TRAVERS SMITH

What's happening in Pensions

Issue 15 *December 2009*

Pre-Budget Report

The Chancellor of the Exchequer delivered the Pre-Budget Report on 9 December 2009. The following pensions announcements were made.

HM Treasury website:
http://www.hm-treasury.gov.uk/prebud_pbr09_index.htm

HMRC website:
http://www.hmrc.gov.uk/pbr2009/index.htm

Tax relief on pension contributions from 6 April 2011
A consultation paper has been published on how the restriction of higher rate tax relief for high earners' pension contributions from 6 April 2011 will be implemented. The consultation closes on 3 March 2010.

As previously announced, higher rate tax relief on individuals' pension contributions will be restricted for those with taxable income of £150,000 or more. For those with taxable income of £180,000 or more, only basic rate (20%) tax relief will be available. For those with taxable income between £150,000 and £180,000, there will be a tapering of relief down to 20%. This will all be achieved by the "*high income excess relief charge*" (HIERC), payable by the individual as part of the income tax self-assessment process.

As we expected, the value of employer contributions (including employer-funded DB pension accruals) will be taken into account in determining whether the individual earns £150,000 or more and the HIERC will also apply to such contributions. Any salary sacrificed under an arrangement entered into since 22 April 2009 will be taken into account. For DB schemes, there will be a (probably age-related) formula for working out the value of the individual's accrual. The HIERC will therefore be, in part, a benefit-in-kind tax on the value of the employer pension contribution or the employer-funded element of DB accrual.

The HIERC will be calculated by working out a percentage rate for the individual and applying it to the value of the total employee and employer pension contributions and/or the value of DB accrual. A key difference from the anti-forestalling measures applying during this tax year and next (the special annual allowance charge) is that, as we already knew, it will apply to regular as well as irregular contributions.

Individuals with a taxable income of less than £130,000 (excluding employer pension contributions but before deducting their own pension contributions and any charitable donations) will not be affected: they need not work out the value of their employer's pension contribution.

Employers will be required to identify any employee to whom they provide gross pay and taxable benefits (not including employer pension contributions) of £130,000 or more and for whom they make pension contributions. Such employers will need to request a benefit statement (as at the end of the tax year) from the scheme on the employee's behalf and the statement must be provided by 6 July. Other employees (for example those with taxable income from another source that might take them over the threshold) will be able to request such statements themselves.

Individuals with HIERCs above £15,000 to pay will have the option of electing for the scheme to pay the charge, with their benefits reduced correspondingly. If this is not possible because the scheme is overseas or heavily underfunded, the Government may allow the individual to pay the charge over a period of up to three years.

The Government is seeking views on how it might exempt those for whom redundancy payments above £30,000 take them above the £150,000 threshold.

We are expecting more details on how this will work over the coming months and will cover these in future editions of WHiP.

The "anti-forestalling" special annual allowance charge
The "anti-forestalling" special annual allowance charge (see **WHiP Issue 12**) applies from 9 December 2009 to those earning £130,000 (previously £150,000) and over.

The rate of the special annual allowance charge (currently 20%) will increase from 6 April 2010. It will apply at a rate calculated on an individual basis (in the same way as for the high income excess relief charge – see above) to reflect the 50% income tax band applicable from 6 April 2010.

Other pension taxes
The 2010/11 rates for the following taxes are to change, reflecting the 50% income tax band applicable from 6 April 2010.

- **Short service refund lump sums**

  Currently, refunds of contributions payable to those who leave a scheme before their benefits have vested are taxed at 20% on the first £10,800 and 40% on the excess. All such refunds paid on or after 6 April 2010 will be taxed at 20% on the first £20,000 and 50% on the excess.

- **Lump sums received from an EFRBS (other than by an individual)**

  The tax rate on such payments (for example payments made to another pension scheme or other type of trust) made on or after 6 April 2010 will increase from 40% to 50%.

