SACKER & PARTNERS

THE OCCUPATIONAL, PERSONAL AND STAKEHOLDER PENSIONS (MISCELLAEOUS AMENDMENTS) REGULATIONS 2009

RESPONSE TO CONSULTATION ON DRAFT REGULATIONS

The comments set out below form the formal response ("Response") of Sacker & Partners LLP ("Sackers") to the consultation by the Department for Work and Pensions (DWP) on the Occupational, Personal and Stakeholder Pensions (Miscellaneous Amendments) Regulations 2009 ("the Draft Regulations") which was published on 8 December 2008 ("the Consultation Document").

Sackers is a firm of solicitors specialising in pensions law. The views expressed in this Response have been collated following discussions with a representative group of the firm's solicitors.

General Comments

We note that the Draft Regulations cover a broad spectrum of amendments, including:

(A) changes to the rules governing employer-related investments;

(B) "statutory override" provisions in relation to revaluation and indexation; and

(C) implementation of certain minor policy changes and some consequential amendments.

In our Response, we comment in particular on (A) and (B), but we also have a number of suggestions in relation to (C).

SECTION A

Draft Regulation 22: Amendments to the Occupational Pension Schemes (Investment) Regulations 2005 ("the Investment Regulations")

We note that the DWP proposes to amend the Investment Regulations in order to remove existing exemptions relating to employer-related investment by occupational pension schemes. Such exemptions are currently permitted under transitional provisions in the Directive on the Activities and Supervision of Institutions for Occupational Retirement Provisions ("the Directive"). European Member States which took advantage of these transitional provisions are required to ensure that they are removed from national legislation from 23 September 2010.

Given this timetable and the complex issues raised by the changes proposed to the Investment Regulations (as explored below), we suggest that these provisions are removed from the Draft Regulations and dealt with as a separate issue.

References in this Section A are to the Investment Regulations, taking account of the amendments proposed by Regulation 22 of the Draft Regulations.

1. ***Commencement***

The Draft Regulations currently provide for the existing exemptions in the Investment Regulations to continue in force until they are required to be removed (from 23 September 2010) under Article 22 of the Directive.

We support the DWP's approach to defer the removal of these provisions until that date, to ensure that schemes have sufficient time to disinvest where necessary.

2. ***Draft Regulation 22(3): Amendment of regulation 13 of the Investment Regulations***

Regulation 22(3)(b) of the Draft Regulations provides for the amendment of regulation 13(3) of the Investment Regulations, while 22(3)(c) provides for the deletion of the same provision. We assume that the latter is an error, but this needs to be confirmed.

3. ***Draft regulation 22(3)(a): Deletion of regulation 13(2) of the Investment Regulations***

We believe that it would be helpful to clarify the intention behind this amendment. Our reading of the objective here is that:

(I) there is no intention to stop occupational pension scheme trustees using insurance policies issued by regulated insurance companies that are within the sponsoring employer's group; and

(II) the objective is simply to amend the Investment Regulations so that the requirement in regulation 11(e) of those regulations (to "look through" the policy to the underlying assets in specific circumstances) applies to policies that are issued by an insurance company in the employer's group.

We reach that conclusion because the opening words of regulation 13(2) (as they currently stand) specifically refer to the exemption in regulation 11(e), with a view to saying that the requirement to look through in regulation 11(e) does not apply to insurance policies. Regulation 13(2) does not have a wider purpose.

Is this correct? There is some concern in the industry that the deletion may have a wider purpose, so clarification would be desirable.

To expand on our point:

(i) Occupational pension scheme trustees use insurance policies for a variety of reasons including:

(a) annuity policies to match specific pensioner liabilities;

(b) unit linked/investment linked policies such as:

- index tracker funds (which are invariably structured as investment linked policies);
- funds used for defined contribution investment options, including "platform" policies which are established to provide access to a range of funds managed by the provider and third party managers;
- some active pooled investment funds which are established via insurance policies for tax reasons; and

(c) life insurance policies.

It is very common for pension schemes established for employees of financial services groups to use insurance policies issued by an insurance company within the employer's group, at least for purpose (b) above. It is also known for them to use the employer's group insurer for (a) or (c).

(ii) Even if an insurance company is in the employer's group, the assets which it holds to back its obligations to policyholders and to meet the minimum solvency requirements that apply under Directives and the Financial Services Authority rules are ring fenced from the employer group's proprietary assets.

(iii) We do not believe that the Directive is intended to stop trustees using insurance policies issued by an insurance company within the employer's group. Article 18(f) talks about "investment in" the sponsoring employer and its group – not contracts with an entity in the sponsoring employer's group.

(iv) Consistently with the Directive, section 40 of the Pensions Act 1995 relates to:

(a) shares or other securities issued by the employer or by any person who is connected with, or an associate of, the employer;

(b) land which is occupied or used by, or subject to a lease in favour of, the employer or any such person;

(c) property (other than land) which is used for the purposes of any business carried on by the employer or any such person;

(d) loans to the employer or any such person; and

(e) other prescribed investments (none of which are relevant to this question).

