Sackers extra

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SO7

Abbreviations commonly used in 7 Days

Alert/News: Sackers Extra publications (available from the client area of our website or from your usual contact)
CPI: Consumer Prices Index
DB: Defined benefit
DC: Defined contribution
DWP: Department for Work and Pensions
HMRC: HM Revenue & Customs
HMT: HM Treasury
PPF: Pension Protection Fund
RPI: Retail Prices Index
TPR: The Pensions Regulator

LEGISLATION

Repeal of Labour's tax relief restriction measures

Following confirmation of the Coalition Government's plans for restricting pensions tax relief from the tax year 2011/12 (for more information, please see our Alert: "Restricting pensions tax relief: the verdict" dated 14 October 2010) it is necessary for the Government to repeal provisions made under earlier Finance Acts which relate to the former Labour Government's plans for the restriction of pensions tax relief.

To effect this, two Orders came into force on 10 December 2010, which repeal Labour's intended amendments:

- The Finance Act 2010, Section 23 and Schedule 2 (High Income Excess Relief Charge) (Repeal) Order 2010

  This Order repeals the provisions which would have amended Part 4 of the Finance Act 2004 with effect for the tax year 2011/12 and subsequent tax years, to introduce a restriction of pensions tax relief to the basic rate for high income individuals.

- The Finance Act 2009, Schedule 35 (Special Annual Allowance Charge) (Cessation of Effect) Order 2010

  In relation to the "anti-forestalling measures" contained in the Finance Act 2009, this Order switches off Schedule 35 to that Act, which introduced the special annual allowance charge (SAAC) with effect from the tax year 2011/12. The Schedule also enabled "high-income individuals" to ask their schemes to refund pension contributions that they had paid which may otherwise have created a liability to the SAAC.

DEPARTMENT FOR WORK AND PENSIONS

The switch from RPI to CPI: Consultation published

On 8 December 2010, the Government published its long awaited consultation on the switch from RPI to CPI for increases to pensions in payment and in deferment.

The consultation sets out the Government's assessment of the impact of the decision to use CPI as the measure of price increases on private sector occupational pension schemes, and seeks views on an amendment to the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006.

Key points emerging from the consultation include:

- for schemes whose rules specifically refer to RPI as the basis for measuring increases, switching to CPI is likely to require a scheme amendment;

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- there will be no statutory easement to make it easier for such schemes to make the switch to CPI;
- there will be no requirement for those schemes which use RPI to change to CPI - making a CPI underpin unnecessary.

The consultation closes on 2 March 2011. For more information, please see our Alert: "The switch from RPI to CPI – consultation published" dated 9 December 2010.

Alongside the consultation, the 2010 Revaluation Order was also published and uses the CPI figures for statutory increases on or after 1 January 2011. This will apply to schemes that use the statutory method for making increases. Further information can be found in the explanatory memorandum which accompanies the Order.

The Pension Protection Fund (Prescribed Payments and Investment Costs - Amendment) Regulations 2011: Consultation on draft regulations

The PPF was designed to ensure that income derived from the pension protection levy and assets transferred from schemes to the PPF Board is kept separate from other assets and monies such as those relating to the Board's administrative expenditure.

Section 173(3) of the Pensions Act 2004 sets out those items which are to be paid or transferred out of the PPF. There is a regulation-making power under section 173(3)(k) to allow further "sums required for prescribed purposes" to be charged to the PPF rather than the Board's administration budget (funded by the administration levy).

The DWP has today (13 December 2010) published a consultation on draft regulations which are intended to allow four sets of costs to be made out of the PPF:

- costs incurred by the Board in connection with making investments for the purposes of the prudent management of its financial affairs;
- expenditure which is incurred for the purpose of exercising the Board's rights as a creditor under the 2004 Act or its functions under that Act that relate to those rights;
- expenditure incurred in relation to the transfer of UK property, rights and liabilities to the Board; and
- expenditure that it is incidental to the Board's functions but only insofar as it relates to those costs that are also to be met from the PPF.

The Government considers it appropriate to make these changes because, among other things, if the PPF were a pension scheme the activities that give rise to these costs would be charged to the scheme rather than the sponsoring employer.

