



# What's happening in Pensions

Issue 5

October 2008

## Scheme funding – Mortality assumptions

The Pensions Regulator has published its response to the recent consultation (see WHiP Issues 1 and 4) on good practice in selecting mortality assumptions for DB pension schemes, and has published final guidance on this topic. The Regulator has backed down from its original proposal to add a new investigation trigger where scheme assumptions do not make adequate provision for future improvements in mortality. However, mortality assumptions will be considered if one of the other triggers causes the Regulator to scrutinise the scheme's funding arrangements.

This will affect actuarial valuations with effective dates on or after 22 September 2008. Detailed information on mortality assumptions will now be requested by the Regulator when scheme returns and recovery plans are submitted.

## "Solvency II" – Impact on defined benefit pension schemes

The European Commission has published a consultative document on the potential impact of the proposed "Solvency II" EU directive on institutions for occupational retirement provision (IORPs), which include UK occupational pension schemes. The consultation closes on 28 November 2008.

Solvency II would, if applicable to DB pension schemes, impose even stronger funding requirements than at present – similar to those applicable to insurance companies. The consultative document proposes, however, that Solvency II should generally not apply to IORPs other than cross-border schemes and "regulatory own funds" (schemes which underwrite risks linked to death, disability and longevity, or provide an investment guarantee, without recourse to a sponsoring employer). Most UK occupational pension schemes will not fall into either category, but non-DC cross-border schemes would be affected.

## Pension protection levy

### 2008/09 levy

Documents relating to the invoicing of the 2008/09 pension protection levy (from 27 September 2008) have been published on the Pension Protection Fund (PPF) website. This year, the PPF will not be accepting corrections or updates to data: trustees are expected to get this right first time.

Trustees are also reminded that the deadlines for submitting voluntary certificates are 5pm on 31 March 2009 for contingent assets and 5pm on 7 April 2009 for deficit reduction contributions.

### 2009/10 levy

The PPF has issued documentation on the proposed pension protection levy for 2009/10. It proposes a levy estimate of £700 million (increased in line with earnings inflation from £675 million for 2008/9) and a levy scaling factor of 2.22 "which is unlikely to change". These proposals are subject to consultation which will close on 23 October 2008.

Dun & Bradstreet have been reappointed as the PPF's insolvency risk provider.

## Long-term levy proposals

The PPF will shortly publish long-term proposals for the pension protection levy, with a three month consultation period. It has indicated in advance that it wants to add a component to the risk-based element of the levy that will take account of a scheme's

### Press release:

<http://www.thepensionsregulator.gov.uk/whatsNew/pn08-20.aspx>

### EC consultative document:

[http://ec.europa.eu/internal\\_market/consultations/docs/occupational\\_retirement\\_provision/consultation\\_en.pdf](http://ec.europa.eu/internal_market/consultations/docs/occupational_retirement_provision/consultation_en.pdf)

### PPF guide to 2008/09 levy:

[http://www.pensionprotectionfund.org.uk/index/pension\\_protection\\_levy-2/invoicing\\_2008\\_09/a\\_guide\\_to\\_the\\_2008\\_09\\_levy.htm](http://www.pensionprotectionfund.org.uk/index/pension_protection_levy-2/invoicing_2008_09/a_guide_to_the_2008_09_levy.htm)

### PPF 2009/10 levy information:

[http://www.pensionprotectionfund.org.uk/levy\\_consultation\\_september\\_2008.pdf](http://www.pensionprotectionfund.org.uk/levy_consultation_september_2008.pdf)

### Press release:

<http://www.pensionprotectionfund.org.uk/news-details.htm?id=6776>

investment strategy and credit risk.

## Conflicts of interest

The Pensions Regulator has published guidance on conflicts of interest for trustees of occupational pension schemes (including directors of corporate trustees). The guidance has been amended from the draft that was issued for consultation earlier this year and on which we reported in WHiP Issue 1.

There are two main documents: the full guidance and a summary of key principles. The Regulator seems to expect all trustees to read both and that trustees should:

- have a policy (or protocol) for identifying and managing actual and potential conflicts of interest;
- have procedures and forms for trustees to declare relevant interests, both when appointed and on an ongoing basis;
- maintain a register of conflicts (or, in reality, of trustees' interests) and regularly review it; and
- consider the possibility of their advisers having conflicts of interest.

Some changes from the draft guidance are as follows.

