portfolios. There is no suggestion in the roadmap that disclosure obligations beyond those consulted on by the DWP would apply to occupational pension schemes.

For FCA-regulated personal pension providers, asset managers and life insurers, the interim report says that the FCA is developing detailed policy proposals for consultation anticipated in the first half of next year. The intention is for the FCA to finalise rules by the end of 2021, with a phased implementation starting with the largest firms initially (e.g. life insurers and pension providers with policy asset values in excess of £25 billion) in 2022.

5. GENERAL LEVY CONSULTATION

On 16 December 2020, the DWP published its consultation paper of its annual review of the general levy (**General Levy**) on pension schemes which closes on 27 January 2021. The purpose of the consultation is to seek views on options for change to the structure and rates of the General Levy from April 2021, 2022 and 2023.

As reported in our UK: Pensions Update - January 2020 and UK: Pensions Update - March 2020, the DWP consulted on changes to the General Levy at the beginning of the year and amendment regulations were laid in February 2020 that would have increased the levy rates by 10% from 1 April 2020 to begin to address a levy deficit that had accumulated. However, as a result of the COVID-19 pandemic these regulations were subsequently revoked as the DWP decided that the increase in the levy rates should not proceed.

The current consultation estimates that if levy rates were to remain unchanged, there would be a deficit of around £230m at the end of 2023/24. The DWP is therefore broadly proposing three options to resolve the deficit and align funding/expenditure going forwards:

1.	**Increasing levy rates and introducing separate levy rates for Defined Benefit, Defined Contribution, Master Trust and Personal Pension Schemes**: • For DB and DC schemes: 10% increase for 2021/22; and • For Master Trusts and Personal Pensions schemes: 5% increase for 2021/22. Higher increases would apply for 2022/23 and 2023/24 in accordance with a table appended to the consultation and the proposal is to set the levy rates for periods of three years in future.
2.	**Increasing levy rates and introducing a separate lower set of levy rates for Master Trusts**: Allowing the levy rates for Master Trusts to be increased by a different percentage than for other occupational pensions schemes recognises that Master Trusts are separately authorised and subject to other fees. The proposed rates are appended to the consultation.
3.	**Retaining existing levy structure and increase rates:** This is clearly not an attractive option for the DWP given the anticipated continued growth of the levy deficit.

6. PPF CONSULTATION & RESPONSE: NEW LEVY RULES FOR 2021/22

On 29 September 2020, the Pension Protection Fund (**PPF**) launched its consultation on the draft 2021/2022 levy rules and was quick to communicate that given its strong financial position at the start of the COVID-19 pandemic, it is expecting to collect £100m less in 2021/22 than for 2020/21. The consultation closed on 24 November 2020 and on 15 December 2020 the PPF published a statement confirming its response to the consultation and the key changes as being:

To adjust the levy for small schemes	Schemes with less than £20m in liabilities will have their levy halved (a factor of 0.5 will be applied to their uncapped calculation). The reduction will also be tapered so that only schemes with £50m or more in liabilities will be charged in full.
To amend the cap on the levy	The risk-based levy cap will be reduced from 0.5% of a scheme's unstressed liabilities to 0.25%.
Insolvency risk measure	The PPF will continue to measure insolvency risk on the basis in use since April 2020, using credit ratings and the PPF specific insolvency risk model operated by Dun & Bradstreet (D&B).

The PPF states that it will also confirm the levy estimate of £520 million for 2021/22 and that the levy scaling factor of 0.48 will be retained.

In light of the challenges posed by the COVID-19 pandemic, the above changes are proposed for 2021/2022 only, and for the next few years levy policy will be set annually (rather than triennially as has previously been the case). Only limited changes are proposed to the methodology for calculating scheme levies for 2021/2022.

The consultation also considered whether there would be merit in extending the PPF's payment plan flexibility announced earlier in the summer to cover the 2021/22 levy. This flexibility was introduced in response to the pandemic to allow schemes/employers affected by COVID-19 to request an extension to payment terms for the levy the PPF has been invoicing this autumn (the 2020/21 levy) and, if approved, the PPF waives any interest charges that would normally have accrued due to late payment for up to 90 days. In this regard the response states that the PPF will keep monitoring the impact of COVID-19 on schemes and sponsors, and respond flexibly to any issues that arise.

The final rules will be published in January 2021 and the PPF will also publish a policy statement summarising the responses it received, and its conclusions.

