Sackers

The Quarterly
March 2011

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

The Quarterly March 2011

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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)

AA: Annual Allowance

A-Day: 6 April 2006

CPI: Consumer Prices Index

DB: Defined benefit

DC: Defined contribution

DRA: Default retirement age

DWP: Department for Work and Pensions

HMRC: HM Revenue & Customs

HMT: HM Treasury

LTA: Lifetime Allowance

NEST: National Employment Savings Trust

PPF: Pension Protection Fund

RPI: Retail Prices Index

TPR: The Pensions Regulator

The coming quarter

Many of the Coalition Government's pension proposals will be included in two key Bills due before Parliament this quarter: the Pensions Bill 2010-11 and the Finance Bill 2011.

Pensions Bill

As well as provisions on workplace pension reforms and RPI/CPI changes (see below), key measures in the Pensions Bill[1] (published in January 2011) include:

State Pension Age (SPA)

SPA increase brought forward

SPA will begin to rise from 65 in December 2018 and will reach 66 by April 2020. As a result, the timetable for equalising women's SPA with men's will also be accelerated, so that women's SPA will reach 65 by November 2018.

Preserving powers to refund surplus

The Bill will implement amendments to section 251 of the Pensions Act 2004 announced by the DWP in October 2010.[2] Section 251 provides trustees with a transitional power to confirm or amend powers in scheme rules to make payments to an employer after A-Day (6 April 2006). The deadline by which trustees need to take action to preserve such powers will be extended to 6 April 2016.

Surplus deadline extended

The Bill also aims to narrow the scope of section 251 so that it will only apply to payments of ongoing surplus.

Pension Protection Fund

Among other things, the Bill will remove the requirement that a PPF assessment period must last at least 12 months, with the aim of allowing some schemes to be processed more quickly.

Finance Bill

Finance Bill due 31 March 2011

The Coalition Government's plans for restricting pensions tax relief from the tax year 2011/12[3] will be included in the Finance Bill 2011. The Finance Bill is due to be formally published on 31 March 2011. However, HMT has already published draft clauses and explanatory notes for the Bill[4], alongside an overview[5] of the draft legislation and draft guidance from HMRC[6].

For more on the changes to pensions tax relief, see below.

1 http://services.parliament.uk/bills/2010-11/pensionshl.html

2 Please see our Alert: "Preserving powers to refund surplus: DWP clarification" dated 19 October 2010

3 Please see our Alert: "Restricting pensions tax relief: the verdict" dated 14 October 2010

4 www.hm-treasury.gov.uk/d/financebill2011_draft_clauses_explanatory_notes.pdf

5 www.hm-treasury.gov.uk/d/financebill2011_draft_leg_overview.PDF

6 www.hmrc.gov.uk/budget-updates/autumn-tax/lta-guidance-2680.pdf

Pensions reform

Pensions tax relief

Annual Allowance

AA reduced to £50,000

As announced on 14 October 2010, the Finance Bill will reduce the AA from £255,000 to £50,000 from 6 April 2011. However, depending on a scheme's Pension Input Period (PIP), this change may already affect members.

Pension Input Periods

A PIP is the period over which pension savings are assessed for the purposes of testing against the AA. PIPs need not correspond with the tax year and can instead match the scheme year. However, there must be a PIP ending in each tax year. Many DB schemes operate with a default PIP (for example, where no PIP has been nominated) ending on 6 April in each year.

PIPs ending in the 2011/12 tax year which began on or after 14 October 2010 will be subject to the AA of £50,000. Transitional rules apply to "straddling PIPs" (which began before 14 October 2010 but which will end in the 2011/12 tax year), which include default PIPs.

Given the above, some trustees may wish to consider changing the PIP (where possible) to align it with the tax year.[7] A retrospective nomination may be made in certain circumstances (although the ability to do so looks set to disappear from 6 April 2011). However, care should be taken in changing a PIP as this could affect an individual's tax liability.

Lifetime Allowance

Reduction of LTA on the horizon

The LTA is to be reduced from £1.8m to £1.5m in 2012.

