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sackers extra

THE QUARTERLY

SEPTEMBER 2009

Introduction

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.

Copies of our Sackers Extra publications referred to in this "Quarterly" are available from the client area of our website www.sackers.com or from your usual contact.

Abbreviations commonly used in the Quarterly:

Alert/News: Sackers Extra publications (available from the client area of our website or your usual contact)
DB: Defined benefit
DC: Defined contribution
DWP: Department for Work and Pensions
FAS: Financial Assistance Scheme
HMRC: HM Revenue & Customs
PPF: Pension Protection Fund
PADA: Personal Accounts Delivery Authority
TPR: The Pensions Regulator

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PENSIONS REFORM

Department for Work and Pensions

Building a society for all ages: Choice for older people

The DWP is consulting on the Government's strategy and proposals for tackling the challenges of our ageing society.[1]

Review of default retirement age brought forward

In this consultation, the Government announced that it intends to bring forward its promised review of the default retirement age from 2011 to 2010. Although a retirement age of 65 has been common for many businesses for some time, the introduction of the Employment Equality (Age) Regulations in 2006 provided for a default retirement age which effectively allows employers to retire employees at age 65. However, the regulations also introduced a new statutory right for individuals to request postponement of retirement beyond age 65 (which employers must consider).

If the outcome of the review is that the default retirement age is no longer appropriate, existing legislation would be amended. The Government has indicated that any changes would not be implemented until 2011, on the basis that this will "give employers sufficient time to prepare, and employees time to consider what impact the new circumstances would have on their plans".

Personal Accounts Delivery Authority

Securing a retirement income

PADA has published a summary of the responses to its consultation - "Building Personal Accounts: Securing a retirement income".

Consultation response published

Some of the key points to emerge from the consultation include:

- acknowledgement that a lifetime annuity (or, where relevant, trivial commutation) is likely to be the most appropriate option for personal accounts members in terms of securing retirement income;
- the need to use accessible language and simple communications;
- general acknowledgement that having a panel of providers could be the most appropriate route for members not wishing to exercise the open market option; and
- recognition that fund sizes are likely to be very small in the early years and that this could present a number of challenges to the scheme and the wider retirement income market.

The feedback received will be used to inform PADA's continuing work to deliver the Personal Accounts scheme.

[1] More information on the overall strategy can be found at the Government's "Building Britain's Future" website: http://www.hmg.gov.uk/buildingbritainsfuture.aspx

LEGISLATION

Finance Act 2009

Royal Assent

The Finance Act 2009 received Royal Assent on 21 July 2009. The Act brings into force new tax relief restrictions on pension savings for high earners which were announced in the Budget on 22 April 2009.[2]

Tax Relief restrictions

Restriction on pensions tax relief

From 2011, individuals with an annual income of £150,000 or more will face a reduction in their tax relievable pension contributions. Relief will be tapered away, so that for those earning over £180,000 it will be worth 20% (equivalent to basic rate tax). These measures will be introduced via a future finance act and will be subject to consultation.

Transitional measures

Transitional measures have effect from 22 April 2009 to prevent affected individuals from taking advantage of available tax relief in the interim by making significant additional pension savings.

Generally speaking, a 20% charge ("the special annual allowance charge") will be levied on individuals:

Special annual allowance charge

- who have an income of £150,000 or more;
- who change the pattern of their normal, regular, ongoing pension savings; and
- whose overall pension savings exceed £20,000 (the "special annual allowance").

Whilst the Treasury anticipates that these measures will protect an estimated £2 billion of tax, they may also have unintended consequences for existing arrangements. HMRC has published some "Q&As" in response to questions raised by the industry. This supplements the guidance it made available on Budget day.[3]

The Material Detriment Test

The Pensions Act 2008 (Commencement No. 4) Order 2009

TPR's new anti-avoidance powers in force

The Pensions Act 2008 added to TPR's existing anti-avoidance powers, enabling it to issue a contribution notice where an act or failure to act has detrimentally affected, in a material way, the likelihood of members' benefits being received (the "material detriment test").

These regulations bring the relevant provisions of the Act into force from 29 June 2009, but the amendments apply retrospectively to 14 April 2008 (the date on which they were first announced).

[2] For more information, please see our Alert: "Finance Act 2009 – this time it's personal" dated 24 July 2009

[3] Available from HMRC's website via: http://www.hmrc.gov.uk/budget2009/tax-relief-pen-cont.htm

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The Pensions Act 2004 (Code of Practice) (Material Detriment Test) Appointed Day Order 2009

TPR's latest code of practice sets out the circumstances in which it expects to issue contribution notices on the basis of the material detriment test.[4] The new code is brought into force by these regulations and takes effect from 29 June 2009.