National Insurance contributions
For 2010/11, the only relevant National Insurance change will be an increase in the lower earnings limit from £95 to £97. This reflects the confirmed 2.5% increase in the basic state pension.

From 6 April 2011, employer, employee and self-employed rates of National Insurance contributions will increase by 0.5%, in addition to the increases of 0.5% (1% for individuals on earnings above the upper earnings limit) announced in the 2008 Pre-Budget Report (see **WHiP Issue 7**). The point at which individuals start to pay National Insurance contributions will increase by £570 to compensate the lowest earners.

Public sector pensions
Employer contributions to the pension schemes applicable to the NHS, teachers, local government and the civil service will be capped. The Report is short on detail but it appears that some form of shared cost arrangement will also apply to increases in pension costs and that individuals earning above £100,000 pa will pay a greater member contribution.

Invalid exercise of a scheme amendment power

Case report:
http://www.bailii.org/ew/cases/EWHC/Ch/2009/2785.html

The High Court has ruled in a case concerning the purported conversion of the IMG Pension Plan in 1992 from DB (final salary) to DC, including a conversion of past service benefits. Members' DB benefits were actuarially converted into DC sums with an addition reflecting a surplus in the scheme at that time. Members were presented with the conversion as a *fait accompli*: they either had to accept the conversion or discontinue membership of the scheme. The independent trustee, appointed well after the conversion, applied to the Court to determine whether the conversion exercise was valid.

The case considered several issues of interest, as follows.

Amending the scheme amendment power
The amendment power in the scheme's original interim trust deed contained a restriction prohibiting amendments with "*the effect of reducing the value of benefits secured by contributions already made*". However, in 1981 the definitive deed included a different amendment power with no such restriction.

The Court held that it had not been possible to use the amendment power to amend away the restriction in it. Otherwise, the restriction could not serve its clear purpose, which was to protect members by preventing amendments that might prejudice their interests. Therefore the original amendment power's restriction continued to apply at the time of the conversion in 1992.

The impact of the restriction in the amendment power
The Court held that the effect of the restriction in the amendment power was not to invalidate the conversion altogether, but to require the application of a DB underpin to the converted benefits. The underpin was the accrued DB pension based on pensionable service up to 1992 and final pensionable salary as at the ultimate date of leaving service, retirement or death.

Retrospective amendments
The conversion had been purported to take effect from 1 January 1992 but the scheme rules were not amended until 3 March 1992. The Court rejected arguments that this two

month retrospection was valid, even though all communications about the conversion were issued before 1 January 1992. The scheme therefore continued to be fully DB until 3 March 1992, when it became (see above) DC with a DB underpin. The Court said that it would be rewriting history to allow the imposition of DC accrual in place of DB (i.e. not just a backdated conversion of benefits DB to DC) from a date in the past. In any event, as mentioned above, retrospective amendment was prohibited by the amendment power restriction.

Estoppel and contractual arguments
It was argued that:

- by completing forms to continue in membership of the converted scheme, members had agreed contractually to the conversion; and/or
- members were "estopped" (i.e. prevented) from claiming that the scheme was still DB (or DC with a DB underpin) because they had returned signed forms representing that they agreed to the conversion and everyone had proceeded on the basis that the scheme had been converted to DC.

The Court held that the members had not entered into a contract: there was no intention to enter into contractual legal relations and no informed agreement to the conversion was sought or obtained. Any such contract could not override contrary provisions in the scheme trust deed without the members' free and informed consent.

The Court rejected the estoppel arguments because there was no clear and unequivocal representation by the members that they would not enforce their rights under the scheme rules and there had been no more than passive acceptance of the conversion by the members.

