TRAVERS SMITH

What's happening in Pensions

Issue 2 *May 2008*

Pensions Regulator - Proposed new anti-avoidance powers

The Government announced new powers for the Pensions Regulator on 14 April, and issued a more detailed consultation paper on 25 April. The new powers are to take effect retroactively from 14 April 2008 and will have an impact on corporate activity, including transactions and reorganisations, mergers and bulk transfers.

Before 14 April, the Regulator could issue a contribution notice (requiring a company or individual to pay a specified sum into a pension scheme) only if there had been intent (a) to avoid or reduce a section 75 debt and the party had acted otherwise than in good faith, or (b) to prevent the recovery of such a debt. From 14 April 2008, the Regulator is to be able to issue a contribution notice in respect of any act, course of action or default that is materially detrimental to the security of pension scheme members' benefits. A major element of benefit security is the strength of the sponsoring employer's covenant.

The Government has stated that this widening of the Regulator's powers is aimed at the "selling" of pension schemes, i.e. separating the scheme from its sponsoring employer (or its business or assets) as an alternative to securing benefits with an FSA-regulated insurer. This kind of "selling" of a scheme is what happened with Telent and Pensions Corporation. The power is deliberately wider than that, in order to cope with unforeseen changes in the pensions buyout market and its alternatives, but the Regulator has agreed to exercise its new powers only in particular circumstances. Those (loosely worded) circumstances are:

- *moving the employer or pension scheme to another jurisdiction;*
- *splitting the operating company from the pension scheme without appropriate mitigation for the pension scheme;*
- *splitting the assets from the operating company without appropriate mitigation for the pension scheme;*
- *transferring scheme assets and liabilities to another scheme which did not have adequate support from an employer;*
- *running a scheme for profit without adequate account being taken of member interests;*
- *business models in which risk is predominantly borne by scheme members, but high investment returns would benefit investors.*

This will apply to transactions occurring before the legislation is in force, at which point fuller Regulator guidance is expected.

We foresee an increase in applications for clearance (the procedure under which the Regulator can be asked to confirm that it will not exercise its powers), since the above list of circumstances can include some "normal" areas of corporate activity. For example, leveraged acquisitions, management buyouts, returns of capital to shareholders, internal restructurings and scheme mergers may be caught, depending on the circumstances.

We expect that the new legislation will, in effect, validate clearance statements that have already been issued in anticipation of the additional retrospective powers.

Consultation paper:

http://www.dwp.gov.uk/consultations/2008/consultation-regulator-powers.pdf

Minister's statement:

http://www.dwp.gov.uk/consultations/2008/statement-regulator-powers.pdf

Pensions Regulator's statement:

http://www.thepensionsregulator.gov.uk/whatsNew/pn08-10.aspx

Employer Debt Regulations – Emergency amendment

Following the amendment of the Employer Debt Regulations with effect from 6 April 2008, as mentioned in WHiP Issue 1, the Government has laid further, emergency regulations to correct an error. These are the Occupational Pension Schemes (Employer Debt – Apportionment Arrangements) (Amendment) Regulations 2008 (SI 2008/1068). They

Amending regulations:

http://www.opsi.gov.uk/si/si2008/pdf/uksi_20081068_en.pdf

came into force on 15 April 2008. They correct a flaw in the amending regulations which would have allowed trustees unilaterally (subject only to consultation) to apportion any amount they wished to a withdrawing employer (including a higher amount than its "liability share").

Explanatory memorandum:

http://www.opsi.gov.uk/si/si2008/em/uksiem_20081068_en.pdf

Employer consent is now needed to a scheme apportionment arrangement or a regulated apportionment arrangement, as follows.

- Where the amount apportioned is less than the liability share, the remaining employer(s) whose liability is thereby increased must consent.
- Where the amount apportioned is greater than the liability share, the withdrawing employer must consent.
- In the case of a regulated apportionment arrangement, employer consent is needed only if the PPF assessment period has not already commenced.

Transfer values - New amending regulations

The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008 (SI 2008/1050) were laid before Parliament on 11 April 2008. They amend the 1996 Transfer Value Regulations with effect from 1 October 2008.

