



What's happening in Pensions

Issue 11

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Pensions Regulator statement on scheme funding

The Pensions Regulator has published a six page statement, case studies and speech on scheme funding. This follows its October 2008 and February 2009 statements to trustees and employers respectively (see WHiP Issues 6 and 9).

The Regulator emphasises the importance of prudent funding levels and recovery plan flexibility. There are no policy changes but the following are points of interest.

- *"At the current time, FRS17 is unlikely to represent an adequate level of prudence without further adjustment."*
- *"Any risk margin in the assumptions for setting technical provisions must take account of the extent to which the employer covenant can support them."*
- *"Technical provisions should not be compromised to make a recovery plan appear affordable; the size of the deficit does not necessarily dictate annual deficit repair contributions to the pension scheme, these must be determined with reference to what is reasonably affordable for the employer."*
- *"Where employers are cash constrained, trustees should look at the widest range of flexibility in recovery plans, mindful of their duties to secure member benefits; these can include lengthening recovery plans, step-up payments, back-end loading of recovery plans, and further security through the use of contingent assets and the distribution of profits fairly between creditors and equity providers."*

Pensions Regulator's anti-avoidance powers: "material detriment" test

The Pensions Regulator's Code of Practice No.12: "Circumstances in relation to the material detriment test", and the relevant provisions of the Pensions Act 2004, were brought into force on 29 June 2009, with effect from 14 April 2008. The code outlines the circumstances in which the Regulator would expect to use its power to issue contribution notices under the "material detriment" test. This applies if the Regulator is of the opinion that an *"act or failure has detrimentally affected in a material way the likelihood of accrued scheme benefits being received"*. Please see WHiP Issue 10 for full details.

It is now easier for the Regulator to issue contribution notices against companies associated with the sponsoring employer if they are involved in activity which weakens the employer's covenant. They should consider how they would be able to demonstrate that they have taken account of the impact on the security of members' benefits and whether to offer the trustees some form of mitigation. They might also consider seeking a clearance statement from the Regulator.

Online guidance on corporate transactions and illustrative examples have been published to complement the code. Unfortunately, the examples only address situations where the Regulator's view is already easily predictable.

A new module to the Trustee Toolkit, "Buy-ins and partial Buy-outs" has also been issued.

The Regulator's guidance notes on clearance and abandonment have been updated to include references to the material detriment test.

Press release:

<http://www.thepensionsregulator.gov.uk/whatsNew/pn09-07.aspx>

Code of practice:

<http://www.thepensionsregulator.gov.uk/codesOfPractice/materialDetriment/index.aspx>

Guidance:

<http://www.thepensionsregulator.gov.uk/employers/corporateTransactions.aspx>

Examples:

<http://www.thepensionsregulator.gov.uk/guidance/examplesMaterialDetriment.aspx>

Trustee toolkit:

<http://www.trusteetoolkit.com/arena/index.cfm>

Press release:

<http://www.thepensionsregulator.gov.uk/whatsNew/pn09-08.aspx>

Tax relief: anti-forestalling measures

HM Revenue & Customs have said that they will issue shortly an FAQ document with more details about how the anti-forestalling measures outlined in **WHIP Issue 10** are to apply. Following feedback from the industry, the FAQs are expected to include:

- confirmation of when a scheme merger or transfer will be affected by the anti-forestalling measures; and
- confirmation that where a person has made pension contributions of differing amounts, the median figure will be used as the regular contribution level, when calculating the member's protected contributions.

It is expected that the Finance Bill will be amended so that the £20,000 used for calculating any special annual allowance charge is increased to no more than £30,000 if the individual's average annual pension inputs over the last three years exceed £20,000.

Pensions Ombudsman: failure to document reasons is maladministration

The Pensions Ombudsman has upheld a complaint of maladministration by Mrs H A Curran against the trustee of the IBC Vehicles Pension Plan. The maladministration was that the trustee failed to document evidence supporting the exercise of its discretion to allocate a lump sum death benefit.

Mr and Mrs Curran were separated when Mr Curran died and Mrs Curran may have been living with her new partner. They did, however, have a joint bank account and mortgage. Mr Curran had not completed an expression of wish form for his scheme benefits but left a will naming Mrs Curran as sole beneficiary. They had five children: three were in foster care; two had been adopted and were not financially dependent on Mr or Mrs Curran.

When making their decision as to how to split the lump sum death benefit, the trustees relied on an oral report from the company's occupational health officer. There was no written evidence before the trustees, other than emails recording Mr Curran's parents' opinion of Mrs Curran's new living arrangements. These emails said very little about the financial position of any of the potential recipients.

