



What's happening in *Pensions*

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Use of CPI instead of RPI

In a consultation response on the impact of the move from RPI to CPI for revaluation and indexation on private sector occupational pension schemes, the Government has confirmed that it will not:

- require schemes to switch from RPI to CPI for revaluation or indexation of pensions in payment where increases by reference to RPI are specifically written into scheme rules; nor
- give any assistance to employers and/or trustees who would like to switch but are hindered or prevented from doing so by the scheme amendment power and/or section 67 of the Pensions Act 1995 (relating to the protection of subsisting rights).

The Government will, however, consider tabling an amendment to the Pensions Bill which would mean that schemes with rules that revalue deferred pensions by reference to RPI would not need to operate a CPI underpin. Please see our briefing note "**Use of CPI instead of RPI**" for full background.

The Government has also published a report on "*Research exploring the effect of uprating by CPI on occupational pension schemes*".

Pension protection levy

Revised levy framework confirmed

The PPF has confirmed (with one tweak) its proposed changes to the pension protection levy framework (see **WHIP Issue 25**). These will apply for levy year 2012/13 and thereafter.

- Barring exceptional circumstances, the PPF intends to fix pension protection levy rules for three years at a time.
- The new formula will for the first time take account of investment risk. It applies "stresses" to different categories of investment based on their volatility. Schemes with protected liabilities of £1.5 billion or more will be required to carry out more detailed analysis of their investments than at present and report the results in their annual return on Exchange. Other schemes may choose to do this. Draft guidance on analysing investments has been published: a consultation on this closes on 24 June 2011.

Consultation response:

<http://www.dwp.gov.uk/docs/cpi-private-pensions-consultation-response.pdf>

Research report:

<http://www.dwp.gov.uk/newsroom/press-releases/2011/jun-2011/dwp066-11.shtml>

Press release:

<http://www.pensionprotectionfund.org.uk/News/Pages/details.aspx?itemID=225>

Draft guidance:

http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/investment_risk_consultation_May11.pdf

- To increase stability, the PPF proposes to use average measures for underfunding and insolvency risks (averaged over five years and one year respectively) so that temporary changes in a scheme's funding level or an employer's insolvency risk score should not disproportionately affect the scheme's levy bill.
- Dun & Bradstreet failure scores of 1 to 100 will be grouped into ten bands (not six, as originally proposed). Levy rates will then vary depending on the band rather than the specific failure score. Credit for a group company guarantee will be given only if the guarantor is in a higher band than the scheme's sponsoring employer; if the score is better but in the same band, no credit will be given.
- The insolvency risk calculation for "last man standing" multi-employer schemes for non-associated employers will no longer be based on the largest employer but will instead be based on a "concentration" formula. This reflects the relative sizes of all employers within the scheme, not just the largest one, to indicate how concentrated or dispersed the risk is.

Partially successful claim to the PPF Ombudsman

The trustees of the Michelin Pension and Life Assurance Scheme have partially succeeded in an application to the PPF Ombudsman over incorrect information provided in respect of their pension protection levy.

The trustees had historically allocated "orphan" dependants' pension liabilities to one employer rather than splitting them *pro rata* between all employers. This was in line with the agreed approach to scheme funding but contrary to the requirement in a PPF FAQ since 2006, reflecting changes to section 75 of the Pensions Act 1995. Initially, this made no difference to the pension protection levy calculation because all scheme employers had the same insolvency score.

For 2008/9, however, the employers' insolvency scores changed. After submitting data, the trustees realised that they could have reduced their levy by about £600,000 if they had allocated the orphan liabilities as required by the PPF. Data provided for the 2008/9 calculation were also used for the 2009/10 levy, so a similar levy saving was also missed for 2009/10. The trustees applied to the PPF for a discretionary review of their levy calculations.

The PPF Board's Reconsideration Committee determined, in June 2009, that the information submitted was "*correct and legitimate in itself*" (this is a reference to language in the formal levy determination document) and that there was therefore no discretion to review the levy calculation. Had the data been incorrect, the Committee said, it would not have exercised its discretion in the trustees' favour anyway.

