

Pensions law – the week in review

3 August 2009

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1 LEGISLATION

1.1 Finance Act 2009 - Explanatory Notes

We reported on 27 July 2009 that the Finance Act 2009 had received Royal Assent. The Explanatory Notes to accompany the Act, which have been prepared by HM Revenue & Customs in partnership with HM Treasury, have also now been published. These can be accessed by clicking on the link below:

http://www.opsi.gov.uk/acts/acts2009/en/ukpgaen_20090010_en.pdf

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2 HM REVENUE & CUSTOMS

2.1 Guidance on trustee residence rules

HMRC has published guidance on its view of the application of trustee residence rules which were introduced by the Finance Act 2006. The rules provide for a common test for both income tax and capital gains tax. The guidance focuses on the residency status of trustees and will be of particular interest for any overseas trust companies which may perform some trust activities in the UK, as it provides a number of practical examples.

To view the guidance, please click on the link below:

<http://www.hmrc.gov.uk/cnr/trustee-res-guidance.pdf>

3 PENSION PROTECTION FUND (PPF)

3.1 PPF updates consultation on long-term levy future

The PPF has published an update on the consultation which it ran between 18 November 2008 and 13 February 2009¹, on “The Future Development of the Pension Protection Levy”.

The PPF proposed developing the formula that allocates the pension protection levy estimate between schemes. Two key themes were:

- assisting the PPF in assessing the probability of a scheme’s sponsoring employer becoming insolvent during a five year period, as well as separately assessing the probability of it becoming insolvent during a one year period, as now; and
- enabling the PPF to take account of the risk that a scheme’s investment strategy poses to the PPF when calculating its individual levy.

¹ For more information on the PPF’s consultation, please refer to 7 Days dated 24 November 2008

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The PPF notes that although there was broad support for its proposal to incorporate unexpected risk in the levy formula, concerns were raised about key details, including the transparency of its long-term risk model and “the derivation of long-term insolvency risk from and the balance between simplicity and accuracy in the investment risk factor.” The PPF has therefore confirmed that the principle of incorporating risk into the levy to formula will be pursued, but that further work will be required to develop and refine the proposals before they can be implemented - which would be no earlier than 2012/13.

The PPF’s press release and consultation update can be accessed by clicking on the links below:

<http://www.pensionprotectionfund.org.uk/news-details.htm?id=7672>

http://www.pensionprotectionfund.org.uk/levy_update_doc_july_2009.pdf

3.2 PPF issues consultation on valuation assumptions

The PPF has published a consultation document on the assumptions used for valuations under:

- section 143 of the Pensions Act 2004 - valuations to determine whether the Board of the PPF should assume responsibility for a scheme; and
- section 179 of the Pensions Act 2004 - which are taken into account when calculating a scheme’s risk based levy.

The Board of the PPF is responsible for keeping the assumptions used for valuations under section 143 and 179 in line with estimated pricing in the bulk annuity market. In the light of recent developments in the buyout market, the Board of the PPF is considering making some changes to these assumptions in order to bring valuations into line with the market.

The PPF has summarised the proposed changes to the assumptions as follows:

- to increase the yields used to discount future payments by 0.1% per annum in deferment;

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- to increase the yields used to discount future payments by 0.3% per annum in payment;
- to change one of the yields used as a reference point to one with a longer duration;
- to increase the assumption about future longevity improvements for males by raising the floor for annual improvements from 1% to 1.25%; and
- to reduce the proportion of members who are married or who have relevant partners by 5%.

Other assumptions would remain unchanged.

It is intended that the changes would be introduced for valuations with an effective date on or after 31 October 2009.

The consultation will close on 11 September 2009.

The PPF's press release and consultation document can be accessed by clicking on the links below:

<http://www.pensionprotectionfund.org.uk/news-details.htm?id=7678>

http://www.pensionprotectionfund.org.uk/s143_and_s179_assumptions_july_2009_consultation_doc.pdf

3.3 Management and Business Plans published

The PPF has published its latest three year Management Plan for the years 2009/10 to 2011/12, which incorporates its Business Plan for the current year 2009/10.

In his foreword to the Management Plan, PPF Chief Executive Alan Rubenstein highlights some of the milestones passed to date. These include:

- the transfer of the 100th scheme to the PPF;
- the exceeding of £3 billion of direct assets under management; and

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- the combining of the PPF's forces with the Pensions Regulator to enhance "Exchange" (the Regulator's on-line scheme return system) to capture all the data required for the levy.

Mr Rubenstein also notes that "the current economic conditions provide a challenging environment to operate in" and that expenditure in 2009/10 "is likely to rise by £3m" to reflect the costs of an extended workload and the increased importance of the PPF's investment operations.

In its 2009/10 Business Plan, the PPF outlines its focus for the coming year. Its objectives are to:

- share the levy more fairly;
- strengthen its financial resilience by developing firm proposals on the long-term risk approach to levies (see 3.1 above), and build on its investment strategy;
- work "smarter" - by building on the knowledge gained from levy invoicing, passing schemes through assessment and paying compensation to members;
- deliver an HR strategy that will support its staff in making the PPF a high performing organisation; and
- deepen its relationships with members and stakeholders.

