Sackers

The Quarterly
December 2012

Highlighting significant developments in pensions law, covering key areas such as pensions reform, regulatory developments, new legislation and cases.

The Quarterly December 2012

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Abbreviations commonly used in the Quarterly:

Alert/News: Sackers Extra publications (available from the Sackers Extra area of our website or your usual contact)

CJEU: Court of Justice of the European Union

CPI: Consumer Prices Index

DB: Defined Benefit

DC: Defined Contribution

DWP: Department for Work and Pensions

EIOPA: European Insurance and Occupational Pensions Authority

GMP: Guaranteed Minimum Pension

HMRC: HM Revenue & Customs

NAPF: National Association of Pension Funds

NI: National Insurance

NICs: National Insurance Contributions

ONS: Office for National Statistics

PAYE: Pay as you Earn

PPF: Pension Protection Fund

RPI: Retail Prices Index

SPA: State Pension Age

TPR: The Pensions Regulator

Legal Agenda for 2013

Automatic enrolment

There is more information on the latest position on page 3

Automatic enrolment was the headline pensions story of 2012 and is again set to dominate in 2013. Auto-enrolment will bring an estimated 600,000 more people into pension saving by Christmas. Whilst only the largest employers are currently within scope, by the end of 2013 all employers with a workforce of more than 500 people will be required to offer pensions. Many clients are planning ahead, designing compliant benefit structures and tackling administration issues.

Scheme funding issues

There is a report on the Bank of England's analysis of quantitative easing on page 9

Economic gloom continues to affect pensions. Factors such as low gilt yields and quantitative easing have caused DB scheme funding to dip dangerously, with the PPF reporting record deficit levels.

TPR has reacted to the current climate by altering its approach to scheme funding. Emphasising flexibilities in the current regime, TPR published a statement in April giving its views on how schemes should manage valuations in the current climate. TPR is also taking a more proactive approach to funding this year, with some schemes selected for discussions (or "early engagement" as TPR is billing it) long before submitting valuations. The April statement is to become an annual feature, so schemes with valuations falling in the year from September 2012 should be on the alert for this.

Contingent assets

Deadlines for 2013 are set out on page 7

Due to both funding pressures and likely hikes to PPF levy invoices over the next few years caused by the increase in potential liabilities, contingent assets remain popular. We anticipate that the period leading up to the PPF's March deadline will be particularly busy this year as it falls immediately before the Easter break.

Solvency II for pensions?

The latest developments are detailed on page 5

Work continues on the European Commission's much criticised plan to "level the playing field" between insurance companies and occupational pension schemes by insisting that pension schemes are subject to Solvency II style capital requirements. We should know more by autumn next year as to the direction this is likely to take.

GMP equalisation

We understand that the Government's response to its January 2012 consultation on the equalisation of GMPs[1] and a possible equalisation method is to be delivered before Christmas. The Pensions Minister, Steve Webb, has announced that, while the DWP is in the process of reconsidering its advice with a view to making GMP equalisation simpler, it still intends to press ahead with these reforms.

Money purchase benefits

Hybrid schemes are still awaiting the DWP consultation

It looks as though we will have to wait until the New Year for more on how the Government plans to implement changes to the definition of "money purchase benefits". The DWP announced this change following the Supreme Court's ruling in the *Bridge Trustees*[2] case, which concluded that certain benefits could be characterised as DC, despite there being potential for a deficit to arise in respect of them. Trustees of hybrid schemes, particularly those who have provided guarantees or offered in-scheme pensions for DC pots, will probably already have this firmly in their sights.

1 Consultation on the Draft Occupational Pension Schemes and Pension Protection Fund (Equality) (Amendment) Regulations 2012 (published 20 January 2012; closed 12 April 2012)

2 *Bridge Trustees v Secretary of State for Work and Pensions (Imperial Home Décor)* [2011] 078 PBLR – [2011 UKSC 42]

Legal Agenda for 2013 (continued)

DC schemes

Six key principles

In line with the changing occupational pensions landscape, TPR has been placing a greater focus on governance issues for DC schemes.[3] As part of its work on DC, TPR has set out six key principles that it considers necessary to achieve good member outcomes. These span the life cycle of a DC scheme, from design, to ongoing management and facilitating appropriate decumulation decisions.