TPR's 12th Code of Practice in force

To complement the new code, TPR has added a new module to its Trustee toolkit (TPR's online training programme) on "Buy-ins and partial Buy-outs", which is designed to provide guidance to those considering transferring pensions risk to insurers.

Authorised payments

The Taxation of Pension Schemes (Transitional Provisions) (Amendment No. 2) Order 2009

Under the Finance Act 2004, a dependent child's pension must generally cease when the child reaches age 23, unless the child qualifies for a dependant's pension on grounds of incapacity.

Existing transitional provisions enable payments to continue beyond age 23, provided certain conditions are met. However, they do not cater for pensions payable to children who were carers looking after an elderly parent where there was a relationship of mutual dependence.

Children's pensions – limited extension of transitional provisions

This latest set of regulations (which will come into force on 1 September 2009) extends the protection of the transitional provisions to children who were financially dependent (or mutually dependent) on the member at the date of the member's death. Entitlement to such pensions must have arisen before 1 July 2008 (the date on which the proposal to make these amendments was made public).

The Pension Schemes (Reduction in Pension Rates) (Amendment) Regulations 2009

The general rule under the Finance Act 2004 is that, once in payment, a scheme pension cannot generally be reduced (and remain "authorised"), except in specified circumstances.

Reductions permitted to certain pensions on winding-up

Under one of these exceptions, all scheme pensions being paid can be reduced at the same rate. However, where a scheme is winding-up in deficit, only some members' benefits (not all) may need to be cut back. Affected individuals may then find that their future pension payments are subject to unauthorised payments charges. The regulations therefore permit pensions reduced in these circumstances to continue to be paid as authorised scheme pensions.

The regulations came into force on 1 July 2009 and have retrospective effect from 6 April 2006 (A-Day).

[4] For more information, please see our Alert: "Material detriment code revisited" dated 7 May 2009

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Miscellaneous

The Pension Protection Fund (Entry Rules) (Amendment) Regulations 2009

Power to prevent scheme amendments during assessment

Under the Pensions Act 2004, the Board of the PPF can give a relevant person (such as the trustees of a scheme) directions regarding the exercise of their powers during a PPF assessment period, with a view to ensuring that the scheme's protected PPF liabilities do not exceed its assets or, if they do exceed its assets, that the excess is kept to a minimum.

These regulations, which came into force on 21 July 2009, allow the PPF Board to make directions that would enable it to stop trustees from making rule changes during an assessment period which would have the effect of increasing the scheme's protected liabilities.

The Pensions Regulator (Delegation of Powers) Regulations 2009

TPR to delegate some compliance powers

Coming into force on 13 November 2009, these regulations relate to the new system of automatic enrolment and the Personal Accounts regime which are due to take effect in 2012. They will enable TPR to delegate certain of its specified compliance powers to external public and private bodies. The aim of this measure is to ensure that employer compliance with the new system can be delivered in the most efficient and cost effective way.

The Financial Assistance Scheme (Miscellaneous Provisions) Regulations 2009

Further FAS regulations implement the remaining enhancements to the FAS which were first announced on 17 December 2007.

The regulations came into force on 10 July 2009 and improve assistance for qualifying members by:

Final FAS enhancements in force

- increasing payments derived from post-97 service by the increase in the Retail Prices Index capped at 2.5%;
- increasing the value of the cap on benefits from £26,000 to £26,936 (this will also increase each year in April by the level of any increase in the Retail Prices Index);
- permitting FAS payments to mirror scheme rules where these permit a reduction in pension payments when the state retirement pension becomes due at age 65; and
- extending survivors' rights to dependent children and surviving partners.

A further package of regulations is expected to be consulted on in detail later this year, which will deal with taking residual FAS scheme assets into Government. Since 10 July 2009, the FAS has been brought within the management of the PPF.

REGULATORY

Board for Actuarial Standards (BAS)

Consultation on proposals for new actuarial standard

The BAS is consulting on proposals for a technical actuarial standard on pensions. One of the key objectives is to ensure that actuarial information provides the best possible support to trustees, sponsors and others who use the information to make decisions.

New actuarial standard put forward

The consultation (which closes on 18 September 2009), covers such areas as:

- the principles underlying the selection of discount rates used to value pension scheme liabilities;
- whether prudent estimates of pension scheme liabilities should be accompanied by best estimates of the same liabilities; and
- the content of the report produced after regular scheme funding reviews of pension schemes.

