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THE QUARTERLY

JUNE 2008

Introduction

Welcome to our Sackers Extra "Quarterly", designed to highlight significant developments in pensions law over the last quarter. The Quarterly is published in March, June, September and December. Each edition covers key areas such as pensions reform, regulatory developments, new legislation and cases.

Copies of our Sackers Extra publications referred to in this "Quarterly" are available from the client area of our website www.sackers.com or from your usual contact.

In this issue

Pensions Reform **2**

- Pensions Bill 2007/08 2
- Employer Debt 2
- IDRP 3
- Transfer Values 3
- Financial Assistance Scheme 3
- Winding-up 4

Regulatory **4**

- Accounting Standards 4
- Actuarial Profession 5
- DWP 5
- HMRC 5
- PPF 6
- TPR 7

Cases **8**

- High Court 8
- VAT Tribunal 10

PENSIONS REFORM

Pensions Bill 2007/08[1]

Amendments agreed

Having undergone a line-by-line examination in the Commons, the Pensions Bill is now being considered by the House of Lords. Amendments to date include:

Extension of TPR's powers

- alteration of the circumstances in which the Pensions Regulator (TPR) may appoint trustees to a scheme (the Regulator will be able to appoint trustees where it considers it 'reasonable' rather than 'necessary' to do so);
- an employee being able to require his/her employer to enrol him/her into a personal account or qualifying private scheme even if his earnings are below the annual £5,035 limit (the employer will not be required to make any contributions); and
- provision for a three year phasing-in period of Personal Accounts for money purchase schemes during which overall contributions must be at least 2% of qualifying earnings in the first year, rising to 5% in the second and 8% in the third. Of these contributions, at least 1% and 2% in the first and second years respectively must come from the employer, before reaching the full 3% contribution in the third.

More information on Personal Accounts

Once the Lords have finished their review of the Bill it will return to the Commons for consideration. Both houses must agree on the text of the Bill before it can be granted Royal Assent (and become law).

Employer Debt

The Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2008[2]

If a company exits an underfunded multi-employer defined benefit (DB) scheme, its share of the deficit becomes a debt due to the trustees (the employer debt).

The Occupational Pension Schemes (Employer Debt) Regulations 2005 were increasingly seen as inflexible and amending regulations were introduced with effect from 6 April 2008 to address this, including:

- changes to the statutory trigger for calculating an employer debt on exit (the "employment-cessation event");
- the possible use of existing scheme apportionment rules subject to complicated transitional arrangements going forward;
- a new "funding test" for scheme apportionment arrangements; and
- the introduction of two categories of withdrawal arrangement – those sanctioned by the trustees and those "approved" by TPR.

Key changes to apportionment of employer debts

As a result of the new regulations, actuarial guidance note GN19 (deficiency calculations) has been withdrawn. This is because the amended employer debt regulations contain sufficient technical detail to enable scheme actuaries to

[1] Details of the Pensions Bill (as drafted when first published) are set out in our Alert dated 7 December 2008

[2] For further details, please refer to our Alert "Whose Debt is it Anyway?" dated 17 March 2008

calculate deficiencies in scheme assets, therefore removing the need for additional professional guidance.

Internal Dispute Resolution Procedure (IDRP)

The Occupational Pension Schemes (Internal Dispute Resolution Procedures Consequential and Miscellaneous Amendments) Regulations 2008[3]

The option of having a simplified single stage IDRP was introduced from 6 April 2008, although trustees can stick with their current two-stage IDRP if they wish. The amended provisions leave it largely up to scheme trustees to design a process for dealing with pension disputes which is appropriate for their scheme (provided certain "framework" requirements are met). Transitional provisions will apply, so any "disagreement which is ongoing" before 6 April 2008 should be dealt with under the scheme's original two-stage IDRP.

Existing IDRP can be retained – but tweaks may be required

TPR's code of practice sets out its expectations that:

- disputes being considered by trustees or managers should usually be decided upon within four months of their receiving the application;
- applicants should be notified of the decision usually no later than 15 working days after the decision has been made.

Transfer Values

The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008 (the CETV Regulations)

The CETV Regulations were laid before Parliament on 11 April 2008.

