



What's happening in Pensions

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Abolition of DC contracting-out

The Government has confirmed its intention to abolish the option to contract out of the State Second Pension using a DC arrangement (occupational or personal) from 6 April 2012. All restrictions on protected rights will be removed. Because protected rights restrictions had to be written into scheme rules, it may be necessary to make rule amendments to take advantage of these relaxations in legislation.

Hansard extract:

<http://services.parliament.uk/hansard/Commons/bydate/20100312/writtenministerialstatements/part005.html>

Employer debt regulations amendments

The Government has confirmed new options for minimising the impact of statutory debts when a group undergoes a reorganisation. The new options are designed to apply only when the ability of the group as a whole to support a DB pension scheme is not affected.

Regulations:

http://www.opsi.gov.uk/si/si2010/uksi_20100725_en_1

Currently, if an employer in a multi-employer occupational pension scheme ceases to employ any active members of the scheme at a time when other employers still do, there is an "employment-cessation event" and a section 75 debt is usually triggered against that employer.

Consultation response:

<http://www.dwp.gov.uk/docs/employer-debt-draft-regs-response.pdf>

New amending regulations, which have changed in several material respects since the September 2009 consultation (see **WHIP Issue 13**), make the following changes from 6 April 2010.

- If certain conditions are met and specified steps are followed in the right order, there will be no employment-cessation event on the transfer of the business and assets from one employer in an occupational pension scheme to another employer in the same group. Broadly, the new employer must take on the old employer's assets, employees and scheme liabilities and must be at least as likely as the old employer to meet those liabilities (as well as meeting its own scheme liabilities). Only "one-to-one" restructurings will satisfy these requirements, though a series of such arrangements could qualify.

Key differences from scheme apportionment arrangements under the existing regulations are that:

- there is no scheme funding test; and
 - whilst the trustees are involved and need to be satisfied that the relevant requirements are satisfied, their agreement would not be required. There are, however, onerous responsibilities placed on trustees to oversee the restructuring.
- For small scale restructurings, a "*de minimis*" easement may apply. The process is broadly the same, except that the trustees do not need to be satisfied that the new employer is at least as likely as the old employer to meet the scheme liabilities. The following conditions must be met for this to apply:
 - the scheme's PPF "protected liabilities" must have been at least 100% funded at the last valuation;
 - DB members with employment with the old employer must represent less than 3% of all DB members in the scheme (or there must be only one or two of them);
 - the total annual amount of accrued pensions of the members concerned must not exceed £20,000 (rising by £500 each year); and

- no more than 7.5% of DB members (or up to five of them if greater) may become the responsibility of new employers under this provision in any three year period. The total amount of accrued annual pensions of the members concerned must not exceed £30,000 in the three year period.

There are many other technical changes. Please ask us for specific advice if considering taking any steps to address a section 75 debt.

Revised Pensions Regulator guidance on employer debts is expected, following the coming into force of the amending regulations.

We can also expect further amending regulations in due course. The Government has said that it will be looking more closely at:

- restructurings that are more complex than "one-to-one";
- elements of the consultation draft that have been withdrawn from the final amending regulations, including the operation of scheme apportionment arrangements and approved withdrawal arrangements; and
- numerous other technical points that were raised in consultation responses (including in our response).

Unprotected "money purchase benefits"

The Court of Appeal has given a ruling on the meaning of "money purchase benefits" that some people may find counter-intuitive and which might result in changes in legislation relating to scheme funding, employer debts and the Pension Protection Fund.

Bridge Trustees v Yates, now known as *Houldsworth v Bridge Trustees Ltd*, concerned the nature - money purchase or not - of benefits under the Imperial Home Décor pension scheme. It considered the statutory winding-up priority order under the Pensions Act 1995 as it stood in October 2003 (when the scheme entered winding-up) and the 1996 winding-up regulations (which carved money purchase assets and liabilities out of the statutory priority order). This was a hybrid scheme, with various salary-related and money purchase elements. For more detail on the structure of the scheme, please see **WHiP Issue 2**.

The Government successfully applied to be joined to the appeal. It was concerned that the effect of the High Court's decision was that the UK might be in breach of its EU directive obligations to protect pensions. Although it had introduced the scheme funding regime, section 75 employer debts, the PPF and the FAS, the effect of the High Court's decision seemed to be that there were some benefits left unprotected.

