Sackers

The Quarterly
June 2010

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

The Quarterly June 2010

In this issue

Abbreviations commonly used in the Quarterly:

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

AVCs: Additional Voluntary Contributions

DB: Defined benefit

DC: Defined contribution

DWP: Department for Work and Pensions

GMP: Guaranteed Minimum Pension

HMRC: HM Revenue & Customs

NEST: National Employment Savings Trust

NICs: National Insurance Contributions

PADA: Personal Accounts Delivery Authority

PPF: Pension Protection Fund

TPR: The Pensions Regulator

Election Special

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New Government?

At the time of going to press it seems likely that the Conservatives will be able to form a Government with or without support of the Liberal Democrats, although negotiations between the parties are ongoing. Leaked details suggest those negotiations have focused on the economy and electoral reform. But what would a Conservative Government (perhaps with Liberal Democrat support) mean for pensions?

Pensions is a consensus issue

The good news is that there is, in theory, a cross-party consensus on pensions (at least on the issues that transcend a single Parliament). For example, despite earlier Conservative rumbling about withdrawing the reforms, there now appears to be cross-party support for the 2012 workplace pension reforms. But that doesn't mean that there aren't differences between the Conservatives and the Liberal Democrats (and Labour).

Points of difference

We analyse some of the key issues below:

- Tax relief for high earners – A policy battle potentially looms. The Conservatives have previously opposed the proposed restrictions on higher rate tax relief for pension contributions whilst the Liberal Democrats have said they will scrap it altogether. Perhaps the silver lining for schemes is that the complicated reforms to restrict tax relief proposed by the Labour Government may be amended or shelved as a result.
- State pension – There is seemingly cross-party support for restoring the basic state pension's link to earnings. In addition, the Conservatives wish to review the rise in state pension age, possibly bringing the increase from 65 to 66 forward to 2016 for men and 2020 for women (currently slated for 2026).
- Public sector pensions – Change is on the agenda. The Liberal Democrats have proposed an independent commission and the Conservatives have already said they wish to cap public sector pensions "above £50,000".

Yet another new Pensions Minister

Finally, who will be the Pensions Minister? Nigel Waterson, the Conservatives Shadow Pensions Minister, lost his seat at the election, perhaps leaving an opening in any coalition cabinet for Steve Webb, the Liberal Democrats spokesman. But whoever is appointed, we just hope for continuity – as, at our count,10 ministers have held the post since 1997.

We will be following developments closely.

Monday 10 May 2010

Pensions Reform

Restriction on pensions tax relief

Tax relief on pensions will be restricted for high earners from April 2011

From April 2011, individuals with an annual income of £150,000 or more will face a reduction in tax relief on their pension contributions. Relief will be tapered away, so that for those earning over £180,000 it will be worth 20% (equivalent to basic rate tax). There will be an income floor on the tax relief restriction, so that the restriction only applies where the individual's income (excluding employer pension contributions) is £130,000 or more.

Transitional "anti-forestalling" measures currently apply, to prevent those potentially affected by the 2011 restrictions from making significant additional pension contributions in the interim. The anti-forestalling measures were introduced with the 2009 Budget affecting those earning £150,000 or more but were extended by the pre-Budget Report on 9 December 2009. Broadly, the anti-forestalling measures now apply where individuals whose income is £130,000 or more change the pattern of their normal, regular, ongoing pension savings. Where this is the case and pension savings exceed a special annual allowance (SAA) of £20,000 (or up to £30,000 where a member pays infrequent DC contributions) a tax charge will apply (the SAA charge).

Pre-Election Budget confirms introduction of tax relief restrictions from 2011

Budget 2010

The pre-Election Budget was delivered on 24 April 2010 and confirmed the Government's intention to implement the tax relief restriction measures.[1]

Alongside the Budget report, the Government published its response to its consultation on implementing the tax relief restriction, which sets out how the Government intends to apply and deliver the restriction.