Amending regulations:

http://www.opsi.gov.uk/si/si2008/uksi_20081050_en_1

Consultation report:

http://www.dwp.gov.uk/consultations/2007/acptv.pdf

The principal changes as regards the calculation of statutory minimum cash equivalent transfer values are as follows:

- The responsibility for calculating and verifying cash equivalents and (for salary-related benefits) the assumptions used to calculate them will pass from the actuary to the trustees.
- The value of salary-related benefits must be calculated on an overall "best estimate" basis.
- The actuary's advice must be obtained but there is no need for the actuary (or the trustees) to certify the actuarial methods and assumptions. There is no employer involvement in the process.
- The cash equivalent of salary related benefits must be calculated on an actuarial basis and (before any adjustment) must be "the amount at the guarantee date which is required to make provision within the scheme for a member's accrued benefits, options and [if applicable] discretionary benefits" (i.e. a scheme-specific basis).
- When deciding what assumptions to make when calculating discount rates, trustees must have regard to the scheme's investment strategy.
- Money purchase benefits are valued by reference to their “realisable value”, including any increases “resulting from a payment of interest made in accordance with the scheme rules”.
- When calculating a cash equivalent, the trustees must consider the extent to which the exercise of options given to the member could increase the value of his or her benefits. Trustees may make an adjustment to reflect the proportion of members likely to exercise the relevant options.
- Trustees must also decide whether any prospect of discretionary benefits should be taken into account, having regard to any established custom and any consent requirement.
- Trustees may still reduce cash equivalents to reflect reasonable administrative costs, but any such reduction must take into account ongoing savings (but not so as to increase the cash equivalent).
- There will no longer be a requirement for the scheme actuary to tell the trustees that cash equivalent transfer values may affect the scheme’s funding position or members’ benefit security.
- There will not be any requirements as regards the calculation of transfer credits in respect of transfers-in. However, the Government will be asking the Pensions Regulator to consider this issue in its forthcoming guidance.
- There is no longer any additional requirement that, where the member has previously transferred in benefits, the cash equivalent should be equitable in relation to, and consistent with, the transfer value received.
- There is no requirement to split transfer value quotations into their component parts (i.e. as regards contracted-out benefits). In practice, however, this will need to continue because the receiving scheme will require this information.
- There are detailed requirements for the preparation of insufficiency reports (which

allow cash equivalent transfer values to be reduced to reflect a deficit).

- There will be new disclosure requirements: members of a salary related scheme who have requested a transfer value quotation must be told:
  - that the FSA, the Pensions Regulator and TPAS provide information that may assist them in making their decision;
  - (if it is the case) that the scheme is PPF eligible and that the Board of the PPF exists; and
  - that they should consider seeking financial advice.
- There is no requirement to disclose assumptions to members. Schemes will be given the latitude to develop their own policy.
- A problem with the existing legislation regarding defined contribution cash transfer sums will be corrected. These can now be adjusted between the date of leaving to the date of disinvestment, in line with investment returns. Under primary legislation, however, the value of the cash transfer sum as at the date of leaving pensionable service must still be quoted as well.

Trustees may pay amounts higher than the statutory minimum if the scheme's trust deed and rules allow and subject to any consent requirement specified there.

The amended regulations preclude the need for an actuarial guidance note, so GN11 will be withdrawn on 1 October 2008. There will be Pensions Regulator guidance in due course.

Pensions Bill

The Pensions Bill has completed its House of Commons stages and has moved on to the House of Lords. There is a new draft available. The bulk of the amendments agreed to date relate to the Personal Accounts regime that is intended to commence in 2012.

There are two other amendments of interest:

- the Bill will allow the Pensions Regulator to appoint a trustee where it is "reasonable" (rather than "necessary", as at present) to do so in order to achieve one of three stated objectives; and
- the Bill will add a wide, fourth objective for which the Regulator will be able to appoint trustees: "otherwise to protect the interests of the generality of the members of the scheme". (See clause 109, amending s7(3) Pensions Act 1995.)

Parliament website page:

http://services.parliament.uk/bills/2007-08/pensions.html

Money Laundering Regulations – Trust or company service providers

In WHiP Issue 1, we reported on the expectation, in April, of improved guidance as to the requirement for trustees to register with HM Revenue & Customs (HMRC) as "trust or company service providers" under the Money Laundering Regulations. The guidance has not yet appeared. HMRC has therefore extended the registration deadline again. The new deadline will be at least four weeks from the date on which the new guidance is published.

HMRC update:

http://www.hmrc.gov.uk/mlr/update-tcsp.htm

Pensions Ombudsman determination – Delayed transfer

There was a delay by Skandia in processing Mr Miller's DC transfer request and the transfer value fell during the period of delay. Skandia defended itself by saying that it was well within the Association of British Insurer's guideline times for processing transfers, but the Ombudsman found that it should have processed the transfer within its normal ten working day turnaround time. In fact, it had taken eleven working days and the transfer value had dropped £2,050.86 on the eleventh working day. Skandia was ordered to pay Mr Miller that amount, in cash because it was too small to be used to buy an annuity.