The Court of Appeal upheld the High Court's decision in the following respects.

- Benefits can still be "money purchase benefits" (as defined in the Pension Schemes Act 1993) even if:
 - they are paid from the scheme, rather than secured by buying an external annuity;
 - they have a GMP underpin;
 - there is a DB guarantee or underpin; or
 - there is a notional or guaranteed rate of investment return on the DC account.
- Money purchase protected rights fell outside the statutory priority order because they were "money purchase benefits" and were not "underpin benefits" (as defined).

It overturned the High Court decision in the following respects.

- When an employer matches members' voluntary contributions, the part of the DC fund attributable to employer contributions provides "*benefits derived from the payment by any member of voluntary contributions*" for the purposes of the statutory priority order. The employer-funded part therefore has the same statutory priority as the part deriving from the member's own voluntary contributions. Note that it may not always be clear whether contributions are voluntary, for example where DC members have a choice of contribution rates.

Case report:

<http://www.bailii.org/ew/cases/EWCA/Civ/2010/179.html>

- Where there is a GMP underpin, DC benefits must be split as between accrual before and from 6 April 1997, when GMP accrual ended. The earlier portion, with the GMP underpin, includes an "underpin benefit" for the purposes of the statutory priority order (as it stood before 6 April 2005) and so was within its scope despite being a "money purchase benefit"; the later portion has no underpin and so was a "money purchase benefit" outside the scope of the statutory priority order.

The decision potentially has much wider relevance than just for schemes that went into winding-up before the Pensions Act 1995 was amended on 6 April 2005 – if, that is, its interpretation of "money purchase benefits" can be applied to every instance of that term in pensions legislation. The Court of Appeal was careful to say that this is not necessarily the case but this was the reason for the Government intervening in the appeal.

The Court of Appeal's decision gives a wide meaning to "money purchase benefits". This could mean that a scheme with the above features is a "money purchase scheme" as defined in the Pension Schemes Act 1993. That has a range of unfortunate consequences:

- no statutory winding-up priority order will apply, despite the fact that the scheme may well not have enough assets to meet its liabilities;
- section 75 will not apply so (subject to the scheme rules) no employer can be made to make up the deficit;
- the scheme funding legislation will not apply; and
- there will no protection for members under the PPF or FAS.

Members could suffer and the UK may have failed to satisfy its EU directive obligations. The Government therefore seems to have three options:

- Seek leave to appeal to the Supreme Court.
- Change the law to bring such arrangements within the above DB scheme legislation.
- Extend the PPF and/or FAS to protect affected members.

Miscellaneous amendments regulations

Miscellaneous amendments regulations have been laid, with the following effect (all amendments take effect from 6 April 2010).

- The error in the 2009 authorised payments regulations (see **WHIP Issue 15**), whereby very small pensions that include GMPs cannot be commuted under the extended commutation provisions applicable since 1 December 2009, has been corrected. This will now be permitted, but only from 6 April 2010.
- The consultation by employers regulations are amended to add changes to the definition of pensionable earnings (even positive ones) as a new "listed change". The relevant changes are "*to change what elements of pay constitute pensionable earnings [defined], or to change the proportion of or limit the amount of any element [defined] of pay that forms part of pensionable earnings*".

The final regulations differ from the consultation draft. One does not necessarily have to amend the definition in the rules in order to change what counts as pensionable earnings. The new drafting therefore covers most, if not all, pensionable earnings changes that do not need a rule amendment, as well as those that do, for example a re-categorising of pay elements.

The Government has confirmed its view that changes to revaluation or indexation provisions are not "listed changes".

- Trustees are given power to amend scheme amendment powers and other scheme provisions by resolution to remove outdated references to "*agreement, consent, approval or confirmation of continued approval*" by HMRC or Inland Revenue. See **WHIP Issue 15** for background.

Pensions Regulator

Clearance: Reader's Digest

Reader's Digest's UK company has entered administration following the Pension Regulator's refusal to give clearance to a funding deal agreed with the UK pension scheme trustees and the PPF.

Regulations:

http://www.opsi.gov.uk/si/si2010/uksi_20100499_en_1

Consultation response:

<http://www.dwp.gov.uk/docs/occ-pen-misc-regs-2010-response.pdf>

The Regulator has not commented on the reasons for refusing clearance. It seems that the Regulator (a) thinks that the trustees will recover more than the offered funding in section 75 debts and/or (b) is considering using its anti-avoidance powers against the US parent company.