The PPF subsequently acknowledged to the Ombudsman that the data was incorrect and that there was, therefore, a discretion to be exercised. The Ombudsman found that the view formed by the Reconsideration Committee that it would not have exercised its discretion anyway could have been tainted by its (incorrect) view that there was no discretion to exercise, and that it was not satisfactory for it to "hedge its bets" in this way. He therefore referred the matter back to the Committee for reconsideration.

As regards the 2009/10 levy, the PPF had exercised its discretion to reconsider and had decided not to accept corrected data. This was on the basis of its published policy (endorsed by the Ombudsman in his determination) that the PPF would not accept corrections except in exceptional circumstances. The Ombudsman found no fault in that decision (save that the PPF had come "*perilously close*" to giving no meaningful reasons for its decision).

Transfer value exercises

The Pensions Minister, Steve Webb, has said in Parliament in response to a question about "incentivised transfer values" that the Government is "*determined to drive out the bad practice whereby ... people are given a bung of cash, sometimes a few weeks before Christmas, and are then given a value for their pension rights which is well below what they are actually worth to them.*" He added: "*I met the Pensions Regulator and other interested groups a few weeks ago, and we are looking very hard at whether regulatory change is needed.*"

Automatic enrolment

Government guide

The Government has issued "*Automatic Enrolment and Workplace Pension Reform – the facts*", a useful basic guide to the automatic enrolment regime and NEST.

Determination:

<http://www.ppf.org.uk/documents/Michelin-Pensions-Trust-Limited.pdf#zoom=100>

Hansard report (at section T9 [58815]):

<http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm110613/debtext/110613-0001.htm>

Government guide:

<http://www.dwp.gov.uk/docs/auto-enrol-and-wpr-the-facts.pdf>

Pensions Regulator guidance

The Pensions Regulator has published detailed guidance notes and other documentation on automatic enrolment. There is also a very short, five step checklist for trustees. New points of interest are as follows.

- **Salary sacrifice**

It is confirmed that compulsory salary sacrifice arrangements will not be compatible with automatic enrolment, since they require members to consent before scheme membership is established. (See para 35 of guidance note 4.)

- **Flexible benefit plans**

Flexible benefit plans under which pension is an option must present no barrier to automatic enrolment and include no requirement for members to make a choice or provide any information in order to be a member. So, for example, requiring jobholders to choose between options including pension will not work. But employers could comply by offering an automatic core pension benefit that meets the requirements for an automatic enrolment scheme, with additional contributions (or accrual) as one of the options under the flexible benefit plan. (See para 35 of guidance note 4.)

There is also an argument that non-pension options under flexible benefit plans might represent an unlawful inducement to opt-out. In most cases, however, and especially for existing plans, there will be no issue because inducement to opt out will not be the "sole or main purpose" of the arrangements. (See paras 22 and 23 of guidance note 8.)

- **GPP/stakeholder schemes**

There should be an agreement between the employer and the scheme provider binding the employer to make the minimum required contributions. Such a legally binding obligation is unlikely to exist for current GPP or stakeholder arrangements. (See paras 56 to 58 of guidance note 4.)

Under the legislation, there must also be an agreement between the individual and the scheme provider for the individual to meet the "shortfall" between the employer's contributions and the minimum contribution requirement (8% of qualifying earnings when the phasing-in process is complete). This too is very unlikely to exist. Given that jobholders cannot be required to enter into such an agreement (this would disqualify the scheme as an automatic enrolment scheme), this is a potentially fatal obstacle to using a GPP or stakeholder scheme for automatic enrolment except where employer contributions meet the minimum contribution requirement by themselves. (This point is not made in paras 59 and 60 of guidance note 4, where this is covered.)

Informal consultation on amending regulations

The Government is conducting an informal consultation on draft amending regulations. These follow changes to be made by the Pensions Bill (see **WHIP Issue 25**) as regards:

- allowing waiting periods of up to three months;
- flexible re-enrolment dates;
- allowing the biggest employers to bring forward their staging date to 1 July 2012 or later; and
- certification of DC arrangements.