The draft provisions mean that the costs would move from the Board's administration budget (funded through the administration levy) to the PPF (funded in part through the PPF levy). A number of controls would, however, remain to ensure sufficient transparency and oversight of costs made out of the PPF.

The consultation closes on 4 February 2011.

Offering a default option for defined contribution automatic enrolment pension schemes: Consultation on draft guidance

The DWP has also published today (13 December 2010) a consultation on draft guidance to set out the standards for default options in automatic enrolment DC pension schemes.

The draft guidance sets out the background to the workplace pension reforms which are due to come into force in 2012, as well as the key considerations for employers and others in the governance, design, review and communication of default options.

The draft guidance is split into two sections - one relating to workplace personal pensions (WPPs) and the other relating to occupational pension schemes. Although both types of scheme provide default options, the governance and underlying responsibilities differ between WPPs and occupational pension schemes.

The consultation closes on 7 March 2011.

HM REVENUE & CUSTOMS

Pension Schemes Newsletter No. 43

The latest Pension Schemes Newsletter explains proposed changes to HMRC's "Pension Schemes Online" service.

As the information reporting requirements are being changed, Pension Schemes Online is also being updated. Currently reports (including the Pension Scheme Return, Event Report and Accounting for Tax Return) must include an individual's address and date of birth. In future, however, this information will no longer be required, and only the individual's National Insurance number (or alternative identifier) will need to be included.

The changes will become effective from 6 April 2011.

HM TREASURY

The reduced Annual Allowance: draft legislation

On 9 December 2010, HM Treasury published draft clauses and explanatory notes for the Finance Bill 2011, alongside an overview of the draft legislation and draft guidance. The Treasury notes that this is the first time the Government has published the majority of a Finance Bill's draft clauses for consultation. It is intended that the publication of draft Finance Bill clauses will become a permanent feature of the tax policy cycle.

The draft clauses include revised provisions to deal with the new Annual Allowance of £50,000 which was announced on 14 October 2010 and which will have effect for the tax year 2011/12 and subsequent tax years, as well the new level of the Lifetime Allowance (LTA) which is to be reduced from £1.8m to £1.5m in 2012.

The draft clauses also include proposals for the operation of a new protection regime for individuals who may have already built up pension savings in the expectation that the LTA would remain at its current level. The new "fixed protection" will give anyone the opportunity to apply for an LTA of £1.8m instead of the reduced LTA of £1.5m on the condition that they no longer actively contribute to their pension or actively accrue pension benefits. Individuals who are already entitled to primary and/or enhanced protection will continue to receive those levels of protection.

The full Finance Bill 2011 is due to be published on 31 March 2011.

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For more information on the Government's new measures for restricting pensions tax relief, please see our Alert: "Restricting pensions tax relief: the verdict" dated 14 October 2010, and look out for our next Alert on further developments in this area.

Please see also:

HMT Written Ministerial Statement dated 9 December 2010

HMRC's autumn tax updates

HMT overview of changes to pensions tax relief

HMT Press Release

Consultation on unfunded pension public service discount rate

On 9 December 2010, the Government launched a public consultation on the discount rate used to set contribution rates in unfunded public service pension schemes. This follows the recommendation in the interim report of the Independent Public Service Pensions Commission (chaired by Lord Hutton) and the Government's commitment in the recent Spending Review.

Among other things, the consultation document sets out:

- the potential impacts of a lower discount rate;
- the objectives against which different approaches to setting the discount rate can be evaluated; and
- the four options for a new approach to setting the discount rate identified by the Commission.

Views are requested as to whether there are any additional impacts not identified, as well as on the objectives, and approach to setting the discount rate and the actual discount rate which should be chosen.

The consultation will close on 03 March 2011.

HMT Press Release

For more information on the interim report of the Independent Public Service Pensions Commission, please see our Alert: Hutton Report - the Future of Public Sector Pensions dated 7 October 2010.

Removal of the requirement to annuitise by age 75: Consultation response

On 9 December 2010, the Government published its response to the July 2010 consultation on the removal of the requirement to annuitise by age 75.