Surrender under section 91 Pensions Act 1995
Some members had entered into compromise agreements in which they purportedly agreed to waive any DB pension rights. These agreements were found to be unenforceable agreements to surrender benefits under section 91 Pensions Act 1995. Public policy arguments about the protection of dispute settlement agreements were rejected. This may raise doubts about the enforceability of other pension dispute compromises or settlements, where those relate to accrued benefits or entitlements, but each case would need to be considered on its own facts.

Improper use of a buyout power

Case report:
http://www.bailii.org/ew/cases/EWHC/Ch/2009/2810.html

The High Court has ruled in a case concerning whether or not trustees are entitled to take account of the existence of the Pension Protection Fund when taking decisions.

The independent trustee of the Ilford Pension Scheme asked the Court to decide if it was entitled to implement an imaginative buyout plan that would have had the effect of significantly increasing the liability of the PPF to provide compensation to members of the scheme, thereby improving members' financial position overall.

The scheme was significantly underfunded and the employer was insolvent. A PPF assessment period had not yet commenced but the trustee, as a very substantial contingent creditor, was able to trigger one by forcing the employer into liquidation.

A group of high earning members who had retired early realised that their benefits would be severely cut back under the PPF, due to its compensation cap and the reduction of pensions in payment before normal pension age. They devised a plan, advised by leading counsel, to buy out in full the benefits of the high earners and others who had retired early. Combined with the PPF compensation for the other scheme members that would surely follow, this would improve the position of some scheme members without disadvantaging others, but would significantly increase the burden on the PPF.

The issues were as follows.

Use of buyout power for an improper purpose?
The buyout power in the rules read as follows:

> *"At the discretion of the Trustees, they shall apply such amount as they shall decide, after taking Actuarial Advice, in the purchase of a Buy-out Policy in respect of a Member or other beneficiary, providing benefits in substitution for the benefits (or relevant part) which would otherwise have been payable under the Plan."*

The Court held that the purpose of the buyout power was to enable the trustees to apply an amount of money which fairly represented the benefits to which a beneficiary was entitled under the scheme (or a specified part of those benefits) in the purchase of a replacement insurance policy. The proposed use of the power would therefore be for an improper purpose, because it would result in a large part of the scheme's assets being used for only some members.

Is the trustee entitled to take into account the existence of the PPF?
The Court held that the existence of the PPF was not a relevant factor for the trustee to take into account, given the drafting of the scheme's buyout power. Nor could the PPF be regarded as a scheme beneficiary, or as akin to one.

If the buyout power were to be validly amended to allow the trustee to take it into account, would that then allow the trustee to do so? No, said the Court: the proposal aimed to minimise the scheme assets that will vest in the PPF and treated the availability of PPF compensation as though it were an advantage to be exploited for the scheme's benefit, whereas Parliament intended the PPF to be a funder of last resort. The Court therefore had "*no hesitation in holding that the proposal represents a blatant attempt to undermine or circumvent the policy of the PPF legislation*".

Furthermore, the proposal could "*hardly be more inimical*" to the public interests of the PPF's financial health and the responsible administration of occupational pension schemes, including the maintenance of proper funding levels.

Public policy issues
It is not surprising that the High Court reached the conclusion that the proposed exercise of the trustee's buyout power would be unlawful, given the public policy implication of any other conclusions. But the case raises difficult questions about when trustees may or may not have regard to the criteria of the PPF and the rules governing PPF compensation – for example when considering mergers or amendments to scheme benefits.

An application has been made to the Court of Appeal for permission to appeal.

Employment-cessation events before 6 April 2008

Case report:
http://www.bailii.org/ew/cases/EWHC/Ch/2009/3258.html

A High Court decision has been issued which may affect some section 75 debts treated as falling due before 6 April 2008.

Before 6 April 2008, when the law was changed (see below), section 75 debts arose when an employer ceased to employ "*persons in the description of employment to which the scheme relates*". It was unclear whether this phrase referred to active members only, or also to other employees of the employer, for example eligible employees who had not joined and those who had opted out of membership but could rejoin.