- There is less emphasis on the possibility of conflicts for officers of the employer and added emphasis on the possibility of conflicts for trade union representatives.
- The numerous references to the need to take legal advice have been changed to recommendations that the trustees seriously consider taking legal advice.
- There are more case studies for DC schemes.
- Changes to the section on advisers' conflicts reflect what occurs in practice: for example the trustees and the employer may be advised by different actuaries at the same firm but both actuaries use the same team to process data and perform calculations (the so called "Y-shaped model").

## DC schemes – Member communications

The Pensions Regulator has published guidance on member communications and an investment guide that can be provided to members. These relate to all forms of workplace DC pension provision: occupational schemes, group personal pensions and stakeholder schemes.

### Guidance on effective member communications

This guidance is for use by trustees and employers. The key messages on communication with members are to:

- *"identify your objectives and have a clear communications plan;*
- *identify the best ways to communicate;*
- *tailor communications to the audience;*
- *remember the needs of all groups, not just active members;*
- *be open and honest;*
- *avoid jargon; and*
- *try to get members to engage".*

### Member investment guide

This is a standard guide for members, entitled "Making pension fund choices – think before you choose". It is designed to be circulated to members by trustees or employers, to help the members decide how to invest their DC accounts.

## Transfer value calculation – Pensions Regulator guidance

The Pensions Regulator has published guidance on the calculation of cash equivalent transfer values in DB pension schemes from 1 October 2008. This follows a consultation that closed on 19 September 2008 (see WHiP Issue 4). The consultation report will follow "in the coming weeks".

### Press release:

<http://www.thepensionsregulator.gov.uk/whatsNew/pn08-22.aspx>

### Pensions Regulator guidance:

<http://www.thepensionsregulator.gov.uk/guidance/dcScheme/memberComms/index.aspx>

### Member investment guide:

<http://www.thepensionsregulator.gov.uk/guidance/dcScheme/fundChoices/index.aspx>

### Press release:

<http://www.thepensionsregulator.gov.uk/mediaCentre/pressReleases/pn08-21.aspx>

There are few notable differences from the draft version we reported on in WHiP Issue 4. One difference is the removal of the suggestion that actuarial assumptions used for scheme funding purposes and those used for transfer values should be calculated at the same time and be "capable of rational reconciliation".

## Transfer values – Amending regulations

New amending regulations came into force on 13 October 2008. Transfer values from DC schemes must be based on the "realisable value" of the benefits. They make it clear that this is to be determined on the date the calculation is being made. Previously, this was not expressly stated and there were possible different interpretations as to when the realisable value was to be measured.

## Age discrimination – Compulsory retirement at age 65

The European Court of Justice's Advocate General, Jan Mazak, has issued his Opinion in the "Heyday" (Age Concern) case against the UK Government.

The High Court is being asked to decide if the UK Government was entitled to legislate, as it did in the 2006 age discrimination regulations, that non-public sector employers who require workers to retire at age 65 are not thereby in breach of age discrimination laws.

There have been a number of individual Employment Tribunal claims brought by people who were required by their employers to retire at age 65. If the (private sector) employers in question have complied with clear UK law, it is difficult to see these claims succeeding. However, they have been put on hold pending the outcome of the Heyday case. Ultimately, depending on the ECJ's decision, claims might be made against the UK Government for failure to implement the directive.

In the Heyday case, the High Court asked the ECJ to answer three specific questions about whether the UK correctly implemented the relevant parts of the EU equal treatment directive.

- Are employment retirement ages within the scope of the directive?
- Are EU Member States entitled to legislate in such a way that employers (and pension scheme trustees) may seek to objectively justify any form of age discrimination or must they specify kinds of discrimination which may be justified?
- Are the directive's objective justification tests the same for both direct and indirect age discrimination? (They are effectively the same under UK legislation.)

The Advocate General has now proposed the following answers to the ECJ.

- The directive does apply to the provisions of the UK's age discrimination legislation concerning employment retirement ages. This is not a matter that is outside the scope of the directive.
- The directive does not require EU Member States to list definitively the kinds of age discrimination which may be objectively justified, whether in line with those mentioned in the directive or otherwise. Accordingly, national legislation may provide for the possibility of objective justification in situations of discrimination not falling within the categories listed.
- A law permitting employers to retire workers at age 65 can in principle be justified if it is "*objectively and reasonably justified in the context of national law by a legitimate aim relating to employment policy and the labour market and it is not apparent that the means put in place to achieve that aim of public interest are inappropriate and unnecessary for the purpose*".

