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sackers extra

THE QUARTERLY

[SEPTEMBER 2007]

Introduction

[Name of Scheme]

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

[Insert cross reference here to issues of particular interest to the scheme]

In this issue

Pensions Reform 2

- Reviews and reports 2
- Responses to consultation 3
- Consultation 3

Regulatory 5

- Actuarial Profession 5
- HMRC 5
- PPF Developments 5
- Latest from TPR 6
- Miscellaneous 8

Legislation Update 8

Cases 9

- Cripps v. Trustee Solutions Ltd & Dubery 9
- JP Morgan Fleming Claverhouse Investment Trust plc v. Commissioners of HMRC 10

Other News 11

PENSIONS REFORM

Reviews and reports

Deregulatory review

Deregulatory review – another step towards simplification?

The aim of the Deregulatory Review (a White Paper[1] initiative) is to simplify the regulatory framework governing private pensions. The Review's key recommendations (published on 25 July 2007[2]) include:

- making it easier for surplus to be repaid to employers;
- moving towards less detailed and prescriptive legislation, starting with simpler rules on disclosure;
- changing the circumstances in which an employer leaving a multi-employer defined benefit (DB) scheme has to satisfy its share of any deficit;
- making changes to the law on trustee knowledge and understanding to concentrate the requirement for trustee "expertise" collectively at board level; and
- providing for restrictions in scheme rules to be overridden where they prevent schemes from taking advantage (for future service benefits) of developments in legislation.

Financial Assistance Scheme (FAS) review of scheme assets

Interim report published

In the June Quarterly, we noted that the Government has commenced a FAS review. The aim is to examine how to make best use of the assets in underfunded schemes which are winding-up with an insolvent employer and to determine whether these sources of funding could be used to increase assistance for affected scheme members.

With the final report due by the end of the year, points emerging from the interim report published on 16 July include:

Final report due by year end

- the current practice of each scheme purchasing annuities for their members may not offer the best use of assets[3];
- additional value could be generated by pooling the schemes' assets to allow them to benefit from economies of scale;
- the possibility of using unclaimed personal pensions and life assurance policies as additional sources of funding;
- examining whether FAS should be extended to cover schemes that wound up underfunded with a solvent employer.

Following publication of the interim report, the Government announced that it would match any additional funds identified by the FAS review. It also accepts the review's recommendation not to enforce the current cut-off date for employer insolvency (31 August 2007) to qualify for FAS, and will consult on whether there should be one at all.

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[1] See our Sackers Extra Alert: "The Pensions White Paper" dated 25 May 2006

[2] See our Sackers Extra Alert: "Deregulatory Review – The Simple Life?" dated 27 July 2007

[3] Legislation will be introduced shortly to prohibit the purchase of annuities, subject to certain exceptions

Law Commission report on co-habitation

Having been asked by the Government to review the law that currently applies to co-habitees when they separate, the Law Commission has concluded reform is necessary. It recommends that financial relief in the event of separation should be available only where the couple satisfy certain eligibility requirements (for example, having had a child together or having lived together for 2 to 5 years).

Co-habitees should have access to pension sharing and attachment orders on separation

If co-habitees are entitled to financial remedies, both pension attachment and pension sharing orders should be available through the courts. However, the pensions order would be principally intended to replace the pension that had been forgone by a non-working co-habitee during the period of co-habitation only (and would not address future support).

It now falls to the Government to decide whether to act upon this recommendation.

Responses to Consultation

Personal Accounts

The Government has published responses to papers relating to the proposed system of personal accounts.[4] Personal accounts will be run as an occupational pension scheme managed by a board of trustees, with the trustees advised by a members' panel and an employers' panel.

Personal accounts to be run as an occupational pension scheme

There will be a contribution limit of £3,600 (in 2005 earnings terms) increased each year in line with earnings. This cap is intended to keep the new scheme focused on its target group of moderate to low earners who do not currently have access to good pension provision.

Paul Myners to head Personal Accounts Delivery Authority

Paul Myners will be appointed as "Chair Designate" of the Personal Accounts Delivery Authority (PADA). The PADA has been established under the Pensions Act 2007 (see Legislation Update below) to carry out the preliminary work needed to create the personal accounts scheme.

Consultation

Employer Debt

Draft amending regulations intended to cure some of the ills of the current employer debt legislation have been published.[5] The consultation closes on 1 October 2007, with the regulations currently pencilled in to come into force some time in December.