The Ombudsman held that "*the outcome, which includes a payment to two children reportedly adopted as babies and with whom there had been no contact since, is unusual and unexplained.*" In these circumstances, he could not say that the trustees had considered all the relevant factors and had not reached a perverse decision. This is because there was no evidence as to what information the trustees had when they took the decision. He ordered the trustees to take the decision again, giving reasons and an explanation of what was taken into account.

This is the latest of several cases in which the Ombudsman has investigated complaints by disappointed potential beneficiaries after a death benefit has been paid out to others. The amounts involved can be substantial. Trustees must be able to demonstrate proper enquiry, diligent consideration of the circumstances and a reasonable decision. The Ombudsman cannot normally substitute his own decision, but can direct the trustees to make a fresh decision after going through the process properly.

Age discrimination: Court of Appeal judgment

The Court of Appeal has given its judgment in *Rolls Royce plc v Unite the Union*. The outcome is that length of service can be used as one of the criteria for selection for redundancy. This is because rewarding long service and encouraging loyalty are legitimate aims and including length of service as one of several criteria for selection for redundancy is proportionate. Although not a pensions case, this is relevant when considering service-related benefits that do not fall squarely within one of the statutory exemptions.

Rolls Royce and the trade union Unite had entered into collective agreements relating to redundancy. Selection for redundancy was under a points system, part of which was based on years of continuous service. Unusually, Rolls Royce argued for the arrangement to be declared unlawful and Unite defended it. They asked the High Court to decide whether or not the redundancy selection scheme was lawful.

Finance Bill home page:
<http://services.parliament.uk/bills/2008-09/finance.html>

Determination:
<http://www.pensions-ombudsman.org.uk/determinations/docs/2009/may/74746.doc>

Case report:
<http://www.bailii.org/ew/cases/EWCA/Civ/2009/387.html>

The High Court had ruled as follows.

- The length of service criterion was indirect age discrimination, but was objectively justified. There was a legitimate aim of carrying out redundancies in a way that was perceived to be fair and could be carried out "peaceably". Also, the criterion recognised and rewarded loyalty and experience and protected older employees against the difficulties of finding new work.
- A "last in, first out" redundancy selection scheme "might be objectionable", but that was not what this was.
- In any event, the exemption for benefits based on length of service in the Age Regulations applied: avoidance of selection for redundancy was a "benefit" (in its natural sense).
- Where the employee has more than five years' service the discriminatory treatment must, under the exemption for benefits based on length of service, reasonably fulfil a business need. This would probably be the case where the redundancy scheme was agreed with a trade union and length of service was only used as part of the equation, as was the case here.

There were four substantive issues in the appeal:

1. Was the length of service criterion in the redundancy policy indirectly discriminatory?
2. What is meant by a "benefit" (for the purposes of the exemption for benefits based on length of service in the Age Regulations)?
3. Was use of a length of service criterion a proportionate means of achieving a legitimate aim?
4. Does it reasonably appear to the employer that it fulfils a business need?

Wall LJ ruled as follows:

- As the parties had agreed, there was indirect age discrimination.
- The allocation of points based on a length of service criterion is plainly capable of constituting a benefit (for the purposes of the exemption for benefits based on length of service), with reference to the wide dictionary definition of "benefit".
- To reward long service is an entirely reasonable and legitimate employment policy.
- The High Court had failed to consider whether the criterion was a proportionate means of achieving a legitimate aim. It could be inferred that it thought it was proportionate, but inference was not enough. However, he considered that including a length of service criterion as one of the criteria for redundancy selection was proportionate, and was in furtherance of the legitimate aim of rewarding loyalty, and the legitimate business need of achieving a stable workforce.

Arden LJ broadly agreed but said that there was no need to show any special justification for a length of service provision.

Aikens LJ dissented. He was prepared to rule only that there was a "benefit" for the purposes of the length of service exemption, but said that there was not enough evidence to consider objective justification.

Pension Protection Fund

Announcement on 2010/11 levy

The Pension Protection Fund has announced a pension protection levy estimate for 2010/11 of £700 million (the figure for 2009/10) plus national average earnings indexation as published in September 2009. The announcement was made earlier in the levy year than usual in order to reassure levy payers, in the current economic climate, that there should not be an unexpected increase for 2010/11.

Guidance for insolvency practitioners

The PPF has updated its "Guidance for insolvency practitioners and official receivers". Of particular interest is the new Part 5 ("Restructuring or rescue of insolvent employers"). This sets out in writing, for the first time, the circumstances in which the PPF would consider helping a business, whose pension liabilities are making it insolvent, to be rescued.