The Court ruled that the phrase did not refer only to active members. On the facts of the case, a section 75 debt had not been triggered when the employer ceased to employ any active members because it continued to employ:

- persons who were eligible to join but had decided not to (even though to join now they would need the trustees' consent); and
- a deferred member (albeit one who had passed normal pension age).

There may be schemes where a section 75 debt has been treated as due because the employer stopped employing active members of the scheme before 6 April 2008 but continued to employ employees who had opted out or declined to join. Any such debts may need to be revisited. However, there should not be a problem, even in these circumstances, where the employer formally ceased to be a participating employer at the time, so that none of its employees could remain in or rejoin the scheme (for example if the employer ceased to participate because it was sold out of the group or notice was given terminating participation).

The law was changed from 6 April 2008 so that an employment-cessation event does occur when an employer ceases to employ active members (if at least one other employer continues to employ active members). However, no section 75 debt arises if the employer notifies the trustees that it intends to employ active members again within the next 12 months and does so.

EU Treaty of Lisbon

The Treaty:
http://www.consilium.europa.eu/showPage.aspx?id=1296&lang=en

With the coming into force of the Treaty of Lisbon on 1 December 2009:

- The articles of the Treaty of Rome have been renumbered. This means that:
  - Article 141 (originally Article 119) on equal pay should now be referred to as Article 157; and
  - The Treaty itself is renamed, from "Treaty establishing the European Community" to "Treaty on the functioning of the European Union".
- References to "European Community" and "EC" are now out of date: it should now be referred to the "European Union" and the "EU".

The European Court of Justice (ECJ) has also been renamed the Court of Justice of the European Union (CJEU) and the Court of First Instance has become the General Court.

Pensions Regulator

Press release:
http://www.thepensionsregulator.gov.uk/whatsNew/pn09-16.aspx

Analysis of recovery plans

The Regulator has published its 2009 analysis of DB schemes' recovery plans. Alongside the previous two years' reports (see **WHiP Issue 7**), it covers schemes with valuation effective dates from 22 September 2005 to 21 September 2008.

The analysis shows:

- a recent increase in both recovery periods and back-end loading of recovery plans;
- greater prudence in mortality assumptions; and
- an increase in recently-adopted discount rates – the Regulator will be keeping an eye on this.

Scheme governance and administration

Press release:
http://www.thepensionsregulator.gov.uk/whatsNew/pn09-17.aspx

The Regulator has launched a campaign "*aimed at encouraging good governance and administration and better management of pension scheme risks*". This includes publication of results of its 2009 governance survey and a statement outlining key focus areas.

Over the coming months, the Regulator will issue:

- updated guidance on internal controls (now issued for consultation – see below);
- revised scope guidance for trustee knowledge and understanding;
- "bite-sized e-learning for trustees on risk management" (now issued – see http://www.thepensionsregulator.gov.uk/safe/index.aspx);
- a consultation on new proposals for record-keeping; and
- updated guidance on winding-up.

Code of Practice 7: TKU

Codes of Practice:
http://www.thepensionsregulator.gov.uk/codesOfPractice/tku/index.aspx

The Pensions Regulator's revised "Code of Practice No.7: Trustee knowledge and understanding (TKU): Second issue" (see **WHiP Issue 12**) has come into force.

The revised Code makes the following changes of interest.

- The requirement for familiarity with the trust deed and rules is strengthened: trustees should now have a working knowledge of the whole document, not just "the most important parts".
- Trustee training providers should check existing TKU levels at the start of a session, so that all trustees can participate fully. At the end, they should certify attendance, subject matter and that attendees have participated and understood.
- Greater prominence is given to the Regulator's online "Trustee Toolkit". Trustees should normally use it as a primary training tool.