Winding-up delays

The Regulator has published a consultation on revised good practice guidance to help trustees and others meet the two-year time frame in relation to winding up occupational pension schemes. The most notable change is that guidance on the equalisation of benefits that include GMPs has been removed. The consultation closes on 5 May 2010.

Consultation:

<http://www.thepensionsregulator.gov.uk/docs/winding-up-con-doc-2010.pdf>

Pension Protection Fund

Reducing pension protection levies

The PPF and CBI have published a guide "*How to reduce your pension protection levy*". It suggests ten actions that can be taken to reduce the levy and ensure that the correct amount is paid.

PPF/CBI guide:

http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/how_to_reduce.pdf

Guidance on disclaiming onerous contracts or terms

The PPF Board has issued guidance for trustees and counterparties on its powers to modify and disclaim onerous contracts under the Pensions Act 2004. This follows an earlier consultation (see **WHiP Issue 9**). Uncertainty in this area was resulting in additional termination clauses being inserted into investment contracts by counterparties for the automatic termination of the contract if the scheme transfers to the PPF.

PPF news item:

<http://www.pensionprotectionfund.org.uk/news/pages/details.aspx?itemID=158>

There is drafting for additional termination events included in the guidance, which trustees are strongly encouraged to adopt in their ISDA contracts. The additional termination events would then not apply if the PPF declares by deed that it will not exercise its powers in this regard.

The guidance also lists the following as contracts or terms that the PPF would consider to be onerous and might therefore seek to disclaim or modify:

- contracts made with persons connected to or associated with the trustees;
- contracts entered into during the assessment period or just before it;
- terms that provide for a specified outcome (e.g. an additional charge) if a scheme transfer to the PPF occurs or becomes likely;
- terms triggered by employer insolvency events, scheme rescue, scheme transfer, etc;
- terms restricting a third party's liability to the trustees; and
- termination provisions with long notice periods or termination penalties; or no termination provisions.

Trustees are expected to consider these points carefully when entering into any contracts.

Miscellaneous amendment regulations

Regulations will come into force on 1 April 2010 (except where stated below) which:

- provide for the charging of interest on pension protection levies that are paid more than 29 days after the invoice date;
- change the age from which a person can apply for early payment of PPF compensation from 50 to 55 (from 6 April 2010) and remove the six month notice period for early compensation applications; and
- provide for compensation in respect of career average schemes to be calculated using the admissible rules of the scheme.

Regulations:

http://www.opsi.gov.uk/si/si2010/ukSI_20100560_en_1

Pension protection levy: insolvency risk

The PPF has published the "*2011/12 Pension Protection Levy Consultation Policy Statement: Insolvency Risk*", following an earlier consultation (see **WHiP Issue 15**). Points to note are as follows.

Consultation response:

<http://www.dwp.gov.uk/docs/ppf-consultation-response-0310.pdf>

- Businesses with three or more branches in different UK regions will be assessed as a national, rather than a regional, employer.

Policy statement:

http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/policy_statement_insolvency_risk.pdf

- "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.
- 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 website.

Affected employers are advised to contact Dun & Bradstreet to ensure that they will be using the correct information.

Automatic enrolment: hybrid schemes

Draft regulations have been published providing further detail on what certain types of hybrid scheme will need to do to meet the quality requirements for automatic enrolment schemes (see **WHIP Issue 16**). The schemes specifically covered are:

- contracted-out hybrid schemes
- sequential hybrid schemes
- self-annuitising hybrid schemes
- cash balance schemes
- final salary lump sum schemes
- combination hybrid schemes.

There is also a general rule applicable to schemes that provide members with DC and DB accrual at the same time. For such schemes, if either section satisfies the quality requirements then the test is satisfied. DC schemes that provide insured lump sum death benefits are not "money purchase schemes" (as defined) and so will be subject to this general rule.

HMRC: registered pension schemes

Short service refunds: tax rates

Following the introduction of the new 50% income tax band from 6 April 2010, regulations amend the tax charge on short service refunds. 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. Refunds paid on or after 6 April 2010 will be taxed at 20% on the first £20,000 and 50% on the excess.

Extension of transitional protections

New regulations allow pre-A-day protections for early pension ages and large pension commencement lump sums to continue in wider circumstances, when transferred between schemes as part of a reorganisation or winding-up. The amendments are backdated to 6 April 2006. The protections now also apply:

- when members' benefits are transferred into an annuity policy rather than to another scheme; and
- when an existing annuity policy is assigned to the member.