Changes proposed to employer debt legislation

Briefly, the regulations:

- introduce five potential ways of dealing with a deficit when an employer exits a multi-employer scheme;
- amend the operation of Approved Withdrawal Arrangements (AWAs) and the test used by the Pensions Regulator (TPR) for approving them;
- propose trustee approved "Cessation Agreements" as a simpler alternative to AWAs;

[4] See our Sackers Extra Alert: "Pensions saving gets personal" dated 20 December 2006
[5] See our Sackers Extra Alert: "Draft Regulations – Forever in your Debt?" dated 10 August 2007

- will apply whenever an employer ceases to employ active members of the scheme.

It will still be possible to apportion liability between employers (subject to certain conditions).

Cross-Border Schemes

A cross-border scheme is an occupational pension scheme established in one European member state which has members who work for a European employer in another member state. The Pensions Act 2004 transposed the cross-border requirements of the European Pensions Directive[6] into UK law.

Area of cross-border activity to be extended to include EEA States

On 12 April 2007 the European Pensions Directive extended operations to three EEA (European Economic Area) countries: Norway, Iceland and Liechtenstein. Draft regulations have now been published because the UK cross-border legislation needs to be updated. The consultation runs until 24 September 2007.

TPR has updated its cross-border guidance to take this change into account. The updated guidance also allows for the possibility of accepting applications for authorisation and approval from schemes already accepting contributions in respect of European members, as well as from schemes accepting contributions from European members for the first time.

Pensions transfer values

Last year the Department for Work and Pensions (DWP) consulted on "Approaches to the Calculation of Pensions Transfer Values". In its response published in January 2007[7], the DWP explained that, in future, the calculation of transfer values would be based on the expected cost to the scheme of providing the pension.

Trustees to take charge of scheme-specific transfer values

Draft regulations[8] are now out for consultation. They:

- provide for trustees to determine how cash equivalent transfer values (CETVs) will be calculated;
- state that assumptions must be calculated by reference to a "best estimate" assessment of the cost to the scheme of providing the alternative deferred benefit;
- define a minimum level for CETVs;
- permit the reduction of CETVs to reflect "reasonable administration costs" or, subject to certain procedures, scheme underfunding; and
- introduce new disclosure requirements.

Regulations expected to be in force on 6 April 2008

The consultation closed on 17 August 2007 with the new law likely to come into force on 6 April 2008 (subject to transitional provisions).

[6] Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision
[7] See our Sackers Extra Alert: "Transfer News: Trustees to take charge" dated 19 January 2007
[8] See our Sackers Extra Alert: "Draft Regulations – tour de transfers" dated 12 July 2007

REGULATORY

Actuarial Profession

Board of Actuarial Standard's (BAS) levy for 2007/8

In April 2006, the Financial Reporting Council (FRC) established a new regime to set actuarial standards and oversee the regulation of the actuarial profession. This is paid for by the BAS levy.

For 2007/8, the FRC proposed to collect 45% of the estimated £2.1 million cost of the BAS levy from larger pension schemes, 10% from the actuarial profession, and 45% from insurance companies.

£945,000 to be collected from pension schemes

The levy on pension schemes with more than 1,000 members will be £2.20 per 100 members (compared to £2 per 100 members in 2006/7). Currently, the levy is voluntary. However, powers have been included in the Companies Act 2006 to make its payment obligatory if necessary.

Interpretation of IAS19

The International Financial Reporting Interpretations Committee has set out new rules governing how the international accounting standard for pensions, IAS19, is to be interpreted. It provides general guidance on the amount of pension scheme surpluses which can be recognised in company accounts and the potential effect of statutory or contractual minimum funding requirements on the pensions asset or liability in the accounts.

New rules on interpretation of IAS19

The new rules are mandatory for annual periods beginning on or after 1 January 2008.

HM Revenue & Customs (HMRC)

E-filing

From 16 October 2007, Pension Scheme Administrators (normally, the trustees) will have to submit certain information to HMRC electronically. As they will need to be registered to use HMRC's "Pension Schemes Online" service, HMRC is urging them to register now.

Administrators urged to register for e-filing

Pension Protection Fund (PPF) Developments

Updated management plan

Under the continued chairmanship of Lawrence Churchill, the PPF has published its updated management plan. The document sets out the PPF's strategic objectives, detailing how it can contribute to reducing risk in the pension system. Alongside this is a detailed business plan for 2007/8.