Press release:

<http://www.pensionprotectionfund.org.uk/news-details.htm?id=7177>

Guidance:

http://www.pensionprotectionfund.org.uk/index/other_guidance/guidance_for_insolvency_practitioners.htm

The PPF and the Pensions Regulator will, in appropriate circumstances, accept an arrangement whereby a scheme's liabilities pass to the PPF and the employer's business continues, thereby protecting jobs. This would normally be considered "abandonment". For these circumstances to apply, however, it must be inevitable that the scheme will enter the PPF in any event, if no deal is done. Generally, the PPF will take a stake in the ongoing business and a cash injection in addition to the scheme's assets.

Revaluation and indexation caps

Regulations brought in on 6 April 2009 give trustees of schemes power to amend their schemes (with employer consent) to reduce indexation and revaluation caps for future accruals, in line with reductions in statutory requirements. As reported in **WHiP issue 10**, the Conservatives objected to the Regulations on the grounds that there had not been a Parliamentary debate on them. The Conservatives' position was that employers should be able to exercise this power unilaterally.

The Conservatives have now withdrawn their objection after being assured by the Pensions Minister Angela Eagle that she will review the Regulations in the light of experience.

Actuarial consultations

BAS consultation paper on pensions

The Board for Actuarial Standards has published a consultation paper setting out proposals for a technical actuarial standard on pensions. The issues covered include:

- *"the principles underlying the selection of discount rates used to value pension scheme liabilities;*
- *whether prudent estimates of liabilities of pension schemes should be accompanied by best estimates of the same liabilities; and*
- *the content of the report produced after regular Scheme Funding reviews of pension schemes."*

The consultation closes on 18 September 2009. The next stage will be an exposure draft of a principles-based standard applicable to actuarial work in pensions. The intention is to replace the "GN" series of guidance notes that apply to pensions.

Actuarial Profession prototype model for projecting mortality rates

The Actuarial Profession has published a prototype model for projecting future mortality rates. It is intended to replace the "cohort" models that were introduced on a temporary basis in 2002 and which do not reflect recent mortality experience. The consultation closes on 31 August 2009. The final version is to be published in October 2009.

Equality Bill

A Government amendment to the Equality Bill (see **WHiP Issue 10**) will give trustees an overriding power to modify scheme rules by resolution to comply with the full range of equality legislation. Under the original draft of the Bill, this power only covered sex equality amendments. The power will apply in the same circumstances as already apply under the Pensions Act 1995 in relation to sex equality.

Advertising for unknown beneficiaries

In *MCP Pension Trustees Limited v Aon Pension Trustees Limited*, the High Court ruled on the meaning of "notice" for the purposes of section 27 Trustee Act 1925. This allows trustees to protect themselves against claims on the trust fund of which they have no notice, when distributing the assets to known beneficiaries. They can do this by placing advertisements in the London Gazette and appropriate local newspapers.

In this case, on the distribution of surplus on a winding-up, 32 beneficiaries had been overlooked. The trustee had issued section 27 advertisements. None of the 32 overlooked beneficiaries had responded to them. The High Court was asked to decide, as a preliminary issue, whether the trustee had "notice" of the overlooked beneficiaries.

Debate transcript:

<http://www.publications.parliament.uk/pa/cm200809/cmgeneral/deleg4/090610/90610s01.htm>

BAS press release:

<http://www.frc.org.uk/bas/press/pub2015.html>

Actuarial Profession announcement:

http://www.actuaries.org.uk/knowledge/cmi/cmi_wp/wp38

Equality Bill home page:

<http://services.parliament.uk/bills/2008-09/equality.html>

Case report:

<http://www.bailii.org/ew/cases/EWHC/Ch/2009/1351.html>

The High Court held as follows.

- Section 27 does apply to pension schemes set up under trust. (This had never been decided by the Courts until now.)
- "Notice" is not the same as "knowledge".
- The trustee did have notice of the overlooked beneficiaries because it did know about them previously. Forgetting about beneficiaries did not mean that the trustee did not have notice of their claims. Notice, once given, cannot later lapse.

The case has implications for trustees who seek to protect themselves through section 27 notices, as it identifies a gap in this protection. If trustees have had "notice" of a beneficiary's claim, then a section 27 notice will not protect them, whether they have lost their records or have lost touch with the beneficiary.

Winding-up: reducing pensions in payment

Regulations came into force on 1 July 2009 (but with effect backdated to 6 April 2006) aimed at preventing unintended tax consequences when a scheme in winding-up reduces some but not all pensions in payment due to underfunding. In such circumstances, it will no longer be a requirement that all pensions in payment are reduced and future instalments of such a reduced pension will no longer be unauthorised payments.

