Sackers

The Quarterly
September 2010

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

The Quarterly September 2010

In this issue

Pensions Reform

RPI to CPI 1

Tax Relief for High Earners 2

Public Sector 2

Round-up 3

Regulatory

Department for Work and Pensions 4

European Union 4

Financial Reporting Council 4

HM Revenue & Customs 5

The Pensions Regulator 5

Cases

The Pilots National Pension Fund v Taylor 7

TPR Determinations 8

In the pipeline

Abbreviations commonly used in the Quarterly:

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

CPI: Consumer Prices Index

DB: Defined benefit

DC: Defined contribution

DWP: Department for Work and Pensions

HMRC: HM Revenue & Customs

NEST: National Employment Savings Trust

PPF: Pension Protection Fund

RPI: Retail Prices Index

SPA: State Pension Age

TPR: The Pensions Regulator

Pensions Reform

Coalition Government plans pensions reforms

The General Election in May 2010 resulted in the Conservatives and the Liberal Democrats forming the first full Coalition Government since 1945. The Coalition has since announced a Pensions and Savings Bill and made a number of other announcements concerning pensions.

RPI to CPI

In the Budget on 22 June 2010,[1] the Government announced that CPI, rather than RPI, would be used for increases (both in deferment and to pensions in payment) to public sector pensions from April 2011.[2] On 8 July 2010 the change was extended to private sector occupational pension schemes.[3]

CPI to apply to both accrued and future service rights

Statutory requirements

Currently the statutory requirement for occupational pension schemes is that pensions in payment must be increased by either a percentage set by the Secretary of State or “limited price indexation” (LPI). For pensions accrued between April 1997 and April 2005, LPI is the lower of 5% or RPI. For pensions accrued since April 2005, LPI is the lower of 2.5% or RPI.

From April 2011, the index used will be switched from RPI to CPI for all rights a member has already accrued, not just future service rights. A member will remain entitled to the increases already granted. The rate of revaluation for pensions in deferment (including GMPs, if any) will also change in a similar way.

Scheme rules should be checked carefully

Points to note

- Depending on how the change is implemented and a scheme’s rules are drafted, the statutory change to CPI may not override the pension increase provision in the scheme rules. For example, a DB scheme which specifies RPI will need to be amended if the change to CPI is to apply.
- While this may result in a decrease of pension liabilities,[4] depending on how the amendments are structured, a guarantee that increases will not be less than CPI may have to be built into scheme rules even if a scheme preserves RPI. This potentially increases liabilities for those years when CPI is higher than RPI.

Full details of the change still awaited

What steps should trustees and employers take?

Full details of how this change will be implemented are still awaited, meaning that definitive advice cannot yet be given.

But TPR issued a statement on 21 July 2010 indicating that trustees may wish to prepare by reviewing their scheme rules and should “plan to communicate with members on the impact”.

TPR also makes it clear that it expects decisions to be made on the current state of the law. For example, it suggests that scheme funding decisions should go ahead, with the aim of reducing the length of any recovery plan only when the impact of the change on scheme liabilities is clear.

1 Please see our Alert: “Coalition Budget 2010: Final economic remedies from Gladstone’s Bag” dated 23 June 2010

2 Please see our Alert: “Pension Increases – the change from RPI to CPI” dated 13 July 2010

3 A DWP press release on 12 July 2010 gave more details

4 The annual rate of increase of CPI in June 2010 was 3.2% whilst RPI was 5.0%

Tax Relief for High Earners

Proposal to reduce the Annual Allowance

Consultation on alternative approach

On 27 July 2010, the Treasury published a discussion paper on a possible alternative approach to Labour's pensions tax relief plans.[5] The Government proposes to reduce the Annual Allowance (AA) from the current £255,000 to an amount in the region of £30,000-£45,000.

Aspects of the alternative approach covered by the consultation include:

- various options for valuing DB accrual;
- possible exemptions from the AA; and
- consequential amendments, including a simultaneous reduction in the Lifetime Allowance (LTA) and transitional protection for those with savings above a reduced LTA.

The consultation closes on 27 August 2010. The Government plans to confirm its approach by the end of September, with a view to implementing the new measures in April 2011. Until then, the anti-forestalling measures remain in place.[6]

Public Sector

Public sector pension scheme transfers suspended

Change from RPI to CPI

As mentioned above, a move from RPI to CPI for calculating pension increases for public sector pensions was announced in the Budget.[7]

Whilst details of the switch to CPI are being ironed out, the Government Actuary's Department has announced that:

- bulk transfers are presently suspended to and from public sector schemes; and
- no new certificates of "Broad Comparability" will be issued (required for a scheme to provide pensions for an outsourced public sector worker entitled to protection under the Fair Deal).

