TRAVERS SMITH

What's happening in Pensions

Issue 19 | *July 2010*

Coalition Government policies and the Budget

Two documents have been published setting out agreements reached between the Conservatives and the Liberal Democrats in forming the coalition Government. The emergency Budget on 22 June made further announcements. Key developments relating to pensions are as follows.

- The Government will "*simplify the rules and regulations relating to pensions to help reinvigorate occupational pensions, encouraging companies to offer high-quality pensions to all employees, and … will work with business and the industry to support auto enrolment*".
- The provisions of the Finance Act 2010 affecting high earners' pension savings (see **WHiP Issue 18**) will be repealed, but not the anti-forestalling special annual allowance charge provisions in the Finance Act 2009. The Government will work with the pensions industry and employers to find alternative proposals to raise the same amount of revenue, probably by reducing significantly the annual allowance for higher rate income tax payers. No consultation has yet been launched but the Government has indicated that an annual allowance of between £30,000 and £45,000, with appropriate safeguards, will be considered.
- The use of non-registered pension schemes (EFRBSs) to avoid tax, including those used to avoid the pensions tax relief restrictions, will be tackled. A general anti-tax avoidance rule is also proposed. Details are to follow.
- The earnings link for the basic state pension will be restored from April 2011 with a "triple guarantee" that pensions are increased annually by the highest of national average earnings, the consumer prices index (RPI for the April 2011 increase) and 2.5%.
- The state pension age will rise to 66, not sooner than 2016 for men and 2020 for women. (It is currently due to start rising from 2024 for both sexes.) A review will be held to determine the effective date. Employers and others are asked to submit evidence for consideration.
- Compulsory annuitisation at age 75 will be abolished from 6 April 2011. Those reaching age 75 in the meantime will be allowed to defer annuitisation until age 77. We presume that the age 77 limit will then also be abolished.
- The default retirement age for age discrimination purposes will be phased out. The timescale has not been specified.
- The Government will "explore the potential to give people greater flexibility in accessing part of their personal pension fund early", for example the 25% lump sum.
- Automatic enrolment and NEST will be subject to an independent review. The NEST administration contract with Tata Consultancy Services will also be reviewed.
- An independent commission, chaired by John Hutton, will be set up to review the long-term affordability of public sector pensions "while protecting accrued rights".
- Employer NIC thresholds will be increased, to counteract the NIC rate increases introduced by Labour due to take effect from April 2011. Employee NIC thresholds will not be increased.

Coalition Government publications:
http://www.conservatives.com/~/media/Files/Downloadable%20Files/agreement.ashx?dl=true

http://programmeforgovernment.hmg.gov.uk/

Budget (HM Treasury):
http://www.hm-treasury.gov.uk/2010_june_budget.htm

Budget (HMRC):
http://www.hmrc.gov.uk/budget2010/index.htm

Statement on tax relief:
http://www.hm-treasury.gov.uk/d/junebudget_restricting_pension.pdf

Call for evidence on age 66 SPA:
http://www.dwp.gov.uk/docs/spa-inc-to-66-call-for-evidence.pdf

Pensions Regulator issues first contribution notice

Press release:
http://www.thepensionsregulator.gov.uk/press/pn10-11.aspx

The Pensions Regulator's determinations panel has issued a contribution notice against a Belgian company, Michel Van De Wiele N.V. ("MVDW"), in relation to the Bonas Group Pension Scheme. MVDW was the parent company of Bonas UK Limited, a textile machinery business, which sponsored the scheme. This is the first contribution notice issued by the Regulator.

MVDW, through its control of Bonas, used a "pre-pack" administration to transfer the business and assets of Bonas to a newly formed subsidiary whilst leaving the pension scheme liabilities (about £8 million) with the insolvent company. All of Bonas's other creditors were paid in full by MVDW before the administration began. The scheme trustees and the Regulator were not informed of the proposal until it was carried out. The panel found that this was a deliberate act.

A contribution notice is an order for the recipient to pay a specified sum to a specified pension scheme. Very broadly, the Regulator is able to issue a contribution notice, if it considers it reasonable to do so, to a party to an act, or a failure to act, a main purpose of which was to prevent the recovery of all or part of a section 75 debt from the employer. (As a result of subsequent changes to the law, a contribution notice can now also be issued if, broadly, there is an act, or failure to act, which may materially detrimentally affect the likelihood of scheme benefits being received.)