The Finance Bill also includes proposals for a new protection regime for individuals who may have already built up pension savings in the expectation that the LTA would remain at its current level. The new "fixed protection" will give individuals the opportunity to apply for an LTA of £1.8m, instead of the reduced LTA of £1.5m, provided they no longer actively contribute to their pension (or accrue benefits). Individuals who are already entitled to primary and/or enhanced protection will continue to receive those levels of protection (but will not be eligible for fixed protection).

Repeal of transitional measures

Anti-forestalling to end

Two orders came into force on 10 December 2010. One repeals the former Labour Government's plans for restricting pensions tax relief, whilst the other will switch off the transitional anti-forestalling measures (which have been in place since 2009) from the tax year 2011/12. An individual whose current PIP ends in the tax year 2011/12 may be affected by both the transitional anti-forestalling measures as well as the reduced AA.[8]

Options for meeting high AA charges

The introduction of the reduced AA means that tax charges are more likely to arise. Recognising that not all individuals will be able to pay this out of income, the Government has consulted[9] on options for meeting the AA charge out of their pension benefits (subject to a suggested minimum threshold of between £2,000 - £6,000).

7 Please see our Alert "Restriction of pension tax relief: further developments" dated 15 December 2010

8 Please see our Alert: "Finance Act 2009 – this time it's personal" dated 24 July 2009

9 www.hm-treasury.gov.uk/d/consult_pensions_301110.pdf

Pensions reform (continued)

The consultation sets out two broad options which would permit either:

Consultation on meeting high AA charges

- meeting a specific year's liability in real time, while pension benefits are still accruing; or
- rolling up the liability, deferring payment of AA charges until the point that the individual's pension benefits crystallise.

In either case, the individual would be required to account for the charge on their Self Assessment tax return. The joint HMRC/HMT consultation closed on 7 January 2011 and we await the Government's response.[10]

Workplace pension reforms

NEST and auto-enrolment take shape

Following the independent review carried out during the summer of 2010, "Making Auto Enrolment Work"[11], the Government has given the green light to plans for automatic enrolment and the new national pensions savings scheme, NEST.

As well as provision in the Pensions Bill to legislate for changes resulting from the review, more detail and guidance on the new regime is becoming available.

Simplification measures

Pensions Bill changes
Changes set out in the Pensions Bill include:

- the introduction of an optional waiting period of up to three months before employees need to be automatically enrolled;
- simplification of the certification process by which employers will be able to demonstrate that their DC scheme meets the requirements for automatic enrolment; and
- alignment of the earnings threshold for automatic enrolment with the personal allowance for income tax.

Default options for DC schemes
The DWP is currently consulting on the design of default options in both workplace personal pensions and in occupational pension schemes. Given the numbers expected to use the default option, this will be an important aspect of the reforms.

Charging structure

NEST charges
NEST Corporation (the governing body of NEST) has announced that it will charge 0.3% annually on a member's funds under management, with a charge on contributions of 1.8%. This charge on contributions is designed to cover the initial set-up costs of NEST, although it is not yet known when the charge will stop being applied.

Guidance on the reforms
NEST Corporation has developed a phrasebook of key terms, phrases and principles, aimed at helping future NEST members gain a better understanding of pensions.[12] In addition, a new version of TPR's leaflet, "An introduction to work-based pension changes", is available. Guidance for larger employers is expected from TPR in the spring (with additional guidance for small and micro employers due in the summer).

10 Sackers' response is available from the Sackers Extra section of our website

11 www.dwp.gov.uk/policy/pensions-reform/workplace-pension-reforms/automatic-enrolment/

12 nestpensions.org.uk/documents/NEST_phrasebook.pdf

Removal of the Default Retirement Age

DRA to be phased out from 6 April 2011

Six month transitional period

Currently, employers can require staff to retire at age 65. However, the DRA will be removed from legislation from 6 April 2011, meaning that employers will need to objectively justify having a compulsory retirement age. (Transitional provisions will cover retirements until 1 October 2011).[13]

Following concerns raised during consultation, an exception will be made for group risk insured benefits (such as life assurance), so these can be stopped at age 65.

