TRAVERS SMITH

What's happening in

Pensions

Issue 3 *June 2008*

Pension Protection Fund – 2008/9 Levy scaling factor announced

The Pension Protection Fund has announced the scaling factor for the 2008/9 pension protection levy, enabling DB schemes to work out their levy for 2008/9 and the PPF to collect the £675 million total pension protection levy. It is 3.77 (up from 2.47 in 2007/8 and more than double the 1.60 estimate issued by the PPF in November 2007).

42% of schemes are reportedly expected to pay a higher risk-based levy, as a percentage of their assets in 2008/9. Consultants have said that many PPF levies are going to be dramatically increased, but the PPF chief executive was reported in the Financial Times as saying that they are scaremongering.

The PPF later added additional sections to its levy FAQs, defending its position in the face of the criticism quoted in the press. In particular, there is a breakdown of why the estimated scaling factor of 1.60 was increased to 3.77.

PPF announcement:

http://www.pensionprotectionfund.org.uk/news-details.htm?id=6597

Levy FAQs:

http://www.pensionprotectionfund.org.uk/index/pension_protection_levy-2/levy_faqs.htm#02

Pensions Bill – Auto-enrolment

The DWP has announced that the Pensions Bill will be amended to allow, from 2012, employers to enrol their employees automatically in workplace group personal pension arrangements, group stakeholder schemes or group SIPPs as an alternative to the Personal Accounts regime. This follows an indication from the European Commission that this would not be considered to be breaching two "inertia selling" EU directives: the Distance Marketing Directive and the Unfair Commercial Practices Directive.

DWP announcement:

http://www.dwp.gov.uk/mediacentre/pressreleases/2008/may/pens068-160508.asp

Government consultation on risk sharing benefit structures

The DWP has launched a consultation looking at how employers can continue to maintain good occupational pension provision through greater risk sharing. The consultation closes on 28 August 2008.

The paper outlines existing risk sharing possibilities, including shared cost schemes, cash balance schemes, reduction of pension in line with longevity improvements, and hybrid schemes (various formats, including schemes with "nursery" DC sections). Named examples are used. It then looks at examples from other countries and considers in detail, and asks for views on the pros and cons of, two possible new ways of sharing risk. These are not permissible within the current regulatory framework:

- **Conditional indexation schemes**

  These would be final salary or career average schemes under which there is a target rate for increasing pensions in deferment and in payment. The scheme would be subject to the statutory funding objective. If the actuarial valuation revealed no deficit, the increases would apply; if it revealed a deficit, the increases would not be provided unless the employer paid additional contributions.

  The Association of Consulting Actuaries has proposed such a career average scheme – this is summarised in the consultation paper. It also features a possibility for raising normal pension ages in the event of increased life expectancy, but only in respect of future pensionable service.

- **Collective defined contribution schemes**

  These would be defined contribution schemes with a targeted rate of career average pension and targeted revaluation and pension increases, calculated using prudent assumptions. If the scheme were to be insufficiently funded to provide the targeted

Consultation paper:

http://www.dwp.gov.uk/pensionsreform/pdfs/pensionrisksharing-consultation-june2008.pdf benefits, revaluation and increases would first be reduced, and then the basic benefits. These would be restored later should funding permit, but no additional contributions would be required. Those nearing retirement would be impacted less heavily than in a traditional DC scheme.

Hewitt Associates put together the outline of such a scheme, which is outlined in the consultation paper.

The DWP's general approach is to consider all of the specific legal (and other) obstacles and suggest ways of adding extra legislation to exempt such types of scheme from them. Both proposed schemes would seem to require annual actuarial valuations, which would increase administration costs.

Pensions Regulator guidance – Relations with advisers

The Pensions Regulator has published best practice guidance on relations with advisers. It covers key issues to consider when appointing a new adviser or reviewing the performance of an existing adviser and key issues to consider in order to get the best service from current advisers. "Advisers" here includes service providers and suppliers but actuaries, auditors, legal advisers, administrators, independent financial advisers and benefit consultants are covered specifically in the guidance.

TPR guidance:

http://www.thepensionsregulator.gov.uk/trustees/relationsWithAdvisers/index.aspx

Pensions Regulator – DC schemes Q&A

The Pensions Regulator has published some Q&As for trustees and employers with DC schemes (occupational and personal). The Q&As cover regulation, governance, administration, investment, charges, retirement and member understanding.

