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Pensions law – the week in review

13 July 2009

AT A GLANCE

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1 LEGISLATION

1.1 Finance Bill 2009

In this year's Budget speech on 22 April 2009, Alistair Darling announced that from April 2011, tax relief on pension contributions will be restricted for those earning £150,000 or more. Transitional measures have applied from noon on Budget day to prevent affected individuals from making significant additional contributions in the interim.

In response to concerns raised by the pensions industry about the complexity of the transitional "anti-forestalling" provisions and their potential to scupper certain existing arrangements, such as those for executives and the self-employed, an amendment was agreed last week during Parliamentary debate on the Bill, which makes limited amendments to the transitional provisions.

Broadly, the amendment permits those who have paid "infrequent money purchase contributions" in excess of £20,000 (the special annual allowance for the purpose of the transitional measures) to receive relief on the lesser of annual pension savings of £30,000 and the average of an individual's contributions over the tax years 2006-2009.

The Finance Bill is expected to receive Royal Assent before the Parliamentary summer recess on 21 July 2009.

For more information, please see our Sackers Extra Alert (dated 10 July 2009): Finance Bill 2009 - Limited relaxation of transitional provisions.[1]

[1] Available from the client area of our website or from your usual Sackers contact

2 HM REVENUE & CUSTOMS (HMRC)

2.1 HMRC publishes new "Q&As" on transitional tax relief restrictions

HMRC has published some additional questions and answers relating to the transitional measures contained in the Finance Bill 2009 (referred to at 1.1 above). These include examples of:

- regular payments;
- flexible benefits;
- discretionary rules;
- high income individuals; and
- redundancy.

HMRC's new questions and answers can be accessed by clicking on the link below:

http://www.hmrc.gov.uk/budget2009/anti-forestalling-qa.pdf

3 ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD)

3.1 Core principles of occupational pension regulation

The OECD has published a paper setting out certain "core principles" for occupational pension regulation in OECD member countries (of which there are 30, including the UK). It has recommended that member countries take account of the core principles and their associated guidelines in "establishing, amending or reviewing their occupational pension regulations in accordance with their own political, administrative and legal context".

The principles, which include recommendations and suggestions for implementation, cover:

- conditions for effective regulation and supervision;
- the establishment of pension arrangements;
- pension scheme liabilities, funding rules, and winding-up;
- asset management;
- rights of members and beneficiaries and adequacy of benefits;
- governance; and
- supervision.

The OECD's paper can be accessed by clicking on the link below:

http://www.oecd.org/dataoecd/14/46/33619987.pdf

3.2 Guidelines for pension scheme governance

The OECD has also published a set of guidelines on pension fund governance. The intention behind the guidelines is to set international standards for the governance of private pension arrangements, with a view to protecting members' benefits from mismanagement and fraud. The guidelines are broadly consistent with the UK Pension Regulator's approach to pension scheme governance.

Among other things, the guidelines recommend that:

- every pension scheme should have a governing body (such as a trustee board) which is accountable to scheme members and beneficiaries, which has the power to administer the scheme and is ultimately responsible for ensuring adherence to the terms of the arrangement and the protection of the best interests of scheme members;

- members of the governing body should collectively have the necessary skills and knowledge to oversee all the functions performed by the scheme and to monitor the performance of administrators, investment managers and others to whom responsibilities have been delegated;

- there are adequate internal controls in place to ensure that all persons and entities with operational and oversight responsibilities act in accordance with the objectives set out in the scheme's governing documentation;

- there are adequate reporting channels in place between all parties involved in the running of the scheme; and

- disclosure by the governing body of relevant information to all parties (including members, beneficiaries, the sponsoring employer, the Pensions Regulator, auditors etc.) should be made in a clear, accurate and timely fashion.

The guidelines can be accessed by clicking on the link below:

http://www.oecd.org/dataoecd/18/52/34799965.pdf

4 PENSION PROTECTION FUND (PPF)

4.1 Updated statement of investment principles published

Under the Pensions Act 2004, the PPF is required to produce a statement of investment principles (SIP). This is reviewed annually by the PPF Board, or earlier in the event of any significant change in the capital markets or the liabilities of the fund.

On 10 July 2009, the PPF published an updated SIP in which it sets out revised principles and policies governing the investment of its funds. The SIP has been updated "to reflect a co-ordinated investment approach to working with schemes going through its assessment period. This approach is designed to ensure efficiencies, minimise transition costs and enable the PPF to better manage its balance sheet risk."

The revised SIP also includes the introduction of "Global Tactical Asset Allocation" which is intended to help the PPF expand its investment opportunities across global markets.

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

http://www.pensionprotectionfund.org.uk/news-details.htm?id=7369

http://www.pensionprotectionfund.org.uk/sip_july_2009.pdf

5 CASES

5.1 Foster Wheeler v Hanley (Court of Appeal)[2]

This highly anticipated decision of the Court of Appeal (the latest in a long line of equalisation cases), was handed down on 8 July 2009. The judgment has been hailed as a good result for schemes as it provides a sensible solution within the confines of the Scheme's rules.

