Sackers extra

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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
ECJ: European Court of Justice
FAS: Financial Assistance Scheme
HMRC: HM Revenue & Customs
NEST: National Employment Savings Trust
PPF: Pension Protection Fund
TPR: The Pensions Regulator

LEGISLATION

Abolition of default retirement age: Revised draft regulations published

Currently it is lawful for an employer to dismiss an employee aged 65 or over by reason of retirement. This is known as the default retirement age (DRA). However, the DRA is to be removed from legislation from 6 April 2011, subject to transitional provisions.

We reported in 7 Days on 28 February 2011 on the publication of The Employment Equality (Repeal of Retirement Age Provisions) Regulations 2011. These draft regulations are designed to repeal and amend provisions in both the Equality Act 2010 and the Employment Rights Act 1996 which provide for dismissal by reason of retirement.

However, revised draft regulations have now been published to correct an anomaly in the original draft, which precluded employers from using the transitional period to retire those employees who are already over age 65. The draft regulations now permit retirements during the transitional period for any person who reaches age 65 before 1 October 2011. As before, employers wishing to retire individuals using this process, must submit a notification to retire before 6 April 2011.

Other changes in the revised draft regulations include:

- for employees being retired under the transitional provisions, the last date for making a request to continue working beyond normal retirement age (NRA) is set as 4 January 2012; and

- in cases where a person is being retired at an NRA which is below age 65, the test in section 98ZE of the Employment Rights Act 1996, as to whether retirement is the reason for the dismissal, will continue to apply during the transitional period, even though that provision will be repealed from 6 April 2011.

The Pension Protection Fund (Revaluation Amendments) Regulations 2011

In the June 2010 Emergency Budget, the Coalition Government announced that it intended to use the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI) as the measure for applying increases (both in deferment and to pensions in payment) to public sector pensions from April 2011. It subsequently announced that the change would also apply to private sector occupational pension schemes and to relevant payments made by the PPF and FAS.

These regulations (which were laid before Parliament on 3 March 2011), amend the Pension Protection Fund (Compensation) Regulations 2005 by replacing references to RPI with a reference to the general level of prices determined in such manner as the Secretary of State may from time to time decide.

The accompanying explanatory memorandum notes that the present intention is that the method of determining the general level of prices will be by reference to CPI. However it also explains that the change has been done in this manner "because it is possible that there will be more than one Consumer Prices Index at some time in the future or an alternative index which may be more appropriate and the reference to the general level of prices will allow the Secretary of State to designate which Index is to be used without having to amend the legislation again".

The regulations are due to come into force on 31 March 2011.

The Social Security Pensions (Low Earnings Threshold) Order 2011

The State Second Pension (S2P) reformed the State Earnings Related Pension Scheme (SERPS) from 6 April 2002. An important element of the reform was the targeting of additional resources on low earners.

The Low Earnings Threshold (LET) allows earnings, used to determine an additional pension, that fall between the National Insurance Lower Earnings Limit and the Low Earnings Threshold (LET), to be treated as being at the LET.

Each year, the Secretary of State is required to review changes in the general level of earnings and if it appears to him that the general level of earnings has increased during the review period, to make an Order to set the LET for the following year. This Order affects the annual uprating of the Low Earnings Threshold for 2011/12. The threshold is increased to £14,400 for 2011/12 (up from £14,100 for the 2010/11 tax year).

The Order is due to come into force on 6 April 2011.

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

The Social Security Revaluation of Earnings Factor Order 2011

The Social Security Revaluation of Earnings Order is made each year to revalue historic earnings factors in line with the movement in average earnings. (Earnings factors are the formulae for converting flat-rate and earnings-related National Insurance Contributions (NICs) into entitlement to flat-rate and earnings-related benefits, and for calculating earnings-related entitlement over the working life.)

This annual revaluation exercise allows earnings factors derived from historic earnings to be restated at current values as part of the calculation of new pensioners' entitlement to Additional Pension under both the SERPS and S2P. The accompanying explanatory memorandum notes that "earnings factors are also used to calculate the Guaranteed Minimum Pension for early leavers and retired persons in contracted-out salary-related schemes".

As average earnings in Great Britain increased by 2.3% between September 2009 and September 2010 (including bonuses), the Order provides for earnings factors for 2010/11 to be increased by that percentage, and for earnings factors for earlier tax years to be increased by percentages which reflect, in addition, the increases provided for by previous Orders.

ACTUARIAL PROFESSION

Two new Actuarial Profession Standards (ASPs) for pensions actuaries

The Actuarial Profession has published two new APSs for pensions actuaries:

- APS P1: Duties and Responsibilities of Pensions Actuaries; and
- APS P2: Compliance Review: Pensions.