The ECJ is expected to issue its ruling in the new year. The ECJ's findings will be considered and applied by the High Court in the UK in determining whether or not the Government has correctly implemented the directive.

If the Courts were ultimately to find that the Government has failed to implement the directive properly, the Government should then take steps to review and possibly amend the age discrimination legislation.

In the mean time, private sector employers in the UK may continue to rely on the specific exemption in the age discrimination regulations that allows them to apply a compulsory retirement age of 65, without having to demonstrate objective justification. However, public sector employers must comply with both the UK regulations and the EU

### Regulations:

[http://www.opsi.gov.uk/si/si2008/ukxi\\_20082450\\_en\\_1](http://www.opsi.gov.uk/si/si2008/ukxi_20082450_en_1)

### Case report:

[ECJ website link](#)

directive and will therefore have to defend any compulsory retirement age on grounds of objective justification.

## Age discrimination – "Young spouse" rules

*Bartsch v Bosch und Siemens Hausgerate Altersfursorge GmbH* concerns a rule in a German pension scheme that denied a spouse's pension where the spouse was more than 15 years younger than the deceased member. We reported on the Advocate General's opinion in WHiP Issue 3. Briefly, his opinion was that a rule that totally excluded a young spouse was unlawful. He suggested, however, that a sliding-scale reduction or a spouse's pension starting only at a certain age would be objectively justifiable.

The ECJ has found against the claimant because the discrimination occurred before the German government had (or was required to have) implemented the EU equal treatment directive. Therefore there was no applicable EU law for the ECJ to rule upon and the ECJ did not have to consider the issues of objective justification. (The Advocate General's opinion, which did, is still a useful reference document.)

### Case report:

[ECJ website link](#)

## Age discrimination – Objective justification

In *MacCulloch v ICI plc*, the Employment Appeals Tribunal considered arguments concerning objective justification of age discrimination in relation to a redundancy scheme. It is a good illustration of how difficult issues of objective justification can be.

ICI's contractual redundancy policy entitled employees to enhanced redundancy payments, calculated by reference to age and length of service (but not in line with the statutory scheme, which would have been specifically exempted under the age discrimination regulations). The EAT considered that in principle the following could amount to legitimate aims:

- encouraging and rewarding loyalty;
- encouraging employee turnover (to prevent "blockages" in career progression);
- protecting older employees, who might be expected to find it harder to obtain new employment.

The EAT referred the matter back to the employment tribunal to consider whether the redundancy scheme was a proportionate means of achieving these legitimate aims, and did not decide this point. It did, however, find that those aims must justify the redundancy scheme as a whole, not the scheme as it affected one individual. But the effect on an individual is relevant to the question of whether the means are proportionate, notwithstanding that proportionality is to be assessed as regards all affected employees.

### Case report:

[http://www.employmentappeals.gov.uk/Public/Upload/MacCullochvImperialFINAL\(3\)08\\_0119fhRCRN.doc](http://www.employmentappeals.gov.uk/Public/Upload/MacCullochvImperialFINAL(3)08_0119fhRCRN.doc)

## Financial Support Directions – Sea Containers Limited

The status of the financial support directions issued by the Pensions Regulator against Sea Containers Limited, a Bermudan company listed in the United States, has been considered by the US Bankruptcy Court.

The US Bankruptcy Court (Delaware) has approved a settlement agreement between Sea Containers and the pension schemes' trustees which accepts the trustees' claims and sets out what the nature of the claims is (including a \$194 million unsecured claim and a \$69 million "equalisation reserve"). The agreement is conditional on the Pensions Regulator's approval.

Other Sea Containers creditors had objected, claiming that no section 75 debt had been triggered and that it was not appropriate to calculate liabilities on the buyout basis. The Court, however, considered that the possibility of a section 75 debt arising was not so remote as to be wholly discounted (because the trustees could effectively trigger one) and that, given Sea Containers' financial situation, a buyout basis for assessing scheme liabilities was not unreasonable.

There do not appear to have been any arguments on issues of jurisdiction.

