

What's happening in Pensions



Issue 35

September 2012

In this issue:

Short service refunds and automatic transfers

Automatic enrolment:

- Scheme information requirements
- Amending regulations
- Hybrid schemes
- Career average schemes
- Certification guidance
- Template letters from employers to workers

Pensions Regulator:

- Financial support directions and insolvency
- Guidance: incentive exercises
- Guidance: multi-employer schemes and employer departures

Contracted-out schemes:

- Former protected rights and short service refunds
- Reference scheme test

Sex-based actuarial factors:

- Gender-neutral insurance and annuities
- Income drawdown tables

Pension protection levy

Tax:

- Annual allowance – "scheme pays"
- Finance Act 2012
- Tax avoidance

Takeover panel: pension scheme trustee rights

OTC derivatives: EMIR

US FATCA tax law – exemption for UK pension funds?

Public sector staff transfers: fair deal

Short service refunds and automatic transfers

The Government has confirmed its intention that members' small deferred DC pots should generally be transferred automatically to their next employer's scheme.

It has issued a response to its consultation (see **WHIP Issue 31**) on proposals designed to address the costs of administering the large number of such pots that will result from automatic enrolment and the forthcoming abolition of short service refunds. The consultation document had mooted systems under which small DC pots would be automatically transferred to the member's next employer's scheme or to an aggregator scheme such as NEST.

The Government has concluded that there should be automatic transfers of small DC pots to a member's next employer's scheme but has not yet decided on the maximum size of DC pot that would have to be transferred. It has also indicated that the prohibition of short service refunds will not apply to "micro-pots" (again, the size has not yet been decided). The individual would be able to opt out of an automatic transfer and there would be no requirement for financial advice to be provided or taken.

The new law on automatic transfers would apply to occupational and personal pension schemes but would not affect DB pensions or existing deferred DC pots. No draft legislation or any further detail has been published because there are still many issues to be considered.

Automatic enrolment

Scheme information requirements

Regulations have been published confirming a shortening of the period for trustees to give basic scheme information to members who have been enrolled automatically or after opting in under a statutory right.

From 1 October 2012, this period will shorten from two months from the start of membership to one month from the date the scheme receives the required information about the member. The intention is that most such individuals will receive the basic scheme information while their opt-out period is running. Schemes that are not automatic enrolment schemes are not affected.

Press release:

<http://www.dwp.gov.uk/newsroom/pres-s-releases/2012/jul-2012/dwp078-12.shtml>

Regulations:

<http://www.legislation.gov.uk/ukxi/2012/1811/contents/made>

Consultation response:

<http://www.dwp.gov.uk/consultations/2012/pen-scheme-disclosure-reg-2012.shtml>

This trustee duty is in addition to an employer's duties to give information to its workers under the automatic enrolment legislation.

The Government published a consultation response to accompany the regulations. We reported on the consultation in **WHIP Issue 33**.

Amending regulations

The Government has confirmed the implementation of the following proposals on which it had consulted (see **WHIP Issue 33**) with amending regulations and a consultation response.

- The two "step-up" dates for the phasing-in of minimum contribution rates to DC schemes are both put back by a year, to 1 October 2017 and 1 October 2018.
- The transitional period for DB and hybrid schemes (ie, the date on which workers who have been eligible to join a DB automatic enrolment scheme must be enrolled in it) is extended to 30 September 2017 rather than 30 September 2016.
- Employers of fewer than 50 workers who share a PAYE payroll with other employers or who include pensioners in their payroll will have a new, later staging date. This will be between 1 August 2015 and 1 April 2017. Their new staging dates are set out in legislation and are determined by reference to their otherwise applicable staging date. For example, small employers with current staging dates of 1 October 2012 and 1 November 2012 will have a new staging date of 1 August 2015.

Such employers cannot be separately identified by the Pensions Regulator but they will not have to apply to change their staging date. They can inform the Regulator that these provisions apply to them when the Regulator writes to them about their staging date.

References to calculating the number of full-time equivalent workers have been removed from the draft: a part-time worker will now count as a whole worker for these purposes.

