TRAVERS SMITH

What's happening in Pensions

Issue 7 ***December 2008***

Pensions Act 2008

The Pensions Bill received Royal Assent on 26 November 2008 and is now the Pensions Act 2008.

The final House of Lords amendments were as follows:

- There will be a review of the operation of the Pensions Regulator's new anti-avoidance powers (see WHiP Issue 6) after four years. An opposition amendment calling for the Regulator to be prevented from amending its accompanying Code of Practice for two years was rejected.
- Employers will be able to self-certify that their existing DC schemes will satisfy, for each coming year, the quality test for "qualifying schemes", i.e. permitted alternatives to Personal Accounts.
- The Regulator will be permitted to delegate a number of its statutory powers.

The Act covers the following matters:

- The structure for Personal Accounts (but with the detail to follow in regulations) (from 6 April 2012)
- Automatic enrolment into Personal Accounts or a qualifying workplace scheme (from 6 April 2012)
- The abolition of safeguarded rights (i.e. the contracted-out element of shared rights following a divorce) (from 6 April 2009)
- Reduction of the statutory revaluation cap for future accruals under DB schemes from 5% to 2.5% (now expected from 6 April 2009)
- Minor provisions about the PPF and the Financial Assistance Scheme
- Extension of the Pensions Regulator's anti-avoidance powers (from 14 April 2008) (see WHiP Issue 6)
- Alignment of Pensions Act 1995 requirements for payments to employers with the Finance Act 2004 rules for authorised employer payments
- Appointment of an independent trustee where the Regulator considers it "reasonable" (rather than "necessary"), including where the Regulator considers it reasonable "to protect the interests of the generality of members of the scheme"
- A power for the Regulator to intervene where it considers that a scheme's technical provisions (i.e. its scheme funding target) do not comply with statutory requirements, for example because the actuarial assumptions are not prudent enough

The Act:

http://www.opsi.gov.uk/acts/acts2008/ukpga_20080030_en_1

Employer debt regulations

The Government is informally consulting industry bodies about further changes to the section 75 regime. The proposed changes are intended to make it easier for a corporate group to restructure without triggering a section 75 debt. We emailed a briefing note about this on 18 November. Please let us know if you did not receive it.

The consultation closed on 5 December 2008 and is likely to be followed in February by a full public consultation, with any new law taking effect from October 2009.

The Government is also informally consulting on various technical amendments to the employer debt regulations. This consultation closed on 18 December 2008. It is expected that a formal consultation on draft amending regulations will follow early in 2009, with amendments again coming into force in October 2009.

Consultation: draft amending regulations

Consultation paper:

http://www.dwp.gov.uk/consultations/2008/pensions-misc-regs-2009.pdf

The Government is consulting on draft regulations to make a variety of amendments to various pieces of legislation from 6 April 2009 (except as otherwise stated below). The proposals of particular interest are as follows.

- **Trivial commutation lump sums**

These amendments will align DWP legislation with proposed HMRC rules on trivial commutation, following changes now due to take effect on 6 April 2009 that extend the circumstances in which a trivial commutation lump sum can be taken (see WHiP Issue 3).

- **Scheme modification to allow reduced revaluation**

Trustees may modify scheme rules by resolution to reflect the new 2.5% revaluation cap under Pensions Act 2008 (see above), including where the scheme rules do not allow such an amendment.

- **Scheme modification to allow reduced indexation**

Trustees may modify scheme rules by resolution to reflect the reduced statutory indexation cap for pensions in payment under Pensions Act 2004, including where the scheme rules do not allow such an amendment.

- **Scheme funding where the actuary sets the contribution rate**

For schemes where the actuary has sole power to set the employer contribution rate in some but not all circumstances, the scheme funding regulations will be amended to apply the relevant provisions (under which the actuary must certify that the contributions are no less than he or she would have determined) to that extent.

- **Employer-related investments**

The investment regulations will be amended from 23 September 2010 to reflect the requirements of an EU directive's transitional provisions that end on that date. Those transitional arrangements provide exemptions relating to collective investment schemes, members' voluntary contributions and certain qualifying insurance policies. These exemptions will all be removed from 23 September 2010. Employer-related investment in an account with a person who has permission to accept deposits, which is currently unlimited, will also become subject to the 5% limit.

- **Consultation regulations - penalties**

The Pensions Regulator will be given power to impose a civil penalty for non-compliance with the employee consultation requirements of Pensions Act 2004.

