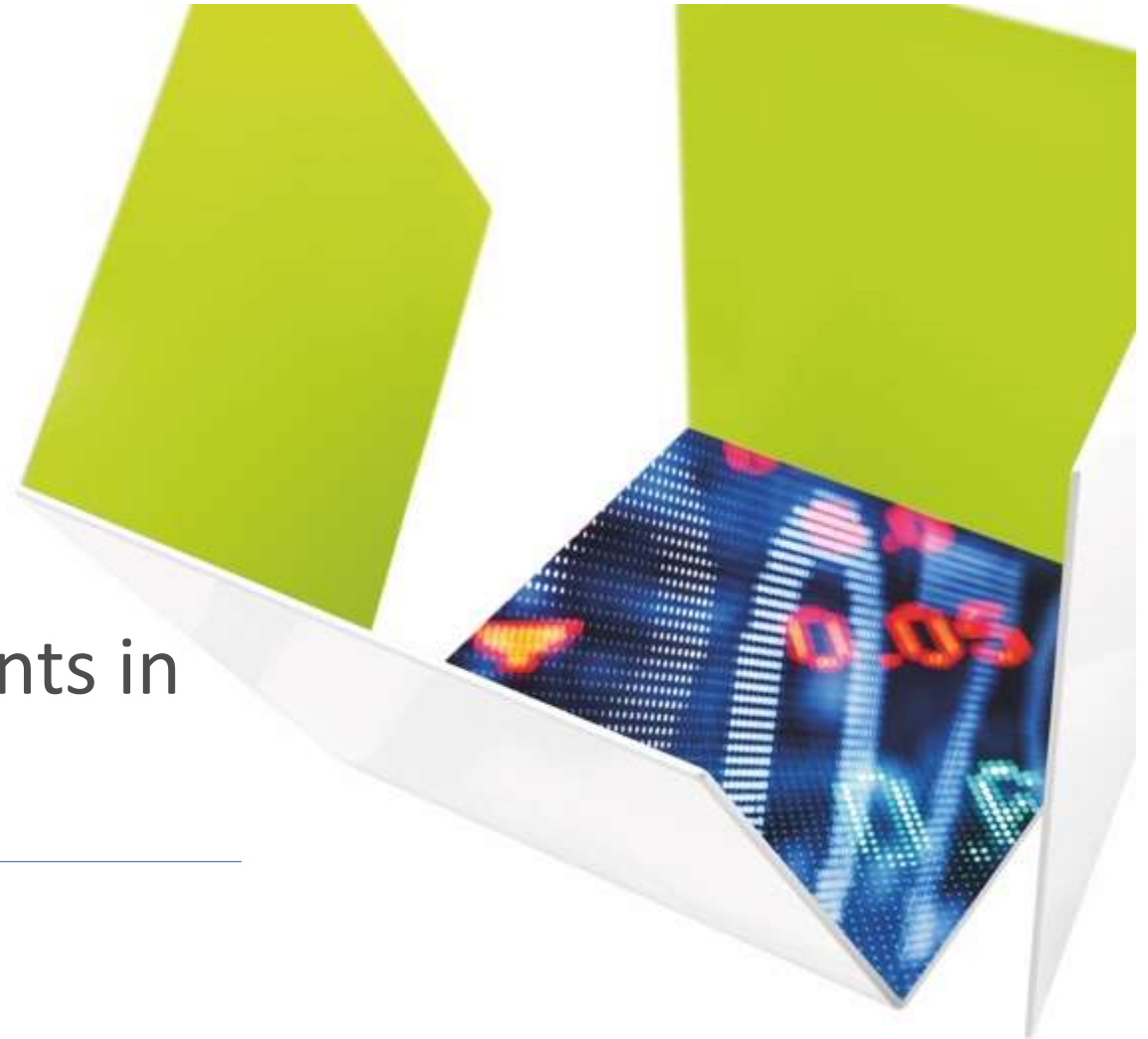


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Recent developments in pensions

Hogan Lovells Pensions Team

12 February 2021



Where are we with GMP equalisation



Duncan Buchanan
Partner, London
Pensions

Reminder

- Lloyds Bank #1 October 2018 (need to equalise benefits to correct for GMPs)
- Lloyds Bank #2 December 2018 clarifying original judgment
- Lloyds Bank #3 Judgment in November 2020:
 - Contracted out schemes that paid transfers out may owe a top up payment plus interest
 - No time limits and discharges ineffective
 - Top up payment can be paid to receiving scheme or to member/another scheme
 - Parties already accepted the Lloyds Bank schemes had a “Coloroll” obligation as the receiving scheme (no argument advanced in Lloyds)
 - Bulk transfers and non statutory transfers different treatment to CETVs