Consultation on revised internal controls guidance

Press release:
http://www.thepensionsregulator.gov.uk/whatsNew/pn09-18.aspx

The Regulator has published, for consultation, revised guidance on internal controls. It is aimed primarily at the trustees of smaller schemes. The key risk areas addressed by the draft revised guidance are:

- a lack of trustee knowledge and understanding
- conflicts of interest

- relations with advisers
- poor record-keeping
- deterioration of employer covenant
- investment risk
- ineffective retirement processes

The consultation closes on 1 March 2010.

Solvency II directive

Press release:
http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/111005.pdf

The EU directive "Solvency II" has been adopted by the EU Council. It sets new solvency rules for insurance companies which many predict will increase the cost of annuities and deferred annuities.

The final text of the directive does not affect pension schemes but a recital says that the EU Commission should conduct its review of the IORP directive (which addresses pension scheme funding) as quickly as possible. It adds that it should "*develop a proper system of solvency rules concerning institutions for occupational retirement provision, whilst fully recognising the essential distinctiveness of insurance and, therefore, should not prejudge the application of this Directive to be imposed upon those institutions*". The implication seems to be that the IORP regime may need strengthening, but not necessarily so as to replicate the regime that applies to insurance.

Financial Services Bill

Parliament Bill home page:
http://services.parliament.uk/bills/2009-10/financialservices.html

The new Financial Services Bill has been published. Key relevant provisions are as follows:

- The FSA will have power to require the provision of information or documents relevant to the stability of the UK financial system from certain persons (not just regulated persons). Such persons are direct or indirect investors in investment funds (widely defined), managers of investment funds, providers of services and/or facilities to authorised firms, their respective connected persons and such other persons as may be prescribed by regulations.
- The FSA will have power to ban the short selling of certain financial instruments, without prior consultation if considered necessary, and to require disclosure (including by non-authorised persons) of short positions.
- The Treasury will have power to make regulations requiring the preparation of a remuneration report by authorised firms.
- The FSA will have to make rules requiring some or all authorised firms to have and implement a remuneration policy, and power to require firms to amend their policy where it does not meet the FSA's requirements.
- The FSA will have power to make rules prohibiting some methods of remunerating employees (e.g. multi-year guaranteed bonuses and large cash bonuses) and to provide that any provision in breach will be unenforceable. The FSA will also be able to claw back any unlawful bonuses.
- Courts will be able to allow collective proceedings (analogous to US-style class actions) against authorised firms and others, for example by consumer groups or representative bodies.

For more on the Bill, please see our more detailed briefing:

http://www.traverssmith.com/assets/pdf/Legal_Briefings/financialservicesbill.pdf

Pension Protection Fund

Press release:
http://www.pensionprotectionfund.org.uk/news/pages/details.aspx?itemID=138

2011/12 Pension Protection Levy: insolvency risk

The PPF has published proposals for the 2011/12 pension protection levy year to change the way it assesses insolvency risk. Key changes will include the following.

- Type B contingent assets (security over cash, real property or securities) will be excluded from Dun & Bradstreet insolvency risk scores, as they reflect the financial position of the scheme rather than the employer.

- When measuring the failure score of a subsidiary whose parent company is at substantial risk of insolvency, the score of the subsidiary will be that of the parent.
- Businesses with three or more branches in different UK regions will be assessed as a national, rather than a regional, employer.
- Employers who seek changes to their industry sector or geographical region will need to show supporting evidence.
- Charities will not need to submit accounts to the PPF; it will obtain them from the Charity Commission.

The consultation closes on 14 December 2009. Note that the changes will have an impact from 31 March 2010 because failure scores from then will apply in the 2011/12 pension protection levy year.

PPF administration levy and general levy
The Pensions Minister, Angela Eagle, has confirmed to Parliament that the PPF administration levy and the general levy will remain unchanged for 2010/11 (as they did for 2009/10 after a significant increase in 2008/9).