Rights to stand-alone lump sums are included, so that they continue to be protected when a scheme winds up and they are secured externally.

New requirement to report excess borrowing

New regulations require scheme administrators to report to HMRC, following the end of the tax year, when a registered pension scheme has borrowed a sum in excess of the limits set out in the Finance Act 2004. A scheme sanction charge of 40% has applied since 6 April 2006 to the amount above the relevant limit but until now there has been no reporting requirement.

Draft regulations:

<http://www.dwp.gov.uk/docs/wpr-hybrid-schemes-qual-req-rules.pdf>

Regulations:

http://www.opsi.gov.uk/si/si2010/ukSI_20100536_en_1

Regulations:

http://www.opsi.gov.uk/si/si2010/ukSI_20100529_en_1

Regulations:

http://www.opsi.gov.uk/si/si2010/ukSI_20100581_en_1

HMRC: Tax relief changes

Special annual allowance charge

Regulations extend protection against the "anti-forestalling" special annual allowance charge (SAAC):

- where there is a change in personal pension provider, but not of contribution rates, on or after 22 April 2009 and the new arrangement begins not more than three months after the old one ends (but see below);
- for contributions (or DB benefits) which an individual or the employer was contractually committed to provide as at 22 April 2009 but which had not started by then; and
- for DC contributions made on 22 April 2009 as well as before then.

Note that, for reasons that have not been explained, the extended protection for a change of personal pension provider does not apply when there is a change of group personal pension provider.

Draft clauses for the next Finance Bill have been published, providing that the SAAC rules apply to those with a relevant income of £130,000 (not £150,000) or more from 9 December 2009 (see **WHIP Issue 15**).

Tax relief changes from 6 April 2011

HMRC has held three workshops on implementing the policy for restricting high earners' pensions tax relief from 6 April 2011 (see **WHIP Issue 15**). The slides and discussion notes have been published on the internet.

DC schemes: investment guidance

The Investment Governance Group (connected to the Pensions Regulator) has published a consultation paper on draft investment governance principles and best practice guidance for both trust-based and contract-based DC work-based pension schemes. The proposed principles address:

- accountability and delegation;
- fund choices and default strategy; and
- communications with members.

The consultation closes on 5 May 2010.

GMP equalisation indemnities

In the case of *Mr A S Barnett*, the Pensions Ombudsman determined that there was no maladministration when a proposed individual transfer was prevented by the transferor scheme declining to sign an indemnity form in respect of GMP-related inequalities and the transferee scheme refusing to waive its standard requirement in this regard.

The transferring scheme was purely DC, with no GMPs, so the transferring scheme trustees could have felt reasonably comfortable in signing the indemnity and the receiving scheme might have agreed to accept the transfer without an indemnity. But they were each entitled to do what they did.

Data protection

New powers to impose fines of up to £500,000 for serious contraventions of data protection law will come into force on 6 April 2010. Guidance from the Information Commissioner gives examples of serious contraventions. These include the loss of data due to inadequate security or operational procedures, for example using unencrypted files and losing data on a disc, memory stick or laptop, or losing records during an office move.

Order:

http://www.opsi.gov.uk/si/si2010/ukSI_20100429_en_1

HMRC announcement:

<http://www.hmrc.gov.uk/pensionschemes/allowance-charge.htm>

Updated HMRC guidance:

<http://www.hmrc.gov.uk/pensionschemes/consolidated-saa-changes.pdf>

HMRC news page:

<http://www.hmrc.gov.uk/news/annual-allowance.htm>

HMRC web page:

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

Press release:

<http://www.thepensionsregulator.gov.uk/docs/igg-press-release-2010.pdf>

Determination:

<http://www.pensions-ombudsman.org.uk/determinations/docs/2010/jan/76149.doc>

Regulations:

http://www.opsi.gov.uk/si/si2010/ukSI_20100031_en_1

Guidance:

http://www.ico.gov.uk/upload/documents/library/data_protection/detailed_specialist_guides/ico_guidance_monetary_penalties.pdf

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.

Travers Smith LLP
10 Snow Hill
London EC1A 2AL
T: +44 (0)20 7297 3000
F: +44 (0)20 7295 3500

www.traverssmith.com