Launch of new initiative on protecting people's pensions

A new initiative – "Protecting People's Pensions" – has been launched by the PPF. It is aimed at raising awareness of the existence of the PPF and the compensation it provides in order to build public confidence in DB schemes.

PPF aims to build confidence in DB schemes

To date, the following publications have been issued:

- a booklet, "Help! My employer has gone bust… and I think I might lose my pension" which explains how PPF compensation works; and
- a leaflet, "Your journey to becoming a member of the [PPF]" which is aimed at all members of work-based pension schemes whose employers have gone bust and who are now going through the PPF assessment process.

7800 index

The PPF's new "7800 index" provides monthly updates on the latest estimated funding positions of 7,800 DB schemes against their PPF liabilities. The estimates are calculated using the latest data about the value of schemes and are based on what would have to be paid to an insurer to take on payment of PPF levels of compensation.

Monthly updates on estimated funding positions of certain DB schemes

Development of the pension protection levy

When the Board of the PPF published "The 2007/8 Pension Protection Levy Consultation document – September 2006", it stated it would undertake a comprehensive review of the levy calculation. This consultation document sets out the PPF's proposals for the levy calculation for the years 2008/9 and beyond.

Consultation on the future of the pension protection levy

The key proposals are that:

- there should be a stable levy estimate (allowing for indexation) for the next three years, subject to there being no significant change in exposures to long-term risk;
- the dates when insolvency and underfunding risk are calculated, and all data is collected, should be brought forward by 12 months to 31 March 2008 (this will relate to the 2009/10 levy year).

PPF hope levy estimate will be stable for next three years

The consultation, which ends on 3 October 2007, also reminds schemes that the statutory deadline for submitting their first section 179 (risk-based levy) valuation is 31 March 2008.

The PPF is also hoping to stabilise the risk-based levy via its new "Long Term Risk Model" – a bespoke system designed to enable it to calculate the many risks it could face in the years to come.

Latest from the Pensions Regulator

First use of anti-avoidance powers

On 18 June 2007, TPR published determination notices indicating its intention to issue its first financial support directions (FSD) to Sea Containers Ltd (SCL). FSDs are part of TPR's armoury of anti-avoidance powers and require employers to face up to their DB liabilities.

Sea Containers to appeal TPR's decision to issue FSDs

Under the Pensions Act 2004, an FSD may be issued where the sponsoring employer is a service company or is insufficiently resourced, and TPR concludes it is reasonable to exercise its powers.

Following an approach by the trustees of the Sea Containers 1983 Pension Scheme (advised by Sackers), TPR agreed that SCL, as parent company, must provide financial support for the two pension schemes of its London-

based UK subsidiary Sea Containers Services Ltd (SCSL). SCSL is a service company and, taking into account all of the circumstances, TPR's Determination Panel deemed it reasonable to issue an FSD. The reasons of the Determinations Panel have been published on TPR's website.

SCL has lodged an appeal contesting the decision.

Review of code of practice on reporting breaches of the law

TPR has completed its first review of the code of practice on reporting breaches of the law and supporting guidance. Although it has decided that the code remains fit for purpose and no changes are needed, some areas of the guidance have been updated.

"Whistleblowing" code still fit for purpose but some guidance updated

The key changes made were as follows:

- improved signposting to other relevant codes in the guidance and the relevant section of TPR's website;
- an additional amber breach situation relating to the actuarial reporting process in recognition of the new statutory funding regime; and
- emphasised importance of maintaining dialogue with advisors in the event a breach is identified together with the advisors' statutory responsibilities.

As part of TPR's increased focus on risks specific to defined contribution (DC) schemes, it will also be considering further whether it would be appropriate to include additional DC-related breach examples in the guidance.

Governance Survey published

TPR's second governance survey was published on 12 July 2007 as part of its ongoing commitment to improving the way pension schemes are governed. Key findings from the survey include:

Risk management, internal controls and management of scheme administration still need improvement

- there has been an increase in trustee training, high levels of which continue to be associated with strong governance;
- schemes are not experiencing significant difficulties in recruiting or retaining trustees;
- scheme confidence in managing conflicts of interest has increased significantly, and most schemes consider they manage conflicts effectively;
- the majority of DB schemes have investigated the financial standing of the employer in the past year; and
- larger schemes are monitoring scheme administration more closely than smaller schemes.