We think it likely that these principles will form the basis of TPR's regulatory approach to DC going forward.

Consultation on the Retail Prices Index

An ONS consultation on changes to the calculation of RPI[4] has the potential to be a re-run of the CPI/RPI debate.

Further details on the consultation can be found on page 6

Although the outcome of this consultation is awaited, we anticipate that (as with the switch to CPI for increases to pensions in payment and in deferment) there may be a scheme rule lottery as to the degree to which any changes made to RPI will apply. It is intended that any changes would be introduced in March 2013.

State pension changes

Changes to state pensions will have a knock-on effect on occupational pension schemes. The anticipated White Paper will give us more detail as to how DB contracting-out will be abolished to make way for the £140 per week flat-rate basic state pension.

See page 5 for more information on bridging pensions

Bridging pensions will be affected by the increases to state pension age. Bridging or level pension options provide for a member's benefits to be smoothed during retirement by either providing an additional sum up to SPA or allowing a readjustment of benefits to take account of state pension provision.

Defined ambition

Changes to the pensions landscape?

Steve Webb has also been working on his plans for a new type of pension – "defined ambition". Defined ambition is a plan to reinvigorate workplace pension provision by allowing some element of risk sharing. Details are still sketchy but, together with automatic enrolment, 2013 is looking positive for pensions.

3 Please see our Newsletter: "TPR's recipe for good DC provision" (October 2012)

4 Please see our Alert: "RPI 2.0 - ONS Consultation on changing the index" (10 October 2012)

Automatic Enrolment

Auto-enrolment now live!

Challenges for employers and trustees

Auto-enrolment went live for Britain's largest employers on 1 October 2012 and will be rolled out to all employers over the next five and a half years. Here we look at some of the challenges currently facing employers and pension scheme trustees.[5]

Who is a worker?

Employers must automatically enrol "workers" who meet the relevant age and earnings parameters.[6]

The term "worker" is broadly defined to include individuals working under an employment contract and those with a contract to perform work or services personally, where the work is not undertaken as part of their own business. Employees in the traditional sense will be covered. However, certain atypical personnel, for example, agency workers, can also be workers. By contrast, those who are paid a fee as a self-employed contractor and office holders will not normally be workers.

However, whether an individual is a worker will depend on the facts in each case. We can assist in determining who is a worker for auto-enrolment purposes.

Benefit design

In many cases, employers getting ready for auto-enrolment will want to use an existing pension arrangement to fulfil their statutory duty. But as many established schemes are unlikely to have been set up with auto-enrolment in mind, certain aspects of benefit design or delivery may need revisiting to ensure that employers can meet their duties.[7] These include:

- **Salary sacrifice:** Employers will be able to use salary sacrifice pension arrangements to fulfil their auto-enrolment obligation. But agreeing to a salary sacrifice arrangement cannot be a condition of scheme membership. This is because no provision of a scheme used for auto-enrolment can require a jobholder to express a choice in relation to any matter, or to provide information, in order to become or remain an active member.

Combining pensions and other benefits

- **Flexible benefits packages:** Employers need to be careful to ensure that they meet the underlying obligations of the new regime. For example, an eligible jobholder must have contributions paid at or above the relevant minimum contribution level for the scheme to be a qualifying arrangement. Provided the option is correctly structured, once enrolled, the jobholder may opt for a lower level of contributions in exchange for alternative benefits, in accordance with the terms of the employer's flexible benefits package and the scheme rules.