- **Member-nominated trustee directors**

The MNT/MND regulations will be amended in respect of schemes with two or more corporate trustees where one is a traditional "in-house" trustee company and the other is an independent corporate trustee. In these circumstances, the independent corporate trustee will not be required to appoint MNDs. (There is already an exemption where the independent trustee company is the sole director.)

The consultation closes on 30 January 2009.

The Pensions Regulator's anti-avoidance powers

Press release:

http://www.thepensionsregulator.gov.uk/whatsNew/pn08-28.aspx

The Pensions Regulator is consulting on a short draft code of practice on the new "material detriment" test for its extended anti-avoidance powers (see Pensions Act 2008 above). This reflects the draft section issued by the Regulator at the time the final form of the extended powers was announced (see WHiP Issue 6) in setting out a general outline of circumstances in which it expects to issue contribution notices under the new test. It also says:

"It is not the regulator's intention that the material detriment test for issuing a contribution notice must be considered for all corporate transactions. The regulator expects to consider the test in circumstances where there could be significant risks to

members' benefits or the PPF, for example as the result of the potential abandonment of a scheme or the creation of models in which risk is underwritten by members or the PPF whilst others seek to profit from the arrangement"

At the same time, the Government issued a consultation paper proposing changes to the "look back period" that applies to the issue by the Pensions Regulator of financial support directions. Any party connected to or associated with a scheme employer at any time during the look back period is at risk of an FSD if the relevant conditions are satisfied. The current 12 month period will be extended to 24 months from 6 April 2010, with gradual increases between the regulations coming into force and that date. This is due to practical difficulties experienced by the Regulator in acting in time, particularly where relevant circumstances have come to the Regulator's attention several months later.

Both of these consultations close on 6 February 2009.

Press release:

http://www.dwp.gov.uk/mediacentre/pressreleases/2008/dec/pens093-161208.asp

Notifiable Events

The same Government consultation paper also proposes the abolition of three current "notifiable events":

- Two or more changes in a key scheme post
- Change in the credit rating of the employer
- Change in key employer posts

Press release:

http://www.dwp.gov.uk/mediacentre/pressreleases/2008/dec/pens093-161208.asp

Risk-sharing schemes

The Government has published its response to the consultation on options for risk sharing benefit structures (see WHiP Issue 3).

The Government has rejected the removal of mandatory increases to pensions in payment ("indexation") and the amendment of legislation to allow conditional indexation arrangements. However, collective DC arrangements will be looked at further. These would be defined contribution schemes with a targeted rate of career average pension and targeted revaluation and indexation, calculated using prudent assumptions. If the scheme were to be insufficiently funded to provide the targeted benefits, revaluation and indexation increases would be reduced first and then the basic benefits. They would be restored later should funding permit, but no additional contributions would be required.

Also, further work will be undertaken:

- to develop proposals for regulations giving DB schemes more scope to reflect changing longevity in their benefit design, for future accruals, with a consultation by Spring 2009 at the latest;
- to consider abolishing the indexation requirement for cash balance schemes; and
- to review "*the burdens imposed by the arrangements for contracting-out*".

Press release:

http://www.dwp.gov.uk/mediacentre/pressreleases/2008/dec/pens091-111208.asp

Pre-Budget Report

The Government has issued its 2008 Pre-Budget Report. Unusually, there was very little pensions content.

- For five years from 6 April 2011, the lifetime allowance will be frozen at £1.8 million and the annual allowance will be frozen at £255,000 (i.e. 2010/11 levels). It appears that individuals will be entitled to tax relief on pension contributions at the new 45% income tax rate applicable from April 2010, but the current 55% tax charge will apply to pension savings above the frozen lifetime allowance. This will also apparently affect others lower down the earning scale, because trivial commutation rules are based on 1% of the lifetime allowance.
- The basic state pension will be increased as usual in April 2009, but an additional payment of £60 per pensioner will be made in January 2009, effectively bringing forward the increase.
- For 2009/10, the Upper Earnings Limit for primary Class 1 NICs will be aligned with the level at which the higher rate income tax band starts. (This large increase had been previously announced and was included in the National Insurance Contributions Act 2008.)

Pre-Budget Report:

http://www.hm-treasury.gov.uk/prebud_pbr08_index.htm

http://www.hmrc.gov.uk/pbr2008

- From 6 April 2011, the main rate of Class 1 (employed) and Class 4 (self-employed) individual NICs will be increased by 0.5% to 11.5% and 8.5% respectively; the Class 1 employer rate will be increased by 0.5% to 13.3% (this will also apply to Class 1A (benefits in kind) and Class 1B (PAYE settlement agreements) NICs); and the additional rate of Class 1 and Class 4 NICs (payable by individuals on earnings above the UEL) will be increased by 0.5% to 1.5%. These increases may make salary sacrifice more popular.