7. TPR PUBLISHES SUPERFUND GUIDANCE

TPR has published new guidance on superfunds for trustees and sponsoring employers of defined benefit (**DB**) pension schemes considering transferring to a DB superfund. The guidance is supplemental to its interim regime published in June (see our UK: Pensions Update – June 2020 for further details) and TPR intends to provide further guidance as the market evolves and to add a list of superfund providers online once the superfund has demonstrated that it meets the expectations.

The guidance reiterates many of the points made by the interim regime, but focusses on aspects such as TPR's expectations around clearance and the due diligence trustees should undertake when deciding whether a transfer to a superfund is appropriate. Some key points include:

Type A Event/ Clearance	• Transfer to a superfund would be a Type A event and employers should apply for clearance (allowing at least 3 months for this process and longer where the superfund is not already approved). • TPR will assess whether the detriment caused by the removal of the ceding employer is mitigated by the transfer to the superfund. Where clearance is given, the transaction should normally take place within 3 months of the clearance statement being issued. • Clearance may not be appropriate in cases where a scheme is in PPF assessment.
Due Diligence	• Trustees should demonstrate they have also considered past significant corporate activity for any material detriment e.g. past M&A activity, bank refinances as well as a review of any recent significant value extraction from the employer by the wider group or shareholders. If any detriment or value extraction is identified, trustees should consider whether the superfund transfer will mitigate it or whether alternative steps might be appropriate. • The nature and level of such due diligence will clearly vary depending on the scale of the scheme, and requirements for the transfer. It is a matter for trustees, with input from their advisers, to make a judgement on.
Gateway Principles	Transfer to a superfund should only be considered if: • a scheme cannot afford a buy-out now; • a scheme has no realistic prospect of buy-out in the foreseeable future, given potential employer cash contributions and the insolvency risk of the employer; and

	• the chosen superfund improves the likelihood of members receiving full benefits.
Role of the Employer	• Employers will need to ensure the trustees have all they need, including the necessary time, resources and information (e.g. access to senior management/business forecasts etc) to consider a transfer and should pay for their professional advice.
Capital Adequacy	Superfunds themselves will have to demonstrate that they will continue to meet TPR's expectations regarding capital adequacy.

8. ENCOURAGING MEMBER ENGAGEMENT WITH PENSION WISE

The DWP has published a statement setting out its intention to legislate for trustees to give members a "stronger nudge" to the pensions guidance made available by Pension Wise when accessing their pension through the pension freedoms. The intention is to require trustees to take proactive steps to facilitate appointments for members and to present taking guidance as a natural part of the process of accessing pension savings. The statement comes following a trial during which members were encouraged to use Pension Wise as a natural part of their retirement journey, resulting in an increased take up of the service to help individuals make an informed choice about their retirement income.

As a result, the Government will commence section 19 of the Financial Guidance and Claims Act 2018 (not yet in force) which will require the DWP to make regulations requiring trustees of occupational schemes to:

- refer members/beneficiaries to appropriate pensions guidance (and explain the nature and purpose of the guidance) when they make an application to draw or transfer flexible benefits; and

- ensure the member/beneficiary has either received the guidance or opted-out of receiving it before proceeding with the application.

The DWP says it will consult on the draft regulations and it is expected that TPR will provide supporting guidance. The Financial Conduct Authority (FCA) will consult on and make equivalent rules for contract-based schemes.

9. RECEIPT OF PERSONAL DATA FROM THE EU

The government has published guidance relating to transfers of personal data after the transitional period. The guidance states that it may be necessary for UK organisations to put in place Standard Contractual Clauses (**SCCs**) in order to be able to receive personal data from the EU after the transitional period, albeit the government is "*confident that adequacy decisions can be concluded by the end of the transition period*" (i.e. such that SCCs/an alternative mechanism wouldn't be necessary). We understand that some organisations are instituting SCCs to address this potential issue (e.g. on an intra-group basis, or in relation to new or renewed agreements with service providers and other third parties), given the industry expectation that an adequacy decision does not come in time.

In practice, this is unlikely to be an issue for UK pension schemes since the position for outward transfers will not be affected (i.e. transfers to administrators/other service providers who process personal data on EU servers), but it will impact schemes that receive personal data from the EU (although we would expect this to be minimal).