The consultation paper also includes draft guidance for DC certification. The consultation closes on 31 May 2011.

Guidance on DC scheme default investment options

The Government has finalised guidance and issued a consultation response on default investment options for DC automatic enrolment schemes. There are separate sections for workplace personal pensions and occupational pension schemes. Both set out principles to be followed in the design, review and communication of the default option.

The consultation response notes that *"If there is sufficient evidence that the guidance is not promoting good practice (widespread excessive charges for example), we will consult with stakeholders on how best to achieve good practice via regulation"*.

Contribution notice dispute settled

The Pensions Regulator has settled its contribution notice claim against Michel van de Wiele in relation to the Bonas Group Pension Scheme for £60,000. £5.089 million had originally been claimed but doubts about the right to claim so much were expressed by

Guidance press release:

<http://www.thepensionsregulator.gov.uk/press/pn11-10.aspx>

Trustee checklist:

<http://www.thepensionsregulator.gov.uk/press/pn11-12.aspx>

Informal consultation:

<http://www.dwp.gov.uk/policy/pensions-reform/workplace-pension-reforms/>

Guidance:

<http://www.dwp.gov.uk/docs/def-opt-guid.pdf>

Consultation response:

<http://www.dwp.gov.uk/consultations/2010/dc-default-option-consult.shtml>

Press release:

<http://www.thepensionsregulator.gov.uk/press/pn11-11.aspx>

Warren J in a strike-out application in January this year. Warren J had indicated that the Regulator should only claim an amount equivalent to the loss to the scheme resulting from the acts giving rise to the contribution notice liability and not the whole funding deficit. See **WHIP Issues 19** and **25** for the background.

Annual allowance

Information requirements

Draft regulations prescribe requirements for the automatic annual provision of information by the scheme administrator (normally the trustees) to members whose scheme pension input amounts exceed the annual allowance by themselves, and on request to other members. They also cover the information that must be provided by employers to scheme administrators to enable them to calculate pension input amounts. In particular:

- where an individual has pension input in a single scheme that exceeds the annual allowance, the trustees must notify the individual of his or her pension input amount for the relevant tax year and the three previous years by the 6 October after the end of the relevant tax year;
- individuals may request their pension input amount for a tax year, which must be provided (free of charge once a tax year) within three months of the request or (if later) by the 6 October after the end of the relevant tax year; and
- employers must provide information to the trustees of schemes with DB, cash balance or hybrid arrangements about the pensionable remuneration and length of service of members of those arrangements by 6 July each year. If the employer is late, the deadline for the trustees of 6 October is extended accordingly.

The above deadlines for 2012 are extended by 12 months (ie, to the same date in 2013) to allow new systems to be put in place. For the 2011/12 tax year, individuals will have to estimate their pension savings and then confirm the figures to HMRC later.

These regulations follow a consultation earlier this year (see **WHIP Issue 25**).

Pension input periods

The Government is proposing amendments to the pension input period provisions of the current Finance Bill (see **WHIP Issue 26**):

- to correct the drafting error whereby default pension input periods would be a day shorter than a year; and
- to change the method for calculating the pension input for the pension input period in which the member retires to ensure that early retirement enhancements are taken into account.

In its Newsletter No.47, HMRC accepts that a pension input period for a new arrangement that ends on 5 April by default in accordance with the current Finance Bill's amending provisions may be extended by nomination even after that 5 April, so long as:

- the pension input period does not exceed 12 months; and
- the new end date is not a date before the date on which the nomination is made.

The Newsletter also gives examples to illustrate the calculation of pension input for:

- members affected by variable accrual rates (e.g. 1/80ths for the first 30 years' service; then 1/40ths);
- members who have exceeded a pensionable service limit (e.g. 30 years);
- early leavers to whom the "n/ns" uniform accrual calculation is applied; and
- active members to whom the "n/ns" uniform accrual calculation is applied.