From 6 April 2011, individuals with DC pension funds will no longer be required to purchase an annuity before the age of 75. Capped drawdown will be available to anyone over the age of 55, with individuals who satisfy a "Minimum Income Requirement" (MIR) able to draw down unlimited amounts from their pension pots. The purpose of the MIR is to ensure that individuals have sufficient secured income to avoid the possibility of members exhausting their savings prematurely, and subsequently falling back on the State.

The MIR will initially be set at £20,000 and then reviewed at least every five years. The cap will be set at 100% of the equivalent annuity, which is broadly the single-life level annuity that could have been bought with the pension fund using annuity rates set by the Government Actuary's Department, and will be subject to review.

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In addition, also with effect from 6 April 2011, most of the rules preventing registered pensions schemes from paying lump sums to members who have reached the age of 75 such as pension commencement lump sums will be removed.

Draft clauses to implement these measures were published on 9 December 2011 for inclusion in the Finance Bill 2011, together with an overview from HMT.

THE PENSIONS REGULATOR

Final incentives guidance published

On 9 December 2010, TPR published its final revised guidance on incentive exercises, including enhanced transfer value exercises.

The final version of the guidance has changed little from the consultation draft (see our Alert: "TPR issues draft guidance on transfer incentives" dated 15 July 2010 for more information). In addition to any legal requirements, TPR expects an incentive offer from an employer to scheme members to adhere to the following five guiding principles:

- Principle 1: Clear, fair and not misleading – members should be able to understand the implications of the offer and make the right decision for them;
- Principle 2: Open and transparent – everyone involved should be made aware of the reasons for the exercise and the interests of the other parties;
- Principle 3: Manage conflicts of interest – conflicts should be identified, appropriately managed and, where necessary, removed;
- Principle 4: Trustee Consultation – the trustees should be consulted and engaged from the start and their concerns (if any) alleviated;
- Principle 5: Independent financial advice – should be made accessible to all members and promoted in the strongest possible terms.

Although the guidance still emphasises that, in TPR's opinion, incentive exercises are not generally in members' interests, it does, however, now acknowledge that there will be individuals who may benefit from accepting such an offer.

For more information, "Guidance on incentive exercises / annuities legislation - the pre-Christmas flurry" dated 13 December 2010.

TPR Press Release

New chairman for the Pensions Regulator

The DWP announced on 8 December 2011 that Michael O'Higgins has been appointed as the new chairman of The Pensions Regulator. He will take up his post from 1 January 2011 for a three-year term.

Mr O'Higgins has been Chairman of the Audit Commission since October 2006, and is also a Non-Executive Director of HM Treasury and Chair of the Treasury Group Audit Committee. He is also the Chair of the youth homelessness charity Centrepoint, having been on its Board of Trustees since 2002. He was recently appointed a Visiting Professor of Economics at the University of Bath.

DWP Press Release

CASES

Lehman / Nortel High Court Challenge

In a surprise judgment, the High Court has confirmed that where a financial support direction (FSD) is issued by TPR against a company after insolvency, the cost of complying with that direction is an expense in that insolvency. The FSD must therefore be paid before any distributions to unsecured creditors.

Background and TPR determinations

In July 2010, TPR published a determination to issue an FSD against 25 companies in the Nortel group (in Canada, the US, and elsewhere). Having concluded that Nortel Networks (UK) Limited (NNUK) (the principal employer of the Nortel Networks UK Pension Plan) NNUK was "insufficiently resourced", TPR's Determinations Panel (DP) found that it was reasonable to impose the requirements of an FSD on NNUK and the other Target Companies. Those companies were therefore required to provide financial support for the Nortel scheme. (The Nortel Determination was reported in 7 Days on 12 July 2010.)

Similarly, in September 2008, Lehman Brothers Holdings Inc. filed for Chapter 11 bankruptcy protection in the United States. On the same date, the UK company Lehman Brothers Limited (LBL), went into administration. As at 1 January 2007, the buy-out deficit in the UK DB scheme, the Lehman Brothers Pension Scheme, was approximately £150m. In May 2010, TPR issued a warning notice of an FSD against a number of companies in the Lehman Brothers group requiring support for the Scheme to be put in place. Again, TPR relied on the statutory ground that the principal employer of the Scheme, LBL, was insufficiently resourced. TPR's DP held that it was reasonable to impose an FSD on: the US parent company, Lehman Brothers Holdings Inc; the three main UK operating companies within the UK; and two intermediate UK holding companies. (The Lehman determination was reported in 7 Days on 18 October 2010.)