The Regulator's determinations panel decided that the conditions were all met. The acts in question were the decision by MVDW to place Bonas into administration without engaging openly with the trustees or the Regulator and retaining the business within the group while avoiding the pension liability.

MVDW argued that there was no prevention of recovery of a section 75 debt because Bonas never had the means to pay any such debt. The panel rejected this, saying that MVDW's attempt to avoid incurring a liability to the scheme, for example by a contribution notice or financial support direction, amounted to an attempt to prevent recovery of some or all of a potential section 75 debt, since any such liability would have been based on the section 75 debt. The panel therefore took a wide and purposive view of the legislation.

The following points are also of interest:

- The amount specified in the contribution notice as the sum required by the Regulator to be paid by MVDW was £5.089 million, being the amount required to bring the scheme up to full funding on a Pension Protection Fund valuation basis. It is interesting that the Regulator did not seek more, for example to fund the scheme on a full buy-out basis. The real beneficiary of the contribution notice is therefore the Pension Protection Fund, not the scheme members.
- MVDW is a Belgian company. The Regulator considers that it is able to enforce contribution notices against overseas companies.
- The determination quotes heavily from advice to and correspondence with the companies. This showed the panel that MVDW knew the risks of enforcement action by the Regulator and, in the panel's view, took "a calculated and deliberate risk" in abandoning the scheme and not involving the trustees or the Regulator. It is clear that the Regulator's extensive information-gathering powers enabled it to obtain a lot of documentary evidence on which to found its case.

It is expected that MVDW will appeal the determination.

The panel declined to issue a contribution notice against MVDW's chairman, Mr Beauduin. This decision was reached on the basis that, although he had been centrally involved in all the relevant decisions, he had not been acting in a personal capacity and so it would not be reasonable to issue a contribution notice against him personally.

Marine pilots litigation

Case report:
http://www.bailii.org/ew/cases/EWHC/Ch/2010/1573.html

In **WHiP Issue 16**, we reported on a significant case in the pipeline concerning the liability of employers and others to defined benefit pension schemes. At the time of writing, the High Court's 179 page judgment had just been issued. We will report separately on this case.

Payments to employers

Section 251 of the Pensions Act 2004 may require trustees to pass a resolution before 6 April 2011 if they are ever to be able to make payments to an employer. Three months' notice must be given to all members and employers before such a resolution can be passed. The requirements apply to any DB or DC scheme if its rules on 5 April 2006 included a power to make payments to an employer. We recently issued a briefing note on this, with more detail and suggested action points: please let us know if you have not received a copy.

The Government have now said that they do not intend to amend section 251, despite expressing the view that it does apply on a winding-up and acknowledging that it unintentionally covers administrative payments as well as payments from surplus. Trustees and employers should therefore be considering what steps they wish to take.

Pensions Regulator

Monitoring the employer covenant
The Pensions Regulator has issued a consultation (closing on 7 September 2010) on draft guidance on monitoring employer support. It covers:

Pensions Regulator website: http://www.thepensionsregulator.gov.uk/strength

- *"the importance of measuring covenant*
- *understanding a group's legal structure and an employer's legal obligations*
- *what to consider when assessing the employer's financial position*
- *what to consider when valuing alternative forms of scheme security other than cash payments to the scheme*
- *when to appoint external covenant assessors and the process to follow in doing so*
- *the importance of regular monitoring of covenant, and actions to take based on this".*

A one page "short guide for employers" and a "bite-sized learning" module have also been issued.

An earlier statement had set out briefly what the Regulator expects of trustees with regard to the employer covenant. This includes an expectation that trustees "*ask probing questions to properly understand the covenant the employer provides for the scheme*", engaging professional help "*where they have any doubts about their ability to do this*".

Statement: http://www.thepensionsregulator.gov.uk/docs/employer-support-DB-statement-june-2010.pdf

Record-keeping
The Pensions Regulator has published guidance for trustees on member record-keeping. It follows a consultation (see **WHiP Issue 16**). Few changes have been made to the consultation draft. The Regulator recommends that schemes take up the guidance as an essential tool within their internal controls processes. There are targets for the standards of data (100% for new data and 95% for old data) and a December 2012 deadline for schemes to have addressed any problems.

Guidance: http://www.thepensionsregulator.gov.uk/guidance/guidance-record-keeping.aspx

Consultation response: http://www.thepensionsregulator.gov.uk/docs/record-keeping-consultation-response.pdf

The Regulator intends to take action against trustees or managers who fail to keep basic records properly.