Hybrid schemes

The Government has published the final terms of The Hybrid Schemes Quality Requirements Rules 2012. They provide that schemes that give DB and DC accrual at the same time satisfy the quality requirement for qualifying schemes if one such section satisfies the relevant standard. They also set out how the quality requirements apply to:

- sequential hybrid schemes (eg, DC until the member completes a specified number of years of membership or reach a specified age; then DB);
- self-annuitising hybrid schemes (ie, schemes that pay DC pensions from the fund, not by buying an external annuity); and
- combination hybrid schemes (ie, DB and DC accrual (not counting AVCs) at the same time, but where neither section meets the relevant quality standard).

Career average schemes

The Government has published final draft regulations on what a career average ("CARE") scheme has to provide in order to be a qualifying scheme.

Under the existing legislation, a CARE scheme can be a qualifying scheme if it gives active members either:

- (a) guaranteed revaluation of at least the annual CPI increase up to 2.5%; or
- (b) discretionary revaluation, whilst funding for at least the level described in (a) and including this in its statement of funding principles.

The amending regulations will allow a CARE scheme to qualify if revaluation is partly guaranteed and partly discretionary. They will also allow schemes to use RPI instead of CPI.

The Government has also published a response to its consultation (on which we reported in **WHIP Issue 33**).

Certification guidance

Final guidance on certifying DB and hybrid schemes as qualifying schemes (with separate guidance for employers and actuaries) and revised guidance on certifying DC schemes has been issued by the Government.

Template letters from employers to workers

The Pensions Regulator has prepared template letters for employers to give information to workers about automatic enrolment. These can be accessed via a web tool on the Regulator's website.

Regulations:

<http://www.legislation.gov.uk/ukxi/2012/1813/contents/made>

Consultation response:

<http://www.dwp.gov.uk/consultations/2012/wpr-rev-implementation.shtml>

Hybrid scheme rules:

<http://www.dwp.gov.uk/docs/auto-enrol-hybrid-schemes-req.pdf>

Regulations:

<http://www.dwp.gov.uk/docs/auto-enrol-career-ave-qual-schemes-reg-36-amend-3.pdf>

Consultation response:

<http://www.dwp.gov.uk/consultations/2012/auto-enrol-career-ave-qual-sch.shtml>

Certification guidance:

<http://www.dwp.gov.uk/policy/pensions-reform/workplace-pension-reforms/guidance/>

TPR web tool:

<http://www.thepensionsregulator.gov.uk/employers/writing-to-workers-about-automatic-enrolment.aspx>

Pensions Regulator

Financial support directions and insolvency

The Pensions Regulator has published a statement on financial support directions (FSDs) and insolvency. Its aim is to help banking, insolvency and restructuring professionals to understand the Regulator's approach to its FSD powers in insolvency situations. It hopes *"to provide clarity and comfort to those concerned by the outcome of the 2011 Court of Appeal judgment [in the Nortel and Lehman Brothers case (see **WHiP Issue 30**)] regarding the position of FSD liabilities where an FSD is issued following an insolvency event"*.

The Nortel/Lehman Brothers Court of Appeal decision gave "super-priority" to FSDs issued after the insolvency event: as expenses of the administration (or liquidation) they rank above other creditors (except those with fixed charges). Insolvency practitioners have therefore been concerned that only a small proportion of their fees (which are also ranked as expenses) might be paid and banks were concerned that they might not recover their debts (even if secured) in the event of the borrower's insolvency. The Regulator has moved to calm those concerns.

The key points to note are:

- The Regulator has no intention of deliberately delaying the issue of an FSD until after an insolvency event in order for it to be treated as an expense of the administration or liquidation (ie, to take advantage of "super-priority").
- Where an FSD is issued after an insolvency event but arises from events before the insolvency event, a relevant factor in assessing what financial support is reasonable will normally be the position under insolvency law had the FSD been issued before the insolvency event (ie, the amount the scheme would receive under an FSD if the trustees of the scheme were an unsecured creditor, as they would be had the FSD been issued before the insolvency event).
- In most circumstances, the Regulator would not seek to object to a subordination of the FSD liabilities behind the insolvency practitioner's reasonable remuneration, where a court application is made to vary the priority order.

Note that the Court of Appeal decision is being appealed.

Guidance: incentive exercises

The Regulator has rewritten its December 2010 guidance for employers and trustees on incentive offers (eg, enhanced transfer values and pension increase exchange exercises). The new guidance is much shorter because the pensions industry's recent code of good practice (see **WHiP Issue 34**) has been endorsed by the Regulator and has largely superseded its earlier guidance.

