Sackers

The Quarterly

March 2012

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

The Quarterly March 2012

In this issue

Abbreviations commonly used in the Quarterly:

AA: Annual Allowance

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

CPI: Consumer Prices Index

D&B: Dun & Bradstreet

DB: Defined Benefit

DC: Defined Contribution

DWP: Department for Work and Pensions

FAS: Financial Assistance Scheme

FSD: Financial Support Direction

GMP: Guaranteed Minimum Pension

HMRC: HM Revenue & Customs

LTA: Lifetime Allowance

PPF: Pension Protection Fund

RPI: Retail Prices Index

SPA: State Pension Age

TPR: The Pensions Regulator

Legislation

Pensions Act 2011

The switch from RPI to CPI

CPI in force for pension increases

Amendments in relation to indexation and revaluation, following the Government's switch from RPI to CPI as the measure for increases to pensions in payment and in deferment, came into force on 3 January 2012.[1]

Unless a scheme complies with one of the alternative methods set out in legislation for increasing pensions in payment or for the revaluation of pensions in deferment, an underpin of CPI will need to be given. For further information, speak to your usual Sackers contact.

Revaluation Order 2011
The 2011 Revaluation Order came into force on 1 January 2012 for the period 1 January 2011 to 31 December 2011. It uses the September to September CPI figure (capped at 2.5%). As well as revaluation, it will also apply to schemes that use the statutory method for making increases to pensions in payment.

Surplus payments

Deadline extended to 2016

Section 251 of the Pensions Act 2004 provides pension scheme trustees with a transitional power to pass a resolution to confirm or amend powers in their scheme rules to make payments to the employer on or after 6 April 2006. The Pensions Act 2011 amends section 251 with effect from 3 January 2012, giving trustees until 5 April 2016 to take action to preserve such powers.

Despite the Government's intention that section 251 should only apply to payments to employers from ongoing schemes, there remain concerns that payments of surplus on wind-up have not been specifically excluded. It may therefore be preferable for schemes with such powers to pass a resolution. However, we will be seeking further clarification on this from the DWP.

Money purchase benefits

Consultation awaited

The new definition of "money purchase benefits", introduced following the *Bridge Trustees*[2] case, has not yet been brought into force. We are still awaiting a consultation on regulations to clarify certain aspects of the change, including transitional provisions.

Employer Debt

Flexible Apportionment Arrangements: Regulations in force[3]

Amendments to the Employer Debt Regulations[4] came into force on 27 January 2012, introducing a new flexible apportionment arrangement (FAA) to assist with the management of employer debts.

New option for dealing with employer debt

It is now possible to use an FAA to manage debts in both open and closed DB schemes, without actually triggering a debt, provided certain conditions are satisfied. Under an FAA there is no need to calculate or to estimate the amount of a debt, as it is the liability (rather than the debt itself) that is apportioned. The inherent flexibility of the arrangement makes it unlikely that scheme apportionment arrangements will be used in future.

1 The removal of indexation for cash balance schemes also came into force on the same date

2 *Houldsworth v Bridge Trustees and Secretary of State for Work and Pensions* [2011] UKSC 42. Please see our Alert: "Bridge too far? DWP set to legislate" (dated 28 July 2011)

3 Please see our Alert: "Flexible Apportionment Arrangements" (dated 16 December 2011)

4 The Occupational Pension Schemes (Employer Debt) Regulations 2005

GMP Equalisation

Government to require GMP equalisation

Government consultation on GMP equalisation[5]

Long promised, in January 2012, the DWP issued a consultation[6] on draft regulations and a "possible method" for occupational pension schemes to use to equalise benefits derived from GMPs.

The DWP has concluded that:

- schemes are obliged to equalise overall scheme benefits "for the effect" of GMPs which accrued between 17 May 1990 and 5 April 1997; and
- under EU law, there is no need for an opposite sex comparator when considering any inequality in GMPs.

"Possible method" for equalisation

The "possible method" published alongside the draft legislation relies on a comparison between a member's GMP (under the scheme rules and the relevant legislation), and their GMP had they been of the opposite sex. Each year, the scheme would pay the member the higher of:

- the amount they would receive under the scheme rules; and
- the amount they would have received under the rules were they of the opposite sex.

