TRAVERS SMITH

What's happening in

Pensions

Issue 30 *November 2011*

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Pensions Act 2011

Pensions Act 2011:
http://www.legislation.gov.uk/ukpga/2011/19/contents/enacted

The Pensions Bill has received Royal Assent and become the Pensions Act 2011. Most of the Act's provisions need to be brought into force by commencement orders which have not yet been issued: exceptions are noted below. The key changes to legislation are as follows.

Indexation and revaluation: CPI for RPI
Legislation currently says (broadly) that trustees of DB schemes with rules that require the increase of pensions in payment in line with RPI (which may be capped in line with the statutory cap) do not have to follow the statutory indexation rules. Under the statutory rules, CPI is now being used in place of RPI as the measure of price inflation but schemes with rules that specify RPI for indexation may continue to do so, provided that they did so before 1 January 2011 – ie, no CPI underpin need be applied.

There are similar provisions on revaluation, so that DB schemes with rules that require revaluation by reference to RPI increases will not have to apply a CPI underpin. There is no requirement for the rules to have provided for this before any particular date.

Schemes with rules requiring the whole of a deferred pension to be revalued fully in line with (uncapped) RPI, including any GMP, currently qualify for special treatment under the legislation. In effect, so long as the member's pension at age 60 (women) or 65 (men) is at least equal to the GMP (including normal GMP revaluation), the anti-franking requirements can be ignored. Many public sector schemes, but not many private sector schemes, are able to take advantage of this special treatment. The relevant statutory provision (section 84(5) of the Pension Schemes Act 1993) is being amended so that the reference to RPI is being changed to "rise in the general level of prices". This will ensure that public sector schemes will qualify for the special treatment. Private sector schemes which have hitherto qualified or now wish to do so should seek specific advice on their position.

The requirement for cash balance schemes to increase pensions in payment is abolished (except for schemes contracted-out on a salary-related basis).

We will be issuing a briefing note giving more detail on this aspect of the Act. Please see our earlier briefing note "**Use of CPI instead of RPI**" for background.

Payments to employers (in force from 3 January 2012)
The following changes have been made to the statutory provisions regarding payments to employers. Please see our briefing note "**Payment to employers: new Pensions Bill**" for background.

- Section 251 of the Pensions Act 2004, regarding the need to give notices and pass a resolution in order to preserve powers to make payments to employers, will apply only to payments of surplus from a scheme not in winding-up. No resolution will therefore be required for payments from surplus on winding-up or payments to an employer for administration costs, when enforcing a lien on members' benefits, etc.
- The period for passing the resolution (if still needed) is extended to 5 April 2016.
- Resolutions passed before 6 April 2011 will remain valid but may be amended, revoked or replaced by further resolution (after 3 January 2012) if the trustees so wish.

Note that resolutions passed between 6 April 2011 and 2 January 2012 (inclusive) will not be effective. Therefore, any notices and resolutions still needed should wait until after 3 January 2012.

"Money purchase benefits"
The definition of "money purchase benefits" in pensions legislation will be amended to mean (broadly) benefits where no funding deficit can arise. This follows the Supreme Court decision that went against the government in *Houldsworth v Bridge Trustees* (see **WHiP Issue 28** for details). In short, it was held in that case that some benefits for which a deficit could arise (including DC benefits with guaranteed investment returns and DC benefits that were internally annuitised) were "money purchase benefits" and so were not subject to legislation on scheme funding, employer debt and the PPF. The government is legislating to change this.

The new definition will apply retrospectively from 1 January 1997 except that there is a very wide regulation-making power in the Act, allowing the Secretary of State to make transitional concessions. No draft regulations have yet been published: there will be a public consultation in due course and the regulations will need to be approved by both Houses of Parliament.

Lord Freud (for the Government) said in the House of Lords debate that *"Our starting point is that trustees should not have to unpick decisions that have already been made in good faith. It would not be practical for trustees to have to unpick decisions that could have been made up to 14 years ago and which could have involved purchasing annuity contracts."*

State pension age changes (in force from 3 January 2012)
Changes are made to state pension ages, accelerating the increase of state pension age for women to age 65 by November 2018 and to age 66 for all by October 2020, but with no woman suffering an increase of more than 18 months.