Guidance: multi-employer schemes and employer departures

The Regulator has updated its *"Multi-employer schemes and employer departures"* guidance following the introduction of flexible apportionment arrangements and amendments to the provisions allowing a "grace period" before a section 75 employer debt is triggered by an employer which temporarily ceases to employ active members,

Please see our briefing note **"Changes to the employer debt legislation"** for more detail.

Contracted-out schemes

Former protected rights and short service refunds

HMRC has laid regulations addressing the issue (noted in **WHiP Issues 33** and **34**) concerning short service refunds paid to members of formerly contracted-out DC schemes following the abolition of protected rights on 6 April 2012.

The regulations allow such schemes to pay partial short service refunds when required by their rules, leaving the former protected rights still in the scheme, without making an unauthorised payment. This may be useful until scheme rules are amended to remove the provision preventing the refund of contributions from former protected rights. In practice, and where possible, trustees may prefer to delay refunds for a short time until their scheme rules can be amended to allow them to make a single refund payment.

The regulations took effect from 8 August 2012.

HMRC has also published draft guidance on what is a member contribution for authorised payment purposes (ie, what can be included when calculating the maximum authorised short service refund lump sum). HMRC takes the view that its age-related rebates can be treated as member contributions for these purposes, although they are not eligible for tax relief, and can therefore be included in the calculation of the ceiling on the amount that can be paid out as an authorised payment under the tax legislation.

Press release:

<http://www.thepensionsregulator.gov.uk/press/pn12-25.aspx>

Press release:

<http://www.thepensionsregulator.gov.uk/press/pn12-24.aspx>

TPR guidance:

<http://www.thepensionsregulator.gov.uk/guidance/multi-employer-schemes-and-employer-departures.aspx>

Regulations:

<http://www.legislation.gov.uk/uksi/2012/1881/contents/made>

Draft guidance:

<http://www.hmrc.gov.uk/pensionschemes/short-service.pdf>

Reference scheme test

When benefit changes are made to a contracted-out salary related scheme, the scheme actuary must certify that the scheme still satisfies the reference scheme test. The Government says that the intention is that this should apply to accrued benefits as well as to future service benefits but that it only works for the latter, since the reference scheme test is forward-looking. The Government is consulting on draft amending regulations that would require:

- the reference scheme test to be applied for future service benefits; and
- the actuarial equivalence test in section 67 Pensions Act 1995 (regarding amendments affecting subsisting rights) to be applied for past service benefits together with the reference scheme test for death benefits.

The consultation closes on 13 September 2012 and the amendments are intended to come into force on 6 April 2013.

Sex-based actuarial factors

Gender-neutral insurance and annuities

The Government will proceed to abolish the exemption for sex-based insurance risk factors in the Equality Act 2010. It will do this from 21 December 2012 as originally proposed (see **WHIP Issue 31**). This will require unisex premiums and payments under new individual insurance contracts, including annuities and life assurance.

The Government's consultation response contains a section on work-based pension schemes. The Government has declined to clarify its position on the law in this area, since this would always be capable of being overruled by the European Court. It acknowledges, however, that the European Commission's expressed view (see **WHIP Issue 31**) is that occupational pension schemes may continue to use sex-based actuarial factors if they are justified by actuarial data. The European Court is not bound to accept the Commission's view. If it is right, however, schemes may continue to use sex-based factors for calculations such as commutation and internal conversion of DC pots into scheme pensions.

Premiums for bulk buy-outs and the pricing of buy-ins and longevity swaps may not be affected, because these are not individual insurance contracts. It remains to be seen, however, how insurers will respond to the change in the law.

The Government acknowledges that the different EU laws applicable to personal pensions and occupational pension schemes could result in a two-tier annuity system. Personal pensions will be subject to a unisex annuity requirement but occupational pension schemes that offer scheme pensions will not. Members of such schemes may, however, exercise their open market option to buy an individual annuity that would be subject to the equality requirement. Trustees of such occupational pension schemes should therefore consider whether or not to move to unisex factors for at least their DC scheme pensions (if they have not already done so).

Please see our briefing note "**Unisex actuarial factors and annuities**" for more detail.