Schemes free to choose equalisation method

What next?

The DWP is not giving "advice" to schemes and it is envisaged that they will be able to select any appropriate method of equalisation.

What trustees do next will depend on their scheme's own particular circumstances. As the proposals are at an early stage, for the many schemes that have yet to address the issue of GMPs and equalisation, a "wait and see" approach would seem to be the most sensible.

PPF compensation

In November 2011, the PPF confirmed the method that it will use for calculating PPF compensation for men and women in respect of GMPs; it will regard GMPs as an 'underpin'.

The PPF is undertaking a six month pilot project with selected schemes.

5 Please see our Alert: "GMP Equalisation: The DWP calls time!" (dated 24 January 2012)

6 The consultation was published on 20 January 2012 and closes on 12 April 2012

Pensions reform

Automatic enrolment

Delay for small businesses

New auto-enrolment staging dates

Starting in 2012, employers will be required to enrol their “eligible jobholders” into a qualifying pension scheme. The Government has announced that small businesses (those with fewer than 50 employees) will have until May 2015 before they need to begin automatically enrolling their staff, instead of April 2014 as originally proposed. No employer with an existing staging date on or before 1 July 2013 is affected. The DWP has published a revised table of auto-enrolment start dates for all employers.[7]

Regulations and guidance finalised[8]

Regulations to implement the recommendations of an independent review[9] of automatic enrolment have been published. Key changes include:

- simplified certification requirements for DC schemes, for employers who calculate pension contributions from the first pound rather than on qualifying earnings;
- the introduction of an optional waiting period of up to three months before the automatic enrolment duty commences; and
- greater flexibility in their re-enrolment date.

Certification requirements confirmed

New guidance for employers explains how they can use certification as a means for ensuring that their DC scheme (or the DC element of their hybrid scheme) can qualify to be used for auto-enrolment related duties.

Consultation on earnings thresholds

The DWP is currently carrying out the first annual review of the automatic enrolment earnings thresholds for 2012/2013. These include the automatic enrolment earnings trigger (introduced by the Pensions Act 2011) and the lower and upper limits of the qualifying earnings band.

Getting ready for auto-enrolment

For more information about preparing now for 2012 and where Sackers and Sackers Support Services can help, please contact your usual Sackers advisers or Mark Wileman, Head of Business Development (mark.wileman@sackers.com).

Deregulation

Formal consultation promised

Consultation due in spring

The Pensions Minister, Steve Webb, has announced that the DWP will be conducting a formal consultation on deregulation in the spring. Press reports suggest that compulsory indexation could be abolished. In addition, the DWP is already consulting[10] on the future abolition of short service refunds of contributions from DC pension schemes and options for transfers to address the proliferation of small pension pots.[11]

7 Timetable for automatic enrolment (25 January 2012)

8 Workplace Pension Reform: Completing the legislative framework for automatic enrolment (1 February 2012)

9 Making Automatic Enrolment Work (27 October 2011). Please see our Alert: “NEST comes home to roost!” (dated 28 October 2010)

10 The consultation closes on 23 March 2011

11 Please see our Alert: “Government consults on transfers and small pension pots” (dated 19 December 2011)

Short Service Refunds

Currently, occupational DC scheme members can receive a refund of their pension contributions if they leave a scheme within two years of joining. Although a right to a transfer payment exists after three months' membership, the default position is a refund of member contributions. The consultation proposes the abolition of short service refunds in the hope that it will boost pension saving.

Transfers

The consultation also proposes three options for consolidating small pension pots:

Government sets out options for consolidating small pots

- minor changes to make member initiated transfers easier and less expensive;
- a transfer system which allows easy consolidation of small, dormant pension pots into an "aggregator scheme"; and
- a system where small pension pots follow individuals from job to job.

In conjunction with the DWP consultation, HMRC published draft guidance[12] which explains how the draft regulations are intended to apply.

Public Sector Pensions

Update on reforms

Uncertainty over changes to public sector benefits

In December 2011, the Government set out the "final position"[13] reached with trades unions on public service pension reform, including the main elements of scheme design to be introduced in 2015. As part of the negotiations, the "Fair Deal" (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 and bulk transfer arrangements for those who wish to transfer their public service benefits) may be retained. However, some unions have rejected the offer.