These are the second and third FSDs to have been imposed by TPR, the first having been issued to members of the Sea Containers Group.

The High Court Challenge

The administrators of twenty insolvent companies in the Lehman Brothers and Nortel Groups challenged TPR's ability to enforce an FSD or a contribution notice (CN) against an insolvent company in certain circumstances.

Mr Justice Briggs in the High Court was asked to determine "whether, in circumstances where an FSD or a CN is first issued after the target company has gone into administration or liquidation, it imposes any and if so what obligation on the target company and its office-holders." As the judgment notes, "[t]he critical issue is whether the cost of complying with an FSD, or the monetary obligation imposed by a CN, ranks in the administration or liquidation of the target as a provable debt, or as an expense, or neither of those, so that it is recoverable only in the very unlikely event that there is a surplus otherwise available for distribution to members after all creditors have been paid in full".

As the questions before the court were purely matters of statutory construction on the enforcement of FSDs and not dependent on the particular facts of any target company's insolvency, it was deemed necessary to determine the questions before the court before TPR could issue the FSDs. The administrators argued that it was not a provable debt (and could not be enforced after the insolvency event), whilst TPR argued that it was an expense of the administration.

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Insolvency Issues

The basic position of insolvency legislation is a requirement for fair treatment of an insolvent person's creditors. The assets of an insolvent company should be realised and distributed equally among the company's creditors in proportion to the amount of their claims. For a claim to qualify in the insolvency, it must be a provable debt, i.e. one which has arisen out of matters which have occurred or begun to occur, prior to the cut-off date.

Briggs J examined a "considerable line" of case law looking at whether a debt was a provable debt for insolvency purposes, and considered himself "bound by precedent". In an earlier House of Lords case, *Re Toshoku Finance plc*[1], statutory liabilities were held to constitute liquidation expenses because they are "necessary disbursements" of the liquidator.

Pensions law issues

The second part of the judgment deals with priority of FSDs and CNs under the Pensions Act 2004 (the 2004 Act). Briggs J examined two questions:

- whether the FSD regime can apply to the target companies in an insolvency process; and
- if so, whether the 2004 Act makes specific provision (by implication, since none is expressed) as to the priority of those obligations (or simply leaves those questions to be decided by the technical provisions of the Insolvency Act and Rules).

Briggs J found that the FSD regime clearly applies to make its financial consequences liabilities of the insolvent target. He described the FSD regime as a "paradigm example" of legislation which imposes corporate liability. In response to arguments that an FSD should not be provable in an insolvency process, Briggs J, considered that it would be "quite bizarre" to attribute to Parliament an intention to differentiate in the FSD regime between solvent and insolvent companies. He went on to note that the only factor which is sensitive to insolvency is the requirement for TPR to determine whether it is "reasonable" to impose an FSD. However, he considered that "this aspect of the reasonableness condition comes nowhere near imposing a blanket ban on the issue of an FSD to a target in an insolvency process". It is simply one of a number of factors for TPR to consider.

In relation to the second question, Briggs J concluded that when formulating the 2004 Act, Parliament had chosen to leave the priority questions which flow from the application of the FSD regime to companies in an insolvency process to be resolved purely by the insolvency legislation. By contrast, in formulating the amendment to section 75 of the Pensions Act 1995 (under the 2004 Act), Parliament had decided at the time not to promote the priority of section 75 above that of unsecured creditors of the employer. Instead, section 75 was framed to ensure that such a debt is deemed to arise immediately before the relevant insolvency event, therefore qualifying as a provable debt.

Decision

Following the principle in *Toshoku*, Briggs J ruled that "this is a case in which Parliament has legislated to create financial obligations applicable to and payable by a company in an insolvency process which may be triggered (after the cut-off date) in such a way that, rather than creating provable debts, they create administration or liquidation expenses, as the case may be".