Section 40(2) cross-refers to the Financial Services and Markets Act 2000 and the Regulated Activities Order[1] to expand on "securities" as used in (a).

Our reading of this is that, like the Directive, section 40 is not intended to cover contract based investments (like insurance policies), which are not "securities" or any other form of asset covered by (a) to (e) above.

[1] The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, SI 2001/544 (as amended)

(v) On that basis, we believe that insurance policies issued by insurance companies within the employer's group are permitted both by the Directive and by section 40. In addition, given that insurance companies' backing assets are ring fenced and have to meet regulatory solvency requirements, it is difficult to see why this should be prevented. It is certainly not, in our view, required to comply with the Directive.

(vi) Turning to our reading of the purpose of draft regulation 22(3)(a) (as set out in (I) and (II) above), we can see that it makes sense to require trustees to "look through" to the assets in (effectively) **bespoke** funds where the trustees or the employer can direct that the underlying assets are invested in "employer-related" assets. This is the case even where the policy is held with an entity in the employer's group, where the value of the policy is determined by reference to the value of the underlying assets. In essence you are extending the "anti-avoidance" provision in regulation 11(e) to all insurance policies.

(vii) We do not believe that it is necessary under the Directive to go any further – either (a) in requiring a look through to the underlying assets or (b) by stopping the use of policies issued by employer group insurance companies. Looking at (a), the issues are very similar to those set out in our comment on the proposed deletion of regulation 13(7) below.

(viii) We do, however, think that it is worth considering making it clearer how regulations 11(d) and 11(e) of the Investment Regulations are intended to operate. We would be happy to suggest some wording after understanding the intention.

4. ***Draft Regulation 22(3)(c): Deletion of regulation 13(7) of the Investment Regulations***

Regulation 13(7), as it stands, allows trustees to invest in certain types of regulated pooled fund without having to monitor whether the pooled fund's manager invests in assets that would be "employer-related investments" if held by the trustees, so long as the pooled fund is appropriately regulated and is used by a suitably wide number of investors. We believe that this is permitted by the Directive and that the deletion of this paragraph is not required to comply with the Directive. We also consider that if

this change were made, it would have a disproportionate impact on occupational pension schemes.

To illustrate the potential impact of this deletion:

(a) Trustees of occupational pension schemes commonly make use of pooled equities or bond funds that are set up as open-ended investment companies and similar vehicles. The trustees do not own the underlying assets – they own units or shares in the pooled fund and, importantly, they do not have any control over the investment decisions made by the investment manager of the pooled fund. The trustees cannot give an instruction to the pooled fund manager to avoid investing in securities issued by the sponsoring employer or its group. It is very difficult for trustees to monitor the position on a day by day basis, particularly if the trustees use a number of different funds that could invest in the sponsoring employer or associated entities.

(b) The impact of the proposed deletion would be that trustees who use this type of vehicle might have to disinvest and set up segregated arrangements where they can give directions to the manager. This would involve appointing custodians and, overall, is likely to be considerably more expensive (at least for small schemes). It would not, in our view, improve the security of members' benefits in any material way.

We do not believe that this change is required by the Directive as this focuses on investment by the pension scheme itself "in" the employer and its group.

We think that it would be worth considering, as a possible alternative, an "anti-avoidance" provision that captures "bespoke" pooled funds that are set up for specific schemes to get around the employer-related investment regulations – in other words to have something similar to regulation 11(e) for collective investment schemes.

SECTION B

Draft Regulations 4 and 9: Statutory override provisions

1. We note that the intention behind these provisions is to allow trustees to amend their scheme rules by resolution (where they would otherwise have been prevented from making an amendment due the restrictive nature of some scheme amendment powers), in order to take advantage of:

- the reduced statutory cap on revaluation of defined benefit pensions in deferment (as provided for in the Pensions Act 2008, which amends the Pension Schemes Act 1993) (regulation 4); and
- the lower cap on indexation (as provided for in the Pensions Act 2004, which amended the Pensions Act 1995) (regulation 9).

2. As drafted, the power given to trustees is very wide. It would enable them to amend the rules without the consent of the employer. It could also potentially permit changes to be made which go beyond the scope envisaged (described in paragraph B1 above), for example, by enabling trustees to increase the cap on revaluation or indexation. Is this intended?

3. In our view, these regulations should require employer consent to any such amendments where its consent would ordinarily be required for an amendment made under the scheme rules. By way of example, this was the approach adopted in the Employment Equality (Age) Regulations 2006 (at paragraph 2 of Schedule 2)[2].

4. There is apparent confusion as to whether employers who wish to take advantage of the reduction in the statutory cap on revaluation (but whose scheme rules do not automatically incorporate this change) would need to consult affected members[3] before a change can be made to scheme rules.

5. The reduction in the revaluation cap does not appear to fall within any of the "listed changes" set out in the relevant regulations. However, given the changes being proposed by draft regulation 23 (which will allow the Pensions Regulator to impose civil penalties on employers who fail to consult), clarification of this point would be most welcome.