Ombudsman determination:

http://www.pensions-ombudsman.org.uk/determinations/docs/2008/mar/26811.doc

Trustees' consideration of factors in making a decision

Sampson v Hodgson (2008) All ER (D) 395 (Apr) was an appeal by trustees against a Pensions Ombudsman's decision. It is a case where an ill health pension was refused on the grounds that incapacity was not permanent. The Ombudsman found maladministration in that the trustees had, in considering conflicting medical evidence, disregarded relevant material and reached a perverse decision. The trustees contended that the Ombudsman had confused the question of what evidence should be taken into account with the question of what weight should be given to that evidence. The High Court held that the trustees were correct.

This case report is currently only available via subscription-based services.

Provided that the relevant material had been taken into account, which it had been, it was for the trustees to determine its weight. The trustees had not erred and their decision was not perverse: their decision would therefore be allowed to stand.

Pension Protection Fund – GMP equalisation

The Pension Protection Fund (PPF) has issued a consultation paper on equalising benefits that include guaranteed minimum pensions (GMPs) in schemes going into a PPF assessment period or that have already transferred to the PPF. Under s171 Pensions Act 2004, the PPF is obliged to provide the same compensation to comparable men and women in the same scheme (subject to the same exceptions as for the equal treatment rule that applied to the scheme). The consultation closes on 28 July 2008.

The PPF concludes that trustees will have to choose between two approaches:

- Determine whether a comparator exists so that PPF compensation is calculated on an equal basis, using the higher of the overall pension figures; or
- Amend the scheme rules to provide for equality without first checking for comparators.

The paper makes no mention of the need, in almost all schemes, for the agreement of the employer in order to make amendments. This is unlikely to be given by many employers until there is greater clarity as to what (if anything) is required to be done. Whilst trustees have a power, under s65 Pensions Act 1995, to amend rules to reflect equalisation requirements, this cannot in practice be exercised for so long as the requirements of the law are not known.

Consultation paper:

http://www.pensionprotectionfund.org.uk/gmp_consultation_april_2008.pdf

Pensions Regulator – Online filing "Exchange"

The Pensions Regulator has launched its "Exchange" online scheme maintenance system. Trustees can input data as and when they need to. Information previously supplied on paper forms (such as form PR10) can now be submitted online. The system allows trustees to:

- register a new occupational pension scheme;
- make changes to scheme details;
- apply for a waiver against the Regulator's general levy; and
- inform the Regulator once a scheme has wound up.

Pensions Regulator "Exchange"

http://www.thepensionsregulator.gov.uk/onlineServices/exchange/index.aspx

Pensions Regulator – Corporate plan

The Pensions Regulator has published its second corporate plan, setting out its business plan for 2008/9 and its intentions for the next three years. It will be publishing a consultation document on its longer term strategy in the summer. No new codes of practice are planned for 2008/9 but nine sets of guidance are expected to be issued. The number of expected clearance applications is up by only 10, from 140 to 150, despite the recent extension of the Regulator's anti-avoidance powers (see above).

Pensions Regulator press release:

http://www.thepensionsregulator.gov.uk/whatsNew/PN08-09.aspx

Retirement options in defined contribution schemes

The Pensions Regulator has published good practice guidance for trustees and employers covering retirement options and the open market annuity option in occupational defined contribution schemes. This is the first in a planned series of guidance for the trustees of DC pension schemes.

The Pensions Advisory Service (TPAS) has launched an internet-based annuity planner to help people with their choices and decisions at retirement, including open market annuity options. The initiative is backed by the Government.

Pensions Regulator press release:

http://www.thepensionsregulator.gov.uk/whatsNew/pn08-11.aspx

TPAS news:

http://www.pensionsadvisoryservice.org.uk/news/articles/20080502.asp

When is a benefit money purchase?

Bridge Trustees Ltd v Yates (2008) All ER (D) 17 (May) concerned the nature (money purchase or salary-related) of benefits under the Imperial Home Décor pension scheme, with reference to the statutory winding-up priority order under s73 Pensions Act 1995 as it stood in October 2003 (when the scheme entered winding-up) and regulation 13 of the 1996 Winding-up Regulations (which carved money purchase assets and liabilities out of

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the statutory priority order). This was a hybrid scheme, with various salary-related and (arguably) money purchase elements.