- **Maintaining tax protection:** As there is no exception for members with enhanced or fixed protection, employers must automatically enrol members with protected tax status. Individuals who have registered for enhanced or fixed protection (and those who have taken flexible drawdown) need to ensure that they opt out of pension saving within one month or lose their protection. HMRC has confirmed[8] that members enrolled into pension saving contractually, rather than under the statutory auto-enrolment requirements, will also not lose their fixed protection, provided that the scheme rules treat individuals who opt out of the scheme as never having been a member.

5 Please see our Checklists: "Auto-enrolment, are you ready?" (October 2011) and "Auto-enrolment, taking action" (October 2012)

6 Enrolment of "eligible jobholders" is required. An eligible jobholder is a person who works in the UK, who is between the ages of 22 and SPA and who earns more than £8,105

7 We are producing a series of Newsletters on tricky auto-enrolment issues. Please see: "Auto-enrolment and salary sacrifice" (August 2012) and "Auto-enrolment and flexible benefits" (October 2012)

8 In an update to the Registered Pension Schemes Manual published on 24 October 2012

Automatic Enrolment (continued)

Ongoing duties

Monitoring eligibility

Once an employer has reached its staging date and started enrolling its workers automatically into pension saving, it will need to have a system in place for identifying individuals and monitoring the ages and earnings of both new hires and existing workers, to ensure that they are automatically enrolled on becoming an "eligible jobholder".

Thresholds for 2013/14

Changes in April 2013?

The earnings trigger for auto-enrolment is aligned with the PAYE threshold. The Government proposes that this will continue and will increase to £9,205 for 2013/14.

The qualifying earnings band sets minimum contribution levels for DC schemes and the Government proposes that this will be aligned, as now, to the NICs Lower and Upper Earnings Limits (taking them to £5,720 and £41,450 respectively).

If changes are made, they will come into effect on 6 April 2013.

Goodbye to stakeholder pensions

To coincide with the introduction of auto-enrolment, regulations have removed the requirement for employers to designate access to a stakeholder pension with effect from 1 October 2012. For employees currently contributing to a stakeholder pension scheme via payroll, employers will be required to continue deducting and paying contributions to the pension provider until the employee asks the employer not to do so or ceases to make contributions at regular intervals.

Pensions Reform

Department for Work and Pensions

Bridging pensions

Increases to SPA affect bridging pensions

SPA is to be equalised for men and women by 2018, and will increase to 66 for both sexes by October 2020. However, when schemes introduced bridging pensions, the possibility of SPA equalising or increasing beyond age 65 may not have been contemplated.

The DWP is consulting on draft legislation to help trustees of schemes that provide bridging pensions to modify their rules to take account of the impact of changes to SPA. The draft regulations introduce a limited power to enable trustees to modify their scheme rules by resolution to allow bridging pensions to be reduced at either SPA or age 60 (for women) or 65 (for men).[9]

In addition, the Finance Act 2013 is set to align the tax rules with the changes to SPA, with the result that reducing a bridging pension after age 65 will no longer be an unauthorised payment. Until the Finance Act comes into force (expected to be July 2013), schemes in which unauthorised payments are payable at the trustees' discretion have a window of opportunity to amend their rules so that bridging pensions cease at a specific age, rather than SPA.

European Union

Solvency II for pensions?

The European Commission is currently in the process of reviewing the EU Pensions Directive. Having intended to deliver a new draft directive in 2012, it is now due to be tabled "before summer 2013". The Commission wishes "to maintain a level playing field between insurance companies and pension funds when they supply similar and interchangeable products". To minimise the impact of Solvency II style capital requirements for insurance companies to pension schemes, EIOPA has devised a system that would allow pension schemes to be valued on the basis of the "Holistic Balance Sheet", requiring liabilities to be balanced by a mixture of assets, contingent assets, sponsor support and possible access to compensation schemes.

QIS underway

A quantitative impact study (QIS) to determine the impact of applying this proposal is currently underway. Although the report detailing the outcome of the QIS is not expected until spring 2013, for the time being at least (and in the face of considerable opposition from the UK Government and other industry bodies), the Commission remains adamant that it will be able to meet its current timetable.