When a member of a pension scheme wants to transfer to another pension scheme, a cash value is placed on their pension rights (called a "cash equivalent") and that amount is paid from the transferring scheme to the receiving scheme. It is then converted into pension rights in the receiving scheme. The CETV Regulations set out new requirements for calculating and verifying cash equivalents, based on a best estimate of the likely cost to the transferring scheme of providing the alternative deferred benefit.

New CETV rules come into force in October 2008

The CETV Regulations are due to come into force in October 2008. Before then, TPR is expected to publish guidance to help trustees understand the different considerations and new requirements in relation to transfers, as well as guidance for scheme members to help them compare the key risks with any potential advantages associated with taking a transfer to another pension vehicle.

Financial Assistance Scheme (FAS)

Keeping track of the recent changes to FAS is hard work. There are three sets of changes in the pipeline at the moment.

FAS is changing (again)

Changes – Part 1

Draft regulations (laid before Parliament on 29 April 2008) are being fast-tracked so that payments under the new regulations can be made as quickly as possible. The regulations are due to come into force by the end of May

[3] For further details, please refer to our Alert "IDRP – The New Arrangements" dated 14 March 2008

Among other things, the regulations:

- increase payments to 90% of a member's accrued pension (subject to a cap of £26,000 per year) – up from 80%; and
- permit payments to be made from a scheme's normal retirement age, rather than from age 65 as currently.

Changes – Part 2

A further set of draft regulations was published on 27 March for consultation (which closed on 9 May). These regulations make provision for the reforms of FAS which were announced in December 2007, and will (amongst other things) extend the FAS to members of certain schemes which wound up underfunded with a solvent employer. They will also allow early payment for those members unable to work due to ill-health.

FAS will be extended to schemes with solvent employers

Changes – Part 3

A final set of FAS regulations will be published later in the year to move the FAS to a position where payments are calculated on a basis which is broadly comparable to that of the Pension Protection Fund (PPF).

The Department for Work and Pensions (DWP) is also using the implementation of these changes as a suitable opportunity to review annuity factors.

Winding-up

TPR, the PPF and the DWP announce a joint consultation on winding-up

In early March, TPR, the PPF and the DWP published a joint consultation paper on winding-up. Among other things, it is proposed that pension scheme trustees should ensure that the key activities relating to winding-up a pension scheme, or passage through the PPF assessment period, are completed within no more than two years.

Wind-ups should be complete within 2 years

REGULATORY

Accounting Standards

International Accounting Standards Board (IASB) publishes discussion paper on IAS19

On 27 March 2008, the IASB published a Discussion Paper on IAS 19 Employee Benefits. The Discussion Paper sets out the IASB's preliminary views on how the accounting for some post-employment benefits, including pensions, could be improved.

Pensions accounting for companies may change

The IASB's preliminary suggestions include removing the options for deferred recognition of gains and losses in defined benefit plans.

Comments are invited by 26 September 2008. The IASB will then review the issues and publish an exposure draft of proposed amendments to IAS 19, with a view to issuing a revised standard by 2011.

Actuarial Profession

Revised GN29 – Amendments to Actuarial Appointment Letters

The professional duties of the Scheme Actuary changed from 1 April 2007 following changes to the Actuarial Profession's Guidance Note 29 (GN29). The main changes reflect the new requirements on trustees to notify the scheme actuary of particular events which, if they occur, may affect the financing or solvency of the scheme.

New scheme actuary appointment letters need to be agreed

As a result of the changes to GN29, new actuarial appointment letters needed to be put in place before 1 April 2008 (subsequently extended to 30 June 2008).

If amended letters have not been agreed by 1 July 2008, provided the actuary proposed the terms to the trustees within four weeks of 31 March 2008, the actuary need not resign as Scheme Actuary (unless otherwise advised by TPR), but must:

- decline to provide any statutory certificates until the situation is remedied; and
- notify TPR of the position.

Department for Work and Pensions (DWP)

Proposed extension of TPR's powers[4]

Consultation on extension to TPR's anti-avoidance powers

The Government plans to extend powers requiring employers to provide contributions to a pension scheme if their actions could threaten the security of members' pensions. The consultation was published by the DWP on 25 April. All but one of the amendments will be effective from 14 April 2008 (the date on which the proposed new powers were first announced).

Once in force the changes will give TPR stronger powers to reduce the risk to members' interests by scheme changes or corporate transactions. They will apply to an employer or their associates, including investors in the employer who might seek to profit from the scheme.

