Sackers

The Quarterly
June 2012

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

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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)

CARE scheme: Career average scheme

CPI: Consumer Prices Index

DB: Defined Benefit

DC: Defined Contribution

DWP: Department for Work and Pensions

ECJ: European Court of Justice

GAD: Government Actuary's Department

HMRC: HM Revenue & Customs

NAPF: National Association of Pension Funds

NPA: Normal pension age

PPF: Pension Protection Fund

RPI: Retail Prices Index

SPA: State pension age

TPR: The Pensions Regulator

Pensions reform

Automatic enrolment

Starting in 2012, employers will be under a duty to enrol eligible jobholders automatically into a qualifying workplace pension scheme and to pay contributions.

We are producing a series of checklists for employers on auto-enrolment. The first is already available – please request a copy from your usual contact.

Automatic enrolment thresholds

Thresholds confirmed for 2012/13

The DWP has confirmed the revised rates for automatic enrolment, which will be aligned with tax and National Insurance thresholds. In 2012/13:

- the earnings trigger for automatic enrolment and re-enrolment has been set at £8,105, in line with the PAYE income tax personal allowance; and
- where the automatic enrolment trigger is reached, contributions will be payable on qualifying earnings between £5,564 and £42,475.

The Secretary of State is required to review these rates each tax year.

Smaller employers

Following an announcement in January 2012 of new staging dates for small businesses (those with fewer than 50 employees) to allow additional time to prepare for auto-enrolment, the DWP has been consulting on changes to the implementation timetable for employers with less than 250 workers in their PAYE scheme. The consultation also focuses on arrangements for the phasing of minimum contributions for all employers. The Government's response is awaited.

Choosing early auto-enrolment

Bringing forward your auto-enrolment date

Employers may bring forward their staging date for automatic enrolment. Any employer wishing to do this must notify TPR in writing at least one calendar month before the new (earlier) date and provide certain information, such as the employer's PAYE reference and Companies House registration number. Once a staging date has been changed it is not possible to revert to the original date.

CARE schemes

The Government intends that CARE schemes can be used as qualifying schemes[1] for the purposes of auto-enrolment, so long as they provide for the accrued rights to benefits under the scheme to be revalued at, or above, a prescribed minimum rate at any time when the jobholder's pensionable service is continuing.

Revaluation can be achieved by the scheme either providing guaranteed revaluation or funded discretionary revaluation. The minimum required by regulations is the increase in CPI capped at 2.5%. The DWP is also consulting on minor technical amendments to allow CARE schemes with a mix of guaranteed revaluation below the minimum rate and a discretionary power to revalue at a higher rate to count as a qualifying scheme.

Cross-border employers

Regulations on cross-border employers are in the pipeline. These are designed to exempt employers from having to automatically enrol individuals who are subject to the social and labour laws (relevant to the field of occupational pensions) of another Member State in the European Economic Area.

1 Please see our Newsletter: "Will your scheme qualify for auto-enrolment?" (March 2012)

Updated guidance

Both the DWP and TPR have updated their auto-enrolment guidance. The DWP's materials include a general overview of auto-enrolment, as well as fact sheets and example case studies showing how individuals may be affected by the forthcoming changes.

Meanwhile, TPR has updated its detailed guidance for employers and published a strategy document setting out its approach to regulation and compliance.

Public sector pensions

Final agreements proposed

Final agreements on public sector pensions were published in March 2012.[2]

New schemes in place by 2015

The proposed agreements remain in line with the approach set out in Lord Hutton's report and are intended to deliver the Government's key objectives of linking NPA to SPA and providing CARE benefits. Those members who were less than 10 years from their NPA on 1 April 2012 are protected from the changes.

The new schemes are due to be in place by 2015.

Fair Deal

In December 2011, the Chief Secretary to the Treasury, Danny Alexander, announced[3] that as part of the deal with unions on public sector pensions, the Fair Deal would be retained.

The Fair Deal is a policy applying to public sector staff who are compulsorily transferred to a private sector employer which requires the new employer to provide a "broadly comparable" pension scheme for the transferred staff.

In addition, GAD has published an update[4] to its December 2011 note: "Public service pension schemes reform and Fair Deal". This explains that, in respect of transferring employees with effect from 1 April 2012, contractors may include the revised employee contribution rates, or make allowance for them, in their proposals for providing a broadly comparable pension scheme under the Fair Deal Policy.