In the light of the Treasury's Statement, GAD issued an update[14] on the reforms to date and the likely impact for broadly comparable schemes. Existing certificates of broad comparability are not being withdrawn and will continue to be valid, with allowance for employee contribution rates in line with those set out in the relevant certificate. Contractors may wish to amend their existing certificate in order to reflect the changes (once agreed) to employee contribution rates from 1 April 2012 for future transferees.

State Pensions

Proposed changes

A number of proposed changes to the state pension are in the pipeline:

Further increases in SPA

- the Pensions Act 2011 includes the planned increase to age 66 by 2020;
- the Chancellor, George Osborne, confirmed in the Autumn Statement that SPA will rise to 67 by 2028;
- the basic state pension will be uprated in 2012 in line with the Government's "triple lock" guarantee, i.e. the highest increase of earnings, prices and 2.5%.

We are still waiting for confirmation that a flat rate state pension will be introduced, following the Government's Green Paper in April last year.[15]

12 HMRC's draft guidance was published on 20 December 2011

13 Statement by the Chief Secretary to the Treasury (20 December 2011)

14 GAD Statement on Public service pension schemes reform (21 December 2011)

15 A state pension for the 21st century (4 April 2011)

Pensions reform (continued)

Tax

Employer asset-backed contributions (ABCs)

Tax relief restricted

The draft Finance Bill[16] includes provisions designed to ensure that the value of tax relief given to employers accurately reflects – but does not exceed – the amount of the payments received by schemes under ABCs, while preserving flexibility for employers to continue using ABCs to manage pension deficits.

The legislation[17] will take effect from 29 November 2011,[18] ensuring that no excessive tax relief arises in respect of new ABC arrangements set up on or after that date. Transitional provisions will apply to existing ABCs that have already received tax relief to ensure that the correct amount of tax relief is given by the end of an arrangement.

Reduction of the LTA: Fixed protection

LTA reduces to £1.5 million from 6 April 2012

From 6 April 2012, the LTA will reduce to £1.5 million from the current level of £1.8 million. Fixed protection can be used to help reduce or mitigate the LTA charge by allowing individuals to crystallise benefits worth up to £1.8 million (although the ability to accrue future benefits is limited). HMRC has published guidance[19] to assist pension scheme members with the application process, the potential impact of changes to scheme rules and late retirement factors and the ways in which fixed protection can be lost.

Annual Allowance: Transitional carry forward provisions[20]

If an individual has a pension input amount of more than £50,000 for a tax year from 2011/12 onwards, they may not be liable for an AA charge for that year despite the reduction in the AA from £255,000. This is because they can carry forward any unused AA from the previous three tax years. This amount of unused AA can then be added to the current year's AA, giving the individual a higher amount of available AA to off-set against that year's pension input amount.

Transitional provisions revised

For the purpose of the carry forward provisions, a notional AA of £50,000 is assumed during the tax years 2008/09 – 2010/11 inclusive (the transitional years). HMRC has now revised its treatment of the carry forward provisions for the transitional years, so that any excess over the notional AA during the tax years 2009/10 and 2010/11 is not treated as using up any available carry forward from the preceding year(s).

HMRC have produced an AA calculator, which is available on their website.

16 The draft Finance Bill 2012 was published on 6 December 2011

17 Consultation on the draft measures closed on 10 February 2012

18 The date the changes were announced in the Autumn Statement

19 In Pension Schemes Newsletter 50 (published 22 November 2011)

20 Worked examples are included in the Registered Pension Schemes Manual which illustrate these provisions

Regulatory

HM Treasury

The use of gender as a risk factor for insurance

In the *Test-Achats*[21] case in 2011, the ECJ ruled that, with effect from 21 December 2012, an exemption in a European Directive[22] which permits insurers to use sex as a determining factor in their assessment of risk where it is based on "relevant and accurate actuarial and statistical data" will no longer be valid.[23]

Government consults on the use of gender as a risk factor for insurance contracts

HM Treasury Consultation

HM Treasury is now consulting[24] on how insurers can use gender as a risk factor in the light of the ruling. The consultation reiterates the Government's legal interpretation that the judgment only applies to new contracts (including annuity contracts) entered into after 21 December 2012. This means that existing contracts are not affected. It also confirms the Government's intention to maintain the existing exception in the Equality Act 2010 for group life insurance policies.