Pension Protection Fund

2009/10 pension protection levy estimate

PPF press release:

http://www.pensionprotectionfund.org.uk/news-details.htm?id=6861

The PPF has published its 2009/10 pension protection levy determination and a policy statement setting out minor changes from the original 2009/10 proposals. The 2009/10 pension protection levy estimate is set at £700 million and the levy scaling factor at 2.22. This confirms previously announced proposals (see WHiP Issue 5). Larger schemes are said to be particularly badly affected.

Consultation on including longer term risk in the pension protection levy

PPF press release:

http://www.pensionprotectionfund.org.uk/news-details.htm?id=6832

The PPF is consulting on including longer-term risk as a factor in calculating the distribution of the pension protection levy between individual schemes, starting from 2011/12. In particular, it proposes to:

- *"assess the probability of a scheme's sponsoring employer going bust during a five year period – as well as separately assess the probability of it going bust during a one year period, as now, and*
- *take account of the risk that a scheme's investment strategy poses to the PPF when calculating its individual levy".*

The consultation closes on 13 February 2009.

Submitting information via "Exchange"

PPF press release:

http://www.pensionprotectionfund.org.uk/news-details.htm?id=6891

The PPF has issued guidance on using the Pensions Regulator's online "Exchange" system to submit documents to the PPF. The new version of Exchange allows the submission to the PPF of all voluntary certificates for contingent assets, deficit reduction contributions and block transfers online. It appears that submission of physical copies will still be allowed as an alternative.

PPF administration levy and general levy

DWP press release:

http://www.dwp.gov.uk/mediacentre/pressreleases/2008/nov/pens087-061108.asp

The Government has announced that the rates for the PPF administration levy and for the general levy will be kept at their 2009/09 levels for the year 2009/2010.

Equalisation of pension ages

Case report:

http://www.bailii.org/ew/cases/EWHC/Ch/2008/2926.html

In *Foster Wheeler Ltd v Hanley*, the High Court was asked to consider the implications of Article 141 of the EC Treaty and the *Barber* decision for a scheme that had initially attempted to equalise by allowing men to take an unreduced early retirement pension from age 60 with employer consent.

The scheme had originally had normal retirement ages of 65 for men and 60 for women. In the immediate aftermath of *Barber*, when it was uncertain what the European Court's decision meant, the scheme was operated to allow men, with employer consent, the same early retirement terms as women (i.e. no early payment actuarial reduction after age 60). From 16 August 1993, normal retirement ages were equalised at 65 but members continued to be entitled, with employer consent, to immediate unreduced pensions on retirement between ages 60 and 65.

In April 2002, the early retirement rule was amended to allow for early pensions (with employer consent) "*reduced to such an extent (if any) as the Trustees shall, with the advice of the Actuary, consider to be reasonable and determine to be appropriate having regard to, among other things, the period between the date of its commencement and the Member's 60th birthday*".

In April 2003, the early retirement rule was amended again, but only in respect of future service, to refer to actuarial reduction by reference to age 65.

The High Court held as follows:

- The words "*among other things*" in the early retirement rule applicable from April 2002 could not in the circumstances be read as allowing age 65 to be used for reducing any particular tranche of pension.
- It was necessary to look at the scheme rules and read them with as little modification as necessary to give effect to the requirements of Article 141.
- In the present case, it was far easier to imply the giving of employer consent than to effectively rewrite the rules to provide for a split pension with benefits partly based on age 60 and partly on age 65.
- The result of implying consent is that male members have the right to take all of their pre-April 2003 pension from age 60 with no early payment actuarial reduction, i.e. including not just the *Barber* "window period" tranche but also the tranches in respect of periods before and after that (up to April 2003).
- It was open to the parties to have rewritten the rules in 1993 to provide for split pensions (which would have complied with *Barber* at a smaller cost) but they had not done so until April 2003. The rules continued up until 2003 to provide for a single pension and a single normal retirement age.

This case will be of concern to any scheme that dealt with the *Barber* "window period" by providing for unreduced scheme pensions from age 60 with employer consent, rather than by setting out in the rules how the early retirement rule would apply to different tranches of pension accrual.