The Government states that "the removal of the DRA does not affect occupational pension schemes" as schemes will be permitted to retain a normal retirement age (NRA). However, this fails to address what provision should be made for employees working beyond the scheme's NRA.

The switch from RPI to CPI

Consultation published

On 8 December 2010, the Government published its long awaited consultation[14] on the switch from RPI to CPI for increases to pensions in payment and in deferment for private sector occupational pension schemes.[15] The resulting changes to legislation were included in the Pensions Bill.

Pensions Bill provides for changes to indexation and revaluation

Key points emerging from the consultation include:

- for schemes whose rules specifically refer to RPI as the basis for measuring increases, switching to CPI is likely to require a scheme amendment;
- there will be no statutory easement to make it easier for such schemes to make the switch to CPI;
- there will be no requirement for those schemes which use RPI for pensions in payment to change to CPI - making a CPI underpin unnecessary (the Pensions Bill clauses generally require schemes to have RPI written into their rules at the "beginning of 2011" if they are to take advantage of this).

Revaluation Order

Alongside the consultation, the 2010 Revaluation Order[16] was published and uses the CPI figures for statutory increases applied on or after 1 January 2011 (for revaluation periods from 1 January 2010). This will apply to schemes which use the statutory method for making increases.

13 Please see our Alert: "The bell tolls for the default retirement age" dated 17 January 2011

14 www.dwp.gov.uk/docs/cpi-private-pensions-consultation.pdf

15 Please see our Alert: "The switch from RPI to CPI – consultation published" dated 9 December 2010

16 www.legislation.gov.uk/uksi/2010/2861/pdfs/uksi_20102861_en.pdf

Abolition of DC contracting-out

More information available

Contracting-out on a DC basis will be abolished from 6 April 2012.[17] Key points arising from a consultation (and response) in 2010[18] include:

Transfers

Relaxation of transfer rules

The consultation proposed that from 6 April 2012 no transfers from contracted-out DB schemes to any DC schemes would be possible. However, recognising that restricting transfers would limit member choice and employer flexibility (and risk creating an artificial transfer market in the run-up to April 2012) the Government has decided to allow transfers from contracted-out DB schemes to schemes which are not contracted-out post-abolition.

Switching the basis for contracting-out

DB schemes which are currently contracted-out on a DC basis can switch to DB contracting-out provided they can satisfy the reference scheme test. The necessary administrative steps will need to be completed by 6 April 2012 as there will be no transitional provisions.

Rule changes?

The removal of protected rights provisions from legislation will not automatically lead to the removal of contracted-out provisions from scheme rules, so schemes will need to make amendments to achieve this. The Government intends to "look into this issue during 2011 to consider whether a statutory override is appropriate".

Removal of the requirement to annuitise by age 75

Consultation response

New options for DC scheme members

From 6 April 2011, individuals with DC pension funds will no longer be required to purchase an annuity before the age of 75. Capped drawdown[19] will be available to anyone over the age of 55, with individuals who satisfy a "Minimum Income Requirement" (MIR) able to draw down unlimited amounts from their pension pots. Initially set at £20,000, the purpose of the MIR is to ensure that individuals have sufficient secured income to avoid the possibility of them "exhausting savings prematurely", and subsequently falling back on the State.

Also with effect from 6 April 2011, most of the rules preventing registered pensions schemes from paying lump sums to members who have reached the age of 75, such as pension commencement lump sums, will be removed.

17 Please see our Alert: Abolition of DC contracting-out: consultation on implementing legislation dated 30 July 2010, and Sackers' response (available from the Sackers Extra section of our website)

18 www.dwp.gov.uk/docs/abolition-contracting-out-dc-consultation.pdf

19 The cap will be set at 100% of the equivalent annuity, broadly the single-life level annuity that could have been bought with the pension fund using annuity rates set by GAD, and will be subject to review

Regulatory

HM Revenue & Customs

End of transitional period

Have A-Day changes been made?