Occupational pension schemes are not the subject of this consultation.[25]

EU Commission Guidelines

In addition, the European Commission has adopted guidelines[26] on the application of the Directive in the light of the ECJ ruling. The Commission confirms that the *Test-Achats* decision does not apply to occupational pension schemes, even if they provide for the payment of a benefit in a specific form, such as annuities.

Pension Protection Fund

The final levy determination for 2012/13 was published in December 2011. In the Determination, the PPF confirmed the levy estimate for the year as £550 million (the lowest ever set).

The PPF has also published final guidance on contingent assets, block transfers and bespoke investment risk calculations.

New levy framework

New certification requirements for PPF guarantees

The new PPF levy framework has been confirmed for 2012/13 (and is now set for the next three years). Key features of the framework include:[27]

- strengthened certification requirements for Type A contingent assets, for new and existing arrangements. Trustees will be required to establish and certify that a Type A guarantor could be expected to meet its full commitment under the contingent asset if called upon to do so as at the date of the certificate;[28]

21 Association Belge des Consommateurs Test-Achats ASBL (Case C-236/09)

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

23 For more information, please see our Alert: "Is it the end of the road for sex-based actuarial factors?" (dated 2 March 2011)

24 HM Treasury consultation: UK response to the 1 March [2011] European Court of Justice ruling that insurance benefits and premiums after 21 December 2012 should be gender-neutral (published 8 December 2011)

25 Directive 2006/54/EC on the implementation of the principle of equal opportunities and equal treatment of men and women in matters of employment and occupation

26 Guidelines on the application of Council Directive 2004/113/EC to insurance, in the light of the judgment of the Court of Justice of the European Union in Case C-236/09 (Test-Achats) (adopted 22 December 2011)

27 The PPF has also published a guide and YouTube video on the PPF levy for 2012/13

28 Please see our Alert: "Contingent assets 2012/13: is your guarantor good for the money?" (dated 12 January 2012)

- investment risk to be used in the levy calculation for the first time. Schemes with liabilities of £1.5 billion or more will have to make their own assessment of investment risk. This will be optional for other schemes, which should consider (with their advisers) the value of doing their own assessments; and
- measurement of insolvency risk by placing sponsoring employers into one of ten levy bands (replacing the table of insolvency probabilities based on D&B Failure Scores of 1 to 100), based on an employer's average monthly D&B failure score over the preceding year (rather than as at a given date).

Deadlines for contingent asset certification / recertification

Data deadlines

The following dates have been confirmed for the 2012/13 levy year:

- 30 March 2012 (5pm): Cut-off point for submission of Scheme Return to TPR. Information from the Scheme Return will be used in the calculation of the levies;
- 30 March 2012 (5pm): Certification/re-certification of contingent assets;
- 10 April 2012 (5pm): Certification of deficit reduction contributions made up to and including 31 March 2012; and
- 29 June 2012 (5pm): Certification of full block transfers that have taken place up to and including 31 March 2012.

The Pensions Regulator

TPR to set out expectations on scheme funding

TPR to issue statement on DB scheme funding

TPR plans to issue a statement in April 2012 to help trustees dealing with the actuarial valuation and recovery plan process in the current economic climate.

Going forward, TPR intends to issue annual statements setting out its expectations of those trustees who are embarking on the valuation process.[29]

Principles for good workplace DC

TPR is in "a dialogue" with the pensions industry on six principles for good design and governance of workplace DC pension provision. The six principles span the lifecycle of a DC scheme from the design and set-up phases through to the ongoing management, including monitoring of scheme governance, accountability, scheme administration and communications with members.

Publication of these high level principles forms part of TPR's work to improve standards of DC pension provision and ensure that the pensions sector is ready to support automatic enrolment. It is intended that the principles will form the basis of its regulatory approach going forward.

29 For details of the current regime, please see our paper on the scheme funding cycle

Cases

TPR warning notice breaches automatic stay

PPF not entitled to super priority in US

High Court confirms CPI is appropriate index

US Court of Appeals

Nortel: US Appeals Court confirms earlier ruling

The US Court of Appeals has confirmed that the issue by TPR of an FSD warning notice against US Nortel companies breached an automatic stay imposed under US Chapter 11 insolvency law.

