Sackers extra

04 June 2012

At a glance

LEGISLATION

- Authorised Payments: NEST

ASSOCIATION OF CONSULTING ACTUARIES

- New ACA Chairman takes office

DEPARTMENT FOR WORK AND PENSIONS

- DWP Business Plan 2012-15
- Increases in life expectancy

EUROPEAN UNION

- Review of the EU Pensions Directive – Timeline extended
- 2012 Ageing report published

FINANCIAL REPORTING COUNCIL

- Consultation on the actuarial assumptions used in pension scheme projections

HM REVENUE & CUSTOMS

- Draft regulations: Short service refunds from pension schemes and changes to the rules on contracting-out
- Pension Schemes Online: User guide updated

PUBLIC SECTOR PENSIONS

- Local Government Pension Scheme: Joint statement on new proposals

THE PENSIONS REGULATOR

- Report under s89 of the Pensions Act 2004: Issued by the Pensions Regulator in relation to the British Midland Airways Limited Pension and Life Assurance Scheme

CASES

- Urenco UK Limited v Urenco UK Pension Trustee Company Limited and Mossop (High Court)

S07

Abbreviations commonly used in 7 Days

Alert/News: Sackers Extra publications (available from the client area of our website or from your usual contact)
DB: Defined benefit
DC: Defined contribution
DWP: Department for Work and Pensions
FSA: Financial Services Authority
GMP: Guaranteed Minimum Pension
HMRC: HM Revenue & Customs
NEST: National Employment Savings Trust
PPF: Pension Protection Fund
RPI: Retail Prices Index
TPR: The Pensions Regulator

LEGISLATION

Authorised Payments: NEST

Under the Finance Act 2004, a "scheme administration employer payment" is a payment made:

(a) by a registered pension scheme that is an occupational pension scheme; and

(b) to or in respect of a person who is or has been a sponsoring employer;

for the purposes of the administration or management of the pension scheme.

Such payments are authorised employer payments under the Finance Act 2004 and, as such, are not subject to income tax.

A payment is prevented from being a scheme administration employer payment if it is made to acquire shares in the sponsoring employer and the total amount of shares in sponsoring employers held in the scheme is greater than 20% of the aggregate of the sums and assets in the scheme.

Given the number of unconnected employers who are expected to use NEST for automatic enrolment purposes, The Finance Act 2004, Section 180(5) (Modification) Regulations 2012 provide for this exclusion to be disregarded in the case of NEST. These regulations came into force on 1 June 2012.

Further information can be found in the explanatory memorandum which accompanies the regulations.

ASSOCIATION OF CONSULTING ACTUARIES (ACA)

New ACA Chairman takes office

The ACA has elected Andrew Vaughan as its new Chairman. Vaughan is a partner at consulting actuaries, Barnett Waddingham, and took office on 1 June 2012. He succeeds Stuart Southall, Chairman of Punter Southall. Recently Vaughan was also elected Chair of the International Association of Consulting Actuaries (IACA).

ACA Press Release

© Sacker & Partners LLP 2012

DEPARTMENT FOR WORK AND PENSIONS

DWP Business Plan 2012-15

The DWP has published the latest annual update of its business plan for 2012-15.

In terms of specific pensions reforms, the business plan notes that the Coalition Government intends to:

- change the State Pension system to help ensure that it is sustainable and fair between generations - the Government's White Paper on a single tier pension for future pensioners is due to be published in June 2012;
- make enrolment into pension schemes automatic - automatic enrolment remains on track to commence in October 2012;
- develop proposals to re-invigorate private pensions - the business plan suggests that a consultation paper will be published in October 2012; and
- develop proposals to address the issues of small pension pots by improving the transfer process and reviewing the rules for short service refunds - the Government's consultation response is due to be published in July 2012, with implementation scheduled for December 2014.

Increases in life expectancy

To coincide with the Queen's 60th Jubilee, the DWP has provided an update on changes in life expectancy during the Queen's reign.

During this period, the number of pensioners has doubled and 44 times as many Britons are reaching age 100. The DWP notes that there are 5.6 million more pensioners today than in 1952, rising from 6.8 million to 12.4 million. The percentage of pensioners in the population has increased by 6% from 14% in 1952.