Position for transferring schemes

- Legal position for transferring scheme clear but significant practical and data issues (judge recognised admin cost could be higher than payment).
- However judge said:

"...the Trustee does need to be proactive in that it must consider the rights and obligations which I have identified, the remedies available to members and the absence of a time bar and then determine what to do."
- What might we see in practice – how active and de minimis
- Does a lack of time limit help or hinder trustees

What about receiving schemes

- Not covered in detail in Lloyds#3
- Defined contribution/ money purchase schemes left hanging
- Uncertainty in reconciling Coloroll vs Lloyds#2
- GMP Equalisation Group scratching heads and preparing guidance

What does Coloroll require?

European Court ruling 1993 – transfers were a small part of the case:

*"In the event of the transfer of pension rights from one occupational scheme to another **owing to a worker's change of job**, the second scheme is obliged, on the worker reaching retirement age, **to increase the benefits it undertook to pay him when accepting the transfer** so as to eliminate the effects,... of the **inadequacy of the capital transferred**, ...due .. to the discriminatory treatment suffered under the first scheme, and it must do so in relation to benefits payable in respect of periods of service subsequent to 17 May 1990."*

What does Lloyds#2 require?

"In principle, the Trustee's obligation to equalise benefits for the effect of unequal GMP applies to benefits accrued on a contracted-out salary-related basis in other schemes during the Barber window which have been transferred into any of the Schemes;"

Example in practice (lawyers numbers)

- Member joined Scheme B in 2002 (so no GMP)
- 2003 receipt of transfer value £40,000 from Scheme A (COSR)
- Member granted 4 year service credit in Scheme B (£333 post 88 GMP and £1000 excess – salary £20,000)
- Member left in 2013 final salary £50,000 (4 years £3333 pa inc GMP £492)
- 2022 scheme approached by Scheme A – offered top up payment £2,500 (£2,000 @2002)
- What should Scheme B do?

A Coloroll only approach

- Scheme B knows that there was “inadequacy” in original transfer £2,000
- How does Scheme B correct inadequacy:
 1. Uplift the original 4 year service credit (42,000/40,000)
 2. Award what £42,000 would buy for member assuming opposite sex GMP (could be less than 4 years)
 3. Convert £2,500 into additional pension (current CETV basis)
 4. Provide defined contribution benefit of £2,500 (concerns re DC governance issues)
 5. Refuse to accept top up payment (admin costs) – consider that inequality of transfer cured by top up payment paid elsewhere (so Coloroll solved)

A Lloyds only approach

- At date of leaving (2013) member's pension 1990/97 was £3,333 pa (inc post 88 GMP of £492)
- Opposite sex (female) comparator at 2013 pension £3,333 (inc GMP of, say, £550)
- Apply B/C2 to benefit when in payment or do D2 conversion to benefit granted

This equalises the benefits Scheme B agreed to provide in return for the initial transfer received of £40,000

A combined Coloroll/Lloyds approach

A potential approach might be:

1. Equalise the original service credit granted (to comply with Lloyds) as part of overall GMP equalisation exercise (say in 2022)
2. If subsequently approached to accept top up payment decide:
 - Reject top up payment (so Coloroll inequality dealt with outside receiving scheme)
 - Accept top up payment but make no change to the benefit provided (what about disadvantaged on transfer in but advantaged in service credit granted?)
 - Accept top up payment and provide additional benefits equal to:
 - The value of top up payment (excluding interest) @ date of original transfer in
 - The current value of top up payment @ date of receipt
 - The amount by which value of top up exceeds cost of equalising original service credit

Conclusion

- Administration costs will be a significant factor in decision making
- May well see schemes adopt “de-minimis” limits for top ups
- Will an “industry standard” approach emerge