Income drawdown tables

HMRC has updated its drawdown guidance, applying unisex actuarial factors to the maximum drawdown pension calculations (for income withdrawal or short-term annuities from a DC arrangement) from 21 December 2012. The conversion rates for women are improved to the level applicable to men (ie, allowing women to draw down more pension than previously).

Pension protection levy

The PPF has published a guide to the 2012/13 pension protection levy, sample invoices and updated FAQs. This is in connection with the invoicing that will begin in September.

Tax

Annual allowance – "scheme pays"

HMRC has responded to a query from the Society of Pension Consultants by saying that it does not think that reducing a member's commutation lump sum to pay an annual allowance charge debt to the scheme, under the "scheme pays" system, is permissible under the Finance Act 2004. This says:

"Where the scheme administrator of a pension scheme satisfies a liability ... in respect of the individual, consequential adjustment must be made to the entitlement of the individual to benefits under the pension scheme on a basis that

Consultation:

<http://www.dwp.gov.uk/consultations/2012/occ-pensions-regs-2013.shtml>

Consultation response:

http://www.hm-treasury.gov.uk/condoc_insurance_benefits_and_premiums_gender_neutral.htm

HMRC Announcement:

<http://www.hmrc.gov.uk/pensionschemes/gad-announcement-august-2012.pdf>

Press release:

<http://www.pensionprotectionfund.org.uk/news/pages/details.aspx?itemID=280>

is just and reasonable having regard to normal actuarial practice."

The reason given by HMRC is that reducing a commutation lump sum:

"... does not meet the 'consequential adjustment' part of the test. The adjustment is in the form of an adjustment to the member's tax free lump sum, however as the member would have to commute an amount of pension to obtain the lump sum out of which an amount would be taken to reflect the tax paid by the scheme administrator, then there does not appear to have been an actual reduction to the member's benefit entitlement. Instead, it appears that the member is using part of the lump sum received to clear a debt that the member has with the pension scheme."

If HMRC is right, the member would need to suffer a reduction of his or her pre-commutation pension and this would have an effect on the maximum commutation lump sum and the benefits that the member can ultimately claim.

Please see our briefing note **"Finance Act 2011 tax changes"** for more detail on "scheme pays".

Finance Act 2012

The Finance Bill has received Royal Assent and is now the Finance Act 2012. It includes provisions on employer asset-backed pension contributions (see **WHiP Issues 31, 32 and 34**) – ie, special purpose vehicles set up to hold employer assets and feed contributions to the scheme. These are in section 48 and Schedule 13.

As previously reported (see **WHiP Issue 34**), HMRC has issued draft guidance on the new law.

Tax avoidance

The Government intends to amend its requirements for disclosing tax avoidance schemes. It will withdraw the obsolete Pensions hallmark (which related to avoidance of the special annual allowance charge) and cover pensions under a new "hallmark" – *"Employment income via intermediaries"*. This reflects the "disguised remuneration" provisions introduced by the Finance Act 2011 from 6 April 2011 (see our briefing note **"Finance Act 2011 tax changes"**). Although the Government says that it is confident that that legislation is effective, it is aware of schemes being marketed that purport to avoid the relevant tax charges.

The consultation closes on 15 October 2012.

Takeover panel: pension scheme trustee rights

The Takeover Panel is proposing to amend the Takeover Code to require greater disclosure in relation to pension schemes. The proposals reflect the significance that pension issues can have in takeover situations and are designed to give greater transparency in this area. The proposed amendments are as follows.

- An offeror should be required to state in the offer document its intentions with regard to the company's pension scheme(s) and the likely repercussions for the scheme.
- The board of the company should include in its circular its views on the effects on the pension scheme and the likely repercussions for the scheme.
- An offeror and the company should be required to make available to the trustees of the company's pension scheme all the documents that they are each required to make available to the company's employee representatives.
- The trustees of the company's pension scheme should be granted equivalent rights to those granted to the company's employee representatives to have circulated a separate opinion from the trustees on the effects of the offer (and any revised offer) on the pension scheme.
- In the event of an offeror entering into a funding agreement with the trustees of the pension scheme, a summary of that agreement should be included in the offer document and a copy of the agreement put on display.

The references to pension schemes are not restricted to DB schemes or UK schemes.

The Panel's consultation closes on 28 September 2012.