Hutton Commission

Spotlight on long-term affordability and sustainability

An independent commission, the Public Service Pensions Commission, with a remit to review public service pension provision has been established. Chaired by John Hutton (a former Secretary of State for Work and Pensions under Labour), it is expected to make recommendations on how public service pensions can be made sustainable and affordable in the long-term, as well as being fair to both the public service workforce and the taxpayer. Existing accrued pension rights are likely to be protected.

An interim report is expected in September, with the Commission's final report, comprising a fundamental structural review, due in time for the 2011 Budget.

5 Please see our Alert: "Restricting pensions tax relief: The Coalition's alternative approach" dated 29 July 2010

6 Please see our Alert: "Finance Act 2009 - This time it's personal" dated 24 July 2009

7 Please see our Alert: "Public Sector Pension Schemes" dated 9 July 2010

Round-up

DRA to be removed from legislation on 6 April 2011

Default retirement age (DRA)

Having committed to the phasing out of the DRA, on 29 July 2010 the Government published a consultation on its removal.[8] The consultation closes on 21 October 2010.

The consultation proposals include:

- the removal of the DRA from legislation on 6 April 2011;
- a transitional period to cover retirements which are already in train; and
- the cessation of retirements using the DRA on 1 October 2011.

From April 2011, employers will need to objectively justify having a compulsory retirement age for their workforce.

SPA rise to be brought forward

State pensions

- The Government intends to accelerate the rise in the SPA to 66, currently planned for 2026. A call for evidence by the DWP closed on 6 August 2010.
- The Government has also announced its intention to restore the link between the basic state pension and earnings from April 2011, with a "triple guarantee" that pensions will rise by the higher of earnings, prices or 2.5%.

Both the DRA and the proposed state pension changes are expected to be included in the Pensions and Savings Bill.

Auto-enrolment and NEST under review

Review of workplace pension reforms

Labour's plans for the implementation of mandatory automatic enrolment into workplace pensions and the delivery of NEST are under review, with the DWP's conclusions and recommendations due by 30 September 2010.

Nonetheless, the NEST Corporation formally took over from the Personal Accounts Delivery Authority (PADA) on 5 July 2010. PADA's role was only ever temporary, being to assist and to advise on the setting up of NEST.

Compulsory annuity purchase

Existing rules on compulsory annuity purchase by age 75 are set to disappear in April 2011.

The Treasury is consulting on proposals designed to give individuals greater flexibility to choose the retirement options which are best for them, while at the same time protecting existing tax revenues. The consultation closes on 10 September 2010.

As an interim measure, transitional arrangements have been included in the Finance Bill to increase the age at which an annuity must be purchased to 77.

DC contracting-out to be abolished from 6 April 2012

Abolition of DC contracting-out[9]

On 28 July 2010, the DWP published a consultation on draft regulations in connection with the proposed abolition of DC contracting-out. It also confirmed 6 April 2012 as the abolition date. The consultation closes on 19 October 2010.

8 Please see our News: "The end of the default retirement age is nigh!" dated July 2010

9 Please see our Alert: "Abolition of DC contracting-out: Consultation on implementing legislation" dated 30 July 2010

Regulatory

Department for Work and Pensions

Preserving powers to refund surplus[10]

Scheme rules commonly include a power to return surplus to an employer on an ongoing basis, as well as on winding-up (subject to the payment of tax).

Section 251 of the Pensions Act 2004 introduced a transitional power allowing trustees, by resolution, to amend, reinstate or leave dormant their scheme rules relating to payments to the employer (following changes made to the tax regime by the Finance Act 2004). But section 251 is ambiguously drafted. It applies to repayments of surplus from an ongoing scheme but potentially also to a wider range of payments, such as refunds of surplus on wind-up, reimbursement of employer expenses in an ongoing scheme, and payments to an employer under a lien.

Three-month notice requirement

If no resolution is passed, any power in scheme rules to which section 251 applies appears to be rendered redundant. Subject to certain conditions being met, the statutory power to pass such a resolution can only be exercised once and, in any event, before 6 April 2011. Trustees must give at least 3 months' notice of their proposal to both the employer and scheme members.