Regulations:

http://www.opsi.gov.uk/si/si2009/ukSI_20091311_en_1

HMRC Pension Schemes Newsletter 37

HMRC has published its 37th Pension Schemes Newsletter It covers the following. The last three items may be more relevant to small self-administered schemes (SSASs):

- Budget 2009 tax relief changes and the special annual allowance (see **WHIP Issue 10**);
- clarification of HMRC's position on employer contributions by way of asset transfers;
- the transfer of pensions in payment (crystallised rights) before normal minimum pension age and the effect on a protected low pension age. HMRC says that protection will only continue if there is a block transfer, but there is no distinction between crystallised and uncrystallised rights.
- concerns of some DC schemes that the 50% borrowing limit is a barrier to commercial refinancing arrangements. HMRC's view is that refinancing of the same borrowing will not represent any increase to the overall scheme borrowing;
- concerns of schemes that have taken security over taxable property, that applying for charging orders to enforce the security might be the acquisition of a right over taxable property, triggering an unauthorised payment charge. HMRC's view is that the making of a charging order (not the enforcement of it) is the acquisition of taxable property. However the amount of the unauthorised payment is nil because there is no consideration given. If fees and costs are paid to obtain the order, they will give rise to an unauthorised payment, but the unauthorised payment charge will be so small as to not be an obstacle to recovering a debt by way of a charging order;
- concerns of schemes that renegotiating leases with connected persons might give rise to an unauthorised payment charge. HMRC accepts that this will not be the case if the renegotiation is carried out on commercial terms and the trustees have acted in the best interests of scheme members.

HMRC newsletter:

<http://www.hmrc.gov.uk/pensionschemes/ps-newsletter37.htm>

IASB proposes amendments to accounting rules

The International Accounting Standards Board (IASB) has proposed amendments to its IFRIC 14 interpretation ("*IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction*"). The consultation closes on 27 July 2009.

The proposed amendments are aimed at correcting an unintended consequence of IFRIC 14, by which employers are in some circumstances not permitted to recognise as an asset some prepayments for minimum funding contributions (i.e. deficit contributions paid earlier than required). There was therefore a disincentive for employers to rectify deficits any earlier than they had to.

IASB press release:

<http://www.iasb.org/News/Press+Releases/IASB+proposes+to+clarify+the+accounting+for+prepayments+for+pension+plans.htm>

EU directives: Solvency II and IORP

The Solvency II directive has been approved by the European Parliament. The directive now needs to be approved by the EU Council. Member states will then be required to transpose it into legislation by 31 October 2012. UK occupational pension schemes will not be affected by the directive as it stands, but it might increase the cost of buying annuities.

The European Parliament has urged the EU Commission to conduct its review of the IORP directive as quickly as possible. A recital to the new draft Solvency II directive goes on to say:

"The Commission, assisted by the CEIOPS, should develop a proper system of solvency rules for pension provision, whilst fully reflecting the essential distinctiveness of insurance and, therefore, should not prejudge the application of the Solvency II rules to be imposed upon them."

The current review, expected to be reported on in autumn 2009, is very limited in scope. There seems to be a move, however, towards a wider review of the question whether Solvency II should be extended, in whole or in part, to institutions affected by the IORP directive. That would include UK occupational pension schemes and could require a stronger funding standard to be applied.

Agency workers directive

The government has published a consultation paper on implementing the EU agency workers directive. It proposes that "occupational social security schemes", which covers UK occupational pension schemes, should be excluded from the equal treatment requirement in forthcoming UK legislation. The proposal if implemented would not change the current position, which is that employers can usually exclude agency workers from access to their schemes. The consultation paper notes, however, that the automatic enrolment obligation applicable from 2012 (see WHiP Issue 9) will apply to agency workers.

FRC levies 2009/10

The Financial Reporting Council (FRC) has finalised its 2009/10 levies, including the levy on pension schemes. The 2009/10 levy is £3.00 per 100 members, up from £2.90 in 2008/9 but less than the £3.10 originally proposed). Schemes with 1,000 or more members are required to pay this levy.

Solvency II directive:

<http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2009-0251+0+DOC+XML+V0//EN&language=EN#BKMD-64>

Consultation paper:

<http://www.berr.gov.uk/whatwedo/employment/employment-agencies/consultation-2002/page30034.html>

Press release:

<http://www.frc.org.uk/press/pub1992.html>

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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 and Andrew Block.

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