HM Treasury

Equitable Life – Update

Following the publication in May 2009 of the Parliamentary Ombudsman's further report into the collapse of the Equitable Life Assurance Society, the Treasury has published a series of Q&As relating to the Government's response.

In addition, Sir John Chadwick (appointed by the Treasury to advise on matters arising from the Government's response) has published his provisional views on the issues to be addressed as part of his investigation, including:

Representations under review

- his understanding of the Ombudsman's Findings of injustice that the Government has accepted;
- the approach he intends to adopt over the course of his work – specifically to enable him to reach a view about the relative losses suffered by different classes of policyholder; and
- the specific issues he thinks need to be addressed to enable him to provide advice to the Government in relation to the Equitable Life ex-gratia payment scheme.

Pension Protection Fund

Section 179 guidance revised

The PPF has published a new version of its guidance for undertaking a valuation in accordance with section 179 of the Pensions Act 2004, the results of which are taken into account by the PPF when calculating a scheme's risk-based levy.

PPF valuation guidance updated

The guidance has been updated to:

- reflect the fact that s.179 valuation information is now provided to the

PPF via TPR's online system "Exchange"; and

- incorporate changes required by recent legislation, such as the change in the cap on revaluation of final salary benefits in deferment for post 5 April 2009 accrual.

The new version of the guidance is effective for valuations with an effective date on or after 1 April 2009, or those which are signed after 1 October 2009.

Consultation on valuation assumptions

PPF consults on valuation assumptions

The PPF is responsible for keeping the assumptions used for valuations under sections 143 and 179 of the Pensions Act 2004 in line with estimated pricing in the bulk annuity market. In the light of recent developments, it is considering making some changes to these assumptions in order to bring valuations into line with the market.

It is intended that the changes would be introduced for valuations with an effective date on or after 31 October 2009. The consultation will close on 11 September 2009.

2010/11 levy

Early announcement on PPF levy

The PPF has announced that it will set a pension protection levy estimate of £700 million, indexed to wages, for 2010/11. This is in line with its August 2007 commitment to keep the levy estimate stable for three years.

By making the announcement earlier in the year than usual, the PPF is hoping to help ease the continuing economic uncertainty faced by employers and pension schemes. The actual levy estimate will be confirmed when the Office for National Statistics publishes wages indexation figures in September. Schemes will then be able to work out their individual levies when the PPF announces the levy scaling factor (the mechanism used to calculate bills) in the autumn.

Consultation on long-term levy future

Long-term levy proposals to be refined

The PPF has now published an update on its consultation regarding "The Future Development of the Pension Protection Levy" which closed on 13 February 2009.

With the aim of sharing the levy more fairly between schemes, key themes emerging from that consultation included:

- assessing the probability of a scheme's sponsoring employer becoming insolvent during a five year period, as well as separately assessing the probability of it becoming insolvent during a one year period, as now; and
- enabling the PPF to take account of the risk that a scheme's investment strategy poses to the PPF when calculating its individual levy.

Although the PPF's proposal received broad support, concerns were raised about certain details, including the transparency of its long-term risk model. The PPF has therefore confirmed that the principle behind the proposals will be pursued, but that further work will be required to develop and refine the proposals before they can be implemented (which would be no earlier than 2012/13).

The Pensions Regulator

TKU: Revised code and scope guidance

Following its 2008 consultation, TPR has published its revised code of practice on trustee knowledge and understanding (TKU), together with updated scope guidance.[5]

TPR's consultation report states that since the implementation of TKU in 2006, it has "become embedded in normal trustee activities" and that trustees approach their responsibilities with new found confidence.

Revised TKU code in force soon

Among other things, the updated code places greater emphasis on good administration, highlights developments in investments and buy-out issues, and reinforces the importance of the employer covenant. TPR is now reviewing the Trustee toolkit to ensure that it reflects the revised scope guidance. It expects to complete this work by autumn 2009.

The revised code has been laid before Parliament and is due to come into effect later this year.

Statement on scheme funding and the employer covenant

Since the Autumn of 2008, TPR has issued several statements regarding the impact on pension schemes of the current economic downturn.[6] A further statement was published in June, emphasising the importance of prudent funding levels for pension schemes and stating that, where sponsors are in difficulty, flexibility is available in recovery plans.

TPR's latest statement on the economic downturn

The statement also notes that technical provisions (the scheme specific funding standard) must be set prudently and should not be compromised. TPR acknowledges that in the current financial climate it may be necessary to lengthen or back-end load a recovery plan, but notes that there is already sufficient flexibility to permit this.