We are hoping for further clarification of these points from the DWP. But given the short timeframe, trustees may, in the meantime, wish to issue a notice to members of their intention to pass a section 251 resolution.

European Union (EU)

EU-wide public consultation on pensions

Pensions Green Paper

Prompted by growing pressure on European pension systems as a result of demographic ageing, the European Commission has launched a public consultation on pensions in the EU (which closes on 15 November 2010).

In recent years there has been much debate over the possible application of insurance-style solvency standards to occupational pensions. Although the Commission indicated back in 2007 that the Insurance Directive, Solvency II, would not apply to occupational pensions,[11] the Green Paper reignites the debate by stating that "the Solvency II approach could be a good starting point, subject to adjustments to take account of the nature and duration of the pension promise, where appropriate."

Financial Reporting Council (FRC)

Code for institutional investors

First UK Stewardship Code published

On 2 July 2010, the FRC published the first Stewardship Code for institutional investors (including pension schemes).

The Stewardship Code is designed to improve the quality of corporate governance through better dialogue between shareholders and company boards, and more transparency about the way in which investors oversee companies.

Institutional investors are encouraged to publish a statement on their website by the end of September 2010, on the extent to which they have complied with the Stewardship Code, and to notify the FRC when they have done so. From the second half of 2011, the FRC will undertake annual monitoring of the take-up and application of this Code.

10 Please see our Alert: "Preserving powers to refund surplus" dated 24 May 2010

11 See response to Question 5 of Europa MEMO/07/286

HM Revenue & Customs

Legislation awaited to ensure no unauthorised payments charge

Pension transfers for people aged 50 to 55

The normal minimum pension age increased from age 50 to 55 from 6 April 2010. A person aged 50 or over but under 55 who started drawing their pension before 6 April 2010 can normally continue to draw it without an unauthorised payments charge applying, even when they are not yet 55. However, unintentionally, legislation imposes this charge if such an individual transfers their pension before age 55 to a new provider.

Provided certain conditions apply, regulations will ensure that there will be no charge arising (to cover transfers made on or after 6 April 2010).

The Pensions Regulator

TPR has recently published new and revised guidance on several subjects. In the last quarter, guidance on employer covenant, employer debt, and transfer incentives has been published for consultation. In addition, TPR's guidance on record-keeping, winding-up and internal controls has been finalised.

Monitoring employer support

Employer covenant[12]

TPR is consulting on draft guidance for trustees on how to monitor employer support, which includes information on how to assess the sponsor's (and other employers') covenant. The consultation closes on 7 September 2010.

As the draft guidance explains: "[t]he covenant is the employer's legal obligation to fund the pension scheme now and in the future. The strength of it depends upon the robustness of the legal agreements in place and the likelihood that the employer can meet them."

The draft guidance notes that trustees "should consider appointing external experts to advise on covenant", unless they have the requisite skills themselves. Items on TPR's covenant hit list include:

- the employer's financial position;
- the scale of pension obligations relative to cash flow;
- an analysis of the wider economy; and
- the relative priority placed on pension obligations by the sponsor's board of directors.

Managing employer departures

Employer departures from multi-employer schemes[13]

TPR is also consulting on guidance for trustees on understanding the support employers provide in multi-employer schemes and how to manage employer departures. The consultation closes on 23 September 2010.

The draft guidance considers the various mechanisms for dealing with employer departures, including the new restructuring tests, as well as scheme apportionment arrangements and approved withdrawal arrangements, drawing out the key considerations for trustees.

12 Please see our Alert: "Employer covenant - first set of guidance issued" dated 18 June 2010

13 Please see our Alert: "Employer Debt and Multi-Employer Schemes" dated 6 July 2010

Transfer incentives[14]

On 13 July 2010, TPR published for consultation draft revised guidance on transfer and other incentive exercises. The consultation closes on 5 October 2010.

Five key principles

The draft guidance sets out five key principles which an employer should adhere to when making an incentive offer. Whilst the guidance is designed to clarify the role of both employers and trustees, TPR is primarily concerned that members of pension schemes will be disadvantaged by incentive exercises. It suggests that trustees should start from the presumption that such exercises and transfers are not in members' interests and "should therefore approach any exercise cautiously and actively".

Trustees to meet record-keeping targets by December 2012

Record-keeping

Revised record-keeping guidance was published in June 2010. While TPR has not significantly modified its original proposals, from December 2012 it will require all schemes to achieve a target of 100% accuracy for new data and 95% accuracy for legacy data (defined as any data created before June 2010). TPR will also use its regulatory powers to investigate standards within schemes, including sampling schemes for data audit and potential enforcement action where there is a breach of legislation.