One of the drivers behind these changes is the launch of "new business models" which, among other features, may look to sever the link between the employer and the pension scheme operating a well funded pension scheme for profit or taking it outside the financial services compensation regime.

TPR has confirmed that between 14 April 2008 and the date on which the new legislation comes into force, it will not apply certain amendments to its powers unless one of the "new business models" is the subject of the proposed use of the power. TPR has also confirmed that its approach to clearance will not change as a result of the proposed amendments and that its clearance guidance still applies.

HM Revenue and Customs (HMRC)

Anti-money laundering: further extension for Trust or Company Service Providers (TCSPs)

TCSPs acting "in the course of business" are caught by new anti-money laundering legislation which came into force on 15 December 2007. Current HMRC guidance suggests that paid trustees may be TCSPs if they are trustee

[4] For more details, please see our Alert dated 16 April 2008: "Proposed extension of anti-avoidance powers"

of more than one scheme and/or they determine their fee.

Back in March, HMRC said that its guidance for TCSPs would be updated. With changes to the guidance afoot, the deadline by which existing TCSPs needed to register with HMRC was extended to 31 May 2008 (from 1 April). This guidance has still not been published and so a new deadline for registration has been set so as to allow "a minimum of four weeks from the date on which updated guidance is published".

New guidance expected on TCSPs – watch this space!

HMRC has said that TCSPs who have not yet registered may wish to delay registering until the updated guidance is available.

Finance Bill 2008

The Chancellor, Alistair Darling, set out new measures for pensions in his Budget Report of 12 March 2008[5]. The Finance Bill 2008, which will enact many of the Budget measures, is due to receive Royal Assent (and become law) in mid-July. Two key changes on the horizon for occupational pension schemes are:

Trivial Commutation

Pension rights giving rise to small entitlements can be commuted into a lump sum. However, this is subject to certain restrictions, including an aggregated limit of 1% of the standard Lifetime Allowance. To ease this administrative burden, in addition to the existing 1% limit, commutation of some small “stranded pots”, as well as savings below £2000 (a limit per scheme) will be permitted.

Trivial commutation rules to be relaxed

Changes to authorised payments

The Finance Act 2004 sets out the payments which a registered pension scheme is authorised to make to members and sponsoring employers. Any payments which are unauthorised attract tax at a penal rate of up to 70%. For example, unauthorised payments include overpayments of pension, over a de minimis limit. Changes will be made so that otherwise unauthorised payments can become authorised. The provisions will be retrospective.

More flexibility on overpayments

Notional Earnings Cap for 2008/2009

HMRC has confirmed that the notional earnings cap (for those schemes which have retained one after 6 April 2006) for 2008/09 is £117,600.

Stamp Duty: Removal of £5 Stamp Duty Charges

The fixed £5 charge on a "declaration of use or trust" is abolished with effect from 13 March 2008. This means that there is no longer any requirement for standard pension scheme deeds (for example, pension scheme trust deeds and rules and any amending deeds) executed on or after this date to be sent to the Stamp Office with a fee for stamping.

Pension Protection Fund (PPF)

PPF Solution to Equalising GMPS

The PPF has announced that it is consulting on a PPF specific method of paying equal compensation to men and women which would otherwise be unequal due to the differences in guaranteed minimum pensions (GMPs). These are primarily brought about by differences in state retirement age.

Sackers will be responding to this consultation

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[5] For more information, see 7days dated 17 March 2008 and our Alert “Budget 2008: What’s in it for Pensions?”

PPF Compensation Cap

Under the Pensions Act 2004, each year the Secretary of State is required to specify the amount of the PPF compensation cap (i.e. the maximum amount of PPF compensation is 90% of the compensation cap).

90% of compensation cap is £27,770

The level of the compensation cap is to be increased to £30,856.35 (up from £29,928.56) from 1 April 2008.

Valuation assumptions: changes announced

The PPF is responsible for keeping the assumptions used for pension scheme valuations under sections 143 and 179 of the Pensions Act 2004 in line with pricing in the buy-out market. Changes were made from 31 March 2008 to these assumptions to bring valuations into line with market prices.

PPF valuation basis amended

The PPF anticipates that the changes could result in fewer schemes entering the PPF because valuations based on the proposed new assumptions may mean that they are able to pay benefits greater than PPF levels of compensation.