Higher standards for DC pensions

As part of its current focus on DC schemes, TPR has issued a statement to trustees and employers setting out how it "aims to enable informed member choices at retirement, and improve the quality of employer engagement in DC pension provision".

DC: Focus on employer engagement

TPR is targeting both the standards of pre-retirement processes and member communications in trust based schemes (the FSA has a similar interest in respect of contract based schemes). It has therefore issued a guide on making retirement choices for DC scheme members who are approaching retirement which summarises the processes for a person in the run up to retirement.

Building on work carried out by it over the past three years, TPR has also published its first analysis of the DC trust based landscape.[7]

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[5] For more information, please see our Alert: "TKU – Updating the Knowledge" dated 15 October 2008

[6] For more information, please see our Alert: "TPR – Your Flexible Friend" dated 18 February 2009

[7] "DC Trust: A presentation of scheme return data" (http://www.thepensionsregulator.gov.uk/pdf/DCTrustJuly2009.pdf)

CASES

Court of Appeal

Foster Wheeler v Hanley[8]

The company and trustees had closed the *Barber* window (i.e. the period between the date of the *Barber* decision on 17 May 1990 and a valid rule amendment being made to equalise benefits) by raising the normal retirement age (NRA) to 65. In practice, the requirement for company consent was waived to allow members to take benefits unreduced between 60 and 65.

Court takes pragmatic approach to equalisation

As in many schemes, the upshot of equalisation was that certain members had mixed normal retirement ages of 60 and 65, but the scheme rules did not expressly deal with how benefits should be paid to them. The High Court judge concluded that such members could take *all* of their benefits unreduced from age 60, without the need for company consent. This resulted in an estimated £30 million of extra pension costs.

Concerned about conferring "windfall" benefits on members, the Court of Appeal took a pragmatic approach and found a solution to the problem in the scheme rules (effectively applying the scheme's deferred benefit rule to reduce benefits paid early referable to a retirement age of 65). It ruled that, where possible, a court should give effect to *Barber* rights by looking to the scheme rules. Where this is not possible, there should be "minimum interference with the scheme provisions", although it may be necessary to use existing rules "in a manner not previously contemplated".

The Court of Appeal also encouraged trustees and employers to work together to find the most appropriate equalisation answer for their scheme without going to Court.

Rolls Royce PLC v Unite the Union

The inclusion of length of service as a factor in a redundancy selection framework is justifiable and in keeping with the Employment Equality (Age) Regulations 2006.

Service related factor in redundancy selection framework was justifiable

The Employer and the Trade Union had entered into a collective agreement for "redeployment and redundancy", which included an assessment framework designed to ensure that the redundancy selection process was "fair in general terms and fair to the individual". Under the framework, points were awarded based on a number of criteria, one of which was length of service. The employer argued that taking long service into account amounted to indirect age discrimination which could not be justified.

A majority of the Court of Appeal found for the Union (as the High Court had done). They held that the inclusion of length of service was a proportionate means of achieving a legitimate aim because it was only one of a number of factors which would be applied under the selection framework and was not, of itself, a deciding factor. In addition, including length of service was "entirely consistent with the overarching concept of fairness" and it enabled an individual's loyalty to be recognised.

[8] For more information, please see our News: "The importance of being equal" dated July 2009

High Court

Colorcon Ltd v Huckell and others

The High Court has recently granted an application for rectification, on a summary judgment basis (i.e. without the need for a full hearing), where there was a mismatch between the scheme rules and actual practice in the context of revaluing deferred pensions.

DB benefits were traditionally revalued by the annual rate of the increase in the Retail Prices Index (RPI) subject to a cap of 5% (Limited Price Indexation or LPI). However, following the appointment of a new actuary, it transpired that the rules in fact specified an annual increase of 5%.

Evidence of parties' common intention led to order for rectification

This provision was first introduced when a definitive deed and rules were adopted in 1996, despite neither the company nor the trustees having intended it. Their common intentions were clearly reflected in other scheme documents, including different versions of the booklet (prepared both before and after the 1996 rules came into effect), actuarial valuations and the scheme's annual reports.

The judge was satisfied that there was a "formidable body of evidence" demonstrating the common intention of the parties that revaluation should be on the basis of LPI, and so was happy to award rectification (namely, allowing the rules to be corrected).

Walker Morris Trustee Ltd v Masterson and Lodge

In this case, the amendment power in the scheme rules required the trustees to obtain an opinion in writing from the scheme actuary to the effect that members' and beneficiaries' rights and interests would not be prejudiced. Although a number of amending deeds had been executed over the years (since 1981), no such opinions had been obtained.