However, there were areas where there has been little improvement, such as risk management and internal controls, and managing scheme administration.

Miscellaneous

Annual Report of the Pensions Advisory Service (TPAS)

On 29 June 2007, TPAS published its annual report for 2006/07.

The report contains factual information, case examples and comment about

TPAS's work during the year. It details some of the major issues consumers have raised with it, both through its helpline and in correspondence.

Pensions Ombudsman's Annual Report published

In his final report published on 16 July 2007, David Laverick comments on:

David Laverick's final report as Pensions Ombudsman

- improvements to pensions administration;
- his continued concern that death benefits are distributed at the discretion of trustees rather than in accordance with the expressed wishes of scheme members; and
- his concern at the lack of effective regulation of independent trustees.

Tony King takes over from David Laverick as Pensions Ombudsman on 1 September 2007.

LEGISLATION UPDATE

Pensions Act 2007 (PA07)

PA07 received Royal Assent on 26 July 2007. It implements the State Pension reforms from the Pensions White Paper, such as the increase of State Pension age from 65 to 68 by 2046.

As regards occupational pension schemes, PA07:

New facility for converting GMPs

- will introduce a facility to convert members' rights to guaranteed minimum pensions (GMPs) into rights to ordinary pension benefits;
- will abolish contracting-out for DC schemes and personal pension schemes;
- gives schemes the option (from 27 September 2007) of replacing their current two-stage internal dispute resolution procedure (IDRP) with a single stage arrangement where all decisions are taken by the trustees.

Schemes may simplify IDRP

Finance Act 2007 (FA07)

FA07 received Royal Assent on 19 July 2007. It makes several key changes in relation to the tax treatment of benefits under registered pension schemes. For details, please refer to pages 5 and 6 of the June Quarterly.

Companies Act 2006 (CA06)

CA06 aims to codify all existing company law. Although it will not be completely in force until October 2008, some of its provisions have been brought forward and are now coming in from 1 October this year.

For occupational pension schemes with a corporate trustee (Trustee Company) it brings about important changes to the protection of its directors from liability.[9]

From 1 October 2007:

Important changes to the protection of Trustee Directors from liability from 1 October 2007

- a provision exempting (or exonerating) directors (Trustee Directors) of a Trustee Company from liability in relation to the Trustee Company will be void (such a provision may be set out in the Trustee Company's

[9] See our Sackers Extra Alert: "The Companies Act 2006 – Exonerations and Indemnities" dated 8 August 2007

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articles of association);

- subject to certain exceptions, indemnities provided by a Trustee Company (or an associated company) to its Trustee Directors will be void;
- but an associated sponsoring employer will be able to indemnify Trustee Directors if certain conditions are met.

The Pension Schemes (Categories of Country and Requirements for Overseas Pension Schemes and Recognised Overseas Pension Schemes) (Amendment) Regulations 2007

UK transfers to Australian QROPSs still possible

Since 6 April 2006 (A-Day) pension schemes must be registered with HMRC to retain full tax advantages. A similar system was introduced for the recognition of overseas pension schemes. For such schemes to be capable of accepting transfers from UK pension schemes without a UK tax charge, they must meet certain requirements. If the requirements are met, they can become either "qualifying registered overseas pension schemes" (QROPS) or "qualifying overseas pension schemes".

Changes to Australian domestic legislation, from 1 July 2007, meant that they would no longer have met the QROPS requirements.[10] These regulations were introduced to broaden the basic requirements for overseas pension schemes to ensure that Australian schemes would continue to qualify as QROPS after that date.

CASES

Cripps v. Trustee Solutions Ltd & Dubery

Important decision for schemes which entered wind-up between 6 April 1997 and 6 April 2005

This Court of Appeal decision concerns male members with "Barber window" benefits (see below) and where they should fall in the statutory priority order which applies when a DB scheme winds up in deficit. It is of particular relevance to schemes which went into winding-up between 6 April 1997 and 6 April 2005.

What is the Barber window?

In the 1990 Barber case, the European Court of Justice (ECJ) ruled that it was discriminatory for pension schemes to provide different retirement ages for men and women. The period between the date of the ruling and a scheme's equalisation of benefits (during which benefits had to be provided on the more favourable basis, normally, retirement at age 60) is known as the "Barber window".