[2] For the text of this provision, please see Annex A

[3] Under the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006

SECTION C

Miscellaneous

1. ***Draft Regulation 5: The Occupational Pension Schemes (Contracting-out) Regulations 1996 ("Contracting-out Regulations")***

We note that the intention behind the amendment proposed by regulation 5 is to streamline winding-up processes and we have no comment on this amendment as such.

However, we are aware of another issue relating to the Contracting-out Regulations which could usefully be addressed in the Draft Regulations. This relates to the payment of lifetime allowance excess lump sums by schemes which are contracted-out on a reference scheme test basis ("relevant schemes").

Regulations 20(1)(a) and (b) of the Contracting-out Regulations list a number of circumstances in which relevant schemes can pay lump sums instead of a pension. However, the list does not include lifetime allowance excess lump sums under section 166(1)(g) of the Finance Act 2004 and paragraph 11 of Part 1 of Schedule 29 to that Act. We understand that this omission is inadvertent and therefore consider this to be an opportune occasion to bring lifetime allowance excess lump sums within the scope of the Contracting-out Regulations.

2. ***Draft Regulation 6: The Contracting-out (Transfer and Transfer Payment) Regulations ("the Transfer Payment Regulations")***

We note that regulation 6 will change the Transfer Payment Regulations to confirm policy intention that it should be possible to make "connected employer transfers" from schemes which were formerly contracted-out rather than only from those which are contracted-out at the actual time of transfer. It would be helpful if it could be made clear in the Draft Regulations that, where past transfers have been made from formerly contracted-out schemes, these will be brought within the scope of the Draft Regulations.

It would also be helpful if it were possible to make transfers **to** schemes which were formerly salary-related contracted-out schemes.

3. ***Draft Regulation 9: The Occupational Pension Schemes (Indexation) Regulations 1996***

In the first line of regulation 9(2), the word "before" should be replaced by the word "after".

4. ***Draft Regulation 21: The Occupational Pension Schemes (Scheme Funding) Regulations 2005***

The balance of powers in scheme rules relating to the payment of contribution rates can be quite diverse. For example, the actuary may have the power to set the rate going forward but not as regards past service deficits (and possibly vice versa). Further thought may need to be given as to whether draft regulation 21 covers the balance of powers in these cases.

5. ***Draft Regulation 23: The Occupational Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006 ("the Consultation Regulations")***

We note that under the Draft Regulations, civil penalties may be imposed on employers who fail to consult on changes to their pension scheme which are classed as "listed changes" under the Consultation Regulations. Given that it is intended that the Pensions Regulator will have more stringent powers than it currently does in relation to consultation, is it also intended that the Regulator will produce guidance for employers on the steps they need to take to comply with their consultation requirements? This would also aid trustees to ensure that proper consultation has been carried out when such changes are proposed by their scheme's sponsoring employer.

6. ***Regulation 25: The Occupational Pension Schemes (Member-nominated Trustees and Directors) Regulations 2006***

We welcome the clarification that a professional independent corporate trustee is not required to appoint member nominated directors in circumstances where a scheme's trustee structure involves two (or more) corporate trustees, one of which is a general trustee company.

7. *General Comments*

All references to the "Registered Pensions Schemes (Authorised Payments) Regulations 2008" will need to be updated to read **2009**.

We note that various sets of regulations are to be updated by the removal of or alteration to references to the "Regulatory Authority". However, there appear to be certain inconsistencies in the approach used. By way of example, in the Pensions on Divorce etc. (Provision of Information) Regulations 2000, regulation 15 of the Draft Regulations proposes the deletion of the definition of Regulatory Authority, but retains the term elsewhere in the regulations. A consistent approach should be applied across all such proposed amendments.

Sacker & Partners LLP
30 January 2009

ANNEX A

The Employment Equality (Age) Regulations 2006

Schedule 2, paragraph 2

(2) Non-discrimination rule

(1) Every scheme shall be treated as including a provision ("the non-discrimination rule") containing a requirement that the trustees or managers of the scheme refrain from doing any act which is unlawful by virtue of regulation 11.

(2) The other provisions of the scheme are to have effect subject to the non-discrimination rule.

(3) The trustees or managers of a scheme may -

(a) if they do not (apart from this sub-paragraph) have power to make such alterations to the scheme as may be required to secure conformity with the non-discrimination rule, or

(b) if they have such power but the procedure for doing so -

(i) is liable to be unduly complex or protracted, or

(ii) involves the obtaining of consents which cannot be obtained, or can only be obtained with undue delay or difficulty,

by resolution make such alterations to the scheme.

(4) Alterations made by a resolution such as is referred to in sub-paragraph (3)-

(a) may have effect in relation to a period before the alterations are made (but may not have effect in relation to any time before 1st December 2006), and

(b) shall be subject to the consent of any employer in relation to the scheme whose consent would be required for such a modification if it were to be made under the scheme rules.