In addition, there are around 13,120 more centenarians, compared with 300 in 1952. The Queen has sent around 110,000 telegrams and messages to centenarians during her reign.

DWP Press Release

EUROPEAN UNION

Review of the EU Pensions Directive – Timeline extended

The European Commission is in the process of reviewing the existing EU Pensions Directive. As part of this process, it has already published a White Paper: "An Agenda for Adequate, Safe and Sustainable Pensions" and sought advice from the European Insurance and Occupational Pensions Authority (EIOPA) on how the minimum capital and solvency requirements for the insurance sector under Solvency II might be applied to pension schemes.

© Sacker & Partners LLP 2012

In a speech to the Insurance Europe Conference in Amsterdam on 1 June 2012, Commissioner Barnier announced that, due to "the complexity and importance of this issue, and particularly the need for first-rate quantitative impact assessments", this process has been delayed, with the revised Directive now due to be tabled "before summer 2013, rather than at the end of 2012".

While Commissioner Barnier reiterated earlier comments that it is not the Commission's intention to apply all the Solvency II rules to occupational pensions institutions, he also repeated his belief that "it is important in regulatory terms to maintain a level playing field between insurance companies and pension funds when they supply similar and interchangeable products" and that "in so far as the risks underwritten by an insurance company or a pension fund are the same […],the prudential rules should also be the same" in order to avoid regulatory arbitrage in the single market.

The Commission intends to continue to work closely with EIOPA on this review, taking into account "the big differences between the pension systems currently in place in Member States".

2012 Ageing report published

The European Economic and Financial Affairs Council (ECOFIN) has published a report which analyses the economic and budgetary impact of an ageing population over the long-term (The 2012 Ageing Report).

In 2010, the ECOFIN Council gave the Economic Policy Committee a mandate to update its common exercise of age-related projections by 2012 on the basis of a new population projection by Eurostat. The report (which was presented to the ECOFIN Council in May 2012), details the expenditure projections covering pensions, health care, long-term care, education and employment transfers for all Member States.

ECOFIN Press Release

FINANCIAL REPORTING COUNCIL (FRC)

Consultation on the actuarial assumptions used in pension scheme projections

On 31 May 2012, the FRC and the FSA published a joint consultation paper setting out proposals to change the assumptions used in projections of the returns from financial products, including pensions.

Projection rates apply to retail investment products, including personal pension plans, stocks and shares Individuals Savings Plans (ISAs), tax free savings plans and endowment policies.

The FRC is seeking views on whether the maximum projection rate used in Statutory Money Purchase Illustrations (SMPIs) should be reduced from 7% per annum to 5% per annum or whether the maximum rate should be removed. Meanwhile, the FSA is proposing to reduce the intermediate projection rate for tax advantaged retail investment products such as personal pensions from 7% to 5%.

FRC Press Release

FSA Press Release

© Sacker & Partners LLP 2012

HM REVENUE & CUSTOMS

Draft regulations: Short service refunds from pension schemes and changes to the rules on contracting-out

Following the abolition of DC contracting-out (protected rights) from 6 April 2012, HMRC has published draft regulations which are designed to make consequential changes to the tax rules for registered pension schemes. This follows the publication on 23 March 2012 of a note by HMRC to alert schemes which were then contracted-out on a protected rights basis of the tax position on short service refunds from 6 April 2012 onwards (reported in 7 Days on 26 March 2012).

One of the conditions for a payment to qualify as a "short service refund lump sum" was that it had to extinguish all of the member's entitlement to benefits under the scheme. While there had been an exception to allow schemes to retain a member's protected rights (as this was a requirement of DWP legislation), when contracting-out on a protected rights basis was abolished on 6 April 2012, protected rights became ordinary scheme benefits and, as a consequence, schemes are no longer able to rely on this exception in order to pay a short service refund lump sum.

HMRC is therefore now consulting on draft regulations to allow a partial payment of former protected rights benefits, by introducing consequential new tax rules for certain short service refunds. This is to ensure that the contracting-out changes do not adversely affect pension schemes which contain rules reflecting the effect of the contracting-out rules (rather than cross referring directly to those rules) and which have not yet amended their rules.