The DWP has published an up to date list of state pension age changes, following the amendments made by the Act.

Table of state pension age changes:
http://www.dwp.gov.uk/docs/spa-timetable.pdf

Automatic enrolment
Modifications are made to the Pensions Act 2008 provisions on automatic enrolment. We will be issuing a briefing note on automatic enrolment covering the updated legislation.

Pensions Regulator: scheme returns

Scheme return changes:
http://www.thepensionsregulator.gov.uk/exchange/scheme-return.aspx

Guidance notes:
http://www.thepensionsregulator.gov.uk/exchange-help/members/

The Pensions Regulator's new scheme return form and guidance notes are available. There are some very important changes this year.

Statutory employers
The form includes new questions about employers, asking:

- whether or not the principal employer and each participating employer is a "statutory employer" (see our briefing note "**Do you know your statutory and scheme employers?**" on this and the comment below);
- for details (if available) of all employers who have ceased to participate since 6 April 1975 and when they so ceased; and
- if employers have ceased to participate, whether this was because the employer was liquidated or dissolved or because it formally terminated participation (no other options are available).

The guidance notes (see the "Employer membership" section) say that, when answering the statutory employer question:

""Yes" should only be selected where the employer meets the statutory definition for all purposes (i.e. scheme funding, section 75 and PPF eligibility). Otherwise select "No". Where there is no employer which meets the statutory definition for all purposes, please

*also contact the regulator. Please see our statement on identifying your statutory employer (**www.thepensionsregulator.gov.uk/docs/identifying-your-statutory-employer-statement-july-2011.pdf**) for more information.*

If there are any other entities which fit the statutory definitions of employer, please ensure you list these as participating employers."

Hybrid schemes
The form now collects information about:

- the structure of the scheme (eg, separate DB and DC sections or underpins);
- the structure of the benefits; and
- whether the same fund manager is used for the DB and DC sections.

Pension protection levy
The form now asks for the results of a "stress" test on investment risk, for pension protection levy calculation purposes. In brief, the new pension protection levy formula (see **WHiP Issue 27**) will take account of investment risk. It applies "stresses" to different categories of investment based on their volatility. Schemes with liabilities above £1.5 billion under their section 179 valuation are required to carry out more detailed analysis of their investments than before. Other schemes may choose to do this. Draft guidance is available in the pension protection levy section of the PPF website.

Pension Protection Fund: equalisation for GMPs and annual report

Press release:
http://www.pensionprotectionfund.org.uk/news/pages/details.aspx?itemID=242

Equalisation for GMPs
The PPF has published a statement on the equalisation of benefits that include GMPs and the application of a statutory minimum to PPF compensation for schemes in a PPF assessment period.

This confirms, following a consultation (see **WHiP Issue 25**):

- how the PPF will calculate compensation to ensure equal treatment for men and women whose benefits include GMPs (see below);
- that the PPF will run a six month pilot project with selected schemes (which have already been informed) to iron out any teething problems before applying the method to all schemes in the PPF or in an assessment period;
- that guidance on how the approach will be fully implemented will be issued after completion of the pilot project; and
- that schemes not included in the pilot project will continue to progress through the assessment process in the existing way, without taking any steps to equalise for GMPs.

The approach to be used for equalisation is confirmed as the "Statutory Minimum Underpin approach" (aka "Modified Method (2)"). A technical statement describes how this will work. Put briefly:

"“Method (2)” requires a comparison of the total pension that would be payable in respect of service periods between 17 May 1990 and 6 April 1997 in respect of two individuals who are equal in every respect except one is a male and the other is a female member. The comparison should be made when the pension comes into payment, and annually (or more frequently) once that pension is in payment. The higher pension amount is then paid.

Modified Method (2) is a partial application of method (2). It is similar to method (2) but allows for the special circumstances applicable to the PPF; namely that PPF compensation treats all pensions after the Assessment Date in the same way and does not differentiate between GMP and excess pension. The PPF approved this method as being the most suitable for PPF compensation payments following the 2008 consultation.