The judgment also considers issues about the date of effective equalisation. In short, an estoppel argument based on communication of the age 65 equalisation in June 1992 was rejected, partly because of a lack of evidence that members had received the communications in question but mainly because there was no evidence of anything more than "passive acceptance" of the changes.

The employer has been granted leave to appeal.

Maximising a section 75 debt

Case report:

http://www.bailii.org/ew/cases/EWHC/Ch/2008/2573.html

In *Easterly Ltd v Headway PLC*, the trustee of the Headway PLC Group Pension Fund was attempting to maximise the section 75 debt due following the scheme going into winding-up with a solvent employer. The winding-up commenced on 11 May 2001, when section 75 debts to schemes in winding-up with a solvent employer were calculated on the MFR, not buyout, basis.

The trustee devised a method of maximising the employer debt as follows:

- Application of scheme assets to buy annuities and deferred annuities to the extent funds allowed. (A partial buyout was specifically permitted by the scheme rules.)
- Fixing an "applicable time" for the computation of the section 75 debt after the partial buyout.
- Applying any debt recovered to buy further annuities and deferred annuities for the members, to top up the annuities bought earlier.

The trustee argued that doing this would significantly increase the section 75 debt and that it was entitled to fix an "applicable time" at a date after the initial partial buyout had been completed.

The High Court agreed with the trustee. The only qualification was that the trustee must be satisfied that the proposed course of action would provide worthwhile value for scheme members, after deducting the costs of implementing it, by materially increasing the section 75 debt due from the employer.

This approach effectively used a buyout basis to value the liabilities bought out at the first stage, at a time when a section 75 debt on a winding-up with a solvent employer was to be calculated by reference to MFR liabilities only. It is not of assistance under legislation applicable to windings-up triggered on or after 11 June 2003, which now applies a buyout basis when valuing liabilities for section 75 purposes.

Trustees personally liable for investment breaches

Determination:

http://www.pensions-ombudsman.org.uk/determinations/docs/2008/aug/l00575.doc

The Pensions Ombudsman determination of a complaint by *Mr N Went* is similar to that of *Lawrence Graham Trust Corporation (Greenup and Thompson Limited Pension Scheme)* (see WHiP Issue 5).

In circumstances similar to that case, trustees have been found personally liable to pay over £400,000 plus interest to the scheme after loaning 46% of the scheme's assets to the ailing sponsoring employer and not claiming interest due on the loans, and purchasing properties in Florida for use by the employer and not obtaining any rental income for most of the periods of ownership.

The Pensions Ombudsman also determined that three of the four trustees could not rely on the scheme's exoneration or indemnity clauses because they had "knowingly" committed breaches of trust.

Bridging pensions

The Finance Act 2004 generally prohibits a reduction of pensions in payment. HMRC has laid regulations concerning the reduction of pensions in payment that include a bridging pension element. These will allow schemes paying pensions since before 3 July 2007, in respect of members and scheme rules in place before 6 April 2006, to reduce them (since 6 April 2006) where the reduction would have been permitted under HMRC's old (pre-6 April 2006) practice note IR12. Pensions commencing on or after 3 July 2007 (when this move was announced) continue to be subject to the Finance Act 2004 provisions unamended.

Regulations:

http://www.opsi.gov.uk/si/si2008/uksi_20082990_en_1

Pensions Regulator: record keeping

The Pensions Regulator has published its response to the consultation on record keeping (see WHiP Issue 4) and guidance on this subject. The guidance sets out a framework of the data items that the Regulator expects trustees and administrators to check. Checks are expected to be made for completeness (i.e. no blank fields) and for appropriate entries (i.e. that the entry is appropriate to the relevant field).

Consultation report:
http://www.thepensionsregulator.gov.uk/pdf/RecordKeepingConsultationReport.pdf

Guidance:
http://www.thepensionsregulator.gov.uk/guidance/recordKeeping/index.aspx

Pensions Regulator scheme funding report

The Pensions Regulator has published a report analysing scheme funding levels and recovery plans. It notes an improvement in reported funding levels, a strengthening of longevity assumptions, and a shortening of recovery plan periods. The figures are based on valuation reports with effective dates up to 21 September 2007. It should be noted, therefore, that the funding positions and recovery plans analysed in the report derive from less difficult financial circumstances than at present.

The report also looks at clearance applications from the inception of the Regulator until August 2008. It notes a downturn in clearance application activity but reports that more than 60% of clearance applications involve a cash contribution being made to the pension scheme.

Press release:

http://www.thepensionsregulator.gov.uk/whatsNew/pn08-27.aspx

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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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