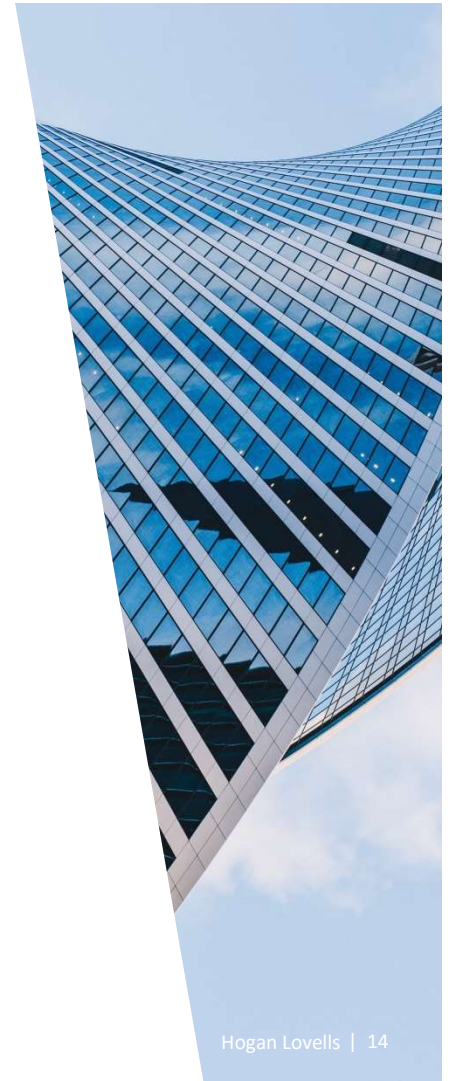
Climate change: draft regulation and guidance



Faye Jarvis
Partner, London
Pensions

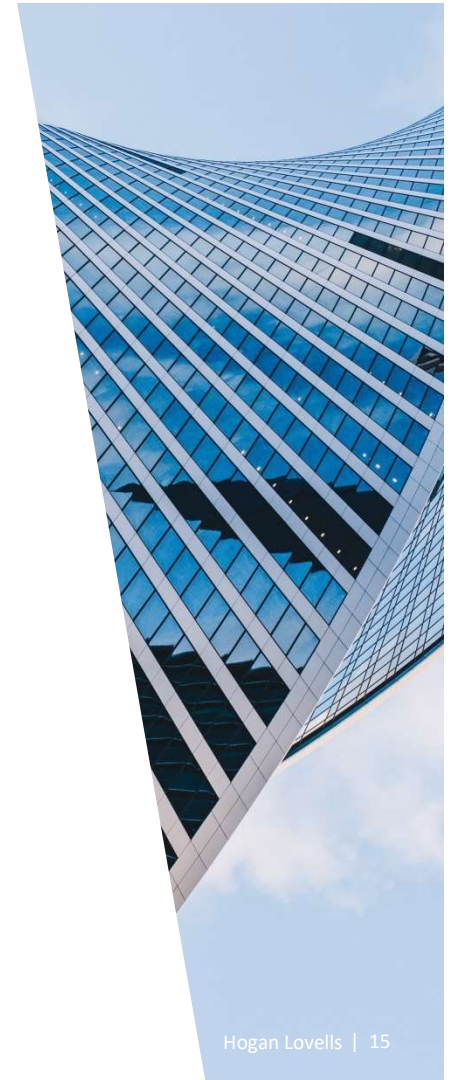
Trustee's fiduciary duty – investments

- *Three core duties:*
 - *Exercise investment powers for their proper purpose*
 - *Take account of material financial factors*
 - *Act in accordance with the “prudent person” principle*
- *New requirements in the Pension Schemes Bill on climate change do not change these duties*
 - *Requirements should therefore always be considered in the context of these duties*