The A-Day transitional provisions expire on 5 April 2011. Schemes which have not preserved pre-A-Day limits, such as the earnings cap, should act now to avoid a potential increase in liabilities from the end of the transitional period.[20]

NMPA changes

A recent HMRC newsletter [21] covers certain issues relating to normal minimum pension age (NMPA), which increased from age 50 to 55 on 6 April 2010. Since that date, people can generally only start receiving their pension without incurring an unauthorised payments charge once they have reached age 55.

Transfers

Legislation (unintentionally) imposes a charge where an individual transfers their pension, before age 55, to a new provider (or changes to a different type of pension), having already started to draw that pension. HMRC has published draft regulations to address this.

NMPA Test

In December 2009, HMRC issued guidance[22] describing the cut-off point for taking advantage of the then NMPA of 50 as "the date on which the member first became *entitled* to draw their pension" [our emphasis]. This was widely assumed to mean the point at which the member had taken all steps needed to bring their benefits into payment.

HMRC revises its guidance on NMPA

HMRC now acknowledges that this was an incorrect statement and that the critical point is "the date of the first payment of the pension". However, HMRC is aware that some scheme administrators and members acted in reliance on their 2009 guidance and "accepts that in these circumstances people and schemes should not incur an unauthorised payments tax charge".

HM Treasury

Equitable Life

Independent Commission recommendations

The Independent Commission published its report in January 2011. Its main recommendation is that the available £775 million is allocated pro-rata between the Equitable Life Policyholders. In addition, the Equitable Life (Payments) Act 2010 received Royal Assent on 16 December 2010, which enables implementation of the Equitable Life Payments Scheme.

Early access to pension savings

HMT has issued a call for evidence[23] on early access to pension savings, asking whether it could provide an effective incentive for individuals to make private pension savings. It also asks for views on the trivial commutation rules and evidence on the barriers to transferring smaller pension pots.

20 Please see our News: "Taxing issues for 2011" dated January 2011

21 www.hmrc.gov.uk/pensionschemes/ps-newsletter44.pdf

22 www.hmrc.gov.uk/pensionschemes/ps-newsletter38.htm

23 www.hm-treasury.gov.uk/d/call_for_evidence_on_early_access_to_pension_savings.PDF

Pension Protection Fund

2011/12 Levy

The PPF has confirmed it aims to collect an overall levy of £600 million.[24]

PPF levy deadlines approaching

The following deadlines apply for the submission of information used in the levy calculation:

- certification / re-certification of contingent assets: 5pm on 31 March 2011;
- deficit reduction contributions: 5pm on 7 April 2011; and
- final certification of full block transfers that have taken place up to and including 31 March 2011: 5pm on 30 June 2011.

2012/13 levy framework

The PPF has also confirmed its intention to implement the new levy framework from 2012/13.[25]

The new deadline for submitting scheme information for the 2012/13 levy year is 31 March 2012. Schemes still need to provide up-to-date information by 31 March 2011, for use by the PPF in setting the levy scaling factor (used to calculate individual levy bills) for the first three years under the new framework.

Equalisation of GMPs

In January 2011, the PPF published its second consultation[26] on the equalisation of GMPs for PPF compensation and FAS assistance purposes.

PPF consults on underpin approach

Based on Counsel's advice, the PPF Board has concluded that the most appropriate treatment of GMPs is to regard them as an 'underpin'. The consultation asks for views as to whether the Board's proposals on how to implement the required changes to PPF compensation and FAS assistance payments are appropriate.