Public Service Pensions

Public Service Pensions Bill

This Bill will implement agreements reached on public service pensions, following the publication, in March 2011, of the Hutton Report.[10] Key changes on the horizon include:

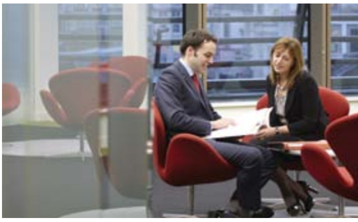
- a move from DB to career average pension schemes;
- the linking of normal pension age to SPA, except for the armed forces, police and fire fighters; and
- improved governance arrangements.

Implementing changes to public sector pensions

Those closest to retirement (those within ten years of their normal pension age on 1 April 2012) will be protected and have no change to their existing retirement date or the amount of pension they will receive when they retire.

9 Please see our Alert: "Consultation on draft legislation – bridging pensions" (8 October 2012)

10 Final report of the Independent Public Service Pensions Commission (10 March 2011)



Regulatory

HM Treasury / HM Revenue & Customs

Sex-based actuarial factors

December deadline for insurers

In the *Test-Achats*[11] case back in March 2011, the CJEU ruled that, with effect from 21 December 2012, an exemption in a European Directive (the Gender Directive)[12] which permits insurers to use sex as a determining factor in their assessment of risk (where it is based on "relevant and accurate actuarial statistical data") will no longer be valid.[13] In the pensions context, the biggest impact is likely to be on annuity rates, as insurance companies will no longer be able to price these using sex based actuarial factors. By contrast, sex based actuarial factors in occupational pension schemes may continue to be used as they are governed by a different European directive – the Equal Treatment Directive.[14]

In light of the case, HMRC[15] has stated that until the practice for annuity providers is clarified, trustees should calculate the maximum drawdown pension for men and women aged 23 and over using the higher male rates from 21 December 2012. This means that from that date, women will be able to take higher drawdown pension income than before; men will see no change in the maximum drawdown pension they receive.

Office for National Statistics

Consultation on the Retail Prices Index

RPI and CPI use different formulas to calculate average prices, as well as there being differences in the basket of goods. This results in a difference of up to 1% between the two indices – the "formula effect".

Changes to RPI proposed

The ONS consultation paper identifies four options for addressing the formula effect:

- no change (retaining the formula effect);
- changing one particular approach to averaging clothing prices (it is for this category that the difference between CPI and RPI formulas has the greatest effect);
- changing one particular approach for averaging changes in prices for all categories (reducing the formula effect but some differences between CPI and RPI would remain); or
- changing RPI so that its formula aligns fully with that used in CPI. This would remove the formula effect but differences would remain due to the different coverages, weights and scope used by the indices.

The consultation closes on 30 November 2012.

11 *Association belge des Consommateurs Test-Achats* ASBL (Case C-236/09)

12 Directive 2004/113/EC which implements the principle of equal treatment between men and women in the access to and supply of goods and services

13 Please see our Alert: "Is it the end of the road for sex based actuarial factors?" (2 March 2011)

14 Directive 2000/78 EC establishing a general framework for equal treatment in employment and occupation

15 HMRC updated its guidance on 8 August 2012

Pension Protection Fund

PPF levy

Further increase in the PPF levy?

The PPF has announced that the pension protection levy estimate for 2013/14 will be £630 million. At the NAPF conference in October 2012, PPF Chief Executive, Alan Rubenstein, warned that the PPF levy might need to rise again, by up to 10% in 2014, if the current economic climate continues.

The PPF is consulting on its 2013/14 pension protection levy determination,[16] with the intention that the new levy formula will remain unchanged until the next three yearly review. The results are due to be announced in December.

PPF levy deadlines

The consultation document also sets out provisional deadlines for the 2012/13 levy year. Key diary dates to watch out[17] for are:

Data deadlines for 2013

- 28 March 2013: Deadline for submission of Scheme Return to TPR. Information from the Scheme Return is used in the calculation of the levies.
- 28 March 2013: Deadline for certification of new contingent assets and recertification of existing contingent assets.
- 30 April 2013: Deadline for submission of deficit-reduction contribution certificates for contributions made up to and including 31 March 2012.