He noted, however that the outcome is "likely to prove unfair to the creditors of an insolvent target" and suggested that the Insolvency Service or Parliament may wish to consider a suitable amendment, either to the Insolvency Rules or the 2004 Act to address this.

[1] [2002] 1 WLR 671

Comment

The effect of this judgment is to give FSDs and CNs "super-priority" in an insolvency. This means:

- Counter-intuitively, an FSD/CN has the potential to be of much greater financial value to a pension scheme if it is issued after a target enters into an insolvency process, rather than before doing so, raising the question of whether this could influence TPR and/or trustees' behaviour.

- The balancing feature to this point is that the amount of an FSD/CN is to be determined by the Regulator and it must be reasonable, and such a determination is subject to review by the Upper Tribunal. The method of financial support provided is also subject to the approval of the Regulator. Indeed, the Regulator has issued a press release saying that its approach in relation to FSDs will not change despite the judgment.

Given the importance of the case for banks and other creditors who now find themselves below trustees on the priority ladder, we expect an appeal to the Supreme Court, perhaps even vaulting the Court of Appeal.

For more background on FSDs and CNs, please see our insight: Anti-avoidance: The Regulator's powers.

International Management Group (UK) Limited v (1) Peter German, (2) HR Trustees Limited (Court of Appeal)

The Court of Appeal has confirmed that section 91 of the Pensions Act 1995 does not prohibit the compromise of a genuine dispute as to whether pension rights in a scheme exist.

Background

In November 2009, the High Court ruled that a restriction in the original amendment power in the governing documentation of the IMG Pension Plan (the Plan), which prevented any amendment having "the effect of reducing the value of benefits secured by contributions already made", should not have been removed by a later deed. Consequently, members of the scheme who were in service when benefits under the Plan were purportedly converted from DB to DC in January 1992, were deemed to benefit from a final salary underpin.

A number of members who had left service, or otherwise complained about their entitlements in the years between the amendment being made and the High Court case being brought, had entered into compromise agreements with the International Management Group (UK) Limited (IMG). In these agreements, IMG gave the members concerned additional employment benefits, in return for the member confirming that they did not have DB rights under the Plan. At first instance, the members argued that these compromise agreements were unenforceable because of section 91 of the Pensions Act 1995.

The Appeal

Section 91 prevents the surrender, assignment or commutation by a member of his/her rights under a pension scheme, except in certain limited circumstances. At the relevant times, this section stated that:

"…where a person is entitled to a pension under an occupational pension scheme or has a right to future pension under such a scheme … the entitlement or right cannot be assigned, commuted or surrendered …and an agreement to effect any of those things is unenforceable."

Arnold J in the High Court found that in general these agreements were unenforceable under section 91 because they amounted to a surrender of rights. As a preliminary matter,

the Court of Appeal was asked whether section 91 would render unenforceable a court-approved compromise.

IMG raised two arguments on appeal:

- section 91 does not apply because a legitimate compromise of disputed or doubtful entitlements and rights does not involve a surrender or agreement to surrender a pension entitlement or right; and
- if compromise agreements are unenforceable, this does not affect the court's power to approve a compromise under the Civil Procedure Rules.

Decision

The Court of Appeal held that section 91 would not render unenforceable a compromise agreement on disputes as to whether a right exists. Applying the ordinary meaning of the wording in section 91, Lord Justice Mummery found it "most unlikely" that the prohibition against surrender or agreement to surrender applied to the settlement of claims to a putative or alleged entitlement or right. If this were the case, he explained that all disputes over entitlements or rights would have to be resolved by legal proceedings and authoritative determination - an "inconvenient result".

Mummery LJ also considered that public policy aims for encouraging, upholding and enforcing compromises would not be met if it were not possible to compromise a dispute about pension entitlements or rights.

In addition, the Court of Appeal confirmed a court-approved compromise (a free standing power under the Civil Procedure Rules) remains available.

Comment

This is the first Court of Appeal decision on the scope of section 91 and, as such, provides clarity as to its operation. Given the court's interpretation of section 91, it helpfully supports the use of compromise agreements where there is a genuine dispute as to whether or not a pension right exists.

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