"Scheme pays" option for the annual allowance charge

Draft regulations (with a consultation closing on 24 June 2011 except where otherwise stated below) will:

- set out the requirements for a member to notify a scheme that he or she wants to exercise the "scheme pays" option (see **WHIP Issues 25** and **26**);
- allow schemes to reduce benefits when they pay a member's annual allowance charge (the drafting is unclear as to whether it applies to attaching spouses' etc pensions as well as to the member's own benefits: we have asked for confirmation that it does); and
- amend regulations on the surrender of pension scheme benefits to allow individuals

Draft regulations:

<http://www.hmrc.gov.uk/pensionschemes/aa1.pdf>

Finance Bill:

<http://services.parliament.uk/bills/2010-11/financeno3/documents.html>

Newsletter:

<http://www.hmrc.gov.uk/pensionschemes/ps-newsletter47.pdf>

Draft regulations:

<http://www.hmrc.gov.uk/pensionschemes/aa2.pdf>
<http://www.hmrc.gov.uk/pensionschemes/aa3.pdf>

Consultation:

<http://www.dwp.gov.uk/consultations/2011/occ-pen-assignment-etc-regs.shtml>

validly to surrender pension in order to meet an annual allowance charge, notwithstanding restrictions in the Pensions Act 1995. This consultation closes on 17 June 2011.

Lifetime allowance

Draft regulations regarding the reduction of the lifetime allowance (see **WHIP Issue 24**) have been issued:

- setting out the requirements for an individual to apply for "fixed protection" from the reduced lifetime allowance; and
- setting out the information requirements for trustees when a member with fixed protection has a benefit crystallisation event, and the requirement for members who have claimed fixed protection to tell the trustees.

The consultation closes on 24 June 2011.

Employer asset-backed contributions

HMRC is consulting on changes to limit the tax relief that can arise from some complex secured funding arrangements. This covers, for example, the use of Scottish limited partnerships to hold an employer asset and pay an income stream deriving from it to the scheme, subject to contingencies. The aim is that the tax relief should accurately reflect the value of payments received by the scheme.

The issue is that tax relief can currently be obtained, due to the operation of accounting rules, on a basis that HMRC believes is excessive because:

- tax relief is given twice: up-front for the discounted value of a future income stream and again for each instalment of the income stream; or
- if an income stream depends upon the future funding level of the scheme, the tax relief obtained may exceed the contributions the scheme actually receives.

The consultation paper uses examples to illustrate these points.

The consultation closes on 16 August 2011. No proposed implementation date is mentioned in the paper.

Contracting-out

Abolition of DC contracting-out

Various regulations and draft regulations have been issued concerning the abolition of DC contracting-out and protected rights from 6 April 2012 (see **WHIP Issues 17** and **24** for background).

Trustees must tell affected members that the scheme is (or will be) no longer contracted-out. This information needs to be given by 5 May 2012. Members also need to be told by 5 August 2012 that they may, from 6 April 2012, accrue an additional state pension and that protected rights become ordinary scheme rights and so the statutory requirement to provide a spouse's or civil partner's pension ceases to apply.

DB "reference scheme" test

Actuarial guidance note GN28, on testing scheme benefits against the reference scheme test for the purposes of salary-related contracting-out, is due to be withdrawn by the Board for Actuarial Standards. Regulations have been laid, to take effect from 1 October 2011. They contain provisions designed to replace the guidance in GN28. These provisions were originally included in draft miscellaneous amendment regulations (see **WHIP Issues 23** and **26** for background).

Court of Appeal decision on interpretation of scheme documents

The Court of Appeal has upheld the High Court's decision in *Stena Line Limited v MNRPF Trustees Limited and P&O Ferries Limited* (see **WHIP Issue 20**) and has confirmed that the trustee of the MNRPF, an industry-wide DB scheme, may use its unilateral power to amend the Fund's rules in order to require former employers, who no longer employ active members, to contribute towards the Fund's deficit.

The matters before the Court of Appeal have little relevance to most other pension schemes but there is an interesting comment by Arden LJ, who gave the Court's judgment, about how the meaning of a scheme rule can change, even if the wording stays the same, when scheme rules are amended and re-adopted from time to time.