The PPF is therefore in the fortunate position that equalisation for GMP when calculating PPF Compensation only needs to be carried out at a single date - the Relevant Time (the day before the Assessment Date)."

DWP guidance is still awaited on equalisation for GMPs by schemes not in a PPF assessment period. Please see our briefing note "**Equalisation of benefits that include GMPs**" on this subject.

Annual report

The PPF has published its annual report to 31 March 2011, showing a £678 million surplus (equivalent to 105.1% funding). It says that the probability of achieving financial self-sufficiency by 2030 has increased from 83% to 87%.

Press release:
http://www.pensionprotectionfund.org.uk/News/Pages/details.aspx?itemID=240

Scheme funding: review of IORP directive

EIOPA report:
https://eiopa.europa.eu/consultations/consultation-papers/index.html

The European Insurance and Occupational Pensions Authority (EIOPA) has issued a 517 page response (to its call for advice - see **WHiP Issue 27**) and second consultation on the review of the EU's IORP directive. Of greatest interest is the European Commission's proposed harmonisation of pension funding requirements.

Recognising the position of UK DB pension schemes, the consultation proposes that a "holistic balance sheet" approach is more suitable than capital requirements similar to those under the Solvency II directive applicable to insurance companies. This is a "*European approach that acknowledges the existing variety of occupational pension systems yet captures all these systems into a single balance sheet by valuing all security mechanisms in an explicit way*". The consultation sets out various options for how this might work, including valuation of the employer covenant as part of the security mechanism.

The consultation also notes that, while recovery periods can appropriately be longer for pension schemes than the short periods allowed for insurance companies in the Solvency II directive, they should not normally last longer than 15 years.

A quantitative impact assessment is noted as being essential for any new legislative proposal.

The consultation closes on 2 January 2012 and is expected to result in a new directive.

Insolvency and FSD/CN liabilities: Lehman Brothers and Nortel

Case report:
http://www.bailii.org/ew/cases/EWCA/Civ/2011/1124.html

The Court of Appeal has delivered its judgment in the Nortel/Lehman Brothers case on the priority to attach to liabilities that arise from a financial support direction ("FSD") imposed on a company in administration or liquidation, or from any contribution notice ("CN") subsequently imposed for failure to comply with that FSD.

The Court upheld the High Court decision (see **WHiP Issue 24**) that FSD liabilities would constitute an expense of a company in administration and would therefore be payable before the claims of other creditors (whether secured or not). The same priority would also attach to any CN subsequently imposed on that company for failure to comply with the FSD.

Please **click here** to read our more detailed briefing note on the Court of Appeal's decision.

The Pensions Regulator issued a statement on the judgment.

TPR press release:
http://www.thepensionsregulator.gov.uk/press/pn11-24.aspx

HMRC: annual allowance

HMRC/JWG correspondence:
http://www.aca.org.uk/files/HMRC_letter_examples_of_how_pension_input_amounts_are_calculated-25_October_2011-20111025165328.pdf

HMRC has written to the Joint Working Group with examples of how they say the annual allowance works for members of DB arrangements who:

- have split pension ages (eg, due to a *Barber* normal retirement date change); or
- do not draw benefits on reaching normal pension age and continue in service.

The examples will find their way into the Registered Pension Schemes Manual in due course.

Pensions Regulator statements

Press release:
http://www.thepensionsregulator.gov.uk/press/pn11-23.aspx

DC schemes

The Pensions Regulator has published a statement "*The role of trustees in DC schemes*". It reminds trustees of key differences between DB and DC schemes and sets out what behaviours the Regulator expects DC scheme trustees to demonstrate. A particular point to note is that the Regulator does not think that charges which differ between active and deferred members are acceptable. A statement on the Regulator's expectations of a good DC scheme will follow shortly.

