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)
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

DEPARTMENT FOR WORK AND PENSIONS

National Employment Savings Trust Corporation Regulations 2011: Consultation responses

NEST has been designed as a low-cost pension scheme, which can be used by employers to fulfil their duty to enrol employees automatically into a workplace pension scheme, when this duty starts to apply from October 2012.

The National Employment Savings Trust Corporation Regulations 2011 extend some of the legislation which applies in relation to a person as a trustee of an occupational pension scheme to the NEST Corporation, subject to certain prescribed modifications to take account of the large scale of the NEST scheme.

We reported in 7 Days on 14 March 2011 that the DWP had published its response to consultation on the above regulations. The DWP has also now published individual responses to this consultation.

EUROPEAN COMMISSION

EU Pensions Directive: First steps towards review

One of the aims of the "IORP" or Pensions Directive[1] was to create an internal market for occupational retirement provisions on a European scale. Among other things, it sets out a framework for the operation of pan-European or "cross-border" pension arrangements.

The European Commission has published a Call for Advice, by which it is seeking input from the EU regulator (the European Insurance and Occupational Pensions Authority (EIOPA)) on how to improve the Directive. It is intended that EIOPA will advise in relation to all types of pension arrangement, including DB, DC and hybrid schemes.

The Commission notes that there are three main reasons for its review of the Pensions Directive:

- there are currently fewer than 80 pension schemes operating cross-border within the EU - a very small proportion of the nearly 140,000 pension schemes operating within the EU. The Commission therefore intends to propose measures which will simplify the legal, regulatory and administrative requirements for setting-up cross-border arrangements;
- to modernise the prudential regulation of DC schemes; and
- to enable schemes to take advantage of "risk-mitigating security mechanisms" which already exist at national level in a number of Member States (for example,

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

recognising that certain risks are borne by the sponsoring employer rather than the scheme itself).

This last point will be of interest for many schemes. The EU Green Paper on Pensions (published in July 2010) suggested that the Solvency II approach (i.e. the risk-based approach which will apply to the regulation of insurance companies from November 2012) could also be a good starting point for occupational pensions. The Call for Advice now notes that one of the Commission's aims is to reflect the true risk position of pension arrangements in the EU, using an economic risk-based approach to assess the overall financial position of schemes.

EIOPA is required to provide its advice to the Commission by 16 December 2011. We will continue to monitor developments in this area.

EU Commission letter to EIOPA (7 April 2011)

PENSIONS POLICY INSTITUTE (PPI)

Retirement income and assets: the implications of ending the effective requirement to annuitise by age 75

Since 6 April 2011, individuals with DC pension funds have no longer been required to purchase an annuity before the age of 75. As an alternative, capped or flexible drawdown arrangements are now available to anyone over the age of 55.

Capped drawdown allows an individual to invest their pension savings in an income drawdown arrangement with no upper age limit and with a withdrawal cap of 100% of what they would have received from an equivalent annuity. Under flexible drawdown arrangements, individuals who satisfy a "Minimum Income Requirement" (MIR) - currently £20,000 per year - will be able to draw down unlimited amounts from their pension pots.

The PPI published a report on 14 April 2011 which explores how the new legislation could affect the risks people face when accessing private pension savings as well as individual financial outcomes in retirement.

The PPI's research indicates that:

- for the vast majority of people, annuitising is likely to remain the safest and most appropriate option for accessing private DC pension savings;
- a small proportion of people might have enough income and savings to meet the MIR but relatively few will be able to use flexible drawdown (for example, due to savings being tied up in DB arrangements); and
- more people might be able to use capped flexible drawdown in future, as saving in more flexible DC arrangements increases.

PPI Press Release

PENSION PROTECTION FUND

PPF updates its valuation assumption guidance

The PPF has updated its guidance for actuaries on the assumptions to be used for completing valuations under section 143 and section 179 of the Pensions Act 2004. These valuations are used, respectively, to determine whether the Board of the PPF should assume responsibility for a scheme and for calculating a scheme's risk based levy.

By law, the PPF has to set its valuation assumptions to reflect pricing in the bulk annuity market.

The PPF notes that the new assumptions, which have effect from 1 April 2011, have been set following talks with insurers earlier in the year and confirmed with respondents following a consultation (the PPF's response to which has been published alongside the revised guidance).

The new assumptions reflect the fact that currently the insurance market is making no difference between the pricing of CPI and RPI linked annuities. However, the PPF intends to monitor the market closely, so that any changes can be reflected in the assumptions as and when the CPI market develops.

In the revised guidance, the assumption changes are to:

- reduce the effective yields used to discount future payments by 0.2% per year for compensation in payment; and
- increase the assumption about future longevity improvements for men.

PPF Press Release

THE PENSIONS REGULATOR

2011 Scheme record-keeping survey

On 12 April 2011, TPR published its second record-keeping survey of trust and contract-based schemes with two or more members.

The survey is designed to assess the extent to which accurate and appropriate record-keeping is being undertaken across the pensions industry. It also looks at progress on take-up of TPR's record-keeping guidance and its effectiveness in addressing problems identified in the first survey which was carried out in 2009.