State pension

Proposed changes

The Government has announced that it will create a single tier state pension (initially of approximately £140 per week), to be introduced early in the next Parliament.

Further increases to SPA on the horizon

As part of the state pension overhaul, the Government also plans to introduce an automatic mechanism for increasing SPA so that it takes account of improvements in life expectancy.

A White Paper on the state pension reforms is scheduled to be published in the spring, with proposals on increasing SPA likely to follow in the summer.

2 As announced by HM Treasury on 9 March 2012

3 In a ministerial statement on 20 December 2011

4 Update on employee contribution changes (8 March 2012)

Switch from RPI to CPI

Consequences

Repercussions of the switch from RPI to CPI include:

- the introduction of a requirement for employers to consult with members before the rate at which pensions are revalued or indexed can be changed in an occupational pension scheme (except where the change is, or is likely to be, beneficial or neutral for the member);
- a debate and vote in the House of Commons after an "e-petition" on the subject received over 109,000 signatures. The vote failed after only 33 MPs voted for the re-introduction of RPI, while 232 voted against the proposal;
- the rejection by the Pensions Ombudsman[5] of a complaint from a pensioner that, in deciding to retire early, he relied on his belief that his pension would be increased to take account of the cost of living as measured by RPI not CPI; and
- a decision in *Danks v Qinetiq* – see Cases.

Taxation

Finance Bill 2012[6]

While no major changes to the pensions tax regime were announced in the 2012 Budget,[7] amendments to the existing framework include:

Additional changes for employer asset backed contributions

- technical amendments to the legislation on "scheme pays" to ensure that the rules in relation to deferred members work as intended;
- further amendments (following announcements made in November 2011 and February 2012) to provisions designed to ensure that the value of tax relief given to an employer accurately reflects, but does not exceed, the amount of the payments received by a pension scheme under an asset backed contribution (ABC) arrangement.

Finance Bill 2013

The 2012 Budget also announced changes for inclusion in the Finance Bill 2013. These include provisions to:

Alignment of bridging pension legislation

- align the tax rules on the payment of bridging pensions with forthcoming changes to SPA. A written ministerial statement[8] announced the Government's intention to introduce a limited power for the trustees of schemes which currently provide bridging pensions to amend their rules to take account of later SPAs;
- ensure that the rules surrounding fixed protection[9] work as intended;
- amend tax legislation to address the abolition of DC contracting-out;[10]
- ensure that arrangements under which an employer contribution is paid to a registered pension scheme for an employee's spouse or family member (as part of a flexible remuneration package) cannot be used to obtain tax and national insurance advantages for either the employee or the employer.

5 Mr R Clarke and the Armed Forces Pension Scheme (82434/3)

6 The official title of this Bill (which was published on 29 March 2012) is the Finance (No. 4) Bill

7 Please see our Alert: "Budget 2012: The pensions story" (22 March 2012)

8 On 26 March 2012

9 Please see our Alert: "Fixed protection: Last minute guidance from HMRC" (30 March 2012)

10 Please see our Alert: "Abolition of DC contracting-out: Final regulations published" (1 March 2012)

Legislation

Protected rights

Making changes: Easement

Contracting-out on a DC basis was abolished with effect from 6 April 2012.

Schemes which were contracted-out on this basis need to consider removing protected rights provisions from their trust deed and rules, as they will not be removed automatically.

Easement for schemes with former protected rights

Regulations[11] designed to assist trustees in making rule amendments came into force on 6 April 2012.[12] These regulations introduce an easement allowing trustees, by resolution, to remove "all or part of a scheme rule which makes special provision in relation to the protected rights of members" and which no longer reflects a statutory provision.

Schemes will have until 5 April 2018 at the latest to make changes and may make amendments retrospective to 6 April 2012.

Other issues

- Regulations[13] remove the protection given to protected rights payments in bankruptcy proceedings and the prohibition on assigning protected rights payments.
- HMRC is due to consult on regulations to allow partial payment of a "short service refund lump sum" where scheme rules require former protected rights benefits to be retained.

Trivial commutation

Extension to personal pensions

Members of occupational pension schemes (who are aged 60 or over) have had the option of commuting small pension pots of £2,000 or less as a lump sum since December 2009. This right in relation to small pots can be exercised in addition to the general rules on trivial commutation, under which members may take all of their pension savings as a lump sum if their aggregate pension savings are less than £18,000.