Background

In the US, when a debtor files for bankruptcy, the Bankruptcy Code imposes an automatic stay which prohibits any new actions from being brought against the company. There are certain statutory exceptions, including the "police power exception" at issue in this case, which allows a "governmental unit" to commence actions to further its police or regulatory powers.

US Decision

The Appeals Court found that neither the trustee nor the PPF were a "governmental unit" within the police power exception and could not therefore impose the FSD.

This ruling leaves the PPF on equal footing with other unsecured creditors in the US proceedings and therefore unable to use TPR's processes to assess the amount of debt they are able to make a claim for during the bankruptcy proceedings.

UK position

Meanwhile in the UK, leave to appeal to the Supreme Court has been granted against the Court of Appeal's decision[30] to give the Lehmans/Nortel FSDs "super priority" in the insolvency proceedings. However, because of a backlog of cases in the Supreme Court, we understand this will not be heard until the end of 2012.

But first, on 12 March 2012, the Upper Tribunal[31] will hear an appeal (from TPR's Determinations Panel) against the imposition of the FSDs.

High Court Round-Up

Judicial review proceedings of the switch from RPI to CPI

Several public sector unions brought judicial review proceedings of the Government's decision to switch from RPI to CPI as the measure for increases to public sector pensions from April 2011.

Unusually, three judges heard the application with Elias J giving the leading judgment. The High Court dismissed the unions' application, concluding (among other things) that:

- CPI was an appropriate index for the Secretary of State to adopt as it was a well established method of assessing the relative increase in prices; and
- it was open to the Secretary of State to take account of economic considerations when deciding to switch to CPI provided he was satisfied that it is a fair and genuine method. However, there was one dissenting judgment on this point.

The unions have announced that they will appeal the judgment. We understand that the appeal was due to be heard on 20 February 2012.

30 Please see our report in the December 2011 edition of The Quarterly

31 Tax and Chancery Chamber

Cases (continued)

Dalriada Trustees Limited v Faulds and others

The “Ark Schemes” operated a “Pensions Reciprocation Plan” (PRP), under which members were given early access to their pension savings. The model used loans between schemes as a means of “unlocking” the pension capital.

Pension unlocking schemes were void

The PRP circumvented HMRC rules that provide that a payment to a member out of their own pension arrangements would be an unauthorised payment and taxed in a penal manner. By transferring funds between schemes, Ark attempted to ensure that all the “loans” to members would be authorised payments.

The Court held that the loans constituted unauthorised payments under the Finance Act 2004 and were therefore void, as they had been made outside the powers of the schemes’ trustees. They were also held to be a “fraud on the power of investment”, as the purpose of these loans was “not investment but disinvestment”. TPR’s involvement was therefore “plainly justified”.

HR Trustees v Wembley

Validity of scheme amendments upheld by equitable maxim

The trustees in this case sought to amend the scheme’s pension increases rule. The Scheme’s amendment power required several steps to be taken, including a declaration of the alteration by the trustees “in writing under their hands”. The issue was whether these formalities had been met, as only four out of five trustees signed a “Scheme Amendment Authority”, which set out the intended changes to the rules.

Despite the failure of one of the trustees to sign the declaration, the judge decided that the amendment had not been invalidated by “this administrative error” as “equity looks on that as done which ought to be done” and made an order confirming the change.

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

In the pipeline

21 March 2012	2012 Budget
29 March 2012	Finance Bill 2012 due to be published
April 2012	TPR to issue statement on scheme funding
5 April 2012	Deadline for application for fixed protection
6 April 2012	Commutation of small pots extended to personal pensions
6 April 2012	Abolition of DC contracting-out
6 April 2012	LTA reduced to £1.5m
Spring 2012	Consultation on deregulation expected
1 October 2012	Auto-enrolment starts to be phased-in
Autumn 2012	Supreme Court hearing due in Nortel / Lehman FSD appeal
December 2012	TPR's record-keeping target date
End 2012	Draft EU Pensions Directive published?

Sacker & Partners LLP
20 Gresham Street
London EC2V 7JE
T +44 (0)20 7329 6699
F +44 (0)20 7248 0552
E enquiries@sackers.com
www.sackers.com

Sackers