Sackers

# The Quarterly
## September 2011

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

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**Abbreviations commonly used in the Quarterly:**

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

**AA:** Annual Allowance

**CPI:** Consumer Prices Index

**DB:** Defined benefit

**DC:** Defined contribution

**DWP:** Department for Work and Pensions

**ECJ:** Court of Justice of the European Communities

**EFRBS:** Employer Financed Retirement Benefit Schemes

**FAS:** Financial Assistance Scheme

**HMRC:** HM Revenue & Customs

**HMT:** HM Treasury

**IASB:** International Accounting Standards Board

**LTA:** Lifetime Allowance

**PIP:** Pension Input Period

**PPF:** Pension Protection Fund

**RPI:** Retail Prices Index

**S2P:** State Second Pension

**SPA:** State Pension Age

**TPR:** The Pensions Regulator

# Legislation

## Finance Act 2011

The Finance Act received Royal Assent on 19 July 2011.[1]

### Pensions Tax Relief

Finance Bill becomes an Act

Measures in the Act relating to the restriction of pensions tax relief include:

- the reduction of the AA to £50,000 (down from £255,000) from the tax year 2011/12;
- the reduction of the LTA to £1.5 million from April 2012 (down from £1.8 million);
- provisions for dealing with pension savings over the AA, including carry forward provisions and the ability to pay charges from pension benefits; and
- closure of the window for changing a scheme's PIP retrospectively from the date of Royal Assent.[2]

### Disguised remuneration

EFRBS lose tax advantage

The Finance Act includes provisions aimed at tackling "disguised remuneration". As well as imposing a tax charge on an arrangement which is designed to avoid or defer income tax, these rules also catch vehicles which aim to avoid the restrictions on pensions tax relief. For example, alternative pension saving vehicles, such as EFRBS, can be caught.

### Removal of the requirement to annuitise at age 75

New drawdown options available

The Act also removes the requirement to purchase an annuity before the age of 75 from 6 April 2011. Capped and flexible drawdown options are now available to anyone over the age of 55, subject to a Minimum Income Requirement (initially set at £20,000) in the case of flexible drawdown.

Schemes which intend to offer a drawdown facility on a regular basis should consider making rule changes to facilitate this. However, helpfully, the Act contains a statutory override which will seemingly allow trustees to offer drawdown even where this is not permitted under the scheme rules.

## Pensions Bill 2010–11

### New version published

Pensions Bill delayed

A new version of the Pensions Bill[3] has been published. However, due to insufficient Parliamentary time, the Bill did not receive Royal Assent before the summer recess. It will be considered again after the House returns in September 2011.

1 Please see our Alert: "Pensions Tax Relief and the Order of the Finance Act" (20 July 2011)

2 Please see our Alert: "The perils of pension input periods" (16 February 2011)

3 Published on the Parliament website on 15 July 2011

# Pensions reform

## Automatic enrolment

Employers will be under a duty (to be phased in from October 2012), to enrol eligible jobholders automatically into a qualifying workplace scheme and pay contributions. New information on implementing the duty is emerging from the DWP and TPR.

### Certification of workplace pension schemes

Simplified certification process

On 19 July 2011, the DWP launched a consultation which follows an independent review published in October 2010, "Making Auto-Enrolment Work".[4] Among other things, the consultation:

- sets out proposals to simplify the process for certifying a DC scheme as an auto-enrolment scheme; and
- includes draft guidance on certification.

### Default options

Standards for DC default schemes

As the enrolment process is automatic, it will not be possible to require employees to make an active investment choice when they are first enrolled. DC qualifying schemes will therefore need to have a default option in place.

Following a consultation which ended in March 2011, the DWP has published guidance[5] on default options for DC auto-enrolment schemes. This principles-based guidance sets out the standards which should be met when governing, designing, reviewing and communicating the default option.

### Guidance

TPR writes to biggest employers

TPR is writing to the chief executives of the UK's biggest employers to signal the countdown to October 2012. Every employer in the UK will receive at least two letters from TPR as they approach their staging date (i.e. the date when automatic enrolment first applies to them, assessed by reference to the size of the employer's PAYE scheme).