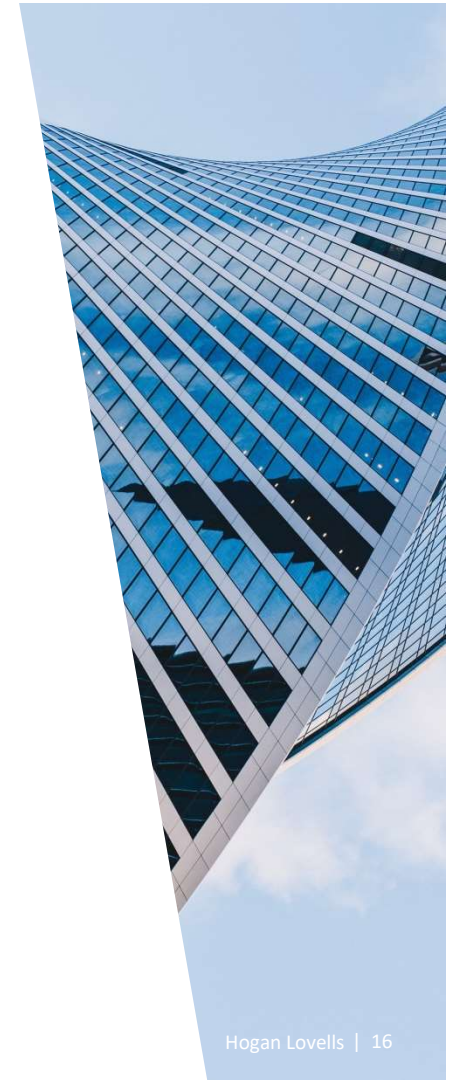
New legislation on climate change risk

- New provision introduced into Pension Schemes Bill requiring trustees to secure effective governance of the scheme with respect to the effects of climate change, in particular:
 - Risks from steps being taken by governments and others
 - Opportunities relating to climate change
- Government currently consulting on regulations & statutory guidance which give more detail on new requirements
 - Consultation ends on 10 March 2021
- Investment decisions remain with trustees and no expectation that trustees must invest / disinvest in particular way



Scope and timing

- From 1 October 2021 (or, if later, date on which audited accounts obtained for year ending on/after 1 March 2020) apply to:
 - master trusts
 - collective money purchase schemes
 - schemes with \geq £5 bn assets
- From 1 October 2022 (or, if later, date on which audited accounts obtained for year ending on/after 1 March 2021) apply to schemes with \geq £1 bn assets
- Review in 2023 whether rollout to all OPSs



Example: scheme year end 31 May, more than £5bn assets

31 May 2020 (first year end after 1 March 2020): relevant assets at least £5bn

31 December 2021: deadline for audited accounts to 31 May 2021

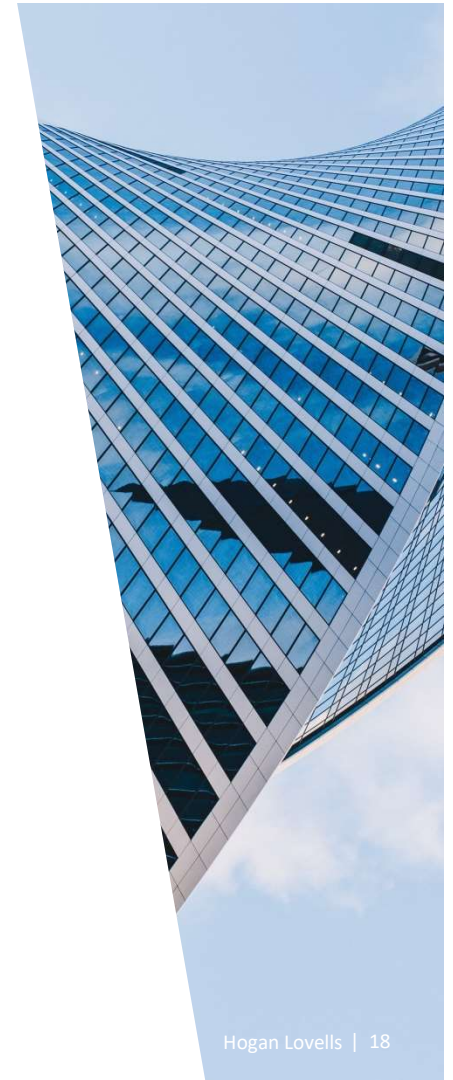
1 October 2021 (or date audited accounts obtained, if later): governance and TKU requirements apply

31 December 2022: deadline for TCFD report for year to 31 May 2022 (and for audited accounts)



DWP consultation: Governance

- Trustees will be required to:
 - Understand the principles relating to identification, management and assessment of climate change risk and opportunities
 - Have oversight, on an ongoing basis, of climate risks and opportunities
 - Put in place processes to satisfy themselves that persons undertaking governance activities (other than trustees) are taking steps to identify assess and manage climate related risks and opportunities
 - Report on the role of those persons and the processes the Trustees have put in place
- Who might be undertaking governance activities in relation to the Scheme?
 - Investment consultants ✓
 - Covenant advisers ✓
 - Legal advisers X
 - Asset managers X
 - Actuarial advisers ?