Two-year target for completion of winding-up retained

Winding-up

TPR's revised guidance on winding-up was also published in June 2010.

TPR has found progress against its original two-year target for the completion of scheme wind-ups (set out in its guidance of June 2008) to have been positive, particularly with DC schemes, and remains of the view that this target is reasonable.

Guidance for trustees on meeting TPR's standard

Internal controls

June also saw TPR publish revised guidance on internal controls.

This guidance highlights procedures for monitoring and acting on deterioration in employer covenant as one of the key risk areas that should be covered by a scheme's internal controls. It also covers a number of other risks, such as conflicts of interest, relations with advisers and record-keeping; and highlights the usefulness of statements of internal controls in pension schemes' disclosure to members.

14 Please see our Alert: "TPR issues draft guidance on transfer incentives" dated 15 July 2010

Cases

High Court

High Court clarifies who is an employer for employer debt and scheme funding purposes

The Pilots National Pension Fund v Taylor[15]

The High Court decision in this case brings some clarity to the key areas of employer debt and scheme funding.

Background

The decision concerns the Pilots National Pension Fund (PNPF), a UK industry-wide pension scheme for marine pilots. The PNPF is approximately £300m in deficit.

The PNPF was set up in 1971 and, from October 1988, was governed by rules made under the Pilotage Act 1987. Due to the unusual nature and complex history of the scheme, it was not clear to the trustee who was liable for contributing to make up the deficit. The trustee therefore asked the High Court for guidance.

Decision

Employer Debt

Prior to 6 April 2008, a debt calculation was triggered in relation to an employer who ceased to employ persons "in the description of employment to which the scheme relates" when at least one other employer did employ such persons (known as the "employment-cessation event" or ECE). This ambiguous phrase has been the subject of much debate.

After a carefully reasoned analysis, Warren J concluded that only ceasing to employ both active members and those eligible to join the scheme would trigger an ECE in relation to an employer, resulting in a debt becoming payable to the PNPF. This clarification does not alter the principle that when a scheme is closed to future accrual by all employers at the same time there is no ECE trigger.

In April 2008, the ambiguity was resolved by a change to legislation and a debt is now only triggered when a company ceases to employ active members.

Scheme Funding

Trustees of a DB scheme must ensure that a scheme has "sufficient and appropriate" assets to cover its liabilities. Warren J held that:

- employers required to contribute to the scheme under a statutory funding regime should dovetail with those required to pay an employer debt. This is to avoid a "funding gap" which could otherwise open up when an employer ceased to employ active members but was not yet required to pay an employer debt because it still employed eligible employees; and
- the trustee could also use the PNPF's own contribution rule to demand greater contributions than would be required under the statutory funding regime.

Comment

This comprehensive judgment deals with a vast array of issues, many of which are specific to the PNPF. However, subject to an appeal which has been granted on limited grounds, the decision gives the trustee a legal framework from which to start addressing the substantial deficit in the PNPF.

15 Please see our Alert : "Pilots Case: Charting a Course to Clearer Water?" dated 28 June 2010

TPR Determinations

Determination on first Contribution Notice

TPR has published a determination to issue a £5m Contribution Notice (CN), in relation to the Bonas Group Pension Scheme (the Scheme). This is the first CN issued by TPR.

Background

TPR can issue a CN (provided it is reasonable to do so) where, in the preceding six years, there has been:

- an act or deliberate failure to act designed to avoid or reduce a debt that would otherwise have fallen due from a company to a pension scheme; or
- with effect from 14 April 2008, an act or failure to act which has detrimentally affected, in a material way, the likelihood of a scheme being able to pay members' benefits.

The CN can be aimed at parent and associated companies, directors or shareholders who were a party to that act (or failure to act) requiring them to pay to the Scheme the amount which would otherwise have been paid.

Facts

The sponsoring employer of the Scheme, Bonas UK Limited (Bonas), was acquired by Belgian company Michel Van De Wiele N.V. (VDW) in 1998. Bonas was operating at a significant loss and continued to do so. By the November 2005 valuation date, the Scheme had a £7.7 million deficit. Bonas itself was heavily financially supported by VDW to allow it to continue in business.