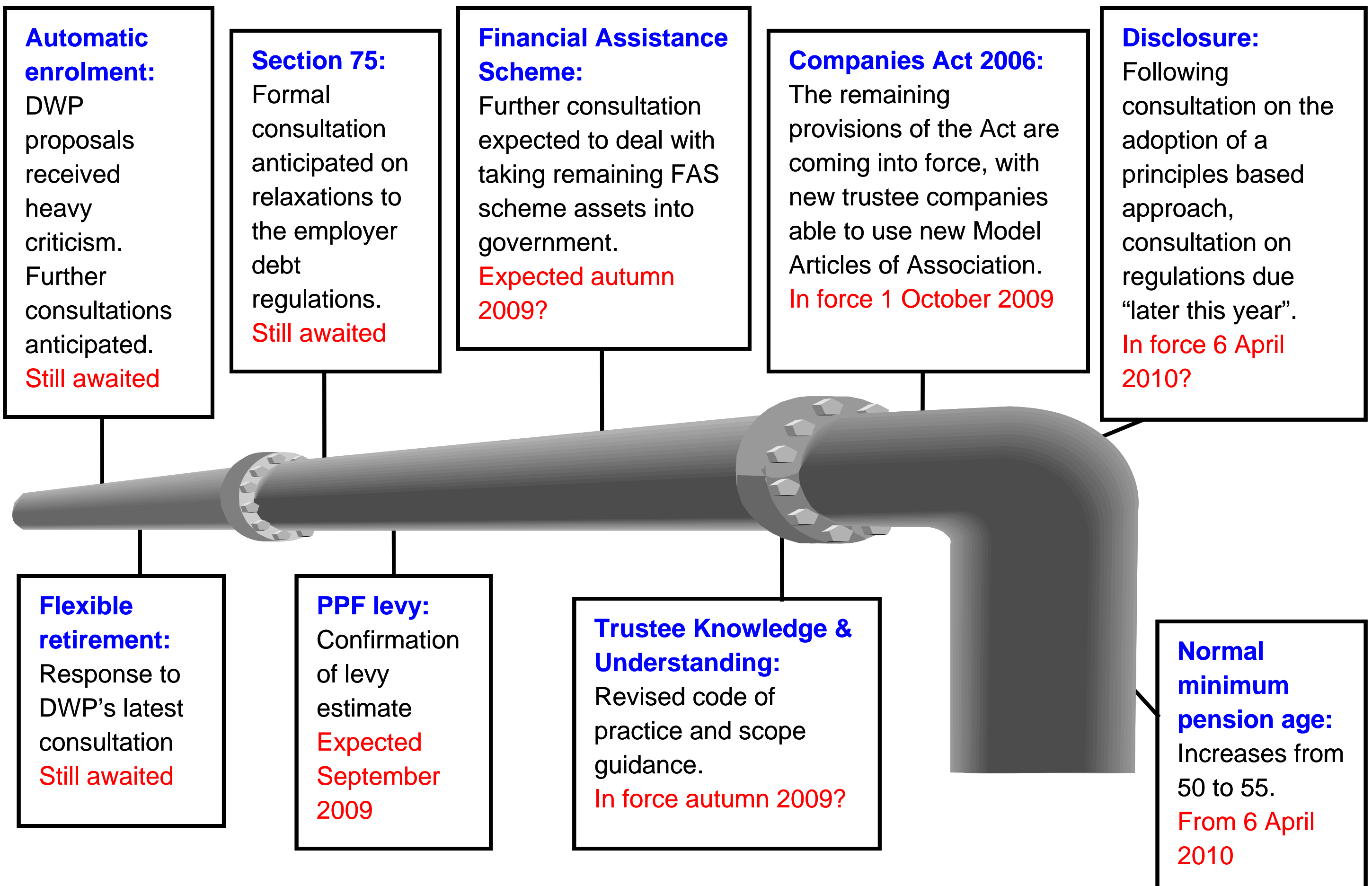
Failure to follow scheme amendment power meant changes were invalid

Even though a number of the purported amendments sought to improve members' benefits, the court found that the failure to obtain the actuary's written opinion rendered the changes invalid. This was the case even in respect of two deeds for which section 67 certificates had been obtained, on the basis that these certificates are designed for a different purpose.

In the end, only one deed was saved - under which benefit improvements were made so as to eliminate a statutory surplus. These changes were needed to ensure the continuation of Revenue approval.

This decision sends a strong reminder to trustees and employers to consider their scheme's amendment power, and to follow the procedure prescribed, before attempting to amend the rules.

IN THE PIPELINE



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