OTC derivatives: EMIR

The European Council has adopted the text of the new EMIR Regulation on OTC derivative transactions, central counterparties and trade repositories. EMIR will apply to occupational pension schemes. The key aspects are:

Finance Act 2012:

<http://www.legislation.gov.uk/ukpga/2012/14/enacted>

Draft HMRC guidance:

<http://www.hmrc.gov.uk/pensionschemes/abc-guidance.pdf>

Consultation:

<http://www.hmrc.gov.uk/avoidance/tax-avoidance-schemes.pdf>

Consultation:

<http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PCP201202.pdf>

- **The clearing obligation** – All standardised OTC derivatives will need to be cleared through a central clearing counterparty (or 'CCP'). A temporary stay of execution from the clearing obligation has been granted to pension funds. The exemption period is expected to last for at least three years after the Regulation comes into force, ie, at least until August 2015. Occupational pension schemes will then need to become a member of a CCP or a direct client of a member of a CCP. Most other counterparties will be required to comply with the clearing obligation at an earlier stage, so occupational pension schemes should expect to see a CCP interposed between them and their OTC derivative counterparties before they become subject to the obligations themselves.
- **The reporting obligation** – All OTC derivatives (whether or not they are centrally cleared) will need to be reported to a trade repository. This obligation will apply to occupational pension schemes as soon as the authorised trade repositories have been established, which must occur by the end of 2014.
- **The risk mitigation obligations** – There will be a set of detailed requirements in relation to risk mitigation to ensure that there are appropriate procedures and arrangements in place to measure, monitor and mitigate operational and counterparty credit risk (including confirmation of trades, daily marking to market/model and the segregated exchange of collateral). These requirements will apply from 1 January 2013 (but possibly later) to all OTC derivatives that are not cleared through a CCP. It will therefore apply to OTC derivative contracts made by occupational pension schemes even while they are exempt from the clearing obligation.

In the meantime, it is unclear what changes will need to be made to the principal templates used for derivatives contracts, such as ISDAs and CSA. The various industry bodies have established working groups to develop the required drafting changes and protocols.

Please [click here](#) for a detailed briefing note on the EMIR Regulation.

US FATCA tax law – exemption for UK pension funds?

A joint statement from the governments of the US, UK, France, Germany, Italy and Spain and a draft agreement with the US Government for each of those countries indicate that UK registered pension schemes could effectively be exempted from FATCA. FATCA (the Foreign Account Tax Compliance Act) is extraterritorial US legislation requiring reporting in relation to US taxpayers and potentially imposing withholding tax charges on UK pension schemes' US investment income.

The relevant provisions are in Article 4, para 3 and Annex II. The Annex has not been completed but schemes that can be exempted are those "*operated to provide pension or retirement benefits or earn income for providing such benefits under the laws of [FATCA Partner] and regulated with respect to contributions, distributions, reporting, sponsorship, and taxation*".

Public sector staff transfers: fair deal

From a date to be announced, all staff whose employments are compulsorily transferred under TUPE from the public service to private sector employers will be entitled to retain active membership of their public service pension scheme. This will also apply on subsequent transfers, eg, to replacement contractors.

The "Fair Deal" system, under which the outsourcing Government body must require the private sector employer to provide broadly comparable benefits under a scheme of its own and take a bulk transfer, will cease to apply.

The Government is expected to announce further details in the autumn.

Press release:
http://www.hm-treasury.gov.uk/press_67_12.htm

Government announcement:
http://www.hm-treasury.gov.uk/d/wms_pensions_040712.pdf

This and previous issues of WHiP can be found on our website. See <http://www.traverssmith.com/news-publications/legal-briefings/?pa=1166&page=0>.

If you do not already subscribe to our pensions mailings and would like to do so, please email pensions@traverssmith.com.

Hyperlinks in this document can be clicked via an up to date version of Adobe Acrobat Reader. We are not responsible for the contents of external websites to which we provide links.

If you wish to discuss any points arising from this note, please speak to your usual contact in the Travers Smith Pensions team or to one of the Pensions partners: Paul Stannard, Peter Esam, Philip Stear, Susie Daykin and Daniel Gerring.

Travers Smith LLP
10 Snow Hill
London EC1A 2AL
T +44 (0)20 7295 3000
F +44 (0)20 7295 3500

www.traverssmith.com