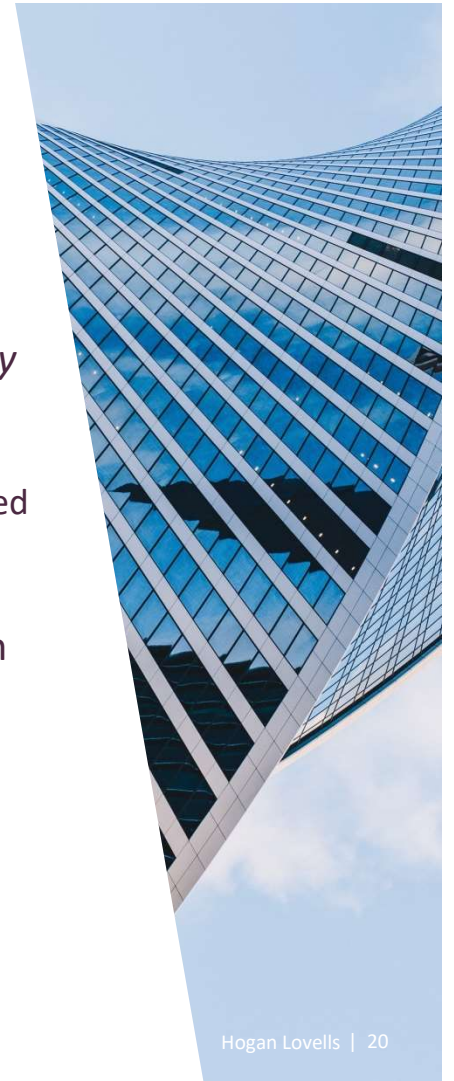


DWP consultation: 5 key requirements

- 1. Strategy:** identify and assess on ongoing basis climate-related risks and opportunities which will affect investment (and funding if DB) strategy over short, medium and long term
- 2. Scenario analysis:** analyse at least two climate-related scenarios in 1st year and then every 3 years, with annual review in intervening years
- 3. Risk management:** adopt and maintain, on ongoing basis, processes for identifying, assessing and managing climate-related risks and integrate within overall risk management
- 4. Metrics minimum:**
 - Two emissions-based metrics (one absolute measure of emissions and one intensity based measure of emissions) and one additional climate related metric
 - Obtain data and calculate metrics as far as are able on annual basis
- 5. Targets:** Set at least one target for one of the chosen metrics and report annually

DWP consultation: other points of note

- For a number of the new requirements, Trustees must comply “*as far as they are able*”, which means:
 - Take all such steps as reasonable and proportionate in the particular circumstances taking into account costs which will be incurred and time required to be spent
- Trustees expected to have regard to statutory guidance and if diverging from it, explain why
- Government recognises there will be issues initially with obtaining data
 - FCA will consult on rules for climate related financial disclosures for asset managers in 2021



DWP consultation: disclosure and compliance

- Publish TCFD report on own or scheme sponsor's website
- Reference TCFD report in annual report and accounts
- Notify members of TCFD report via annual benefit statement or annual funding statement
- tPR scheme return to include link to TCFD report, SIP and implementation statement
- Mandatory penalty for complete failure to publish a TCFD report (min £2,500)
- Other penalties subject to tPR discretion

PCRIG – non-statutory guidance on climate related risk

- **Investment beliefs:** focus Trustees' investment and decision making and make it more effective. Integrate climate change into these beliefs
- **Setting scheme investment strategy:** consider how different investments and investment strategies could be affected by a transition to a low carbon economy
- **Build into selection, review and monitoring of managers and advisers:** set objectives on factoring in climate related risk into their advice and consider climate competence when carrying out reviews
- **Approach to Stewardship:** where delegated consider manager's policies and ensure approach is in line with Trustees' climate related investment beliefs
- **Assessing impact on covenant:** consider risks of climate change on employer covenant and ensure building climate related risks into IRM approach