The debate concerned the "Moneymatch" and "VIP" elements. Moneymatch involved matched contribution rates, with accounts featuring a guaranteed interest rate and potential investment bonus, an internal scheme annuity option and a GMP underpin for pre-April 1997 benefits. There was also a balance of cost employer contribution rule. VIP again featured matched contribution rates, an internal annuity option, and a balance of cost employer contribution rule. There was also a guarantee that the account would not be less than the value of certain converted benefits.

The High Court held, distinguishing *Aon Trust Corporation v KPMG (2005) EWCA Civ 1004*, that:

- The use of actuarial factors to convert a pension pot into an annuity within the scheme was not fatal to the benefits being money purchase. The actuarial factors here did not define the benefit (as they did in the *KPMG* case). Otherwise, in a scheme where internal annuities are an option, one could not say whether a member was entitled to money purchase benefits until the annuity (internal or external) was bought. Such uncertainty cannot have been intended. In other words, it is not the case that a scheme that provides for internal annuities is thereby not providing money purchase benefits.
- The guaranteed rate of interest and potential investment bonus were merely rates of return, albeit that they were calculated by reference to the performance of different funds over a number of years. They therefore did not prevent the benefits from being money purchase.
- As indicated in *KPMG*, the existence of a balance of cost contribution rule was similarly not fatal: this was to cater for annuity factors unintentionally putting a strain on the fund.
- Defined contribution pensions in payment are still money purchase in nature after their conversion into scheme annuities, but fall within the meaning of pensions entitlement to payment of which has arisen in s73(3)(b), because the assets corresponding to the liabilities can no longer be determined. If the assets cannot be carved out of s73 by regulation 13 of the 1996 winding-up regulations then neither can the liabilities.
- Where a member is entitled to a GMP, the GMP is a pension in its own right, not merely a calculation factor. The whole of his or her pension is therefore an "underpin benefit" within the meaning of regulation 13(3) of the 1996 winding-up regulations, and so not money purchase for the purposes of s73. There is nothing in regulation 13(3) to allow "tranching" (i.e. part of the benefit to be treated as defined benefit and the excess part to be treated as money purchase). The judge disagreed with words (not directly relevant to the decision) to the contrary in *Marsh and McLellan v Pensions Ombudsman (2001) 16 PBLR* . The same principle applied to the VIP benefits subject to a value guarantee.
- Voluntary contributions, which were excluded from the s73 priority order, do not include employer's contributions matching the member's voluntary contributions.

The decision may be appealed.

Trustee liability insurance

NBPF Pension Trustees Ltd v Warnock-Smith (2008) All ER (D) 203 (Mar) concerned a winding-up and in particular the distribution of scheme assets and the purchase of insurance against claims following the conclusion of the winding-up.

Case report:

http://www.bailii.org/ew/cases/EWHC/Ch/2008/455.html

The High Court authorised the trustees, under s57(1) Trustee Act 1925 (power of Court to authorise dealings with trust property), to pay out final benefits in the form of taxable lump sums, despite this being prohibited by the scheme rules. (The reason why this was done is not stated but presumably it was because the sums involved were too small to purchase annuities.)

The Court also considered the question of insurance against claims by untraced, unpayable and unknown beneficiaries. It authorised the purchase of "run off" insurance, protecting against claims by known beneficiaries, but refused to authorise insurance against claims by unknown beneficiaries. The trustees had advertised and otherwise searched for unknown beneficiaries and it was common ground between the parties that such persons would not now have any claim against the trust. Applying *Kemble v Hicks No.2 (1999) PLR 287*, therefore, the Court refused to approve such insurance: it did not benefit the trust because there was no claim to insure against. It would only have been for the trustees' own protection.

Obligation to provide information to members

Secretary of State for Health v Marshall (2008) All ER (D) 430 (Apr) concerned Mrs Marshall, who had worked for a Scottish health board and then different health authorities in England. She complained that NHS Pensions had failed to tell her that she had the right to repurchase pensionable service in respect of which she had received a refund when she left the Scottish health board's scheme. Regulations required the NHS scheme to give members certain information upon joining, but this information was not included in the requirement. The information was nonetheless included in the scheme booklet. The Pensions Ombudsman found, however, that Mrs Marshall had not been given the booklet, though she had been informed that a scheme guide was available from the hospital's general office. The Ombudsman found maladministration against NHS Pensions.

Case report:

http://www.bailii.org/ew/cases/EWHC/Ch/2008/909.html

When the Ombudsman issued his determination, both he and NHS Pensions were unaware that Mrs Marshall had in fact resolved her situation by buying added years from the Scottish scheme, which she had subsequently rejoined. The Ombudsman refused to re-open his determination on the ground that he had no power to reconsider final determinations.