Extension of anti-forestalling provisions

Finance Act 2010

Following the Budget, the Finance Bill was rushed through the Parliamentary process during "wash-up", before Parliament was dissolved for the General Election. It received Royal Assent on 8 April 2010.

The Finance Act 2010 incorporates the provisions for restricting tax relief on pension contributions. It also extends the "anti-forestalling" measures to individuals earning £130,000 or more in line with the Pre-Budget Report announcement of 9 December 2009.

[1] Please see our Alert: "Scant relief for pensions in Darling's pre-election Budget" dated 25 March 2010

Legislation

2012 Workplace Pension Reforms

A number of key elements of the workplace pension reforms from 2012 have recently been finalised.

Employees to be enrolled automatically into a qualifying workplace scheme

Automatic enrolment

The Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010 include:

- the process and time limits for employers to achieve active membership for jobholders as well as the related information requirements;
- arrangements for employers who already operate a higher quality scheme to postpone automatic enrolments for up to three months;
- the time limits for re-enrolment of eligible jobholders who have opted out; and
- provisions regarding quality requirements for qualifying schemes.

NEST scheme Order and Rules published

Establishment of the National Employment Savings Trust[2]

NEST will be established by the National Employment Savings Trust Order 2010 from 5 July 2010. The Order is akin to the trust deed of an occupational pension scheme and provides for the NEST Corporation to be the trustee of the scheme.

The Rules accompanying the NEST Order provide for the administration and management of NEST and incidental matters. Together the Order and Rules set the scope and parameters within which NEST will operate.

Combination charge to apply to NEST members' accounts

NEST charging structure

By an announcement of 16 March 2010, the Government has confirmed that initially the charges will consist of two elements:

- a charge of 0.3% of the total value of a member's funds under management each year, known as an annual management charge (AMC). This is the charge structure also used by Stakeholder pension schemes; and
- a contribution charge of around 2% which will apply until the costs of establishing the scheme have been met.

NEST is intended to be self-financing in the long-term, through the charges paid by its members. However, as there will be a gap between its costs and revenues before it is fully established, the Government intends to provide NEST with a loan, in line with its commitment that the scheme be established at nil cost to taxpayers.

First members of the NEST corporation appointed

NEST appointments

- Lawrence Churchill, the current chair of the PPF has been appointed Chair designate of the NEST Corporation with effect from 5 July 2011.
- Jeannie Drake will be the Deputy Chair. In addition, Tom Boardman, Laurie Edmans, Dianne Hayter, Chris Hitchen, Julius Pursaill and Sue Slipman will be members of the NEST Corporation.
- Tata Consultancy Services has been announced as the successful bidder for NEST scheme administration services.

[2] Please see our News "The Road to 2012: Will your scheme qualify?" dated 26 April 2010

Consultation requirements

Employers must consult before changing “pensionable earnings”

New listed change

From 6 April 2010, the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006 have been amended to add a new “listed change”. The change means that an employer is required to consult affected pension scheme members before changing what counts as “pensionable earnings” (even outside the scheme documentation) when proposing changes to a DB scheme.

Equality Act 2010

Equality Act provisions in force from October 2010

Consolidation of anti-discrimination legislation

The Equality Act 2010 received Royal Assent on 8 April 2010. The Act seeks to harmonise existing discrimination legislation, such as the Sex Discrimination Act 1975 and the Employment Equality (Age) Regulations 2006, providing a single approach to discrimination issues where appropriate.

The majority of the Act’s provisions will take effect from 1 October 2010.

Employer debt

Easements added to Employer Debt Regulations

Easements for use on business restructurings

Amending Regulations which came into force on 6 April 2010 introduce two easements to the Employer Debt Legislation[3]. There is a general easement and a “de minimis” easement – both designed to facilitate one-to-one corporate restructurings between two employers participating in the same DB scheme.

Provided certain statutory steps are taken “without undue delay”, no employment cessation event will occur and no employer debt will arise. But because of the complicated steps required and restrictive application of the easements, we anticipate that there will be limited take up.