Recent Pensions Ombudsman determinations



Beth Sheehan
Senior Associate, London
Pensions



Jade Rigby
Associate, London
Pensions

Re Prudential Assurance Company, Re Rothesay Life

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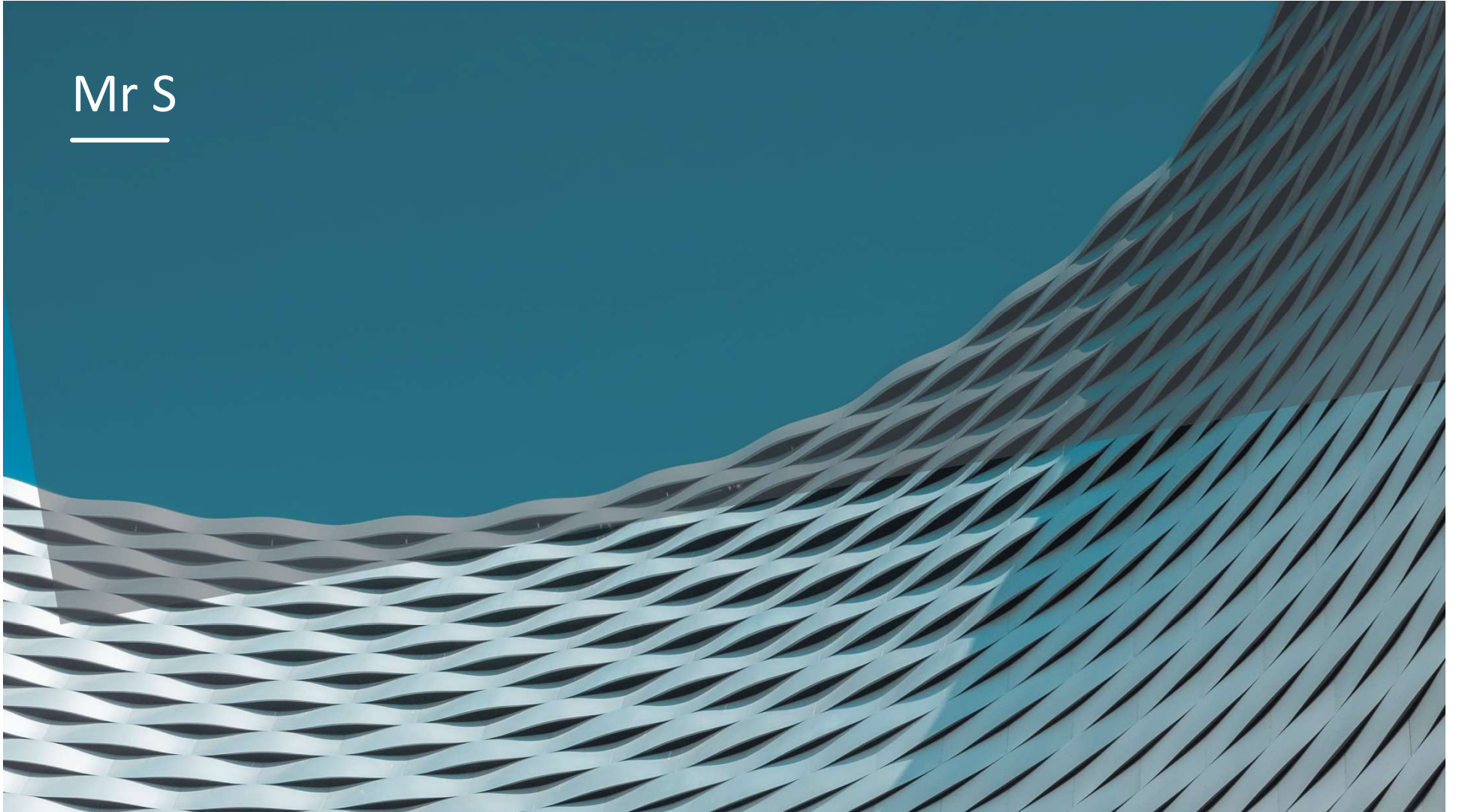
Re Prudential Assurance Company, Re Rothesay Life

- Application to sanction transfer of £12bn annuity business under Part VII FSMA
 - Considered by FCA and PRA – no objections
 - Independent expert – Solvency II metrics of insurers “comparable” and likelihood of failure of either insurer remote
- High Court (August 2019) refused to sanction
 - Balance between interests of policyholders and commercial parties
 - Relevant to consider impact on policyholders of non-consensual change of provider
 - Policyholders had chosen Prudential for its venerability and reputation
 - PAC potentially more support from corporate group

PAC / Rothesay Life: Court of Appeal (December 2020)

- Court's paramount concern: would transfer have any material adverse effect on receipt by policyholders of their annuities
- HC judge had erred in approach to discretion:
 - Once Solvency II requirements met, likelihood of non-contractual parent support not a relevant factor
 - Failed to give adequate weight to: independent expert's opinion; no objection from FCA/PRA; future regulation of Rothesay Life
 - No weight should be given to policyholders' representations on reputation or assumption of remaining with same provider
- Allowed appeal and remitted application to High Court for consideration by different judge

Mr S



Mr S: Background

- Mr S employed by BA plc
- Member of New Airways Pension Scheme
- Absent from flying duties on grounds of ill health since April 2016



Mr S: Background

Rule 14 of Scheme rules dealt with ill health pensions:

“(a) If a Member’s employment with a Participating Employer is terminated before Normal Retirement Age by that Employer on the grounds of Medical Incapacity and the Principal Company so notifies the Management Trustees, the Member is entitled to an immediate yearly pension...”

“(b) ... If before Normal Retirement Age a Pilot or Officer:

(i) no longer holds an appropriate licence;

(ii) has lost that licence for medical reasons;

(iii) in the opinion of the Principal Company’s medical adviser will not recover for the foreseeable future;

his contract of employment will be terminated by the Participating Employer on the grounds of Medical Incapacity and the Principal Company will notify the Trustees accordingly.”