10 ESMA PUBLISHES SECOND REPORT ON PENSION SCHEME CLEARING SOLUTIONS

On 17 December 2020, the European Securities and Markets Authority (**ESMA**) published its second report (to input into the Commission's own report) assessing whether any viable solutions have been developed for pension scheme arrangements (**PSAs**) in the context of the expiry of the exemption available to PSAs to clear over-the-

counter derivatives under the European Market Infrastructure Regulation and the regulations extending that exemption.[3]

In short, the report finds that it is clear at this stage that there is no "silver bullet" solution and that in practice it may be that refinement of existing solutions is where we end up. The report highlights ESMA's strong support for the broad adoption of the clearing obligation, including for PSAs, and states that feedback is that a majority of PSAs do in practice want a central clearing solution. However, ESMA acknowledges the difficulty for PSAs in meeting the cash margins required to meet the clearing obligations given the make-up of their investments and low cash allocations. The report concludes that the additional efforts needed to develop and implement the various solutions that would collectively enable PSAs to clear their derivative contracts may still require additional time.

11 CMA COMPLIANCE STATEMENT SUBMISSION

As reported in the March 2019 and June 2019 editions of our UK: Pensions Update, the Competition Market Authority's (**CMA**) Investment Consultancy and Fiduciary Management Market Investigation Order 2019 (**the Order**) imposes certain obligations on occupational pension scheme trustees regarding reviewing/monitoring the performance of their investment consultants and requiring a competitive tendering process to be run for certain fiduciary management appointments.

One such obligation is to submit an annual compliance statement setting out the ways in which the relevant provisions of the Order have been complied with. While the intention had been to bring the monitoring of the CMA regime within TPR's remit (which would also see this reporting requirement converted into a TPR notification) due to current parliamentary pressures the regulations to do so are not expected to be finalised until next year. As such, by 7 January 2021, trustees will need to submit and certify a compliance statement confirming that they have complied in all material respects with the requirements of the Order and reasonably expect to continue to do so. Non-compliance must similarly be reported to the CMA within 14 days of becoming aware of the failure.

12. DEPARTURE FROM EU CASE LAW

As reported in our UK: Pensions Update – September 2020, over the summer the Government consulted on the departure from retained EU case law by UK Courts and tribunals. The Government's consultation response was published in October 2020. The outcome is that:

- Power to depart from retained EU case law will extend beyond the UK Supreme Court to the Court of Appeal (and equivalent courts across the UK).
- The test to be used by these courts in deciding whether to depart from retained EU case law will be the same test as the UK Supreme Court uses in deciding whether to depart from its own case law i.e. that it will treat former decisions of the UK Supreme Court as normally binding, but that it will depart from a previous decision "*when it appears right to do so*".
- The existing rules of precedent will apply (i.e. where the UK Supreme Court has already considered the question of whether to depart from retained EU case law, lower courts will be bound by this).
- Regulations will be considered and debated by Parliament with a view to come into effect at the end of the transition period.

13. PAC & ROTHESAY INSURANCE BUSINESS TRANSFER

As reported in our UK: Pensions Update - September 2020, in August 2019, the High Court[4] refused to sanction an insurance business transfer scheme under Part 7 of the Financial Services and Markets Act 2000 that involved the transfer of a £12 billion portfolio of individual and bulk annuity policies from The Prudential Assurance Company Limited (**PAC**) to Rothesay Life PLC (**Rothesay**). On 2 December 2020, the Court of Appeal allowed PAC and

[3] See our UK: Pensions Update – June 2020 for background.

[4] Re Prudential Assurance Company Ltd [2019] EWHC 2245 (Ch).

Rothesay's appeal of the High Court's decision and there will now be a further hearing at the High Court to decide whether the proposed transfer should be approved (no date has yet been set).

14. ON THE HORIZON

Brexit

There will not be any immediate changes following the end of the transition period which runs to 31 December 2020 albeit there is scope for divergence if the UK does not in the future follow EU pension initiatives. UK courts will not be bound by decisions of the EU made after expiry of the transition period, but "*may have regard*" to those decisions "*so far as relevant to any matter before the court*" and the power to depart from retained EU case law will extend beyond the UK Supreme Court to the Court of Appeal (and equivalent courts across the UK). It remains to be seen in practice to what extent the English courts will follow/apply post-Brexit decisions of the EU that develop new pensions law principles post-Brexit.

COVID-19

COVID-19 continues to impact businesses and pension schemes and present challenges for all parties. While it is hoped that circumstances will return to a stronger sense of normal by Spring 2021, there is no certainty and it is hoped that TPR, the PPF, other regulators and the Government will operate pragmatically and sympathetically as the pandemic continues.

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