[3] Please see our Alert: “Employer Debt - Seven Steps to Heaven?” dated 18 March 2010

Regulatory

Department for Work and Pensions

DC contracting-out to end

Protected rights to be abolished from 2012

The DWP has confirmed that the option to contract-out of the additional state pension on a protected rights basis into a DC pension scheme will be abolished from 6 April 2012. Individuals who are contracted-out on this basis will be automatically brought back into the additional state pension from this date.

DWP publishes note on existing options for risk sharing

Risk sharing options

Following its consultation on risk sharing in private pensions which took place during the summer of 2008[4], the Government made a commitment to publicise the risk sharing options which are currently available.

The DWP has now published an information note[5] which sets out some of the options and uses a number of case studies from employers to show how schemes have used them.

Financial Assistance Scheme

FAS was established in 2005 to provide payments to be made to, or in respect of, certain members or former members of underfunded DB schemes which went into winding-up between 1 January 1997 and 5 April 2005.

Final FAS regulations in force

Regulation update

- The Financial Assistance Scheme (Miscellaneous Amendments) Regulations 2010 came into force on 2 April 2010 and complete the delivery of a package of changes to FAS announced in December 2007. In particular, they allow for the transfer of pension scheme assets to Government.
- The Financial Assistance Scheme (Tax) Regulations 2010 came into force on 1 May 2010 and make certain consequential tax provisions.

FAS Guidance

Guidance has recently been published on the transfer to Government of residual assets in FAS qualifying schemes. This includes information on:

- Equalisation – following consultation the guidance has been amended "to clarify that the suggested methodology for equalising asset shares between men and women for the effect of GMPs is not prescriptive, but rather a possible route to achieve equalisation that actuaries may choose to apply if they considered it appropriate for the particular scheme";
- Valuations – detailing the method and assumptions to be used when undertaking valuations of schemes for FAS purposes.

In addition, guidance has been published on the synthetic buy-out basis designed to help actuaries estimate the cost of securing bulk annuities with insurers when undertaking FAS valuations.

[4] Please see our Alert: "Risk Sharing – The Government Consults" dated 11 June 2008

[5] http://www.dwp.gov.uk/docs/risk-sharing-db-pension-schemes.pdf

HM Revenue & Customs

New Scheme Sanction Charge process

Changes to the Scheme Sanction Charge (SSC)

If an unauthorised payment is made by a registered pension scheme a 40% tax charge is payable by the member or, in some instances, the employer (the unauthorised payments charge) and the scheme (the SSC) respectively[6]. However, the actual payment of the unauthorised payments charge gives rise to a deduction in the SSC payable[7].

In Pension Schemes Newsletter No. 40[8], HMRC sets out its new process for handling the SSC from 6 April 2010 (and for the years up to and including the tax year ended 5 April 2010). This new process is designed to provide certainty to the trustees about the level of the SSC payable.

From 6 April 2010, if trustees make an unauthorised payment and they wish to obtain certainty about the SSC, they will be able to ask the member to complete a mandate. The mandate will give trustees authority to withhold an amount equivalent to the tax (and, if applicable, any surcharge) that the member would otherwise be responsible for paying via their Self Assessment tax return. The trustees can then pay that amount to HMRC (together with the SSC).

Reporting excess borrowing to HMRC

Excess borrowing

If a registered pension scheme has borrowed a sum in excess of the limits set out in the pension tax legislation, a tax charge will apply. The Registered Pension Schemes (Provision of Information) (Amendment) Regulations 2010, which came into force on 6 April 2010, require trustees to make a report to HMRC for the purpose of assessing that tax charge.

Annual and lifetime allowances frozen

Annual and Lifetime Allowances

From April 2011 the annual allowance and lifetime allowance will be frozen for five years at £255,000 and £1.8 million respectively, up to and including the tax year 2015/16.