Other publications provided by TPR to date include[6]:

- a summary of employer duties;
- an indicative table of staging dates for the new duties;
- detailed guidance on all aspects of the workplace pension reforms; and
- a checklist for trustees of existing schemes.

### Short service rules

Further consultation expected

There are concerns that differences between trust based occupational pension schemes and contract based workplace personal pensions may lead to a windfall for employers.[7] If a short service refund is requested from an occupational pension scheme, only employee contributions are paid back, leaving employer contributions in the scheme (which may be used by the employer to provide benefits for other members). There is no right to such a refund from a personal pension scheme.

The DWP has indicated that proposals to address short service refunds, as well as small pension pots and transfers, will be put forward by the Government later this year.[8] In the meantime, employers should not assume that short service rules will continue to exist in their current form.

4 Please see our Alert: "The Road to 2012: Final Preparations Underway" (22 July 2011)

5 Guidance for offering a default option for defined contribution automatic enrolment pension schemes (May 2011)

6 Available from TPR's website

7 Preparing for automatic enrolment: Regulatory differences between occupational and workplace personal pensions (31 January 2011)

8 Call for evidence: DWP response (27 June 2011)

# Employer debt

## Consultation

Flexible apportionment arrangements

In 2010, two easements to the employer debt legislation were introduced to facilitate corporate restructurings, provided stringent conditions were met. However, as these have not generally afforded sufficient flexibility for companies, the DWP is consulting [9] on further draft amending regulations.

The consultation proposes a new option for dealing with an employer debt in a multi-employer DB scheme, the "Flexible Apportionment Arrangement" (FAA). Where certain conditions are met, it will be possible to use an FAA in any circumstances, not just a corporate restructuring, and no debt will be triggered.

It is also proposed that trustees will have discretion to extend an employer's "period of grace" (which allows an employer to cease employing an active member of the pension scheme temporarily without triggering a debt), up to a maximum of 36 months.

# Sex-based actuarial factors

## Test-Achats: The use of gender by insurers

Only new insurance contracts to be affected

In March 2011 the ECJ ruled that, with effect from 21 December 2012, an exemption in a European Directive[10] which permits insurers to use sex as a determining factor in their assessment of risk, will no longer be valid.

A recent Treasury announcement [11] indicates that the Government considers the judgment only to apply to new contracts for insurance and related financial services entered into on or after 21 December 2012. It intends to amend the Equality Act 2010 in early 2012 to make the necessary changes.

However, the written statement does not address the issue of sex-based actuarial factors used in occupational pension schemes. This is a distinct but analogous issue, governed by a different EU directive.[12]

# State pension reform

## Summary of responses to consultation

Single tier pension preferred by respondents

The Government has published a summary of responses[13] to its April 2011 consultation[14] on the following options for reforming the state pension system:

- faster flat rating of S2P, with S2P remaining separate from the basic state pension; and
- a single tier pension, combining the basic state pension and S2P into one.

No conclusions have been drawn by the Government in the response, but we expect a White Paper and full Impact Assessment to follow.

9 Please see our Alert: "Employer Debt Revisited" (30 June 2011)

10 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

11 Financial Secretary to the Treasury: Written Ministerial Statement (30 June 2011)

12 Please see our Alert: "Is it the end of the road for sex-based actuarial factors?" (2 March 2011)

13 A state pension for the 21st century: A summary of responses to the public consultation (27 July 2011)

14 Please see our Alert: "A State Pension for the 21st Century?" (6 April 2011)

# The switch from RPI to CPI

## Consultation response

### No statutory override

The Government has published a response[15] to its consultation on the switch from RPI to CPI for increases to pensions in payment and revaluation in deferment. In addition, related changes have been made to the Pensions Bill.