The introduction of APS P1 and APS P2 is part of the Actuarial Profession's "GN Transitions Project", which is designed to replace existing actuarial Guidance Notes (GNs) containing ethical material with APSs which will complement the Technical Actuarial Standards (TASs) produced by the Board for Actuarial Standards.

The new APSs move from a reliance on detailed rules to a more principles-based regime of ethical and professional standards.

Both standards are due to come into effect on 1 April 2011.

Actuarial Profession Professional Standards Updates

DEPARTMENT FOR WORK AND PENSIONS

DWP research report on the use of vesting rules and default options in occupational pension schemes

The DWP has published the findings of research exploring the use of vesting rules and default options in occupational pension schemes in Research Report No. 725.

The report provides the findings from a study conducted by RS Consulting on behalf of the DWP, examining the use of these two aspects of trust-based DC pension schemes. It is intended that both elements of the research will help the DWP understand more about how trust-based DC pension schemes operate in the run-up to the implementation of the workplace pension reforms in 2012.

Vesting

Vesting rules for trust-based DC pension schemes specify the period of time that an active member must wait after joining, before they become entitled to benefits under the scheme. The current rules stipulate that employees that leave a trust-based pension scheme with between three months and two years of pensionable service may not receive full benefits, and so trustees may give them the choice of a short service refund or a transfer of the fund to a new scheme. While a transfer includes all employee and employer contributions, the refund includes only the employee contributions, with the employer contributions refunded back to the scheme.

The results of the research suggest that the rules around short service refunds alone are unlikely to be a driver of scheme choice in most cases. For the majority of employers, the 'pot' generated through short service refunds was unlikely to generate sufficient funds for them to be of major importance.

The report notes that only in the case of the very largest employers, and those with a very high turnover of staff, was the short service refund pot seen as a substantial benefit. The employers in this group were, however, already offering high-quality schemes, and in these cases the short service refunds were often used to fund activities that benefited members, such as advice and communications. In many cases the short service refund rules were a key part of the employer's decision to offer a high-quality trust-based scheme.

The report also suggests that, while the findings of this study cannot predict how employers will approach scheme decision-making after automatic enrolment is introduced, it is however reasonable to assume that, for smaller employers at least, the benefits of the vesting rules are likely to be marginal.

Default Options

A pension scheme's default options represent the fund choice and lifestyling options that are selected automatically for a member joining a pension scheme if they do not choose an alternative. At present it is not compulsory for an employer with a trust-based DC scheme to provide a default option, but after the reforms are implemented every pension scheme that an eligible job-holder could be automatically enrolled into will have to have one.

Like other similar studies, this research indicates that within most employers, over 80% of employees are likely to end up in the default option. Consequently, decisions about the design of default options will affect a very high proportion of UK employees after the introduction of automatic enrolment. The report notes that decisions which trustees need to take about employees' risk profile and the most appropriate fund choices for them are therefore critical.

The report also indicates that the objectives of pension scheme default options are typically to provide a safe and balanced investment option that would achieve long-term growth for the member.

Related to this, the DWP's consultation on draft guidance on offering a default option for defined contribution automatic enrolment pension schemes closed today (1 March 2011). Sackers has submitted a response.

Research Summary

Government response Part 2 (PPF): The FAS and PPF (Valuation, Revaluation and Indexation Amendments) Regulations 2011

The DWP has published the second part of its formal response to consultation on the draft Financial Assistance Scheme and Pension Protection Fund (Valuation, Revaluation and Indexation Amendments) Regulations 2011.

The DWP notes that changes proposed relating to PPF revaluation have not changed significantly from the consultation draft. The main changes are:

- the removal of the draft provision in respect of the application of the section 143 funding test (to determine the level of a scheme's funding on the PPF valuation basis) to schemes funded close to 100% on this basis which have entered a PPF assessment period before the new CPI-based provisions come into force. This provision has been removed after respondents indicated that it would be difficult to apply in practice, and would be unlikely to be of benefit to the small number of schemes it was designed to help; and

- the separation of the FAS and the PPF changes into two separate sets of regulations. It is anticipated that both sets of regulations will come into force on 31 March 2011.

For details of Part 1 of the DWP's response, please see 7 Days dated 14 February 2011.

Alongside these regulations, the DWP has also published an Equality Impact Assessment.

EUROPEAN UNION

EU Pensions Green Paper: Latest updates

In July 2010, the European Commission launched an EU-wide debate, in the EU Green Paper: "Towards adequate, sustainable and safe European pension systems". Nearly 1700 responses to the consultation were submitted.

The Green Paper covered a wide range of issues relating to pensions, including: the future solvency regime for pension funds; increasing longevity; the internal market for pensions; mobility of pensions across the EU; and governance at EU level.