The Pensions Regulator (TPR)

Conflicts of interest: Consultation published

TPR has published for consultation draft guidance on conflicts of interest (consultation closes on 30 May 2008).

Draft guidance on conflicts published

The guidance is designed to help trustees of occupational pension schemes assess the adequacy of the governance arrangements they put in place to manage conflicts of interest. Conflicts are examined through 5 key principles:

- understanding the importance of conflicts of interest;
- having a conflicts of interest policy in place;
- identifying conflicts of interest;
- evaluation, management or avoidance of conflicts; and
- managing adviser conflicts.

Clearance Guidance published

Clearance was introduced in April 2005 as a voluntary process to meet concerns about how TPR was going to use its anti-avoidance powers. The original clearance guidance was understandably focused on process, but reflecting three years of experience, the revised guidance now looks to when clearance may be available (structured on a set of "guiding principles").

Final clearance guidance available

Consultation on mortality assumptions

TPR is looking at good practice in choosing assumptions for defined benefit pension schemes.

The TPR consultation (which closed on 12 May 2008) focused on mortality and suggests the use of mortality assumptions as a "trigger" for funding plans. By introducing such a trigger, TPR would be able to examine in more detail valuations which it considers to have left insufficient headroom for improvements in mortality, in particular, if schemes use a mortality assumption which is less prudent than the one known as "PA92 Long Cohort". TPR will also expect schemes to use forecasts that assume life expectancy improvements will not come to a sudden stop but will continue in future, albeit

TPR consulting on mortality triggers

at a slower rate.

Consultation on updating the Myners Principles

An update to Myners in the pipeline

HM Treasury, the DWP and TPR have launched a combined consultation on updating the Myners principles (which closes on 23 June 2008). These are a voluntary set of 'comply or explain' principles designed to improve trustee investment decision-making and governance of pension funds.

The consultation responds to last year's National Association of Pension Fund Review Institutional Investment in the UK: Six Years On, which recommended updating the Myners principles to ensure the continued spread of best practice among pension schemes. The consultation therefore proposes a set of refreshed and simplified, higher-level principles and the development of a comprehensive suite of authoritative best practice guidance and tools which will give further assistance for trustees to improve investment decision-making and governance.

Guidance published as part of continued focus on DC schemes

TPR's new focus on governance results in guidance on DC

As part of its commitment to promoting the good running of defined contribution (DC) schemes, TPR has published the first of a planned series of good practice guidance for trustees and employers. The new guidance covers retirement options and the open market option in occupational DC schemes.

TPR also intends to issue guidance in the coming months on:

- question and answers on DC schemes;
- communicating with members - good practice examples and case studies;
- analysis of DC scheme returns; and
- investment practices.

CASES

High Court (HC)

Alexander Forbes Trustee Services Ltd v Geoffrey Alan Clarke and others (High Court) (5 February 2008)

Another case looking a winding-up priority orders

The Trustee sought directions as to the appropriate order of priority under section 73 of the Pensions Act 1995, in force on 23 May 2000 (the date the scheme went into winding-up) for the application of the net assets of the scheme on its winding-up.

Background

Section 73 of the Pensions Act 1995 sets out the statutory priority order for paying benefits on the winding-up of defined benefit (DB) occupational pension schemes. As drafted in 2000, it gave members who had become entitled to pension a higher priority than members whose entitlement to pension had not yet arisen (i.e. deferred members) at the date the winding-up was triggered. The practical effect of this was that deferred members would receive only a percentage of their benefits, whilst pensioners would receive their benefits in full.

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The Claim

The main question in this case was whether the deferred members and/or the active members could also be considered to be "entitled" to their benefits from the scheme and thereby benefit from the higher priority on winding-up afforded by that sub-section.

Decision

- the deferred members had the right to request (which the Trustee accepted meant "require") that an early pension be paid to them with immediate effect albeit with actuarial reduction. As the employer's consent was not required, it was held that the making of such a request was a unilateral act entirely within the power of the individual member. Accordingly, the judge found these members had the right to call for payment of an early pension and could therefore fall within the highest winding-up priority (i.e. they had the same priority as pensioners).
- the active members had an additional hurdle in that they were still in service when the scheme terminated. It was held that it was within the power of the active members to terminate their service by giving notice or even by simply ceasing to attend for work. The judge held that if they did so, they would have an entitlement to a deferred pension, with the option to convert that into an early pension. As such, their position was indistinguishable from that of the deferred members (and pensioners).