Background

In *Barber*[3], the ECJ concluded that pensions provided under an occupational pension scheme constitute "pay" for the purposes of Article 119 (now article 141) of the EC Treaty and, as such, need to conform to the principle of equal treatment. At the time, the majority of schemes had retirement ages of 60 for women and 65 for men, which resulted in unequal benefits in certain respects. For example, if a male member opted to retire at 60, his benefits would be reduced for early payment while a female member's benefits would not be. Therefore, in the wake of *Barber*, schemes were required to equalise retirement ages from 17 May 1990 (the date of the judgment). This could be done by increasing Normal Retirement Dates (NRDs) going forwards, but providing benefits on the more favourable basis for the period between the date of the *Barber* judgment to the date of a valid amendment to equalise benefits. The period is known as the "*Barber* window".

[2] For a summary of the High Court's decision, please refer to 7 Days dated 8 December 2008

[3] *Barber v Guardian Royal Exchange Assurance Group [1991] QB 3440*

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The Foster Wheeler Pension Plan (the Scheme)

The Trustees and Foster Wheeler Limited (the Company) took prompt action to try to equalise the Scheme's retirement ages following the *Barber* judgment and equalisation provisions were formally incorporated into the Scheme's governing documentation on the execution of a new trust deed and rules on 16 August 1993 (the Rules).

From the date of the amendment, all members had an NRD of 65 and so members with *Barber* window benefits had mixed NRDs of 60 and 65. The Scheme Rules did not expressly deal with how benefits should be paid to such members, but permitted early retirement with the Company's consent, subject to a reduction for early payment of benefits between the date of retirement and the member's 60th birthday. In line with advice it had received on the implications of the *Barber* judgment, the Company continued its post-*Barber* practice of freely giving consent to early retirement and applying no actuarial reduction between the ages of 60-65. Initially this was not an issue for the Scheme (as it was in surplus), but when faced with a deficit of £57 million in 2002, the Company sought to revise the early retirement rule. Therefore in 2003, it introduced a power to reduce benefits paid early between the ages of 60-65. This change permitted periods of service before and after 30 April 2003 to be considered separately, with scope to reduce benefits in respect of service after that date if they were taken before age 65.

The High Court decision

The court had to consider a number of issues, with particular focus on the treatment of benefits for members who, following *Barber*, had mixed NRDs and retire between the ages of 60 and 65. The court was presented with three possible options:

(1) payment in full of all benefits on retirement;

(2) payment of all benefits on retirement but with a discount for benefits paid early by reference to NRD 65; or

(3) "split pensions", i.e. separate pensions payable at each NRD.

The judge opted for (1), concluding that members with mixed NRDs could take *all* of their benefits unreduced from age 60, without the need for consent. The split pension option (option (3)), was rejected, as effect could be given to *Barber* by paying a single pension under the Scheme's early retirement rule.

The Appeal

The Company argued against option (1), on the basis that it conferred a windfall on members with mixed NRDs by allowing them to receive more than they were entitled to under the Scheme rules in relation to their NRD 65 benefits. Instead, it argued in favour of option (2), but (in an argument not raised before the High Court), suggested that the discount for early payment of NRD 65 benefits could be achieved by reference to the Scheme's deferred pension rule, which allows for a reduction for early payment.

The Court of Appeal decision

The Court of Appeal allowed the appeal, ruling in favour of the revised option (2). The decision brings members with mixed NRD benefits within the deferred early retirement provision in the Rules, meaning that an actuarial reduction can be applied to the non-*Barber* window benefits

Option (1) was overturned on the basis that "the windfall element constituted a fatal flaw". Lady Justice Arden considered that "the court should, where possible, give effect to *Barber* rights by adhering to the provisions of the relevant scheme where it is possible to do so in preference to some other approach. If some departure is required, it should in general, so far as practicable, represent the minimum interference with the scheme provisions." She indicated that "minimum interference" should be determined by taking account of the form and the substance of any notional amendment and acknowledged that a "minimum interference" solution might need to be achieved by using a scheme's rules "in a manner not previously contemplated".

The split pensions approach (previously advocated by the Court of Appeal in *Cripps*[4]) was not found to be appropriate here. Being more complex than single pensions, they would require "a more substantial interference with the provisions of the scheme" (both quantitatively and qualitatively) than option (2) using the deferred pension rule. However, it was acknowledged that giving effect to *Barber* by splitting periods of service may work in other cases.

Comment

This decision will send a positive message to other schemes with difficult equalisation issues. Not only has the Court of Appeal demonstrated judicial willingness to reach the right equalisation solution for the Scheme, and to find a workaround that fits within the Scheme's rules, but it has also sent a message of encouragement to employers and trustees, that they should work together to find solutions for their particular scheme without having to resort to judicial proceedings. It stated that "it must be much more satisfactory, from every point of view, if the task of ensuring compliance with Community law can be accomplished in the case of most schemes without recourse to the court."

Sackers will be publishing a newsletter on this case shortly.

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[4] Cripps v Trustee Solutions [2007] 45 PBLR - [2007] EWCA Civ 771 (See 7 Days dated 30 July 2007)

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