Confirmation of notional earnings cap

Notional Earnings Cap

The notional earnings cap for 2010/11 will be £123,600. This is the last year for which HMRC will publish a notional earnings cap (but schemes will be able to calculate it themselves using pre-6 April 2006 legislation).

Investment Governance Group

Draft investment governance principles for DC schemes

Draft investment governance principles for DC schemes

The Investment Governance Group (IGG) was established following the 2008 review of the Myners Principles (originally introduced following a review of institutional investment in the UK). The IGG has recently consulted on draft governance principles and guidance for workplace DC pension schemes.

The aim of the guidance is to raise standards of investment governance for DC schemes, in three key areas:

- roles, responsibility and accountability;
- fund choices and any default strategy; and
- communications with pension scheme members on the decisions they can make.

[6] An unauthorised payments surcharge of 15% applies if unauthorised payments made by a registered pension scheme go above a set threshhold within a certain time period
[7] Calculated as the lesser of 25% of the unauthorised payment charge and the tax paid by the member or employer
[8] http://www.hmrc.gov.uk/pensionschemes/ps-newsletter40.htm

The Pension Protection Fund

PPF guidance on onerous contract terms

Guidance in relation to the PPF Board's power to modify relevant contracts

When the PPF assumes responsibility for a scheme it has the power to disapply any term of a contract which has been entered into by that scheme, or to substitute a reasonable term or condition in its place, if it considers that term to be "onerous". Although it has not yet used its powers, the PPF has published guidance on the onerous contract terms which include, for example, proposed standard wording to include in International Swaps and Derivatives Association (ISDA) contracts between trustees and counterparties that specifies when an "Additional Termination Event" will arise.

PPF compensation rules updated

Changes to pension compensation provisions

The Pension Protection Fund (Miscellaneous Amendments) Regulations 2010 amend various existing provisions governing the payment of pension compensation by the PPF, including:

- the raising of the minimum age at which a person can apply for early payment of pension compensation from age 50 to age 55 (unless an individual has a "protected pension age") to tie in with the increase in the minimum age for the payment of pensions generally;
- modification of the calculation of pension compensation for active members of career average revalued earnings (CARE) schemes to reflect the way in which pension benefits are calculated in those schemes.

PPF compensation on divorce

Pension compensation on divorce: Consultation on draft regulations

The DWP is consulting on two sets of draft regulations for the provision of pension compensation on divorce or dissolution of a civil partnership, in relation to members of schemes for which the PPF assumes responsibility.

- The first set of regulations are designed to enable PPF pension compensation to be shared when a person seeks a divorce or a dissolution of their civil partnership, thereby enabling the former spouse or civil partner to receive a share of that person's pension compensation.
- The second cover the situation where a pension sharing order or an attachment/earmarking order was made before the PPF assumed responsibility of the scheme, but was not implemented by the scheme.

Lady Judge appointed Chair of Pension Protection Fund

Barbara Judge has been appointed as the new Chair of the PPF, with effect from 1 July 2010 for an initial period of three years.

The Pensions Regulator

TPR to toughen up on record-keeping

Additional record-keeping consultation

In December 2008, TPR published guidance on "Good practice in measuring member data", designed to encourage high standards of record-keeping. However, TPR has found take-up of this guidance to have been low.

As a result, TPR proposes to set record-keeping targets and is currently consulting on revised guidance. Where schemes fail to have adequate plans to resolve data issues, TPR has said it will use its existing enforcement tools to require them to improve – for example, by issuing improvement notices.

Good practice guidelines to be updated

Winding-up: Consultation on revised guidance

TPR is also consulting on a revised version of its June 2008 "good practice guidelines" which it produced to help trustees and others meet the two-year timeframe for winding-up occupational pension schemes.

Cases

Houldsworth v Bridge Trustees

The Court of Appeal (CA) has ruled on what constitutes DC benefits in the context of a hybrid scheme which is winding-up.