TPR notes that wile there are some encouraging findings from the survey, there are still areas where improvement is needed.

Among other things, the survey found that:

- 90% of administration providers had plans to measure common data, checking that they hold essential information such as members' names, dates of birth and National Insurance numbers;
- 47% of administration providers had got as far as agreeing an action plan with trustees to check that the data held was accurate; and
- 63% of scheme reported no data problems in the last 12 months.

TPR expects 100% of new data and 95% of legacy data to be accurately completed by December 2012.

TPR Press Release

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TPR guide to better scheme administration

In connection with its record-keeping survey, TPR has also published a guide setting out "5 simple steps" to help trustees of smaller pension schemes understand their responsibilities and to improve standards of administration in their scheme.

In its current education drive, TPR has been highlighting the importance of high standards of administration, including maintaining accurate data, to ensure that members are properly protected. TPR is keen to raise further awareness around the roles and responsibilities that trustees and administrators have in these areas.

TPR Press Release

CASES

Prudential Staff Pensions Limited v The Prudential Assurance Company Limited and others

This case was brought by the trustee, at the request of the members, who challenged the right of the sponsoring employer to change, unilaterally, the basis on which discretionary increases to pensions in payment were granted.

Background

The Prudential Staff Pension Scheme (the Scheme) was established in 1918. At the time of the hearing, the Scheme operated in two parts - a DB section and a DC section.

The DB section (the focus of this case) was closed to new members in 2003. It was governed by rules adopted by deed of variation dated 23 June 2005 (effective from 1 July 2005) and had net assets as at 5 April 2010 in excess of £5 billion.

Under the rules, statutory increases were payable on pensions in payment in respect of service on or after 6 April 1997. Increases in respect of pre-April 1997 service were payable solely at the discretion of the Employer and were subject to the payment of such additional sums as the Scheme Actuary certified were necessary.

Historically, the Scheme had paid increases in line with RPI, except in times of high inflation. During the 1970s when inflation was particularly high, increases fell below RPI. However, a catch-up exercise was undertaken in the 1980s, with the effect that overall, these pensions were broadly fully index-linked.

In 2005, the Scheme's actuarial valuation showed a deficit and a decision was made by the Prudential board to provide these discretionary increases at RPI subject to a cap of 2.5%.

The Members' challenge

The members argued that Prudential's decision to impose a 2.5% cap on pension increases in respect of pre-April 1997 service was a breach of its obligation of good faith. They argued that, whilst members were aware that such increases were discretionary, it had always been understood that Prudential would pay increases in line with RPI unless there was a good reason not to do so, such as a period of high inflation. This expectation was the result of Prudential's practice, over more than 50 years, of exercising its discretion in this way.

Prudential, on the other hand, argued that the obligation of good faith should not be taken as a requirement for an employer to reach a substantively "fair" decision when exercising its power under the Scheme rules. For the obligation of good faith to be breached, it argued

that the conduct in question must be serious and, viewed objectively, be destructive of the relationship of trust between employer and employee.

The court's decision

The judge considered that the test for a breach of the obligation of good faith was whether Prudential had acted irrationally or perversely in changing its practice of granting increases in line with RPI. Newey J found that Prudential's 2005 decision to limit discretionary increases to RPI capped at 2.5% was not irrational or perverse.

Although the interests and expectations of members may be of relevance when considering whether or not an employer had acted irrationally or perversely, in this instance the power to grant discretionary increases was not a fiduciary power. As such, Prudential was entitled to have regard to its own interests when deciding on the level of increases to be awarded. This was the case, despite the members' strong and reasonable expectations that the practice of granting increases in line with RPI would continue.

Newey J agreed that "the obligation of good faith is not to be taken as requiring an employer to arrive at a decision which is substantively "fair" when exercising a power given to him in apparently unfettered terms by pension scheme rules." He concluded that there was no support for such a requirement in the *Imperial Tobacco*[2] case or in subsequent pension authorities.

He also held that it was not necessary for Prudential to engage "in genuine negotiation" with the trustee over the level of increases to be applied, given that the discretionary power was the employer's alone.

Arguments of estoppel and contractual entitlement to the increases also failed:

- there had been no assumption that Prudential was committed to increasing pensions in line with RPI and it was not apparent that the Scheme members had suffered any detriment as a result of relying on any assumption as to pension increases; and

- the relevant documents contained no promise that pensions would be increased, let alone without any decision to that effect by Prudential.

Comment

This is the first substantive case since *Imperial Tobacco* in 1990 to consider the employer's duty of good faith in connection with occupational pension schemes. Ultimately, however, as Newey J did not reopen these issues, *Imperial Tobacco* remains the main source of information as to what can be an implied term in the pensions context.

As matters stand, for a pension scheme employer to fall foul of the obligation of good faith, it is necessary for their decision to be irrational or perverse.

Sackers acted for the representative beneficiaries in this case - please see our press release for more information.

[2] Imperial Group Pension Trust Ltd and others v Imperial Tobacco Ltd and others [1991] 2 All ER 597

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