Regulations:

<http://www.hmrc.gov.uk/pensionschemes/ta1.pdf>
<http://www.hmrc.gov.uk/pensionschemes/ta2.pdf>

HMRC web page:

<http://www.hmrc.gov.uk/budget-updates/march2011/index.htm#24may>

Regulations and draft regulations:

<http://www.legislation.gov.uk/uksi/2011/12/45/contents/made>
<http://www.legislation.gov.uk/uksi/2011/12/46/contents/made>
<http://www.legislation.gov.uk/uksi/2011/12/66/contents/made>
<http://www.legislation.gov.uk/uksi/2011/12/67/contents/made>
<http://www.legislation.gov.uk/ukdsi/2011/9/780111511374/contents>
<http://www.legislation.gov.uk/ukdsi/2011/9/780111511367/contents>

Regulations:

<http://www.legislation.gov.uk/uksi/2011/12/94/contents/made>

Case report:

<http://www.bailii.org/ew/cases/EWCA/Civ/2011/543.html>

She said that:

"... even though the very same clause is effectively re-adopted in the same form, its meaning may change on each re-introduction if the context in which it is re-adopted is materially different. ... Likewise, ... it is possible that the meaning of a clause changes on re-adoption because there has been some material change in the scope or effect of some other clause in the period between its introduction and its re-introduction that has an impact on it."

This may be relevant to the question whether a rule amendment is better made by a free-standing deed of amendment or by adopting an amended definitive deed.

Travers Smith acted for Stena Line, representing the current employers. The decision may be appealed to the Supreme Court.

Review of EU IORP directive

The European Commission has called for advice from the European Insurance and Occupational Pensions Authority (EIOPA) regarding the review of the IORP Directive. This directive affects UK occupational pension schemes and covers matters such as scheme funding and cross-border pension provision. EIOPA is asked to provide its final advice by 16 December 2011.

The document outlines the three main reasons why a review is considered necessary.

- Measures are needed to simplify the requirements for setting up cross-border schemes. (There are currently only 80 of them in the EU.)
- Measures should allow IORPs to *"benefit from the risk-mitigating security mechanisms at their disposal"*. *"In particular, on the liabilities side, pension funds may have the possibility to call on additional contributions from members and/or sponsors, reduce or suppress the indexation of pension rights or reduce the pension liabilities (i.e. the technical provisions themselves) in going concern. On the asset side pension funds may have recourse to sponsor covenants, contingent assets outside the balance sheet of the IORP, or to reinsurance from a pension guarantee fund."*
- Regulations need to be modernised to cater for the current prevalence of DC schemes.

There has been concern that a new IORP directive will impose funding requirements similar to the capital requirements for insurance companies under the Solvency II directive. This is suggested in the call for advice, but only if IORP *"itself, and not the sponsoring undertaking, underwrites the liability to cover against biometric risk, or guarantees a given investment performance or a given level of benefits"* (ie, one that is subject to the "own fund" requirements – not UK DB occupational pension schemes).

Record-keeping

The Regulator has published a report on its 2011 record-keeping survey.

Financial Assistance Scheme

The Government is consulting on the proposed extension of the Financial Assistance Scheme to cover schemes which, despite the payment of pension protection levies, are ultimately not covered by the Pension Protection Fund because, for example, the employer of scheme members no longer participates in the scheme. The consultation closes on 1 September 2011.

European Commission web page:
http://ec.europa.eu/internal_market/pensions/commission-docs_en.htm

Survey report:
<http://www.thepensionsregulator.gov.uk/docs/scheme-record-keeping-2011.pdf>

Consultation:
<http://www.dwp.gov.uk/consultations/2011/fas-regs-2011.shtml>

This and previous issues of WHiP can be found on our website. See: www.traverssmith.com/?pid=24&level=2&eid=17

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, Philip Stear and Andrew Block.

Travers Smith LLP
10 Snow Hill
London EC1A 2AL
T: +44 (0)20 7297 3000
F: +44 (0)20 7295 3500

www.traverssmith.com