Key points:[16]

- there will be no statutory override or modification power to make it easier for schemes with RPI written into their rules to make the switch to CPI;
- a statutory easement will make a CPI underpin unnecessary for schemes which use RPI for pensions in payment;
- the statutory easement will also extend to revaluation of pensions in deferment; and
- the proposed easement conditions have been amended so that measures do not act as a "disincentive to business mergers and acquisitions" (for example, where a bulk transfer is made, an underpin would not be required if RPI increases have been continuously provided).

# Workplace Retirement Income Commission

## Final report published

### Recommendations for reform

Led by Lord McFall, the independent Workplace Retirement Income Commission (WRIC) was set up in early 2011 to conduct a review of retirement saving. Its final report[17] sets out 16 proposals for further action by Government, the industry, regulators and pension savers.

WRIC sees automatic enrolment as a positive step to get more people saving for their retirement, but estimates that around nine million people risk missing out. Key recommendations include:

- the development of new, more opaque, charging structures;
- a default transfer option for small pension pots, such as NEST; and
- the establishment of a permanent, independent pensions commission.

15 Government response to consultation: The impact of using CPI as the measure of price increases on private sector occupational pension schemes (16 June 2011)

16 Please see our Alert: "No surprises: the RPI/CPI consultation response" (21 June 2011)

17 Published on the WRIC website on 1 August 2011

# Regulatory

## Accounting Standards

### IAS19

"IAS19 Employee Benefits" is the standard which prescribes the accounting and disclosure for employee benefits.

Pensions accounting changes

The IASB published an amended version of IAS19 in June 2011. The amendments are designed to provide a clearer picture of an entity's obligations resulting from the provision of DB pensions and how those obligations will affect its financial position, financial performance and cash flow.

## European Union

### AIFM Directive

The Council of the EU has adopted the Alternative Investment Fund Managers (AIFM) Directive[18] to harmonise rules for entities engaged in the management of alternative investment funds, such as hedge funds and private equity firms.

Directive in force

The Directive is aimed at:

- establishing common requirements for the authorisation and supervision of AIFMs, to provide a coherent approach to the related risks and their impact on investors and markets in the EU; and
- allowing AIFMs to provide services and market EU funds throughout the EU single market, subject to compliance with strict requirements.

The Directive came into force on 21 July 2011. Member States now have two years from that date to transpose the Directive's provisions into national law.

### Review of the Pensions Directive

The European Insurance and Occupational Pensions Authority is reviewing the Pensions Directive[19] in order to provide advice to the European Commission and has asked for views.

The consultation focuses on the scope of the Directive, the definition of "cross-border activity", the scope of prudential regulation and the governance of pension schemes.

## HM Treasury

### Employer asset-backed contributions

Tax relief must reflect actual value of contributions

HMT and HMRC are consulting jointly on changes to the tax rules relating to employer asset-backed contributions (ABCs) to DB registered pension schemes.

It is proposed that the changes will limit the unintended tax relief that can arise from the way in which some ABCs are structured. The Government's main aim is to ensure that the amount of tax relief given to employers accurately reflects the value of the contributions received by pension schemes, while preserving flexibility for both employers and schemes to use such arrangements to manage pension deficits.

18 Directive 2011/61/EU on Alternative Investment Fund Managers

19 Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision

# Regulatory (continued)

First payments made to policyholders

## Equitable Life Payment Scheme

The Treasury has published the Equitable Life Payment Scheme design document[20] and the first cheques were sent to Equitable Life policyholders on 30 June 2011.

# Pension Protection Fund

## New levy framework

The Board of the PPF has announced details of its new pension protection levy framework which will take effect from 2012/13.

Levy framework fixed for three years

Key features of the new framework include:

- fixing levy rules for three years to provide certainty;
- averaging funding levels so that short-term volatility in financial markets is not reflected in the measure of underfunding risk;
- reflecting investment risk in the levy calculation for the first time; and
- a system of ten insolvency rating bands - an increase from the six originally proposed. This addresses industry concerns that six bands would create “cliff-edges”, where schemes could possibly face large levy rises.

## Fraud compensation levy

The PPF Board has decided to raise a Fraud Compensation Levy for 2011/12. The levy will be charged at the rate of 25p per scheme member.