Schemes wishing to put in place or to recertify PPF contingent assets are advised to start this process in good time to ensure these deadlines can be met.

The Pensions Regulator

Record keeping deadline ahead

31 December 2012 deadline for common data

In 2010, TPR set targets for schemes to improve their "common" data records by 31 December 2012. Common data includes a member's name, address, date of birth and NI number. For new data created after June 2010, TPR requires 100% accuracy, while a target of 95% is set for data created before that date (legacy data).

For practical tips on how to target resources effectively to meet the deadline, please see our Governance Team's newsletter on record keeping.[18]

Consultation on contributions

Auto-enrolment will be challenging for DC scheme administration. Reflecting this, TPR is focusing on ensuring that DC contribution processes are tightly regulated.

TPR is consulting[19] on amendments to its codes of practice on the late payment of contributions to both occupational DC and personal pension schemes and on two new sets of accompanying guidance.

Under TPR's proposals, all trustees / managers would be required to monitor the contributions they receive. Before reporting an employer to TPR for failing to make a payment, trustees will be required to contact the employer a minimum of three times (at least once by phone) requesting payment and an explanation. In addition, it is proposed that the requirement to report a payment failure after 90 days will be removed, with only "materially significant" payment failures or contributions that remain outstanding for 120 days needing to be reported.

16 Consultation on the 2013/14 Pension Protection Levy (September 2012)

17 The March dates are slightly earlier than usual because of Easter

18 Governance spotlight: "Keep playing the "record"" (August 2011)

19 Please see our Alert: "TPR consults on revised "contribution" codes and accompanying guidance" (3 October 2012)

Cases

High Court

IBM United Kingdom Pensions Trust Limited v IBM United Kingdom Holdings Limited, IBM United Kingdom and Metcalf

In this recent decision, Warren J in the High Court agreed with the trustees that, when a new section of the IBM Pension Plan ("the Scheme") was created by an amending deed in 1983, it was intended that active members would have a right to retire on an unreduced pension at any age between 60 and 63, without any employer consent. However, the rules, as drafted, contained a requirement for consent.

The Decision

This case was unusual in that there was both documentary and witness evidence on the key issues, dating back 30 years.

Active members

High Court orders rectification of scheme rules

Warren J found there to be "compelling" evidence that both the trustees and the principal employer intended to provide an entitlement for members to retire between the ages of 60 and 63 without employer consent. He therefore concluded that the Scheme's trust deed and rules did not reflect the original intention of the parties and should be rectified accordingly in respect of active members.

New joiners

Those members who joined the scheme post 1987 were provided with a new booklet drafted in 1987 which reflected the rules (i.e. retirement with consent only). This group had no expectation of receiving the more favourable early retirement benefits. Nonetheless, Warren J concluded that post 1987 new joiners were also entitled to unreduced early retirement without consent.

Deferred members

In relation to deferred members, the claim for rectification failed as the judge concluded that the amending deed accurately reflected the parties' intentions. This was despite the fact that, if the amending deed had been drafted as intended, it would have discriminated against deferred members (which was not permitted by preservation rules at the time). In reaching this conclusion, Warren J rejected IBM's argument that this was a defence to the claim for rectification in respect of active members.

Comments

- It is unusual to see a case, brought by trustees, to increase members' benefits beyond those provided in the rules. More often, such actions are prompted by an employer's desire to bring the wording of a scheme's governing documentation into line with the lower benefits being paid in practice.
- In a statement, IBM estimated the costs of complying with the judgment to be £100 million.
- A second, connected, case in relation to the Scheme is due to be heard in February 2013. We understand that this case deals with issues of good faith.

Areas of interest for pension schemes as investors[20]

Quantitative Easing

The Bank of England has issued a paper on Quantitative Easing (QE), explaining the costs and benefits to groups that are perceived as having been negatively affected.