Mr S: Background

- Rule 14(e): “*Medical Incapacity*” is incapacity:
 - from which the individual is unlikely to recover for the foreseeable future; and
 - which prevents the individual from carrying out his normal duties even after reasonable adjustment
- Guidance between BA and BAHS:
 - Unlikely to recover in foreseeable future
 - BA and Trustees have agreed “foreseeable future” means two years

Timeline of events



Diagnosis of
general anxiety
disorder by Dr
Arkell

April 2016

BA authorise ill
health early
retirement
pension

4 August
2017

Dr Caddis
concludes
criteria not met

October
2017



Dr Emslie reviews
Dr Caddis' opinion

July 2017

BA confirms it
will terminate
employment
due to medical
incapacity

21 August
2017



Mr S attends
appointment
with Dr Caddis



Mr S obtains
opinions
from Dr
Arkell and Dr
Chapman

November
2017

Ill health early
retirement
pension
payments
stopped

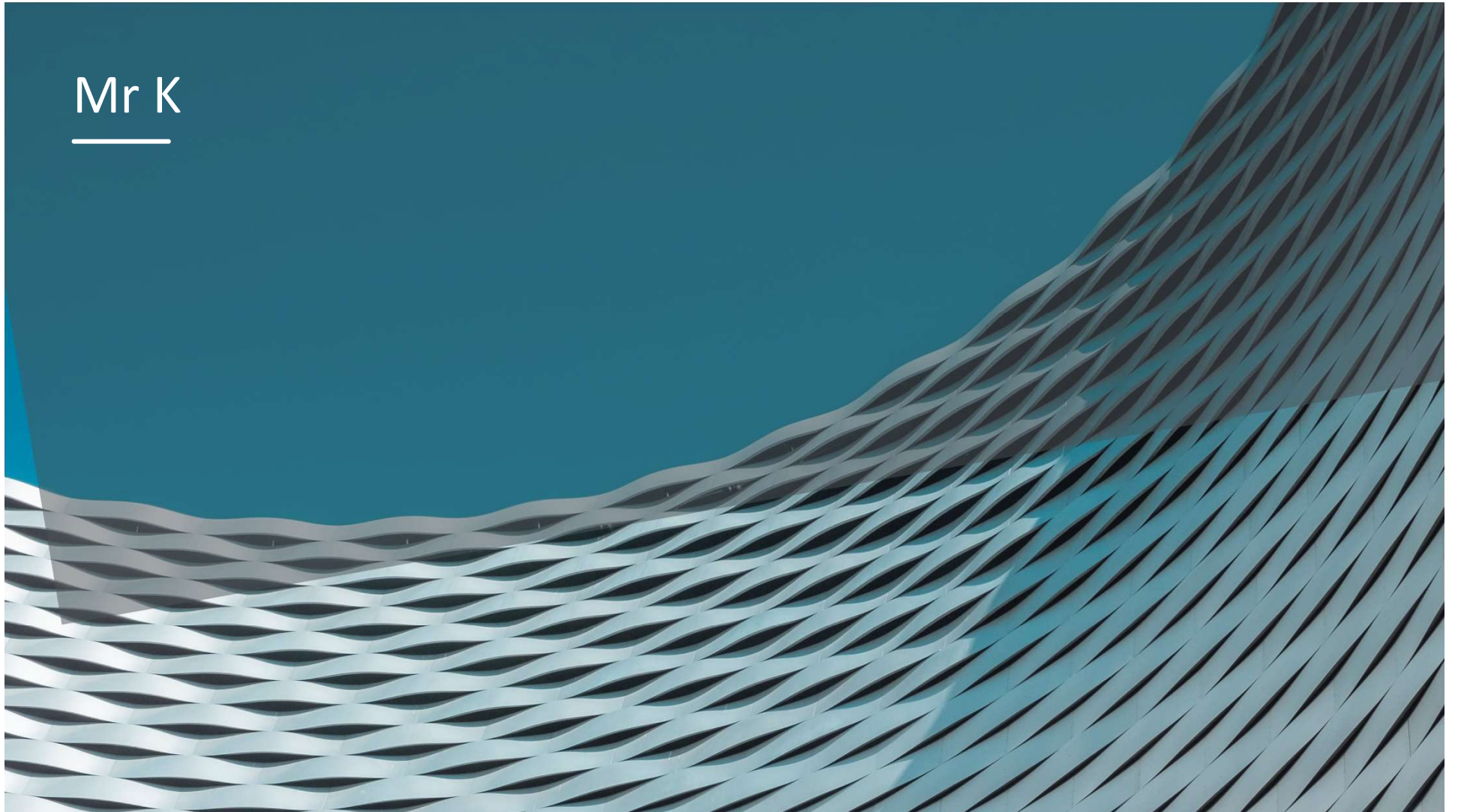
Pensions Ombudsman

- Main question under Rule 14: Was BAHS of opinion Mr S was likely to recover sufficiently to return flying within foreseeable future
- In coming to an opinion, BAHS expected to consider case in a proper manner
- Duty to consider all relevant information and ignore all irrelevant information
- Dr Caddis had not reached decision in proper manner
- Dr Caddis' opinion differed significantly from opinions expressed by Mr S' own physicians
– PO expected Dr Caddis to provide a clear explanation as to why his opinion differed
- Reports prepared by Dr Caddis and Dr Emslie “confusing and contradictory”
- BAHS failed to act in a proper manner during decision making process by proceeding to final decision without asking for further clarification

Pensions Ombudsman decision

- Upheld Mr S' complaint
- Maladministration by BAHS
- Mr S' eligibility for a pension under Rule 14 not correctly determined
- BAHS to:
 - Obtain additional evidence from Dr Arkell and Dr Chapman regarding treatment options at time Mr S' employment terminated
 - Reconsider Mr S' application for ill-health retirement
 - Pay Mr S £500 for significant distress and inconvenience

Mr K



Key Facts

- 3 August 2001: Pension (including GMP element) came into payment
- 1 April 2002: 1st pension increase
"The first such increase shall ... be deemed to have been made on 1st April 1979 except that if the pension has been in payment for less than 12 months the first increase shall be reduced proportionately."
- 2015: HMRC changed Mr K's state pension following a revaluation of his GMP entitlement from the Plan. Mr K queried how the pension increase was pro-rated. Trustee determined on the basis of completed month
- Mr K complained:
 - this ignored 29 days of payment; and