# The Pensions Regulator

Scheme funding analysis

## Recovery plans: Scheme funding and other security arrangements

TPR has published part two[21] of its December 2010 report, “Recovery plans: Assumptions and triggers”, presenting an analysis of recovery plans with valuation dates up to and including 21 September 2009 that were submitted to TPR before 1 February 2011. It specifically considers the funding aspects of these plans, where the December 2010 report covered the technical assumptions underlying funding targets and statistics relating to TPR’s triggers.

Who is a statutory employer?

## Identifying statutory employers

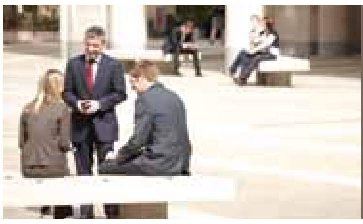
DB scheme trustees need to identify their scheme’s statutory employer for a number of reasons, including assessing the nature and extent of the employer’s legal obligations towards the scheme. Given the importance of this exercise, TPR has published a statement[22] which is designed to help trustees with this.

From November 2011, TPR’s Scheme Return forms will include a requirement that trustees identify the statutory employer for their scheme.

20 On 16 May 2011 (available from the HMT website)

21 Published in June 2011 (available from TPR’s website)

22 On 28 July 2011 (available from TPR’s website)



# Cases

## Supreme Court

### Houldsworth v Bridge Trustees Limited

The Supreme Court's decision in this case was handed down on 27 July 2011. It addresses the dividing line between DB and DC benefits. How the benefit is classified makes a difference to the protections afforded by legislation. For this reason, the Government intervened in the case, sponsoring the appeal first to the Court of Appeal and then to the Supreme Court.

**Background**

When the winding-up of the Imperial Décor Pension Scheme (the Scheme) began in October 2003 it had a £40 million deficit. Originally a DB scheme, changes over the years had resulted in a varied and complex benefit structure. The original application to the Court was brought by the Scheme's trustees to determine how the statutory priority order [23] on winding-up should apply.

DC benefits with a guaranteed investment return are "money purchase benefits"

The priority order establishes priority for payment where a scheme winds up in deficit. Where DB assets are insufficient to satisfy all the liabilities in a particular class they are applied across the whole class and any lower ranking class remains unsatisfied. Under the relevant legislation, "money purchase benefits" fall outside the statutory priority order.

The two benefits at issue in the appeal to the Supreme Court were not obviously DB or DC. They were:

- a money purchase benefit with a guaranteed investment return; and
- a pension benefit purchased in the Scheme with a money purchase "pot" (known as an internal annuity).

Internal annuity purchased with DC pot remains DC

In both cases a deficit could arise in the Scheme as a result of the provision of these benefits. The Government considered both these benefits to be DB in nature – its view being that a money purchase benefit can have no mismatch between assets and liabilities.

**Decision**

The Supreme Court disagreed. It concluded that:

- DC benefits with a guaranteed investment return could be "money purchase benefits" for the purposes of pensions legislation; and
- DC internal annuities may also be characterised as DC not DB, both the investment and longevity risk being retained within the Scheme.

**Comment**

DWP to change law

The DWP has issued a statement which explains that it intends to introduce retrospective legislation [24] which will ensure that benefits which may create a funding deficit may not be classified as "money purchase". It is particularly concerned that members with these types of benefits may not have the advantage of protective legislation, such as that relating to scheme funding, employer debt, the PPF and FAS.

23 The case concerned the pre-2005 statutory order of priority on winding up

24 At least to the date of the judgment

# Court of Justice of the European Union

## Fuchs & Köhler v Land Hessen

**Background**

German Federal law requires permanent civil servants to retire on reaching the "retirement age". The retirement age is determined by the individual states and is set at 65 in Hessen, subject to certain limited exceptions. (The law also allows retirement to be postponed for periods of no more than a year if this is "in the interests of the service", subject to an overall retirement age limit of 68.)

Mr Fuchs and Mr Köhler, state prosecutors, brought actions disputing the retirement age when their applications to work beyond age 65 were rejected.