Hybrid schemes

The Regulator has published a statement "*Understanding and managing your hybrid scheme*". It includes checklists to help trustees of schemes that include both DB and DC benefits to understand the risks to members. The Regulator is particularly concerned that trustee meetings spend far less time on DC considerations than on DB.

Press release:
http://www.thepensionsregulator.gov.uk/press/pn11-25.aspx

CPI and RPI: September figures

The September 2011 CPI and RPI figures have been announced by the Office for National Statistics. The September annual increase figures are used for increases to state pensions and other benefits, and for minimum revaluation and indexation requirements. Scheme rules also often specify September as the month for measuring annual inflation.

The annual increases were 5.2% for CPI and 5.6% for RPI. (In September 2010, they were 3.1% and 4.6% respectively.)

ONS announcement:
http://www.ons.gov.uk/ons/rel/cpi/consumer-price-indices/september-2011/index.html

Amendment formalities

In *HR Trustees Limited v Wembley PLC (in liquidation)*, the High Court was asked to consider the validity of an amendment document which had been executed by only four of the five trustees.

The rule amendment was intended to change the pension increase rule from providing fixed 5% pa increases to increases in line with RPI up to 5%. The scheme rules required the trustees to declare an amendment "*in writing under their hands*" if authorised by the employer to make the amendment. The written amendment was signed by four of the five trustees, with the signature for the employer appearing below the trustees' signature.

The Court had to decide:

- whether the declaration requirement was a matter for the trustees' discretion or just an incidental formality;
- whether the requirement had been satisfied by the amendment document;
- whether the fifth trustee's signature could be treated as having been included; and
- whether the authorisation and declaration had occurred in the right order.

The Court held as follows.

- The need for a declaration was an essential part of the amendment machinery and the requirement to declare the amendment included an element of discretion on the part of the trustee.
- "*In writing under their hands*" meant that all of the trustees needed to sign, not just a majority. No declaration had therefore been made under the rules, although the trustees had exercised their discretion to declare the amendment.
- Here, the trustees had unanimously decided to exercise their discretion but, due to an administrative error, had not made the declaration then required by the rules. Members could have made them do so because they were in breach of the terms of the deed in not doing so. The equitable maxim "*equity looks on as done that which ought to be done*" therefore could, and properly should, be applied to treat the fifth trustee's signature as if it had been included.
- The "presumption of regularity" meant, in the absence of evidence to the contrary, that the employer's authorisation came before the trustees' declaration, notwithstanding that the signature for the employer appeared below that of the four trustees.

Part-time workers who would not have joined anyway

Case report:
http://www.bailii.org/ew/cases/EWCA/Civ/2011/1281.html

The Court of Appeal has upheld earlier tribunal decisions denying part-time workers compensation for not being allowed to join the Littlewoods scheme when the evidence showed that they would not have joined had they been given the option.

In *Copple v Littlewoods plc*, the Court of Appeal upheld decisions of the Employment Tribunal and Employment Appeal Tribunal. It held that although there had been indirect sex discrimination, the workers had suffered no financial loss. Their only remedy was therefore a declaration that there had been unlawful discrimination. This was consistent with European law because to give them now the right to join retrospectively (if they paid backdated contributions) would be to treat them more favourably than full time workers.

Levies

DWP consultation:
http://www.dwp.gov.uk/consultations/2011/occ-pen-levies-regs-2012.shtml

The DWP is consulting on draft regulations to make changes to the rates of the general levy and the PPF administration levy for 2012/13 onwards. The consultation closes on 30 January 2012. It is proposed that the general levy be reduced by at least 12% and the PPF administration levy by at least 25% (largely because some PPF administration costs now come out of sums funded by the pension protection levy).

HMRC: VAT

HMRC note:
http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile?contentID=HMCE_CL_000089

HMRC has revised its online note on VAT for funded pension schemes. It says that there is no change to the technical content but that the note should now be more readable. It does not cover the contentious issue of VAT on fund management fees payable by DB occupational pension scheme trustees and common investment funds (which has been referred to the European Court in the *Wheels (Ford CIF)* case (see **WHiP Issue 29**)).

This and previous issues of WHiP can be found on our website. See: 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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