### Case report:

<http://www.deb.uscourts.gov/Opinions/2008/seacontainers.06.11156.memorandum.order.pdf>

## Myners principles – HM Treasury consultation response

The Government has published its response to the consultation on proposals to update the Myners principles (see WHiP Issue 1). The key themes identified by HM Treasury are:

### HM Treasury web page:

[http://62.164.176.164/d/PU632\\_-\\_Myners\\_Response\\_FINAL\\_PDF.pdf](http://62.164.176.164/d/PU632_-_Myners_Response_FINAL_PDF.pdf)

- *"There will be a smaller number of simplified, higher-level principles.*
- *These principles will be linked to a body of higher quality, more selective and accessible guidance and trustee tools.*
- *There will be greater industry ownership of the principles, guidance and trustee tools through the establishment of a joint Government-industry Investment Governance Group.*
- *There will be a more robust approach to disclosure and industry debate, within a voluntary 'comply or explain' approach."*

## Financial promotion in the workplace

The Financial Services and Markets Act 2000 (FSMA) generally prohibits the promotion of financial products except by FSA-authorized persons. Employers who offer group personal pensions and stakeholder schemes are exempt from the FSMA financial promotion regime in relation to those arrangements. HM Treasury has now issued a consultation paper and draft Order proposing further changes. The change that concerns pension arrangements is that the exemption will be extended to cover the acts of third party administrators. In practice they, rather than the employer, often issue the relevant information to employees and may not be FSA-authorized. The consultation closes on 12 December 2008.

### HM Treasury web page:

<http://www.hm-treasury.gov.uk/6659.htm>

## Government consultation on conversion of GMPs

The DWP has issued a consultation document with draft regulations to allow schemes to convert guaranteed minimum pensions (GMPs) into standard scheme benefits.

The consultation closes on 28 October 2008 and the regulations are intended to be brought into force on 6 April 2009. The key points are as follows:

- The GMP must be converted into "actuarially equivalent" benefits.
- The employer must have consented and affected members must have been consulted (so far as reasonably possible).
- Trustees will be responsible for deciding the assumptions to be used for this purpose, having taken advice from the actuary. The actuary then makes the calculations and certifies actuarial equivalence.
- 50% survivors' benefits will still need to be provided.
- There will be no special restrictions on transferring converted benefits.

This would seem to give trustees flexibility to administer benefits on a more straightforward basis but the big problem is equalisation as between men and women. In this regard, there are two major obstacles to GMP conversion:

- GMPs do not normally have to be calculated until the member retires. GMP conversion will require an early calculation, at which point equalisation will need to be considered. Any inequality will then need to be addressed, and the result could be different than if this was considered at retirement. There could be an equalisation cost that would not otherwise arise.
- No one knows what is the correct way of equalising benefits that include GMPs because the relevant legislation and case law is unclear. The value of the equalised benefit is therefore unknown, so actuarial equivalence may be difficult or impossible to calculate and certify.

### Consultation paper:

<http://www.dwp.gov.uk/consultations/2008/occ-pen-contracting-out-consultation.pdf>

## SIPPs and protected rights

Regulations came into force on 1 October 2008 that allow self-invested personal pensions (SIPPs) to hold protected rights provided that they have a contracting-out certificate. This removes a difficulty for members of contracted-out schemes wanting to take transfers to a SIPP.

### Regulations:

[http://www.opsi.gov.uk/si/si2008/uksi\\_20081979\\_en\\_1](http://www.opsi.gov.uk/si/si2008/uksi_20081979_en_1)

## Pension sharing on divorce

The DWP has published its response to its consultation on draft regulations to allow pension credit benefit to be taken by the ex-spouse from age 50 (age 55 from April 2010)

### Consultation report:

<http://www.dwp.gov.uk/consultations/2008/govt-resp-pspcb-amdt-regs08.pdf>

subject to the scheme rules permitting it.

The regulations will come into force on 6 April 2009. Under the Pensions Bill that is currently proceeding through Parliament, safeguarded rights (i.e. the contracted-out element of shared rights) are to be abolished at the same time. The DWP agreed with respondents that it would be easier to implement these changes together.

## Trustees personally liable for breach of trust

In *Lawrence Graham Trust Corporation (Greenup and Thompson Limited Pension Scheme)*, a claim brought by a Pensions Regulator-appointed independent trustee, the Deputy Pensions Ombudsman found individual trustees personally liable to repay outstanding amounts of £130,074 plus interest from a £150,000 loan they had made in breach of trust to the scheme's sponsoring employer. (The loan also appeared to be in breach of statutory duties, but the Deputy Ombudsman did not consider this because the Pensions Regulator was already investigating the matter.) The loan had been made at a time when the employer was in financial difficulties and already owed £143,500 on an unsecured loan and unpaid contributions to the trustees.