The consultation closes on 27 June 2012.

Pension Schemes Online: User guide updated

On 1 June 2012, HMRC published an updated version of its "Guide to using the online service for scheme administrators and practitioners". The guide includes updated information on how to register as a scheme administrator (which may be the scheme trustees) or practitioner.

PUBLIC SECTOR PENSIONS

Local Government Pension Scheme (LGPS): Joint statement on new proposals

Following the acceptance by the Government of a principles document submitted by the Local Government Association, UNISON and the GMB on how to take forward the reform of the LGPS in England and Wales, a project has been set up to reach agreement on the elements of the new scheme together with the management and governance of the scheme going forward. This project is known as "LGPS 2014".

Key provisions of the proposed LGPS 2014 include:

- a Career Average Revalued Earnings (CARE) scheme using CPI as the revaluation factor (the LGPS is currently a final salary scheme);
- an accrual rate of 1/49th (currently 1/60th);

© Sacker & Partners LLP 2012

- each member's normal pension age (NPA) will be their State Pension Age (NPA is currently 65);
- average member contributions of 6.5%, with the rate determined on actual pay; and
- the option for scheme members who are outsourced to be able to stay in the scheme on first and subsequent transfers (this is currently a choice for the new employer).

LGPS 2014: "At a glance"

THE PENSIONS REGULATOR

Report under s89 of the Pensions Act 2004: Issued by the Pensions Regulator in relation to the British Midland Airways Limited Pension and Life Assurance Scheme (the Scheme)

TPR has published a report setting out the background and reasoning for its decision not to issue a Financial Support Direction (FSD) or Contribution Notice (CN) to Lufthansa following a clearance application to substitute Lufthansa for a shell company and to discharge the BMI Group under an apportionment arrangement. In the end, it was agreed that the Scheme would enter the PPF in return for a contribution in the form of voluntary funding of £84m, as well as a payment of £16m into the Scheme from Lufthansa.

Background

Since 2009 BMI has been a wholly owned subsidiary of Lufthansa and, over that period, BMI has been significantly loss-making. For example, in 2010 BMI made an operating loss of £124m on a turnover of £782. The Scheme's buy-out deficit was £450m, and the PPF deficit £230m.

Following a strategic business review, Lufthansa concluded that it could not continue to lend its support to BMI and, unless an alternative solution was found, insolvency was inevitable. The Trustees concluded that, in the absence of such support, the Scheme could not continue as a going concern.

Lufthansa had never had any direct obligation to fund the Scheme but had nevertheless provided, voluntarily, a limited level of funding.

Original Proposals

A purchaser was found in December 2011 but the share purchase agreement was expressed as being subject to clearance from TPR. As part of the clearance application, Lufthansa agreed to provide limited funding on a conditional basis – which would result in a 25 year recovery plan.

The recovery plan proposal relied on investment outperformance to reduce the PPF deficit. This would expose the other PPF levy payers to the underwriting of that risk and any delay to PPF entry would result in an increase in liabilities (through priority drift).

Outcome

Clearance was not granted for the original proposals. But, having considered the circumstances of the case, TPR concluded that its moral hazard powers were not available

- "an important factor" in TPR's consideration was the support provided during Lufthansa's period of ownership, which enabled BMI to continue as a going concern and fund the Scheme.

As a result, it was agreed that the Scheme would enter the PPF (via a Regulated Apportionment Arrangement) in return for Lufthansa providing mitigation outside the PPF in the form of voluntary funding of £84m, as well as a payment of £16m into the Scheme. A clearance statement to facilitate the proposal was issued on 20 March 2012.

Comment

TPR has made it very clear that the result in this case was unusual. Principally because its anti-avoidance powers were not available, TPR's view was that the "proposed transaction represented the best possible outcome in the circumstances".

TPR Press Release

CASES

Urenco UK Limited v Urenco UK Pension Trustee Company Limited and Mossop (High Court)

The High Court has ruled that pension benefits provided following a transfer of members from the public sector to a private company on an outsourcing, must be no less favourable than the benefits provided by the transferring scheme on the transfer date, disregarding the potential for amendment in the transferring scheme under its power of amendment.