The PPF's Management and Business Plans can be accessed by clicking on the link below:

http://www.pensionprotectionfund.org.uk/business_plan_jul_2009.pdf

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4 CASES

4.1 Headway PLC v Eastearly Ltd (Court of Appeal)

The Court of Appeal has upheld the High Court's backing of a measure proposed by the trustee of a scheme which went into winding-up before 11 June 2003² to maximise the funds available to the Scheme to pay benefits.

Background

The Headway PLC Group Pension Fund (the Scheme) went into winding-up in May 2001, following the cessation of the (solvent) company's manufacturing business. As the Scheme's assets were insufficient to buyout members' benefits in full, a debt to the Scheme was due from the employer under section 75 of the Pensions Act 1995. Under the statutory rules that apply in this instance, the debt was based on the minimum funding requirement (MFR) valuation of the Scheme's liabilities.

An arrangement with three distinct stages was devised by the trustee to try to minimise the shortfall between the value of the Scheme's assets (including the section 75 debt) and the cost of securing members' benefits with annuities (the Arrangement).

As a first step, the trustee proposed using the Scheme's partial wind-up provision to purchase annuities for members with the existing funds available in the Scheme. It would then subsequently fix the "applicable time" for calculation of the statutory debt due to the Scheme. The proceeds of the statutory debt would then be applied to purchase further annuities. The trustee was of the view that this Arrangement would increase the statutory debt due under section 75, "thereby [increasing] ... the amount available at the third stage for securing the balance of the benefit due to the members".

² The effective date from which the full buyout requirement was introduced for solvent employers winding-up a defined benefit or hybrid scheme

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High Court Decision

The High Court approved the proposal in principle. It held that the trustee would be entitled to fix an applicable time after the partial buyout had taken place, on the basis that the Scheme continues to be in winding-up to the extent that its assets remain uncollected or unapplied. However, the judge found it to be uncertain whether the proposal would materially increase the debt due by the company under section 75 (as this would depend upon the extent to which members' guaranteed minimum pensions could be secured by the partial buyout). Before proceeding therefore, the trustee was required to ascertain whether using the three stages would "provide worthwhile value for the members of the Scheme by materially increasing the [section 75] debt due".

Court of Appeal (CA) Decision

Two questions were raised on appeal:

- (1) If the Arrangement was entered into, would it in fact result in the section 75 debt being increased over what it would otherwise be under the conventional approach?
- (2) Could the trustee lawfully enter into the Arrangement, in view of the statutory obligations relating to guaranteed minimum pensions (GMPs), and if this was not possible in relation to all Scheme members, could the Trustee enter into a "truncated" version of the Arrangement, and if so, how?

In respect of (1), the CA considered that the purchase of annuity contracts at stage 1 of the Arrangement would discharge the Scheme's liabilities to members only to the extent provided by those contracts. Therefore if the Arrangement could be properly implemented under (2), it would enhance the section 75 debt due from the Company.

With regard to (2), the CA found that the trustee was not precluded by either the Pension Schemes Act 1993 or the Occupational Pension Schemes (Discharge of Liability) Regulations 1997 (the Discharge Regulations) from buying out GMPs in part.

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However, although the rules had been drafted to reflect regulations which preceded the Discharge Regulations (the wording of which, on this point, is “very similar indeed” to that of the Discharge Regulations), the wording of two provisos in the rules potentially inhibited the partial buyout of GMPs.

This meant that although the GMPs for some scheme members could be bought out in full, there were insufficient funds in the scheme to buy out in full the GMPs of around 60 members whose level of GMP was such that it would not be possible to secure the GMP in full at stage one (“the high GMP members”). These high GMP members would therefore need to give their consent to the partial buyout of their GMPs in order for the Arrangement to be implemented as proposed, or a truncated Arrangement (i.e. limited implementation of the Arrangement to low GMP members and any high GMP members consenting to the truncated arrangement) would need to be implemented in its place.

The CA concluded that the Arrangement could be implemented. This could be achieved either by way of full implementation if the high GMP members consented to the partial buyout of their GMPs, or by implementation of a truncated version of the Arrangement if some or all of the high GMP members did not consent.

The CA found that in terms of maximising the assets available to the Scheme to buy out members’ benefits on winding-up, “the truncated arrangement would produce a better result than the conventional exercise, but a less good result than the full Arrangement.”

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Comment

The impact of this decision, while of interest to trustees of schemes in wind-up where the section 75 debt is not calculated on buyout basis, is likely to be limited, given that:

- the employer debt requirements have changed significantly since 2003 and are now based on the cost of buying-out all benefits in full; and
- for the Arrangement to work, there needs to be an employer with sufficient assets to meet the section 75 debt.

In addition, trustees would need to consider other factors, such as whether additional costs and potential delays will achieve a result that will benefit members.



Solicitors specialising in pensions law

Sacker & Partners LLP
29 Ludgate Hill
London EC4M 7NX
Tel 020 7329 6699
Fax 020 7248 0552

enquiries@sackers.com
www.sackers.com