The Bank notes that QE has “a broadly neutral impact on a fully funded [DB] scheme” and that the pension incomes of people coming up to retirement in a DB scheme, whether fully funded or not, will have been unaffected by QE. However, it acknowledges that “schemes that were already in substantial deficit before the financial crisis are likely to have seen those deficits increased”. For DC schemes, QE is “estimated to have had a broadly neutral impact on the value of the annuity income”. Although lower gilt yields resulting from QE have reduced annuity rates, the Bank suggests that QE has raised the value of pension fund assets.

Implementation of the UK-US Foreign Account Tax Compliance Act (FATCA)

Exemption for UK pension schemes

FATCA aims to combat tax evasion by US persons with non-US accounts. As the US tax system is based on citizenship, US persons do not need to be resident in the US. FATCA therefore requires financial institutions outside the US to report information on US account holders to the US Internal Revenue Service. If financial institutions fail to report the required information, 30% US tax would be withheld on all US payments to them.

The UK Government has agreed to implement FATCA, with an exemption for most UK occupational pension arrangements from the new reporting requirements.

Pensions Infrastructure Platform (PIP)

In the 2012 Budget, the Government announced that it would support the establishment of a new PIP owned and run by UK pension funds. Since then, the NAPF and the PPF have announced[21] that several major UK pension funds have agreed to sign up to the PIP as “Founding Investors”.

The Government has worked closely with the NAPF and the PPF to support the foundation of the PIP, which has a target fund size of £2 billion and is designed to provide pension schemes with the expertise and tools needed to make long-term investments in UK infrastructure. Work is expected to start on recruiting adequate resource and further developing the PIP in time for its launch in early 2013.

Wheels Common Investment Fund Trustees v HMRC

In June 2007, the CJEU concluded that investment trusts were special investment funds and should be exempt from paying VAT on investment management services, but HMRC did not extend this to pension trusts.

European Court decision awaited

In 2008, Wheels Common Investment Fund and the NAPF agreed to bring a joint legal challenge against HMRC to the CJEU. The case was heard in September 2012 and the court’s decision is awaited. The NAPF estimates that pension schemes could save about £100m a year in VAT if the CJEU agrees that the fees should be exempt.

20 Please see also our “Investment Briefing” (November 2012)

21 NAPF Press Release (18 October 2012)

Sackers Extra Briefing:

Dates for your diary

Sackers Extra Briefing presents seminar and workshop style briefings addressing topical issues of current interest and relevance.

Event	Date	Time	Details
Quarterly Legal Update Autumn 2012	22/11/12	8:15am	Welcome, registration and breakfast
		9.00am	Seminar commences
		10.30am	Further discussion, tea and coffee
Chairman of Trustees Forum: How good are your negotiation skills?	27/11/12	4:00pm	Welcome, registration and tea and coffee
		4:30pm	Seminar commences
		6:00pm	Further discussion, drinks and canapés
Quarterly Legal Update Winter 2013	06/02/13	8:15am	Welcome, registration and breakfast
		9.00am	Seminar commences
		10.30am	Further discussion, tea and coffee
Quarterly Legal Update Spring 2013	02/05/13	8:15am	Welcome, registration and breakfast
		9.00am	Seminar commences
		10.30am	Further discussion, tea and coffee
Quarterly Legal Update Summer 2013	18/07/13	8:15am	Welcome, registration and breakfast
		9.00am	Seminar commences
		10.30am	Further discussion, tea and coffee

If you would like to attend any of our seminars, please contact our marketing team at marketing@sackers.com.

Our programme of regular seminars brings together pensions professionals to share and discuss knowledge and best practice. Part of this rolling programme is our "Quarterly" seminar, which focuses on the latest legal and regulatory developments in the pensions world. Our Quarterly video distils content from this seminar into bite sized chunks, highlighting some of the current key issues. You can access the Quarterly video, and our "In focus" series of spotlights on specific pensions issues, by scanning the adjacent code with your smartphone or tablet.

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