There was no evidence of bad faith: the trustees were found personally liable on the basis of failing to meet the "prudent man" standard for exercising their power of investment. They argued that they had been trying to act in the members' interests by helping to keep their employer afloat.

The Deputy Ombudsman also found that the trustees could not rely on the scheme's exoneration clause because of section 33 Pensions Act 1995, which prohibits exoneration in respect of a failure to exercise reasonable care and skill in connection with the exercise of an investment function. Nor could they be indemnified under a scheme rule that provided for an indemnity from scheme assets: that would be contrary to the clear purpose of section 33.

## Trustees liable for paying demutualisation proceeds to employer

In *Kemp v Sims and another*, the High Court considered a Pensions Ombudsman decision (*Mr RAJ Sims*) concerning the payment by trustees to the employer of £75,000 that they received following the demutualisation of Scottish Widows.

The Ombudsman had found the five trustees liable for breach of trust but relieved four of them from liability (under section 61 Trustee Act 1925) because they had acted "honestly and reasonably". The fifth trustee, Mr Kemp, remained liable on the grounds that he had not acted reasonably (he had persuaded the other trustees to make the payment and, as a lawyer, should have known better) and had indirectly benefited from the payment. Mr Kemp appealed to the High Court.

The High Court held that the Ombudsman had been mistaken in finding that Mr Kemp had benefited from the payment but held that that error did not vitiate the Ombudsman's determination. The Court also confirmed that there had been a plain breach of trust by the trustees in making the payment to the employer.

## Distribution of surplus by an independent trustee

In *Bridge Trustees Limited v Noel Penny (Turbines) Limited*, the High Court was asked to decide whether the principal employer or the independent trustee should exercise the power to distribute remaining surplus in a scheme in winding-up.

The independent trustee had been appointed when the principal employer went into administration. The principal employer had originally also been the trustee of the scheme. Statute had vested the power to return surplus, as a fiduciary power, in the independent trustee but the power had returned to the principal employer when, although still insolvent, its administration ended.

The sole director of the principal employer was advised that he should not exercise the power, due to an unavoidable conflict of interest. An application to the Court was therefore made, asking it to make an order that the independent trustee could exercise the power, notwithstanding that the administration had ended.

The High Court decided, very pragmatically, as follows:

- The power to determine the destination of the surplus was a fiduciary power (or a power held under trust).

### Determination:

<http://www.pensions-ombudsman.org.uk/determinations/docs/2008/jul/q00623.doc>

### Press report:

<http://www.telegraph.co.uk/news/newstopics/lawreports/2476336/KEMP-v-SIMS-and-ANR.html>

### Case report:

<http://www.bailii.org/ew/cases/EWHC/Ch/2008/2054.html>

- It was obvious that an independent person needed to exercise the power, and the statutory policy reflected this need. Nothing of significance changed when the principal employer's administration ended, and it seemed absurd that the protection offered by Parliament should not continue beyond then.
- Section 41 Trustee Act 1925 (power of the court to appoint new trustees) had no application, because the fiduciary power was not a power held by a trustee as trust property in the sense intended in that section. Section 41 could not, therefore, be used to appoint the independent trustee as trustee of the power to distribute surplus.
- Because the principal employer was bound to exercise the power, but declined to do so, the Court could intervene "under its inherent jurisdiction to execute a trust, to exercise the power or cause it to be exercised in whatever way and by whatever means it thinks fit".
- The Court may use its inherent jurisdiction also to appoint some fit and proper person to exercise a fiduciary power in place of the person to whom it had been given. This follows in principle from the inherent jurisdiction of the Court (aside from section 41) to appoint a trustee and to execute a trust.
- The Court could have made the decision about the surplus itself but that would not be the most appropriate course in this case. The independent trustee had scheme knowledge and expertise; the Court, on the other hand, would need to be presented with a good deal of evidence. It was not right to incur additional costs needlessly.
- It was right that creditors of the principal employer had not been joined to the proceedings. That would have added to the costs, and they had no claim of their own to any of the surplus: they were strangers to the trust.

This and previous issues of WHiP can be found on our website: <http://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 and Philip Stear.

---

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

[www.traverssmith.com](http://www.traverssmith.com)