Ability to commute small pots extended to personal pensions

Since 6 April 2012, personal pension scheme members can also take advantage of this measure, but to prevent abuse of the easement, they will only be able to take two such lump sum payments in their lifetime. These payments can be made regardless of the value of the individual's total pension savings and in addition to any trivial commutation lump sum payments or small pots paid from occupational pension schemes.

11 The Occupational Pension Schemes (Contracting-out and Modification of Schemes) (Amendment) Regulations 2012

12 Please see our Alert: "Abolition of DC contracting-out: Final regulations published" (1 March 2012)

13 The Pensions Act 2008 (Abolition of Protected Rights) (Consequential Amendments) (No.2) (Amendment) Order 2012

Regulatory

Department for Business Innovation and Skills

Kay Review of equity investment

Interim report published

Professor John Kay has published an interim report[14] of his independent review into investment in the UK equity market and its impact on the long-term performance and governance of UK quoted companies. The interim report summarises the responses of the review's call for evidence and presents a broad discussion of the issues raised, including:

- the purpose of equity markets – both economically and in facilitating stewardship and corporate governance;
- the company and the board – including directors' duties, takeovers, voting rights and executive pay; and
- asset management – including the role of regulation in driving investment behaviour.

Professor Kay is due to present his final report, including recommendations for action, in the summer.

Department for Work and Pensions

Changes to disclosure regulations

The DWP is consulting on amendments to disclosure requirements, with the aim of bringing existing provisions into line with auto-enrolment.

Disclosure regulations to be aligned with notification requirements for auto-enrolment

Current legislation requires occupational pension schemes to provide basic scheme information to prospective members or to new members within two months of joining. With the introduction of auto-enrolment, this could mean that members may not receive this information until the opportunity for them to opt-out of pension saving has expired. The DWP therefore proposes to amend these timescales, to make it more likely that jobholders will receive basic scheme information before the expiry of the one month opt-out period.

The DWP has a longer term aim of creating a single set of disclosure regulations for pension schemes. It had intended to do this to coincide with the introduction of auto-enrolment, but due to the Government's current "Red Tape Challenge" (which seeks views from members of the public on whether or not existing legislation should be retained, simplified or removed), the next major set of disclosure regulations for pension schemes has been put back until 2013.

European Union

Review of the Pensions Directive

The European Commission has published a White Paper[15] on pensions, confirming it's intention to review the Pensions Directive,[16] with the aims of maintaining "a level playing field with Solvency II" and promoting cross-border activity.

Solvency II news

The European Insurance and Occupational Pensions Authority (EIOPA) was asked by the Commission to provide advice[17] on, among other things, how the minimum capital and solvency requirements for the insurance sector under Solvency II might be applied to pension schemes (but not whether they are appropriate). EIOPA has devised a "holistic balance sheet" approach to deliver the Commission's aim.

14 The Kay Review of UK equity markets and long-term decision making – Interim report (February 2012)

15 White Paper: An Agenda for Adequate, Safe and Sustainable Pensions (16 February 2012)

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

17 Advice to the European Commission on the review of the IORP Directive

Responses to EIOPA's consultation revealed overwhelming objections to the proposals from the UK and other Member States. The NAPF has written an open letter to the Commission[18] to express its concerns over the review. In addition, a DWP Select Committee Inquiry has been hearing submissions on the subject, including from the Commission. A Quantitative Impact Study is awaited, and a draft directive was expected by the end of 2012 (although it is anticipated that this timetable will slip).

Financial transaction tax Directive

The European Parliament and the Council of the European Union are considering proposals for a directive aimed at developing a common financial transaction tax (FTT). The idea is to set a common tax on all transactions carried out by financial institutions based in the EU. The latest developments include:

- the publication by the European Federation for Retirement Provision of a position paper setting out its concerns about the structure of the proposal which it says "would severely impact pension beneficiaries";[19] and
- the adoption (in April 2012) by the European Parliament Economic and Monetary Affairs Committee of a resolution and amendment to the directive.[20]

The next stage is for the proposal to be discussed by the European Parliament.[21]

Pension Protection Fund

PPF levy ceiling and compensation cap

The following rates have been confirmed in connection with the PPF levy for the financial year beginning 1 April 2012:

2012/13 rates announced

- the compensation cap has been set at £34,049.84 (up from £33,219.36). For members whose PPF entitlement is restricted to 90% of benefits (those below their scheme's normal retirement age), the maximum level of compensation payable to an individual at age 65 will be £30,644.86; and
- the levy ceiling (which controls the maximum amount of levy that the PPF is allowed to charge schemes) has been set at £918,854,855.