Internal controls
The Pensions Regulator has published revised guidance on trustees' internal controls, following its December 2009 consultation (see **WHiP Issue 15**). The guidance adopts five high-level principles:

Guidance: http://www.thepensionsregulator.gov.uk/codes/code-related-internal-controls.aspx

- understanding the importance of adequate internal controls;
- identifying risk;
- evaluation of risk – assessing impact;
- managing risk; and
- effective monitoring of controls.

Consultation response: http://www.thepensionsregulator.gov.uk/docs/internal-controls-consultation-response.pdf

Particular emphasis is placed on the importance of regularly reviewing risk and recording risks in a formal register.

Winding-up
The Pensions Regulator has published revised guidance on winding-up, following its February 2010 consultation (see **WHiP Issue 17**). In its June 2008 guidance, it set a two year target for completing any winding-up then in progress. That period expires on 30 June 2010: schemes still in winding-up can expect intensive scrutiny.

Guidance: http://www.thepensionsregulator.gov.uk/guidance/guidance-winding-up.aspx

A consultation response has also been published. References in the previous edition of the guidance to GMP equalisation have been removed so as to avoid potential inconsistency with the position of the DWP and with FAS and (forthcoming) PPF guidance in this area.

Consultation response: http://www.thepensionsregulator.gov.uk/docs/winding-up-consultation-response.pdf

Independent trustee register

The Pensions Regulator has published a response to its December 2009 consultation on how it assesses some of the judgment-based conditions for acceptance onto the Trustee Register (e.g. having sufficient relevant experience). A draft application form has also been published.

Consultation response:
http://www.thepensionsregulator.gov.uk/docs/trustee-register-consultation-response.pdf

Special annual allowance: refunds of contributions

HMRC RPSM page:
http://www.hmrc.gov.uk/manuals/rpsmmanual/rpsm15108060.htm

Newly published pages of the Registered Pension Schemes Manual confirm that the tax charge on contributions refund lump sums will be 50%, to reflect the new highest income tax band. These are the refunds that may be claimed by high earners who inadvertently trigger the special annual allowance charge.

This was a knock-on effect of the amendment to the tax charges for short service refund lump sums made by regulations earlier this year (see **WHiP Issue 17**): the Finance Act 2009 links the tax charge on contributions refund lump sums to the highest rate charged on short service refund lump sums under the Finance Act 2004. This means that an individual who has received 40% tax relief on his or her 2009/10 pension contributions could pay tax at 50% on the refunded contributions.

Compromising pension disputes

The Court of Appeal has been hearing the appeal of *HR Trustees Ltd v German* (see **WHiP Issue 15**). We understand that the parties wish to agree a settlement. However, the High Court had ruled that section 91 of the Pensions Act 1995 (which generally prohibits assignment or surrender of rights under an occupational pension scheme) precludes any compromise of benefit claims. The Court of Appeal has therefore been asked to overturn this aspect of the High Court judgment, so that the case can be settled. We understand that the Court of Appeal will be giving a ruling to this effect.

The decision is yet to be published. We expect that it will remove doubts raised by the High Court's judgment about the scope of section 91.

Civil Service Compensation Scheme: accrued rights

Case report:
http://www.bailii.org/ew/cases/EWHC/Admin/2010/1027.html

The Civil Service Compensation Scheme (CSCS) contains a provision preventing the reduction of benefits in so far as "*directly or indirectly referable to rights which have accrued*" unless member representatives (i.e. trade unions) have agreed.

Civil Service redundancy rights have always been subject to a common law and statutory discretion to withdraw them but in practice have been paid when the conditions were met. The Government agreed changes with five out of six trade unions but one, the Public and Commercial Services Union (PCSU), did not agree. Nevertheless, the changes were purportedly implemented on 1 April 2010.

In *R (on the application of PCSU) v Minister for Civil Service*, PCSU challenged the legality of the implementation. The High Court agreed with PCSU's arguments that:

- "*rights which have accrued*" included rights to early pensions on redundancy and in similar circumstances that were not legal entitlements but that were "*entitlements as a matter of established and declared administrative practice*" as set out in the terms of the CSCS; and
- such rights are not limited to benefits payable when retirement occurs at normal retirement age but also include rights to benefits under the CSCS on redundancy, compulsory early retirement, etc.

The High Court therefore decided that the amendments to the CSCS should be quashed. There will be further consideration between the parties of the proper extent of the quashing, with any dispute being referred back to the Court.