Towards the end of 2006, VDW put Bonas into administration and immediately afterwards the business and assets of Bonas were transferred to a new company (this type of arrangement is often known as a "pre-pack administration"). The liability of the Scheme remained with Bonas. At no point in the run-up to this pre-pack administration did VDW give the trustees of the Scheme any opportunity to negotiate as to the level of contributions to the Scheme, nor was TPR's guidance sought.

Contribution notice imposed after company failed to engage with trustees and TPR

Determination

TPR's Determinations Panel (the Panel) found that VDW had deliberately avoided telling the Trustees or TPR about the pre-pack administration so that it could walk away from the Scheme, taking the risk of a CN being sought by TPR rather than face the swift imposition of a financial support direction or a CN. The Panel found that this was VDW's main purpose in refusing to engage with the Trustees and TPR.

The sum stated on the CN of £5.089 million was agreed by both parties as representing the amount needed to fund the Scheme on the PPF basis. TPR considered that it was reasonable to impose a CN for this sum, particularly in view of the fact that the 'act' in question was the concealment by VDW from the trustees of the imminent administration of Bonas.

VDW has appealed the decision.

FSD imposed on overseas group companies

Financial Support Direction issued against Nortel Group companies

TPR has also published a determination to issue a Financial Support Direction (FSD) against 25 companies in the Nortel group in Canada (the Canadian entities), the US (the American entities), and a number of other countries in EMEA region[16] (together, the Target Companies). This is the second FSD imposed by TPR.[17]

Background

When TPR believes that the sponsoring employer of a pension scheme is a service company or is "insufficiently resourced", it can (if it considers it reasonable to do so) issue an FSD directing other group companies (or associates) to put financial support in place. For the purposes of the insufficiently resourced test, from 14 April 2008, TPR may take into account the resources of the whole group of companies.

Facts

Nortel Networks (UK) Limited (NNUK) was a member of the worldwide group of Nortel Network companies (the Group). NNUK was the principal employer of the Nortel Networks UK Pension Plan (the Scheme).

The Group faced serious financial difficulties following the "dot com" crash in 2001. Eventually, after a failed restructuring, NNUK entered administration in January 2009.

The day before NNUK went into administration, the Scheme's assets were valued at £1.4 billion, while the debt due under section 75 was in the region of £2.1 billion. It was estimated that the likely distribution to NNUK's creditors (which included the Scheme) would be of the order of 15%.

Determination

Having concluded that NNUK was insufficiently resourced, the Panel also found that it was reasonable to impose the requirements of an FSD on the Target Companies, thus requiring those companies within the Group to provide financial support for the scheme.

Comment

The American Entities and the Canadian Entities went into Chapter 11 insolvency proceedings in January 2009. Chapter 11 is a form of financial reorganisation which allows companies to continue to function while they follow debt repayment plans. An "automatic stay" is applied to prevent new debts being issued against a company in Chapter 11.

Following the issue of the FSD warning notice, in early 2010, both the Ontario Superior Court in Canada and the US Bankruptcy Court declared that the imposition of an FSD would breach the automatic stay of proceedings. Therefore, the FSD was void. A subsequent appeal by TPR in Canada failed. No judgment has yet been published in relation to the US Appeal.

Nonetheless, TPR presented its case to the Panel on 2 June 2010, at which hearing the Target Companies chose not to participate. The Panel released its determination with reasons to all parties on 25 June 2010.

16 Europe, Middle East and Africa

17 The first was imposed on the Sea Containers Group, see our press release dated 6 February 2008

In the pipeline

End September 2010	Institutional investors to publish statement of compliance with Stewardship Code
1 October 2010	Majority of the Equality Act 2010 in force
April 2011	Switch from RPI to CPI as the statutory measure of price inflation for increases to pensions in payment and deferment
6 April 2011	Pensions tax relief restrictions implemented?
6 April 2012	Abolition of DC contracting-out
1 October 2012	Start of phasing-in of employer duty to enrol jobholders automatically into NEST or a qualifying pension scheme (subject to review)
December 2012	Record-keeping targets in force

Sacker & Partners LLP
29 Ludgate Hill
London EC4M 7NX
T +44 (0)20 7329 6699
F +44 (0)20 7248 0552
E enquiries@sackers.com
www.sackers.com

Sackers

Nothing stated in this document should be treated as an authoritative statement of the law on any particular aspect or in any specific case. Action should not be taken on the basis of this document alone. For specific advice on any particular aspect you should consult the usual Solicitor with whom you deal. © Sacker & Partners LLP September 2010