Background

The Nuclear Decommissioning Authority (NDA) is a non-departmental public body created under the Energy Act 2004 (the Energy Act), with power to outsource functions connected with the decommissioning of nuclear sites to private bodies.

In 1998, a transfer took place as a result of a Sale and Purchase Agreement (SPA) between the NDA, Sellafield Ltd and Urenco UK Limited (Urenco). A small number of employees (including Mr Mossop) transferred to Urenco under the SPA (the Transferred Employees). As part of the transfer, the pension rights of these employees were transferred from the Combined Pension Scheme ("CPS" - a public sector pension scheme) to the Urenco Pension Scheme (the Urenco Scheme).

Under the "Fair Deal" (a policy applying to public sector staff who are compulsorily transferred to a private sector employer), the new employer is required to provide a “broadly comparable” pension scheme for the transferred staff.

The benefits under the Urenco Pension Scheme were materially less favourable than those under the CPS in two respects:

- members were required to pay contributions at the rate of 7.5% of pay, as opposed to 5% under the CPS; and
- the rules provided for pension increases to be reduced below RPI, whereas this was not possible in the CPS.

The differences were identified by the Government Actuary's Department (GAD) when the schemes were assessed for broad comparability ahead of the transfer. To address these issues, undertakings (the Undertakings) were given by Urenco to GAD (and included in the SPA) that:

- the transferring employees would be compensated for the requirement to pay contributions at the higher rate of 7.5%, by a non-pensionable allowance designed to ensure that their take home pay would not be less than it had been before the transfer; and

- pension increases for the transferring employees would not be reduced below the rate of RPI.

When a substantial deficit in the Urenco Scheme was revealed as a result of an actuarial valuation carried out during 2009 and 2010, amendments were proposed to tackle the deficit, including an increase in the rate of member contributions and a reduction in the rate of pension increases.

In relation to the future service benefits of the Transferred Employees, the Court was asked:

- to what extent they were protected by the Energy Act, in particular whether the requirement to provide broadly comparable benefits was subject to the power of amendment in the Urenco Scheme; and

- whether the power of amendment in the Urenco Scheme was constrained by the SPA or the Undertakings.

Decision

The Court held that the power of amendment in the Urenco scheme could not be operated in such a way that the future service benefits of the Transferred Employees would be detrimentally affected.

In reaching this conclusion, Warren J examined the protections afforded to the Transferred Employees by Schedule 8 of the Energy Act. Among other things, this provides that a pension scheme will be an "appropriate scheme" for the purposes of an outsourcing from the NDA, if the NDA is satisfied that "the benefits that are available […] are no less favourable than the benefits available under the provisions (taken as a whole) of the nuclear pension scheme in respect of which he is entitled to protection".

Although he found the arguments to be "finely balanced", when looking at the relevant provisions, Warren J was of the view that the potential for amendment (in other words, the transferring scheme's amendment power) should be ignored by the NDA when applying the test of broad comparability. Benefits in respect of all future service for the Transferred Employees in the Urenco Scheme could therefore be no less favourable than the provisions governing the members' entitlements which were in force in the CPS immediately before the transfer.

Warren J also concluded that the Undertakings should be read as having permanent effect – he found no justification for implying into the Undertakings "a power similar to the power of amendment or any other power to remove or reduce the value of that undertaking".

Comment

In general, for the purposes of measuring the broad comparability of benefits on a transfer from the public to the private sector, scheme rules are assessed at the date of transfer. This case was unusual as restrictions were included in undertakings outside the scheme rules – and in part it was these restrictions which prevented changes being made. In addition, although the SPA in this case affected only a small number of individuals, the points at issue are relevant to other employers who are governed by the Energy Act 2004.

Nothing stated in this document should be treated as an authoritative statement of the law in any particular aspect or in any specific case. Action should not be taken on the basis of this document alone. For specific advice on any particular aspect you should consult the usual Solicitor with whom you deal. © Sacker & Partners LLP June 2012