The European Commission has now published a brief overview of the responses received to this consultation, as well as a more detailed summary of responses. This overview has been used as the basis for an exchange of views at the session of the Employment, Social Policy and Consumer Affairs Council which was due to take place today (7 March 2011).

The Commission's summary of responses indicates that most respondents are:

- in favour of a review of the Pensions (or IORP) Directive[1], to clarify uncertainties relating to cross-border activity; and
- supportive of risk-based supervision, considering the right approach to be one which focuses on the nature and duration of pension liabilities, taking account of the additional risk-mitigating security mechanisms available to pension funds. In relation to this, the European Parliament remains of the view that "the qualitative elements of Solvency II form a valuable starting point for enhancing the supervision of IORPS".

A European White Paper on pensions is due to be published in the third quarter of 2011, with a review of the IORP Directive scheduled for the fourth quarter.

HM TREASURY

Managing high AA charges from pension benefits: The Government's response

A reduced Annual Allowance (AA) of £50,000 will apply to pension savings from the tax year 2011/12. This will inevitably affect a greater number of pension savers than current AA of £255,000. Generally, those caught will be the highest earners, but also potentially affected are DB scheme members with long service and/or a generous accrual rate in their scheme. As a result of the reduced AA, far more pension savers may be subject to an AA charge than currently.

To help affected individuals manage the cost of high AA charges, in a consultation published on 30 November 2010, the Government proposed permitting the AA charge to be met by an individual's nominated pension arrangement, either by:

- meeting the liability "in real time" while pension benefits are still accruing (i.e. following the tax year in which the charge arises); or
- rolling-up the liability, so that payment of AA charges is deferred until the individual's pension benefits crystallise.

The Government confirmed its approach in a Written Ministerial Statement on 3 March 2011, and accompanying response to consultation, stating that where AA charges are met from pension benefits, the tax should be paid at the point the charge arises. Key elements of this facility for paying high AA charges from pension benefits include:

- a minimum threshold of £2,000 (across all schemes);
- it will be available to all types of scheme including DC;
- a scheme will be obliged to offer the facility to members who exceed the minimum threshold in that scheme in a particular year. It will be optional for schemes to offer the facility in other circumstances;
- schemes will have the flexibility to set the terms on which they offset AA charges through reductions to pension benefits, as well as their terms of engagement with individuals;

[1] Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision

- there will be a limited exception for schemes entering a PPF assessment period; and
- the facility will be free of charge for members.

Draft legislation, a draft explanatory note and a revised Tax Impact and Information Note have been published by HMRC.

We will be issuing an Alert, with further details of the Government's response.

HM Treasury Press Release

Consultation on Fair Deal policy

On 3 March 2011, the Government launched a consultation on the Fair Deal policy, in response to a recommendation made in the interim of the report of the Independent Public Service Pensions Commission (chaired by Lord Hutton) (the Commission).

The Fair Deal is a non-statutory policy applying to pension provision for public sector staff when they are compulsorily transferred to a non-public sector employer. It requires the new employer to provide a broadly comparable pension scheme for the transferred staff and bulk transfer arrangements for those staff who wish to transfer their public service pension benefits.

One of the Commission's findings was that the Fair Deal policy, coupled with current public service pension structures, "creates a barrier to the plurality of public service provision", making it more difficult to achieve the efficiencies and innovation which new providers can offer public service delivery.

The Government is therefore seeking views on:

- whether there are other groups not identified who are affected by the consultation;
- how the Fair Deal policy operates currently and whether this is relevant to future policy;
- whether there are any other objectives that should be considered other than those identified in the consultation;
- if there is a case for changing the current Fair Deal policy and if so what pension requirements should be;
- proposals for future policy; and
- what approach should be taken for subsequent transfers of staff when previously transferred public services are re-tendered and for employees returning to the public sector having been transferred out in the past under the Fair Deal policy.

The consultation closes on 15 June 2011. The Government intends to report on the consultation in the summer.

As we reported on 28 February 2011, Lord Hutton is due to publish his final report on 10 March 2011, setting out his recommendations to the Government on pension arrangements that are sustainable and affordable in the long term, fair to both the public service workforce and the taxpayer and consistent with the fiscal challenges ahead, while protecting accrued rights. We will be producing an Alert when the final report is available.

HM Treasury Press Release

NATIONAL ASSOCIATION OF PENSION FUNDS

Pension fund challenge over VAT on investment management services referred to the ECJ

In 2008, Wheels Common Investment Fund (WCIF) and the NAPF agreed to bring a joint legal challenge against HMRC on the application of VAT on the investment management services supplied to occupational pension funds. This followed the JP Morgan Fleming Claverhouse Investment Trust plc ruling in the ECJ, which stated that investment trusts were special investment funds and should be exempt from paying VAT on investment management services.