The case report is relatively short. It is not clear to what extent it is relevant to most private sector pension schemes with restricted amendment powers. In particular, there does not seem to have been argument about the meaning of "accrued".

Inheritance tax and omission to exercise pension options

Case report:
http://www.bailii.org/uk/cases/UKFTT/TC/2010/TC00398.html

In *Fryer v HMRC*, the First Tier Tribunal ruled in favour of HMRC over an inheritance tax claim for unclaimed personal pension benefits.

Section 3(3) Inheritance Tax Act 1984 provided at the relevant time (the current language is very similar) that:

> *"Where the value of a person's estate is diminished and that of another person's estate, or of settled property where no interest in possession subsists, is increased by the first-mentioned person's omission to exercise a right, he shall be treated for the purposes of this section as having made a disposition at the time (or latest time) when he could have exercised the right, unless it is shown that the omission was not deliberate."*

In 1995, Mrs Arnold took out a personal pension policy under which she could take her benefits at any time between ages 50 and 75. The "normal retirement date" she chose was 8 September 2002 (her 60th birthday, it seems). In April 2002, she was diagnosed with cancer and she died on 30 July 2003 without having drawn any benefits under the policy. Benefits then fell to be paid to her dependants under discretionary trusts free of inheritance tax.

HMRC had determined that her deferral of benefits under the policy beyond 8 September 2002 was the result of a deliberate decision and that there was a disposition of the value of the policy benefits for the purposes of section 3(3).

The Tribunal found as follows.

- Mrs Arnold had omitted to exercise her right but the disposition date should be treated as the day she died, not 8 September 2002, this being the "latest time" when she could have exercised the right. Her decision not to take benefits was a conscious and deliberate one, albeit that she had apparently taken it because she did not need the money rather than to keep the pension benefits outside her estate.
- Because the policy included discretionary trusts in the event of her death, there was settled property whose value had increased for the purposes of section 3(3). It was irrelevant that this did not exist until after she died.

The fact that HMRC claimed inheritance tax in this case suggests a change in policy in this area. In the past, HMRC has indicated that tax would be payable only in cases where there was evidence of a personal pension scheme being used to avoid inheritance tax by someone with short life expectancy. There was no evidence, however, of that being the intention in the *Fryer* case and indeed the Tribunal found the contrary.

HMRC IHTM page:
http://www.hmrc.gov.uk/manuals/ihtmanual/ihtm17092.htm

Providing sufficient information about members' options

Determination:
http://www.pensions-ombudsman.org.uk/determinations/docs/2010/mar/74426%202.doc

Mr D McLeish complained that leaving service options given to him were inadequate to enable him to make a proper decision. The Ombudsman determined that he should have been given more information to be able to work out that one of the options was plainly unattractive.

When he left service in 1995, Mr McLeish was given the options of a refund of contributions (with reinstatement in SERPS), a deferred pension or a transfer. He chose the deferred pension option.

In 2006, the scheme commenced winding-up. In 2007, Mr McLeish requested an early retirement pension quotation. This was ignored and the administrators reinstated him in SERPS and sent a cheque representing refunded contributions (without interest and without explanation). He sent this back and started an IDR dispute.

The administrators informed him that he would be better off being reinstated in SERPS and taking a contribution refund and that he could not have an early retirement pension in any event because it would be lower than his GMP at age 65.

The scheme was underfunded, so the decision had been taken to pay contributions equivalent premiums (CEPs) and contribution refunds for deferred pensioners. Members would thereby receive a benefit broadly equivalent to the GMP (plus indexation), which was better than the PPF compensation that would otherwise have been paid to them. They would also receive a refund of their own contributions.

The Pensions Ombudsman found that there was nothing to be gained in 1995 by choosing the deferred pension option, because Mr McLeish's contributions were very close to the actuarial value of the GMP and less than the CEP. The deferred pension option was plainly less attractive than reinstatement in SERPS plus a contribution refund. Mr McLeish was not given sufficient information by the then administrators to be able to work this out for himself because he was not told what the SERPS reinstatement would be.

Had he been given appropriate information in 1995, he "inevitably" would have taken the SERPS/contribution refund option. He had lost the use of the contribution refund and should now receive interest on the refund but only up to the date when he was sent the cheque representing the refund of contributions that he did not bank.

Contracting-out guidance

HMRC has updated its CA14 guides to contracting-out procedures

Press release:
http://www.hmrc.gov.uk/pensionschemes/news.htm

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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