Hansard report:
http://www.publications.parliament.uk/pa/cm200809/cmhansrd/cm091109/wmstext/91109m0002.htm#0911094000021

Annual report 2008/9
The PPF has published its annual report for the year to 31 March 2009. It then had £2.9 billion of assets, with an investment return over the year of 13.4%. However, increased claims resulted in an increased deficit, with the PPF being 88% funded (i.e. £1.2 billion underfunded).

Press release:
http://www.pensionprotectionfund.org.uk/news/pages/details.aspx?itemID=137

HMRC modification regulations

Regulations:
http://www.opsi.gov.uk/si/si2009/uksi_20093055_en_1

The Registered Pension Schemes (Modification of the Rules of Existing Schemes) Regulations 2009 came into force on 11 December 2009 but with effect backdated to 6 April 2006.

The regulations relate to schemes with amendment powers, reflecting the pre-A day tax approval regime, requiring the consent, approval, confirmation, etc. of the Inland Revenue (or HMRC) in relation to amendments. Any such requirement is to be disregarded but only until 5 April 2011 or, if earlier, the date on which the scheme rules are amended to disapply these transitional provisions. (If a scheme has already disapplied the 2006 Modification Regulations, it may nevertheless rely on these new regulations, which are free-standing.)

Further legislation is expected during 2010 to allow schemes with restricted amendment powers to be amended to remove the redundant requirement for Inland Revenue (or HMRC) consent, approval, confirmation, etc.

Authorised payments regulations

Regulations:
http://www.opsi.gov.uk/si/si2009/uksi_20092930_en_1

The Occupational and Personal Pension Schemes (Authorised Payments) Amendment Regulations 2009 came into force on 1 December 2009. They amend contracting-out and other legislation to allow the new forms of pension commutation authorised by HMRC regulations from 1 December – see **WHiP Issue 10**.

Consultation response:
http://www.dwp.gov.uk/docs/pensions-auth-pyt-consultation-response.pdf

The consultation response acknowledges that the regulations do not work as regards the commutation of GMPs. The Government will consider correcting this in miscellaneous amendment regulations planned for April 2010. Trustees wishing to commute benefits that include GMPs should therefore await further developments.

No compensation for distress and inconvenience after death

Determination:
http://www.pensions-ombudsman.org.uk/determinations/docs/2009/sep/74124.doc

In *Mr R J Beard*, the Pensions Ombudsman took the view that he could not make an award for distress and inconvenience because the complainant had died since making his complaint to the Ombudsman. The Ombudsman said: "*In the circumstances, I am not able to make such an award because, unlike financial loss, Mrs Beard is not able to take her husband's distress and inconvenience forward on his behalf*".

Accounting for pensions

Press release:
http://www.iasb.org/News/Press+Releases/IASB+issues+minor+amendment+to+pensions+accounting+and+proposes+consequential+change+for+first-time.htm

The International Accounting Standards Board has issued an amendment to IFRIC 14, which is an interpretation of international accounting standard IAS19 on accounting for pensions. When an entity is subject to a minimum funding requirement, such as the UK's statutory funding objective, and makes an early payment to cover the relevant liability, it may treat that contribution as an asset in its accounts.

This is a correction of a deficiency in the original IFRIC 14, as mentioned in **WHiP Issue 11**.

Perpetuities and Accumulations Act 2009

The Act:
http://www.opsi.gov.uk/acts/acts2009/ukpga_20090018_en_1

This Act has received Royal Assent (but is not yet in force). It applies a perpetuity period of 125 years to new trusts generally but exempts occupational pension schemes, personal pension schemes and public service pension schemes (in much the same way as existing law).

The exemption does not cover instruments nominating benefits under the scheme or made in the exercise of a power of advancement arising under the scheme. The rules against perpetuities and accumulations are still relevant (but usually not problematic) when establishing trusts for lump sum death benefits and when setting up common investment funds and some other pooled investment arrangements.

This and previous issues of WHiP can be found on our website: www.traverssmith.com/?pid=24&level=2&eid=17

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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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