Court found both active and deferred members should have same priority as pensioners

Comment

The key consideration was that a member should have the unfettered right to bring about payment of a pension by taking steps that were entirely within his/her own power. It was not essential that he/she should have been able to take all of the necessary steps on the date on which the Scheme commenced winding-up.

This judgment will be particularly relevant for other schemes which are winding-up in deficit, where the winding-up commenced between 6 April 1997 (when section 73 came into force) and 6 April 2005 (when section 73 was amended extensively by the Pensions Act 2004). However, we understand that the case is being appealed.

But the case is going to appeal

Alitalia-Linee Aeree Italiane SPA v (1) Filippo Rotunno and others (High Court, February 2008)

The case concerned an application to ascertain the basis on which the scheme needed to be funded, on the true construction of a scheme's employer contribution rule.

Judicial scrutiny of the contribution rule

Background

The Alitalia Italian Airlines Pension and Assurance Scheme (the Scheme) is closed to new entrants but otherwise ongoing and provides pension benefits for employees of Alitalia's UK branch on a defined benefit (DB) basis.

The employer contribution rule (Rule 9.1) provides that:

"Each of the Employers shall make contributions to the Fund at a rate determined from time to time by the Trustees acting on the advice of the Actuary after consultation with the Principal Employer to secure the benefits under the Scheme in respect of members in or formerly in its Service."

The question was whether the trustees were required to determine the rate of employer contributions by reference to funding the scheme on a buyout basis

or on some other basis. In considering the arguments, the judge had to decide what meaning and significance should be attached to the words "to secure the benefits under the Scheme".

Decision

The use of the word "secure" in Rule 9.1 did not mean that the Scheme had to be funded to buy-out level but on an ongoing basis. The judge concluded that the "funding objective" is not to guarantee members' benefits in all circumstances, and still less to do so on the assumption (which may be wholly unrealistic) that a winding-up is always imminent or even likely to occur in the foreseeable future. The objective is instead to safeguard or protect members' benefits by adopting whatever funding method is best suited to the changing circumstances of the scheme.

"Secure the benefits" does not mean buy-out

Comment

The Court's pragmatic approach took into consideration the prevailing legislative landscape in deciding that the Scheme was not required to be sufficiently funded to purchase annuities for all members at any point in time. The case does however highlight the continuing importance for trustees and sponsors to be familiar with their scheme rules.

VAT Tribunal

Legal challenge over VAT on investment management services

Wheels Common Investment Fund (WCIF) and the National Association of Pension Funds (NAPF) have agreed that they will jointly bring a legal challenge against HMRC on the application of VAT on the investment management services supplied to occupational pension funds. The NAPF press release notes that WCIF is an £8 billion multi-employer scheme covering Ford Motor Company Limited, Jaguar Cars Limited and Land Rover.

Challenge from pension funds following Claverhouse

This challenge follows the ruling of the European Court of Justice (ECJ) in *Claverhouse*[6] which stated that investment trusts should be exempt from VAT on investment management services. The NAPF and WCIF, having taken advice, believe that occupational pension funds should also be exempt.

The NAPF considers that a successful challenge could mean that the pension funds sector as a whole could stand to receive up to an estimated £300 million in backdated VAT over the past three years. In addition, pension funds would no longer have to pay an estimated £100 million per annum in VAT going forward.

The NAPF notes that beneficiaries of a successful challenge would mainly be private sector defined benefit pension schemes with segregated investments. The NAPF is encouraging schemes to talk to their investment managers about submitting protective claims if they have not done so already. Pension funds which have already submitted claims and had those claims rejected should also consider asking for their appeal to stand behind the WCIF/NAPF appeal.

Action may be required

Nothing stated in this document should be treated as an authoritative statement of the law on any particular aspect or in any specific case. Action should not be taken on the basis of this document alone. For specific advice on any particular aspect you should consult the usual Solicitor with whom you deal. © Sacker & Partners LLP May 2008

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[6] See Sackers' Extra News "The ECJ, VAT and Investment Trusts" dated July 2007

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