The Pensions Regulator

Procedures for TPR's Case Team and Determinations Panel

TPR is consulting on the procedures for its Case Teams and Determinations Panel. Case Teams deal with the day-to-day management and investigation of TPR's cases, while the role of the Determinations Panel is to decide whether TPR should take certain serious regulatory actions.

TPR consults on procedures for its Case Team and Determinations Panel

The Case Team procedure consultation covers matters such as the issue and contents of a "warning notice". Proposed revisions to the Determinations Panel procedure include more detail on the "special procedure", which allows the Panel to make an initial determination, without giving parties prior notice, where there is a need to act urgently to protect the interests of members or pension scheme assets.

18 Letter to the President of the European Commission (13 February 2012)

19 EFRP Position on the Proposal for a Council Directive on common system of Financial Transaction Tax and amending Directive 2008/7/EC (February 2012)

20 EU Parliament press release 25 April 2012

21 Due to take place on 23 May 2012

Regulatory (continued)

Statement on scheme funding

In April 2012, TPR published the first in what is to be a series of annual statements on scheme funding.[22] Aimed at providing guidance for trustees of DB schemes who are going through the valuation process, the statement sets out TPR's views of "acceptable approaches" to scheme funding in the current economic climate.

TPR's first annual funding statement

While TPR's statement is aimed at trustees and employers who are undertaking valuations with effective dates between September 2011 and September 2012, it is relevant to all trustees and employers with a DB pension scheme.

Emphasising that "there is sufficient flexibility within the funding framework" to address current market volatility and the resulting challenges this brings, TPR expects that the majority of schemes and employers "will be able to manage their deficits within current plans" and that recovery plans should "usually be based on what is reasonably affordable without compromising the employer's long-term ability to support the scheme".

Key factors when calculating a scheme's technical provisions include:

- measurement of investment outperformance on the basis of a "near-risk free return" (such as would be assumed if a scheme adopted a substantially hedged investment strategy);
- consistency of asset and liability measures – smoothing of the discount rate is not considered to be consistent with the requirement to value assets on a mark-to-market basis.

Warning against early release pension offers

Having detected an increase in "early release" schemes, TPR has issued a statement[23] warning consumers about pension offers that claim to be able to provide loans to or release tax-free cash from their pensions before age 55. By the end of 2011, known transferred funds amounted to nearly £200m.

Report on Uniq plc Pension scheme

TPR has published a report setting out how it worked with the trustee of the Uniq plc Pension Scheme, the Uniq Group and the PPF to address the scheme's funding problems while avoiding employer insolvency and PPF entry.

Ultimately TPR concluded that it could not use its powers to issue a contribution notice or financial support direction as the key transactions and corporate events had occurred before those powers were in place.

22 Please see our Alert: "Funding in a cold economic climate – TPR's first annual statement" (27 April 2012)

23 Warning against early release pension offers (25 February 2012)

Cases

Supreme Court

Seldon v Clarkson Wright and Jakes (CWJ)

In this long running case, the Supreme Court has ruled that an employer is free to select its own objectives when seeking to justify age discriminatory practices.

Employer free to choose own objectives when justifying age discrimination

Mr Seldon was an equity partner at CWJ solicitors and signed a partnership deed which provided for each equity partner who attained the age of 65 to retire the following 31 December, unless the other partners consented to their remaining in practice. Mr Seldon wished to continue working at CWJ beyond his retirement date but was not offered any post-retirement position.

Arguments in the Court of Appeal had focused on whether an employer could justify age discrimination using their own objectives or whether, following the ECJ[24] and High Court[25] decisions in *Heyday*, it must have social policy objectives. This appeal was dismissed as the court concluded that the need for a social aim to justify discriminatory action related only to the UK Government and the age discrimination legislation enacted by it, not to a private employer.

Agreeing with the Court of Appeal, Lady Hale (who delivered the main judgment) dismissed Mr Seldon's appeal. She concluded that employers have flexibility to choose which legitimate aims to pursue, provided that these objectives:

- can count as legitimate objectives of a public interest nature within the meaning of the EU Directive;[26]
- are consistent with the social aims of the state; and
- the means used are proportionate, i.e. both appropriate to the aim and (reasonably) necessary to achieve it.