Classification of DC benefits on winding-up of hybrid scheme

Background

When an underfunded scheme with DB benefits winds-up, the statutory priority order applies. This establishes payment priority where there is 'competition' for payment (it does not apply to schemes which only have DC benefits). The statutory priority order has changed a number of times, most recently on 6 April 2005 to reflect the introduction of the PPF. But this case concerned the pre-2005 statutory order of priority on winding-up.

Facts

At the time the Imperial Home Décor Pension Scheme (the Scheme) began winding-up in October 2003, it had a £40 million deficit. Although originally a DB scheme, earlier changes to benefits had resulted in a complex benefit structure. Certain DC benefits benefited from a DB guarantee and some were contracted-out on a GMP basis prior to 6 April 1997.

In order to apply the statutory priority order, the trustees needed to determine whether certain benefits payable under the scheme were "money purchase benefits". If not, they could be used to subsidise the DB funding gap. The structure of the Scheme, and in particular the dearth of original scheme documents, made this difficult to assess.

Decision

The CA decided the following in relation to the different benefits under the Scheme:

AVCs

- voluntary contributions (which were given top priority under the pre-2005 priority order) included not only the individual's AVCs but also the employer's matching contributions;
- DC benefits which were provided with a notional rate of investment return were still DC;

In-scheme pensions

- although DC benefits were secured within the scheme at retirement (by applying actuarial conversion factors) they were nonetheless DC in nature;

DB underpin

- the fact that some DC benefits included DB guarantees did not prevent them from being "money purchase benefits" under the relevant legislation;

GMP underpin

- benefits of DC members with GMPs were essentially split into two parts:
  - in respect of pre-6 April 1997 accrual, the GMP was regarded as an underpin benefit for the purposes of the winding-up legislation, with that part of the DC pot therefore falling within the statutory priority order;
  - in respect of service on or after 6 April 1997 (when GMPs ceased to accrue), benefit accrual was treated as DC with no underpin, and so excluded from the general asset pool.

Comments

When considering its application to other schemes, it should be remembered that the case was decided on a previous statutory priority order and that the Scheme had a number of unique features. We also understand that the case will be appealed.

Low & Bonar PLC and Bonar Pension Trustees Limited v Mercer Limited

This Scottish equalisation case highlights the fact that the formalities for amending pension schemes may be less restrictive under Scottish law than they are in England and Wales.

Effective equalisation by means of a board minute under Scottish law

Background

In common with many schemes, prior to the *Barber*[9] judgment on 17 May 1990, normal retirement date (NRD) under the scheme was 65 for men and 60 for women. Following Barber, all UK occupational pension schemes were required to equalise pension ages. Mercer recommended the equalisation of NRDs under the scheme at age 65.

The trust deed and rules required amendments to be made by deed, by agreement of the company with the consent of the trustees. Despite this, the company argued equalisation had been achieved by means of a resolution at a meeting of the board of directors on 5 March 1991. The resolution stated that the change was to come into force on 1 July 1991 and was approved by the trustees in the minutes of their meeting on 5 July 1991. No formal rule amendment was made until August 2002.

Decision

The Scottish Court of Session held that the board minute amounted to a deed for the purposes of the trust deed and rules and therefore found NRDs to have been validly equalised.

Comment

Under Scottish law the word "deed" does not have a technical meaning as it does under English law. A deed in Scotland simply needs to have some degree of formality and demonstrate an intention to create legal relations. The Scottish Court of Session in this case took a very practical and commercial approach in its decision as to whether the requirements of the deed had been met.

[9] *Barber v Guardian Royal Exchange Assurance Group* [1991] QB 3440

In the pipeline

1 October 2010	Equality Act 2010
1 October 2010	Disclosure of information: Subject to consultation, regulations will formalise the use of electronic communications between pension schemes and their members
6 April 2011	Full pensions tax relief restrictions implemented?
1 October 2012	Automatic enrolment: start of phasing-in of employer duty to enrol jobholders automatically into NEST or a qualifying pension scheme

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