TPR Q&As:

http://www.thepensionsregulator.gov.uk/guidance/dcScheme/questions/index.aspx

VAT test case brought by Ford and NAPF

The NAPF and a Ford common investment fund are bringing a test case against HM Revenue & Customs (HMRC) over VAT paid on investment services. This follows ECJ decisions that fees for investment management services provided to OEICs, authorised unit trusts and investment trust companies should be exempt from VAT. The claim is that there can be no distinction for pension schemes: they should not have to pay VAT on investment management services either.

The NAPF has written to member schemes encouraging them to ask their investment managers to lodge protective claims with HMRC. There will be no need for DC schemes, local authority schemes or schemes with investment arrangements structured as insurance policies to claim, since such schemes can already claim back VAT. Schemes with existing claims are asked to apply to stand them over pending resolution of the test case.

In an update letter to NAPF members, the NAPF said that HMRC is keen to identify an appropriate test case but has not yet agreed to the one put forward, or to the joinder of the NAPF to the claim. HMRC is therefore making its own application in those proceedings for a fixed period stand over and requesting information from each claimant (fund or fund manager).

The NAPF has provided HMRC with a copy of the "Pension Funds and their Advisers" directory, which covers some of the information requested by HMRC, but claimant schemes will need to provide HMRC with a copy of their trust deed, booklets and fund manager engagement letters. The NAPF recommends that members consent to HMRC's fixed period stand over request.

NAPF circular:

http://www.napf.co.uk/DocumentArchive/Press%20Releases/02_2008/20080512_12-05-2008%20-%20Pension%20Fund%20And%20Industry%20Body%20To%20Bring%20Joint%20Legal%20Challenge.pdf

US securities class actions

US securities class actions are fast becoming a topic of interest to UK pension scheme trustees. These are actions, brought by persons who have bought shares in US-listed companies (including non-US companies that are listed there), claiming that share prices have been artificially inflated. This may have occurred as a result, for example, of the company making false statements to the market. Claims are commonly brought against directors and officers and sometimes against banks and advisers to the company, or against the company itself. The NAPF has issued useful information to its fund members on this subject (see the link for details).

Whilst all qualifying shareholders are entitled to benefit from class actions, action is required in order for the US court to include a party in the class entitled to benefit if the action is successful. Claims are usually run by US lawyers on a "no win, no fee" basis and a "lead plaintiff" is selected to run the case.

NAPF circular:

http://www.napf.co.uk/DocumentArchive/Policy/Corporate%20Governance/20070315_Securities%20Litigation%20-%20Questions%20for%20Trustees%20-%2015%20Mar%202007.pdf

It has been suggested that trustees could be in breach of their fiduciary duties if they do not take steps to participate in these US class actions where they could have done so, but there is no case law on this point. There are some US law firms that are marketing their services in this field. There are also organisations who provide a service tracking class actions, so that prospective claimants can find out about them.

If investment in US-listed shares is through a pooled vehicle (such as a policy or unit trust), then the trustees need not take any action. If, however, trustees hold such shares in a segregated portfolio, they should ask their fund manager what its position is on US securities class actions, and what steps it takes to monitor the opportunities and take advantage of them. Depending upon the response, such trustees may wish to start taking steps themselves.

German age discrimination case on young spouse rules

Bartsch v. Bosch und Siemens Hausgerate Altersfursorge GmbH is a German age discrimination case referred to the European Court of Justice (ECJ). It concerns a "young spouse" rule in a private pension scheme, under which a spouse more than 15 years younger than the member received no survivor's pension. The reference pre-dated the 1 December 2006 deadline for implementing the 2000 Equal Treatment Directive. Mrs Bartsch claimed unlawful age discrimination. The UK made submissions to the ECJ about the legal issues, which clearly could affect UK schemes too.

ECJ website page:

http://curia.europa.eu/jurisp/cgi-bin/form.pl?lang=en&Submit=Rechercher&alldocs=alldocs&docj=docj&docop=docop&docor=docor&docjo=docjo&numaff=C-427/06&datefs=&datefe=&nomusuel=&domaine=&mots=&resmax=100

The Advocate General gave his opinion as follows:

- Article 13 of the EC Treaty, which permits the European Commission to take action to combat discrimination on various grounds, and the 2000 Equal Treatment Directive are evidence that there is a general principle in EC law prohibiting age discrimination where the situation falls within the scope of EC law.
- There was no specific rule of EC law governing the situations to which that general principle of equality applied at the relevant time. This was because the EC Treaty was merely enabling and the deadline for implementing the 2000 Directive had not yet passed.
- The Directive could not be enforced "horizontally" between individuals and private employers.
- On any analysis, an "age-gap" rule can amount to direct age discrimination.
- The employer's objective justification argument, which was that the employer had a legitimate interest in limiting the risks assumed by voluntary pension schemes, failed:
  - (a) It was more of a "foreseeable obligation", actuarially assessable, than a risk.
  - (b) Any justification has to show that it was "appropriate and necessary" to pursue a "legitimate aim". "*Given the broad discretion which Member Sates enjoy in the field of social and employment policy, I am prepared to accept that a policy choice made by a Member State so as to allow private pension schemes to include some sort of age-gap clause might, in principle, serve a legitimate aim…*". However, the total exclusion of a spouse from any payment whatsoever could not be justified. It is strongly suggested that a reduced benefit on a sliding scale or a spouse's pension starting only at a certain age would be accepted, at least by the Advocate General, as justifiable.
- There is no reason for the ECJ to impose any temporal limitation on its decision.

Advocate Generals' opinions are not binding, but are often followed by the ECJ in its ultimate decision.

Winding-up – Use of DC assets in a hybrid scheme

Bainbridge v Quarters Trustees Ltd relates to the use of money purchase assets on a pre-6 April 2005 winding-up. The High Court held that the money purchase section of a scheme was part of a single fund with the final salary section assets. Clear words are therefore needed in the trust deeds of pension schemes beginning winding up before 6 April 2005 (and after then too) in order to ring-fence money purchase assets. The booklet and scheme accounts indicated that money purchase assets were segregated, but the trust deed and rules took precedence in accordance with recent case law.

Case report:

http://www.bailii.org/ew/cases/EWHC/Ch/2008/979.html

Beneficiaries claiming against directors of a trustee company

In *Gregson v HAE Trustees Ltd and Others*, a settlement beneficiary failed in a claim against directors of a trustee company under a "dog-leg" claim for breach of trust. The beneficiary wanted to hold the trustee directors accountable as if they were themselves the trustees of the settlement. The High Court held that the directors owed their relevant duties to the company and that the duties had not become held on trust for the benefit of the beneficiaries. There would therefore be no lifting of the "corporate veil".

Case report:

http://www.bailii.org/ew/cases/EWHC/Ch/2008/1006.html

Pension sharing on divorce – Discrimination claim

In *R (Thomas) v Ministry of Defence*, an ex-spouse who benefited from a pension sharing order complained of unlawful discrimination (of an unspecified nature) in that whilst her husband's pension had started when he retired from the army at age 49, her share could not start for many years. She brought an application for judicial review.

The High Court refused permission to apply for judicial review. It was, the Court held, close to being completely unarguable that an award made under a pension sharing order was "pay" within the meaning of Article 141 of the EC Treaty; "pay" for this purpose means "*the ordinary basic or minimum wage or salary and any other consideration, whether in cash or in kind, which the worker receives directly or indirectly, in respect of his employment from his employer*".

Case report:

http://www.bailii.org/ew/cases/EWHC/Admin/2008/1119.html

Ability of insolvency practitioner to challenge certified section 75 debts

In *Gleave and Others v Board of PPF*, the Turner and Newall group had become insolvent and entered administration in October 2001. Voluntary arrangements were approved by creditors and became effective in October 2006. Several group companies had become liable for section 75 debts to the group pension scheme when they ceased to participate in July 2004. The scheme had entered a PPF assessment period, so the PPF Board was a party to the proceedings rather than the trustees.

Case report:

http://www.bailii.org/ew/cases/EWHC/Ch/2008/1099.html

Claims to be considered in the administration were those existing as at October 2001 (when the administration began). It was common ground that the section 75 claims were therefore to be classed as contingent claims. A difference of opinion had arisen as to the calculation of the value of the claims. The actuary had calculated the section 75 debts in March 2006, but the supervisors of the voluntary arrangements took issue with the mortality assumptions used: they argued that life expectancies should be decreased to take account of the members' exposure to asbestos (asbestos claims were the reason why the group had gone out of business).

More fundamentally, the parties disagreed as to whether the section 75 claims must be accepted as certified by the actuary, or whether the supervisors were entitled to determine the value themselves. And if it was the latter, did the supervisors have to take account of the actuary's certificate, given that the claims were to be assessed as at October 2001?

The High Court held as follows:

- There was an established "hindsight principle" such that in valuing contingent claims, account is taken of those subsequent events that can bring greater certainty to the process of estimation.
- The supervisors were not entitled to substitute their own mortality assumptions. The findings of the actuary are binding on an insolvency practitioner, subject only to such rights of challenge as would be available to any employer (i.e. only where there is evidence of error or fraud).