Background

s73 gave priority to those whose benefit entitlement had arisen

Section 73 of the Pensions Act 1995 (which came into force on 6 April 1997) sets out the statutory priority order for paying benefits on the winding-up of a DB scheme. At the relevant time, a member who had become entitled to his pension at the date of wind-up was given a higher priority in relation to available assets than a member who had not.

High Court ruled that Barber window benefits gave an entitlement at age 60

Although the scheme's normal retirement date was 65, the High Court ruled that male members with Barber window benefits who had reached age 60 before the scheme began winding-up (the Male Members) should be treated as

[10] Please see our Sackers Extra Alert: "New 'Aussie Rules' on UK Transfers" dated 7 June 2007

though they had become entitled to *all* of their benefits. This meant that, for the purposes of the winding-up priority order, their retirement age should have been age 60, rather than age 65.

The appeal

Mrs Cripps (a deferred member appointed as a representative beneficiary) appealed the decision. Before the decision of the High Court, the Male Members would have fallen much further down the statutory priority order as they would have been considered deferred members rather than pensioners at the date of wind-up. Therefore, the High Court ruling would have cut back the amount of benefits Mrs Cripps (and other deferred members) would eventually receive.

High Court decision appealed by deferred member

The Court of Appeal's decision

The Court of Appeal decided that the Male Members' Barber window benefits (and not *all* of his benefits) should be given higher priority. Benefits accrued before and after the Barber window would therefore rank lower down the priority order (along with other deferreds).

Split service - only an entitlement to Barber window benefits arose at 60

JP Morgan Fleming Claverhouse Investment Trust plc (Claverhouse) v. HMRC

The ECJ recently ruled on the VAT treatment of management services to UK investment trusts.

Background

The EC VAT Directive[11] exempts the "management of special investment funds as defined by Member States" from VAT. UK legislation[12] limits the scope of this exemption to the management of:

UK VAT legislation challenged by ITC

- an authorised unit trust scheme (AUT) or of a trust based scheme; and
- the scheme property of an open-ended investment company (OEIC).

The management of other types of investment vehicles (including investment trust companies (ITCs)) is subject to VAT.

This means that when a fund manager charges an AUT or an OEIC for its services it does not charge VAT. However, when a fund manager supplies similar services to an ITC, VAT must be charged.

The case

Claverhouse (an ITC) challenged the validity of this aspect of UK VAT legislation. In the 10 years ending on 31 December 2003, it had paid £2.7 million in non-recoverable VAT on management services.

The ECJ was asked to consider the following:

a) Whether "special investment funds" could include closed-ended investment funds, such as ITCs?

Answer: Yes

[11] Directive 77/388/EEC on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value-added tax: uniform basis of assessment
[12] The Value Added Tax Act 1994

b) If so, whether Member States had discretion to select which type of fund should benefit from the exemption.

Answer: Yes, but when exercising that discretion they had to consider the purpose behind the VAT exemption which was to facilitate investment in securities, while ensuring that vehicles in competition for this business are treated equally for tax purposes.

ECJ held VAT exemption could include ITCs

The effect of the ruling

In general

If the UK VAT and Duties Tribunal agrees with the ECJ's decision, this will mean that ITCs should not pay (or historically have paid) VAT on management fees. (It is possible to reclaim up to 3 years of overpaid VAT).

On pension schemes

Decision unlikely to extend to pension schemes

The ECJ deliberately steered clear of extending its conclusions beyond the types of fund specifically identified in the case.

The main purpose underlying pension schemes (and the funds held in them) is to fulfil benefit promises. Unlike ITCs, it is unclear whether one of the main purposes is also to promote investment in securities. It therefore seems unlikely that the case opens the door for DB schemes to mount similar VAT claims and a test case is probably required to clarify this.

It could be said that DC schemes are closer than DB schemes to "special investment funds". However, most DC schemes invest via insurance wrappers where management fees are not subject to VAT.

Pending any test case and the Tribunal's judgement, schemes with a material amount of money at stake may wish to seek advice regarding the possibility of protecting their position.

OTHER NEWS

New Secretary of State for Work and Pensions

New Ministerial appointments

Under Gordon Brown's first cabinet reshuffle, Peter Hain MP has moved across from the Northern Ireland office to replace John Hutton as Secretary of State for Work and Pensions.

Mike O'Brien takes over from James Purnell as Minister of State for Pensions Reform.

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