A Tribunal hearing held in London between 10-15 February 2011 has decided that the ECJ should interpret the scope and meaning of that exemption. The Tribunal and the parties concerned will now work towards formulating questions and an outline of the issues on which the ECJ may provide an interpretation of EU law.

The NAPF Press Release notes that The WCIF has £6 billion in assets under management and is a multi-employer scheme which includes a number of Ford Motor Company Limited Pension Funds. It also suggests that a ruling in favour of the NAPF and WCIF could mean that DB pension funds no longer have to pay an estimated £100m a year in VAT and that backdated claims covering a number of years could be made in some cases.

For further background to this case, please see our June 2008 Quarterly.

PENSION PROTECTION FUND

Block Transfer Guidance for 2011/12 Levy

On 2 March 2011, the PPF published guidance for calculating and certifying block transfers for 2011/12 including the relevant qualification and submission dates.

Block transfer certificates provide the PPF with the estimated section 179 valuation positions of the schemes involved in a transfer of liabilities. The PPF may use this valuation information in lieu of the formal section 179 valuation information to calculate the levy.

For the 2011/12 levy year, the PPF recognises two categories of block transfer:

- *a full transfer:* where a scheme has transferred members to one or more PPF eligible schemes, and there are fewer than two members left in a scheme as at 1 April 2011; and

- *a qualifying transfer:* this is not a full transfer, but where a scheme has transferred £1.5million, or more than 5% of the assets of either the transferring or receiving scheme. Such transfers can be to PPF-ineligible schemes or to insurance companies.

Block transfers can be certified on Exchange for levy purposes, but there are different rules and deadlines for each category of block transfer.

Deadlines for certification for the 2011/12 levy:

- 5pm on 30 June 2011 for full transfers; and

- 5pm on 30 June 2010 for qualifying transfers.

The guidance confirms that there will be no reporting deadline for qualifying transfers in June 2011.

Full details of how to complete block transfer certificates for the 2011/12 levy year, can be found in the Board's levy Determination, the Transfers Appendix, and the Guidance for Calculating and Certifying Block Transfers.

PPF Press Release

CASES

Association belge des Consommateurs Test-Achats ASBL and others

The judgment of the ECJ in the "Test-Achats" case[2] was handed down on 1 March 2011. This case challenged the validity of an exemption in the EU Directive implementing the principle of equal treatment between men and women in the access to and supply of goods and services (the Directive).[3]

Background

The Directive provides a framework for combating discrimination based on sex regarding the access to and supply of goods and services. Its preamble indicates it does not apply to men and women "in matters of employment and occupation", as this is dealt with elsewhere in EU law.

The Directive generally prohibits the use of sex as a factor which would result in different premiums and benefits being used for men and women in insurance products. However, when implementing the Directive, Member States were able to take advantage of an exemption under article 5(2) permitting "proportionate differences" in individuals' premiums and benefits, "where the use of sex is a determining factor in the assessment of risk based on relevant and accurate actuarial and statistical data".

Where the Belgian Government had taken advantage of this exemption for life assurance contracts, Test-Achats (a non-profit making consumer organisation) brought an action for annulment on the basis that the law was incompatible with the principle of equal treatment for men and women.

In her opinion (published in October 2010), the Advocate General considered that the use of actuarial factors based on sex is incompatible with the principle of equal treatment for men and women and that Article 5(2) of the Directive was therefore invalid. She was also satisfied that there is no reason to treat life assurance as a special case.

ECJ decision

Although the Directive is silent as to how long the exemption itself would continue, it required Member States taking advantage of this exemption to review their decision by 21 December 2012 (five years from the original implementation date of the Directive).

The ECJ considered this lack of "temporal" limitation to hinder the achievement of the objective (both in the Directive and of the EU generally) of equal treatment between men and women. The ECJ therefore declared the exemption invalid with effect from the review date of 21 December 2012.

Comment

As the UK Government also took advantage of the exemption in the Directive, the Government will need to give effect to the ECJ's decision. It seems certain, however, that insurers will need to use sex neutral factors for assessing premiums and benefits under new insurance contracts (including annuities) from 21 December 2012.

Currently occupational pension schemes are required to use sex-based actuarial factors to determine, for example, funding requirements, transfer values and commutation. The

[2] Case C-236/09

[3] Directive 2004/113

Government will need to decide whether this legislation also needs to be amended in the light of the ECJ's decision.

Although trustees need not take action immediately, they should monitor the fallout from the case. When considering actuarial factors, they will no doubt wish to bear in mind the direction in which Europe is moving when it comes to the use of sex-based factors.

For more information, please see:

- our Alert: "Is it the end of the road for sex-based actuarial factors?" dated 2 March 2011;
- our summary of the Advocate General's opinion; and
- Association of British Insurers' Research Paper No.24, 2010, on the use of gender in insurance pricing.