The Registered Pension Schemes (Authorised Payments) Regulations 2008

These regulations will correct some glitches in the Finance Act 2004 regime, including the following:

Draft regulations:

http://www.hmrc.gov.uk/finance-bill2008/clause-89-sch29-para1.pdf

- Trustees will be able to make lump sum payments to members where the scheme has received an unexpected payment following the transfer out of a member or an annuity purchase. The permitted sums are up to £500 and £2,000 respectively.
- Trustees will be able to pay lump sums of up to £2,000 to or in respect of members over age 75 who had previously been untraceable for at least five years.

- Trustees will be able to pay trivial commutation lump sums of up to £2,000. However, all occupational pension schemes of the member will need to commute the member's benefits within a month and the total cannot exceed £2,000. The member must be aged between 60 and 75 and there must also have been no transfer out within the last three years.
- There will be relaxations relating to pensions paid in error or at the wrong level, and relating to pensions or pension commencement lump sums paid after the member's death. The changes in this bullet point are expected to be backdated to 6 April 2006.

We will report fully when the regulations are finalised.

There is no indication of how, or if, the above figures will be increased. The NAPF is asking HMRC to specify them as percentages of the lifetime allowance, so that they will automatically increase.

The Pension Sharing (Pension Credit Benefit) (Amendment) Regulations 2008

Consultation paper:

http://www.dwp.gov.uk/consultations/2008/PensionSharing-PensionCreditBenefit-Amendments-Regulations2008-Consultation.pdf

The DWP is consulting on these draft regulations. The consultation closes on 21 July 2008.

The Pensions Bill contains legislation that will abolish safeguarded rights (contracted-out rights that are subject to pension sharing). These regulations will align the rules for the payment of pension credit benefit with standard pension payment rules as regards the payment of benefits in lump sum form. It is intended that the legislation will come into force on 1 October 2008.

Pensions Ombudsman decisions

Mr EFV Perrott – Failure by provider to invest SIPP assets as instructed

Determination:

http://www.pensions-ombudsman.org.uk/determinations/docs/2008/may/27819.doc

Suffolk Life managed a self-invested personal pension (SIPP) for Mr Perrott. He had instructed them how to invest his £1000 monthly contributions, but they had left them in his SIPP-linked bank account. He claimed the investment loss of £5,592. Suffolk Life admitted their error but offered only £2,800, because they had sent annual statements to his advisor for two years which showed that the sums had not been invested. They pointed to an unspecified decision by the previous Pensions Ombudsman in which liability was shared with the adviser in similar circumstances.

The Pensions Ombudsman was not satisfied that this would be a just approach in the present case. Mr Perrott had no reason to delay contacting Suffolk Life, so he must not have known about the error until it was indentified two years later. The Ombudsman pointed out that he was not bound by his predecessor's (or even his own) decisions. There was no obligation on Mr Perrott to read the statements or any agreement that he would be liable for any unnoticed errors. The complainant's duty to mitigate his loss is not mentioned in the determination, and appears to have been overlooked.

Suffolk Life was ordered to recalculate the loss at the current date and pay that sum to Mr Perrott. They should deduct 40% (or whatever his highest marginal rate of tax is) to reflect the tax relief that he will be able to claim when paying it into his SIPP (which he had earlier transferred to another insurance company).

Mr T Firth – Ill health pension procedure

Determination:

http://www.pensions-ombudsman.org.uk/determinations/docs/2008/may/27460.doc

Mr Firth complained that the trustees of his scheme improperly refused him an ill health pension. Medical reports indicated that he would not be able to work again, but a report based on video surveillance report said that he was not as disabled as had been advised by the medical experts. The trustees refused his incapacity pension application and gave no reasons. The ill health pension rule required the member to have been dismissed by reason of ill health.

The Pensions Ombudsman determined as follows (we have left out a less interesting additional limb of the claim):

- It was not clear whether Mr Firth had been dismissed on grounds of ill health, though that appeared to be the case.
- The trustees were clearly implying that Mr Firth's claim was dishonest. The interests of justice required that he should have been given the opportunity to comment on the video evidence report before a decision was made.
- The medical adviser should then have been asked to review all the evidence, including the video surveillance report and Mr Firth's comments on it.

- The trustees should also have told Mr Firth at which hurdle his application had failed – the grounds for dismissal or the evidence as to incapacity.
- The trustees must therefore take the decision again.