The High Court held as follows:

- There was generally implied into the contractual relationship between an employer and employee an obligation on the employer to take reasonable steps to bring to the attention of the employee the existence of valuable rights which were contingent on the employee acting in a particular way, of which the employee could not have been expected to be aware unless specifically notified.
- Here, the Secretary of State for Health had not been Mrs Marshall's employer, but statute imposed the management of her pension rights on NHS Pensions. NHS Pensions delegated the provision of information to local health authorities, but did not thereby avoid vicarious administrative responsibility.
- In any event the Ombudsman was entitled to conclude that there was maladministration, for which NHS Pensions was responsible.
- The Pensions Ombudsman was correct that he had no power to re-open a final determination.
- The Court was entitled to hear an appeal against a finding of maladministration even if no injustice had resulted in practice.
- The failure of the Scottish scheme administrators to bring to Mrs Marshall's attention her right to buy added years from that scheme had no bearing on the finding against NHS Pensions: they were joint "maladministrators". Mrs Marshall was entitled to pursue her remedy against either party. In practice she had obtained satisfaction from the Scottish administrators. The Court would therefore not allow her to enforce the Ombudsman's determination against NHS Pensions as well (and her husband had confirmed that she had no intention of doing so).

Deputy Pensions Ombudsman decision – Stopping a pension paid in error

In Ward, Mulloy and Daniels (R00248, S00024, R00121) 7 March 2008, the applicants were employed by Sandwell, a company contracted by local authorities to provide school meals. In August 1994 their employments were transferred under the "TUPE" regulations to Scolarest when the contract was outsourced to it. In August 2005, Sandwell took back responsibility for providing the meals. Employees were TUPE transferred back to Sandwell, but the applicants did not transfer because they had all retired from Scolarest's employment in the mean time.

Ombudsman determination:

http://www.pensions-ombudsman.org.uk/determinations/docs/2008/mar/r00248&r00121&s00024.doc

The applicants were all entitled to local government gratuity pensions from Sandwell by reason (among other things) of having been in non-pensionable service before 6 April 1978. When they retired from Scolarest's service, Scolarest had paid them gratuity pensions, apparently under a mistaken belief that it was required by reason of TUPE to do so. Scolarest ceased payment when Sandwell took back responsibility for the services.

The applicants claimed against both Sandwell and Scolarest. Sandwell said that it was not responsible for any gratuity pensions because the applicants were not in its employment when they retired. Scolarest belatedly discovered that the right to a gratuity pension was a right under an occupational pension scheme (and therefore fell within the exception to TUPE requirements applying to some rights under such schemes): the right to receive a gratuity pension had effectively fallen away upon the 1994 TUPE transfer taking place.

The claim ended up, therefore, as a claim for estoppel by convention: was Scolarest entitled to terminate payment of the gratuity pensions after ten years of payment or was it "estopped" (prevented) from asserting that the payments were not due? The applicants claimed that they had been assured that the 1994 TUPE transfer would not affect their gratuity pension rights.

The Deputy Pensions Ombudsman issued a short determination to the following effect:

- Both Scolarest and the applicants operated under a shared assumption that the gratuity pensions were payable by Scolarest.
- The applicants did not have to show that they only remained in Scolarest's employment in order to receive the gratuity pensions. It was enough that they continued to work in the expectation that they would receive them.
- It would be inequitable simply for Scolarest to refuse to make further payments.
- Scolarest were therefore estopped from asserting that the gratuity pensions were not payable. They must recommence, with interest added to back payments and an award of £150 for distress and inconvenience.
- No consideration of the claim against Sandwell was necessary.

In estoppel cases, there is a requirement that the complainant shows that he or she has acted to his or her detriment in reliance of the act in question. This was not considered here, so the determination is open to challenge. The sums involved seem to be small, however, so an appeal may not be brought.

Cross-border legislation – Government consultation report

The Government has published a report on its consultation on the "success" of the cross-border pension scheme legislation. The report acknowledges that the legislation has in practice discouraged a number of defined benefit and hybrid schemes from operating cross-border, due to the full funding requirement, but indicates that the EU will need to change its position in order for UK legislation to be relaxed. The Government's findings are being sent to the European Commission for its review of the IORP directive, the results of which are expected later in 2008.

Consultation report:

http://www.dwp.gov.uk/consultations/2007/rops-cba-regs05.pdf

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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 and Philip Stear.

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