 - Discriminated against members depending on when they were born, in breach of the Equality Act 2010
- Trustee:
 - The Equality Act 2010 did not apply as Mr K's pension was not a protected characteristic
 - "Proportionately" was not defined in the Plan rules, but the calculation adopted was common practice in private sector occupational pension schemes and the Trustee had the power to determine matters of doubts
- September 2019: Trustee discovered an error and recalculated Mr K's benefits. Offered him an award of £500 in recognition of the distress and inconvenience caused

Mr K's arguments

- The 1989 and 1997 deeds were invalid:
 - introduced retrospective changes; and
 - the trustees had failed to adhere to notification requirements
- A mathematical approach should be adopted when calculating what was 'proportionate'
- A 'complete months' approach led to a systematic underpayment of pensions

Trustee's arguments

- Although the deeds could not have retrospective effect, this did not in itself invalidate the deeds since they were still applicable to new joiners of the Plan and for existing members' benefits after the date of the 1997 amendment
- The Trustee had sent a letter setting out the amendments at a high level in March 1996
- Using complete months was common industry practice at the time and in line with language used in statute

PO Determination

- Validity of the deeds:
 - 1996 letter gave notice of the main amendments
 - Even if the letter did not cover everything it should have done, the trustee's non-compliance with the notification requirement did not necessarily invalidate the amendments to the Plan rules since they were separate matters
 - The 1997 deed was valid for new joiners and existing members in respect of their future pensionable service
 - 1989 trust deed remained valid, irrespective of the retrospective clauses, because the statutory restrictions in section 67 of the PA 1995 were not in place at the time
- Matters of doubt
 - The Trustee had power to determine all matters of doubt, including the definition of "proportionately"
 - The Trustee's interpretation of "proportionately" was reasonable
- Trustee had to:
 - Recalculate Mr K's benefits and pay with interest; and
 - pay Mr K £1,000 for non-financial injustice due to the 3 year time period

Any questions?



Contact us



Duncan Buchanan

Partner, London

Pensions

T +44 20 7296 2323

duncan.buchanan@hoganlovells.com



Faye Jarvis

Partner, London

Pensions

T +44 20 7296 5211

faye.jarvis@hoganlovells.com



Beth Sheehan

Senior Associate, London

Pensions

T +44 20 7296 5711

beth.sheehan@hoganlovells.com



Jade Rigby

Associate, London

Pensions

T +44 20 7296 5199

jade.rigby@hoganlovells.com





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