Compulsory retirement age of 65 held to be capable of objective justification

**Decision of the ECJ**

The ECJ was asked to consider whether the retirement age for state prosecutors was incompatible with, in particular, Article 6 of the Framework Directive on Equal Treatment[25] (age discrimination).

The ECJ concluded that a compulsory retirement age could be objectively justified as a proportionate means of meeting a legitimate aim:

- its aim of establishing a balanced age structure to encourage the recruitment and promotion of young people and to improve personnel management (thereby preventing possible disputes concerning employees' fitness to work beyond a certain age), was legitimate; and
- the setting of a compulsory retirement age did not go beyond what was appropriate and necessary to achieve the aim. Broadly, retirement age was the only means of ensuring fair distribution of employment among the generations. Further, prosecutors are able to retire at 65 on a pension equivalent to 72% of their salary and are not precluded from finding alternative employment.

Cost alone not enough

**Can cost savings be a legitimate aim?**

The German government asked whether an aim of "achieving budgetary savings" would be regarded as a legitimate aim for the purposes of establishing objective justification. The ECJ considered that such savings could underpin the chosen social policy of a Member State and influence the nature or extent of the measures it wished to adopt but that such considerations could not *in themselves* constitute a legitimate aim for the purposes of the Directive.

**Comment**

The case will be remitted to the German courts for a decision on the facts.

It provides useful guidance for UK employers on potential legitimate aims for justifying the use of compulsory retirement ages and seems to support some of those argued in the case of *Seldon v Clarkson Wright & Jakes* last year.

It would appear from its comments on cost as a legitimate aim for the purposes of establishing objective justification, that the ECJ still considers that such an aim would be insufficient on its own. This fits with current UK case law on the issue (see *Cross v British Airways*), suggesting that *Woodcock v Cumbria Primary Care Trust,* in which cost alone was sufficient to prove objective justification, is confined to its own facts.

25 Directive 2000/78/EC

# The Pensions Regulator

## Contribution notice in relation to the Bonas Group Pension Scheme

TPR has issued a contribution notice (CN) against Michel Van de Wiele (VdW) in relation to the Bonas Group Pension Scheme (the Scheme).

**Background**
The sponsoring employer of the Scheme, Bonas UK Limited (Bonas), was acquired by VdW in 1998. Bonas was operating at a significant loss and continued to do so. 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. Neither the trustees nor TPR were consulted.

First CN issued

**TPR's decision**
TPR's Determinations Panel (the DP) concluded that VdW had deliberately avoided telling the Trustees or TPR about the pre-pack administration, 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 DP issued a CN for £5.089 million, based on the PPF deficit.

**Review of TPR's decision**
VdW made an application to the Upper Tribunal (where appeals from the DP are heard) to strike out TPR's case. This was refused by Warren J who confirmed that a CN can be issued in circumstances where a business is sold for a low value and the trustees are disadvantaged.

However, he also made a number of non-binding comments on the way in which the CN should be calculated. Warren J's view is that the purpose of the legislation was not to impose a penalty, merely to provide compensation for detriment caused. TPR has made it clear that it remains of the view that a CN is not limited to compensation.

Settlement agreed

**Settlement**
In June 2011, TPR announced that a settlement had been reached and that a CN should be issued for £60,000. This is obviously a significant reduction from the sum originally proposed and, we understand, reflects an amount proportionate to the detriment suffered (in line with Warren J's reasoning in the Tribunal).

# In the pipeline

| | |
|---|---|
| Autumn 2011 | Pensions Bill to receive Royal Assent |
| Autumn 2011 | Court of Appeal decision in *Nortel / Lehman* expected |
| Autumn 2011 | Consultation on GMP equalisation? |
| Autumn 2011 | Further consultation on disclosure legislation? |
| 1 October 2011 | Employer debt amendments in force? |
| 6 April 2012 | Abolition of DC contracting-out |
| 6 April 2012 | LTA reduced to £1.5m |
| 1 October 2012 | Auto-enrolment starts to be phased-in |
| December 2012 | TPR's record-keeping target date |

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