Mr A B Dallas – Suspension of pension for alleged fraud

Mr Dallas complained that the trustees of the ALHCO scheme had wrongly suspended pension payments due to him whilst the sponsoring employer company sued him for £442,302 for alleged fraud. Mr Dallas is defending that claim. The scheme rules permitted the trustees to reduce benefits if a member had committed a criminal, negligent or fraudulent act or omission. The trustees argued that they had considered the evidence and concluded that this was the case.

Determination:

http://www.pensions-ombudsman.org.uk/determinations/docs/2008/mar/s00040.doc

The Pensions Ombudsman determined as follows:

- The trustees could not properly reach the decision that Mr Dallas was guilty of the offence. They were too close to the company, Mr Dallas was contesting the claims, and the trustees were not entitled to pre-empt the decision of the court.
- The rule did not give the trustees power to reduce benefits pending recovery of the loss being enforceable.
- The trustees were exercising a lien, within the meaning of s91 Pensions Act 1995, but were not entitled to do so because that section prohibits such action where there is a dispute as to the amount unless the obligation has become enforceable by court order or arbitrator's award.
- The trustees must therefore reinstate Mr Dallas's pension and pay him the withheld amounts plus interest.

Mr R J Griffiths – Reduced transfer value

The Turner & Newall scheme was (as mentioned above) in an assessment period for the PPF and transfer values were suspended and are now being reduced. Mr Griffiths would suffer a £60,000 reduction. He claimed that he did not take a full transfer when he could have done because of a statement by the employer that "Qualified pension plans are protected by law". He also claimed that the trustees wrongly allowed the PPF to take over negotiations with the employer's administrator, to the detriment of scheme members and that monies expected from the employer had not been taken into account in calculating his transfer value but should have been.

Determination:

http://www.pensions-ombudsman.org.uk/determinations/docs/2008/mar/r00682.doc

The Deputy Pensions Ombudsman determined as follows (only points of interest are covered here):

- Mr Griffiths was reading too much into the statement that pensions were "protected by law". It did not mean that there would be no effect on the scheme's ability to pay members' accrued benefits in full. Mr Griffiths did not appear to have sought clarification or confirmation of his understanding from any source.
- He had not been able to show that his decision was made in reliance on any misleading statement by the employer.
- The trustees had decided, correctly, that they risked the scheme being excluded from the PPF if they continued to negotiate with the employer's administrators. In any event, both parties were interested in maximising the payment to the scheme.
- The trustees were reasonable and prudent not to take into account monies expected from the employer but not yet received in calculating transfer values.
- In the particular circumstances of the scheme, the trustees were not guilty of maladministration in communicating with members by press release.

Pensions Bill – Government announcement

In the announcement about the risk sharing consultation (see above), it was also announced that the Pensions Bill will be amended to abolish the protected rights rule requiring individuals with a spouse or civil partner to buy a joint life annuity. This is to be implemented at the same time as the abolition of defined contribution contracting-out, planned for 2012.

DWP announcement:

http://www.dwp.gov.uk/mediacentre/pressreleases/2008/jun/pens-071-050608.asp

Financial Reporting Council – 2008/9 Levies

The Financial Reporting Council (FRC) has announced its 2008/9 levies, including the levy on pension schemes. The 2008/9 levy will be £2.90 per 100 members (for schemes with 1,000 or more members), up from £2.20 in 2007/8. The FRC does not currently expect to propose such a significant increase again next year.

FRC announcement:

http://www.frc.org.uk/press/pub1624.html

Maternity leave – HMRC salary sacrifice guidance

HMRC has issued guidance on salary sacrifice and non-cash benefits following changes to the Sex Discrimination Act 1975 as regards maternity leave. The changes will require, in respect of women with an expected delivery date on or after 5 October 2008, the continuation of contractual non-remuneration benefits during additional maternity leave, including during unpaid additional maternity leave.

There are some mentions of pensions: these reflect the Government's previously stated (but dubious) position that there will still be no obligation to provide pension contributions or accrual during unpaid additional maternity leave.

HMRC guidance:

http://www.hmrc.gov.uk/employers/sml-salary-sacrifice.pdf

HMRC NISPI Newsletter no.33

HMRC's National Insurance Services to the Pensions Industry (NISPI) has published its 33rd Pensions Industry Newsletter. One point of interest is that some schemes and administrators use their own versions of HMRC contracting-out forms. HMRC is currently reviewing these forms and needs to know what variations there are. Copies of variant forms should be emailed to NISPI – see the Newsletter for details.

NISPI newsletter:

http://www.hmrc.gov.uk/nic/newsletter33.pdf

Hyperlinks in this document can be clicked via an up to date version of Adobe Acrobat Reader. We are not responsible for the contents of external websites to which we provide links.

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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