The aims identified by CWJ were capable of being "legitimate aims" for the purposes of the equality legislation, falling within two broad categories of legitimate objective identified by the ECJ: "inter-generational fairness" and preserving the dignity of older workers.

The case has now been sent back to the Employment Tribunal for a decision on whether age 65 of itself is appropriate.

High Court

Premier Foods Group Services Limited v RHM Pension Trust Limited

High Court takes practical approach to equalisation amendments

The trustee of the RHM Pension Scheme decided to equalise pension ages following the ECJ's decision in *Barber*.[27] An announcement to members in August 1990 followed a trustee resolution to equalise NPA at age 65. A "Deed of Intention" was then executed, setting out:

- an intention to amend the trust deed and rules as soon as practicable to reflect the alterations described in an attached newsletter (which included the equalisation changes); and
- that pending such amendment, the trustee would continue to administer the scheme in accordance with the trust deed and rules, subject to the alterations described.

24 *R v Age Concern England v Secretary of State for Business Enterprise and Regulatory Reform* [2009] ICR 1080

25 *R (on the application of Age UK) v Secretary of State for Business, Innovation and Skills* [2009] WLR (D) 291

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

27 *Barber v Guardian Royal Exchange* ECJ Case C-262-88

Cases (continued)

A deed of amendment providing for a NPA of 65 for men and women was subsequently executed in February 1993.

The court had to decide whether the deed of intention effected a valid amendment or if it was simply an agreement to amend the scheme at a future date.

In a pragmatic judgment, Warren J explained that pension scheme documentation should be construed practically and purposively, noting the "well established principle" that "in choosing between an interpretation which makes the instrument valid and effective and one which makes it invalid or ineffective, the court should lean towards the construction which saves the instrument". Applying this approach, he was satisfied that the deed of intention achieved the equalisation – it did not matter that it did not include a formal "textual" amendment of the scheme.

Danks v Qinetiq Holdings Limited & Pocock

The judge in this case concluded that the scheme rules gave the trustees power to dictate the index used to increase and revalue pensions on an annual basis. This meant that they could switch from RPI to CPI without triggering the application of section 67 of the Pensions Act 1995.

CPI is an appropriate index

The rules required pensions in payment to be increased "on 1 April each year by an amount equal to the percentage increase in the Index over the period of 12 months ending on the previous 30 September". "Index" was defined as "the Index of Retail Prices published by the Office for National Statistics or any other suitable cost-of-living index selected by the Trustees".

The judge concluded that this wording did not afford members a right to a specified level of increase or revaluation. An entitlement to a certain increase or level of revaluation only arose when that increase or revaluation actually occurred. This meant that it would be possible for the trustees to adopt CPI in place of RPI in respect of future increases without section 67 applying to the change.

While the switch from RPI to CPI continues to prove controversial in both the public and private sectors, this judgment provides helpful guidance on what may be done for those with similar rules.

Alexander Forbes Trustee Services v John Doe & Richard Roe

Court considers application of DC benefits in winding-up priority order

This case concerns two underfunded hybrid schemes in wind-up, where both DC and DB benefits were provided from the same fund. The Court was asked to consider the applicable order of priority on wind-up, in particular whether members' money purchase pots could be diverted for the benefit of the DB members. The schemes began to wind-up before the PPF came into operation.

The Court held that DC benefits were outside the winding-up priority order under the version of section 73 of the Pensions Act 1995 in force when the schemes went into winding-up.[28] This meant that they could only be used to provide members' DC benefits and not for the purpose of cross-subsidising DB benefits.

Unusually, fictional defendants were used in this case rather than representative beneficiaries. This was because the issue before the Court was a pure point of law which did not involve issues specific to different types of member which could potentially change the outcome. However, the judge criticised the use of fictional defendants and suggested that, in future, courts may dispense with representative defendants altogether, making test cases more cost effective.

28 As amended by regulation 13 of the Occupational Pension Schemes (Winding-up) Regulations 1996

In the pipeline

Spring 2012	White paper on state pension reforms expected
Summer 2012	Proposals on increases to state pension age expected
1 October 2012	Auto-enrolment starts to be phased in
Autumn 2012	Supreme Court hearing due in Nortel / Lehman
December 2012	TPR's record-keeping target date
End 2012	Draft EU Pensions Directive to be published?
2013	Consolidation of disclosure regulations for pension schemes?

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