The Pensions Regulator

Final guidance published

TPR has published final guidance on the following issues:

- Incentive exercises: despite widespread criticism in the press, the final version of the guidance has changed little from the consultation draft;[27]
- Multi-employer schemes and employer departures;[28] and
- Monitoring employer support: Covenant, contingent assets and other security.[29]

24 www.pensionprotectionfund.org.uk/levy/1112_determination/Pages/11-12Determination.aspx

25 www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/levy_consultation_oct10.pdf

26 www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/GMP_consultation_Jan11.pdf

27 www.thepensionsregulator.gov.uk/guidance/incentive-exercises.aspx

28 www.thepensionsregulator.gov.uk/guidance/multi-employer-schemes-and-employer-departures.aspx

29 www.thepensionsregulator.gov.uk/guidance/monitoring-employer-support.aspx

Cases

Court of Appeal

International Management Group (UK) Limited v (1) Peter German (2) HR Trustees Limited

The Court of Appeal has confirmed that section 91 of the Pensions Act 1995 does not prohibit the compromise of a genuine dispute as to whether pension rights in a scheme exist.

Background

Section 91 prevents the surrender, assignment or commutation by a member of their rights under a pension scheme, except in certain limited circumstances. The Court of Appeal was asked to consider whether agreements between members and the employer to compromise claims to certain rights (concerning the conversion of DB benefits into DC) were enforceable.

Decision

The Court of Appeal held that section 91 would not make these compromise agreements unenforceable as they related to whether a right existed. Mummery LJ gave the following reasons:

Court approves compromise

- it was "most unlikely" that the prohibition against surrender applied to the settlement of claims to an alleged entitlement or right;
- if compromise agreements were unenforceable in pensions, all disputes over entitlements or rights would have to be resolved by legal proceedings, described by the judge as "an inconvenient result"; and
- public policy aims for encouraging, upholding and enforcing compromises would not be met if it were not possible to compromise a dispute about pension entitlements or rights.

In addition, the Court confirmed that a court-approved compromise (a free standing power under the Civil Procedure Rules) remains available.

Comment

This is the first Court of Appeal decision on the scope of section 91 and it helpfully supports the use of compromise agreements where there is a genuine dispute as to whether or not a pension right exists. However, a compromise agreement will not be enforceable if it amounts to a surrender of rights, the existence of which are not disputed.

High Court

Lehman / Nortel High Court Challenge

In a surprise judgment, the High Court has confirmed that where a financial support direction (FSD) is issued by TPR against a company after insolvency, the cost of complying with that direction is an expense of that insolvency. The FSD must therefore be paid before any distributions to unsecured creditors, turning TPR into a "super creditor".

Background

In 2010, TPR published determinations to issue FSDs against companies within the Lehman Brothers and Nortel groups, both of which were involved in insolvency proceedings in the UK and elsewhere. In each group there was a significant employer debt.

The administrators of the insolvent companies in those groups challenged TPR's ability to enforce the FSDs. The administrators argued that they should not have to take the FSDs into account as they were not a provable debt (i.e. one which has arisen out of matters which have occurred, or begun to occur, prior to the insolvency cut-off date). TPR argued that it was an expense of the administration and should therefore be paid out before other creditors.

Decision

TPR awarded "super priority" in insolvency proceedings

Briggs J held that he was bound by precedent to find that FSDs were an expense of the administration.

He noted, however, that the outcome is "likely to prove unfair to the creditors of an insolvent target" and suggested that the Government may wish to consider a suitable amendment, either to the Insolvency Rules or to the Pensions Act 2004 to address this.

The effect of this judgment is to give FSDs and contribution notices "super priority" in an insolvency.

Comment

Given the importance of the case for banks and other creditors, who now find themselves below trustees on the priority ladder, we expect an appeal.

In the pipeline

31 March 2011	PPF contingent asset certification/recertification deadline
5 April 2011	A-Day transitional period expires
5 April 2011	Expiry of anti-forestalling (transitional anti-avoidance measures)
6 April 2011	AA reduced to £50,000 from the tax year 2011/12
6 April 2011	Abolition of the DRA
6 April 2011	Requirement to purchase an annuity at age 75 abolished
6 April 2012	LTA reduced to £1.5m
6 April 2012	Abolition of DC contracting-out
1 October 2012	Auto-enrolment starts to be phased-in
December 2012	TPR's record-keeping target date

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