Sackers

The Quarterly
September 2012

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

The Quarterly September 2012

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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)

CARE: Career Average Revalued Earnings

CN: Contribution Notice

CPI: Consumer Prices Index

DB: Defined Benefit

DC: Defined Contribution

DWP: Department for Work and Pensions

ECJ: European Court of Justice

EEA: European Economic Area

FSD: Financial Support Direction

GAD: Government Actuary's Department

HMRC: HM Revenue & Customs

HMT: HM Treasury

NAPF: National Association of Pension Funds

NEST: National Employment Savings Trust

PPF: Pension Protection Fund

SPA: State pension age

TPR: The Pensions Regulator

TUPE: Transfer of Undertakings (Protection of Employment) Regulations 2006

Pensions reform

Automatic enrolment

Starting in October 2012, the UK's largest employers (those with a PAYE scheme of over 120,000) will be required to enrol their eligible jobholders[1] into a qualifying pension scheme and pay contributions. However, provisions to prevent an employer from inducing or offering incentives to their staff or prospective employees to abandon retirement saving came into force on 1 July 2012 for all employers.

Staging dates

Staging dates confirmed

The Government has confirmed the automatic enrolment implementation timetable[2] for employers with fewer than 250 workers in their PAYE scheme.

The requirements for "small employers" have been simplified, so employers are now only required to establish the number of workers in their PAYE scheme as at 1 April 2012. The changes also allow any employer with a PAYE scheme for 50 or more persons (as opposed to "workers") to move their staging date. This measure is designed to help those small employers who pay a company pension to former employees through their payroll.

Eligible jobholders

Increase in qualifying earnings band

There have been a number of adjustments to legislation, including:

- an increase in both the earnings trigger for automatic enrolment and re-enrolment to £8,105, and the qualifying earnings band in the Pensions Act 2008 to between £5,564 and £42,475, in line with tax and national insurance thresholds;
- the inclusion of offshore workers within automatic enrolment if they are working (or "ordinarily work") in the UK sector of the continental shelf; and
- the exclusion from automatic enrolment of cross-border employees who are subject to the social and labour laws (relevant to the field of occupational pension schemes) of another EEA Member State.

Contributions

Period of phasing for minimum contributions extended

- The phasing of minimum contributions for DC schemes has been extended to ensure that all existing employers are brought into automatic enrolment before the minimum 1% employer contribution increases to 2% in October 2017. The transitional period for DB and hybrid schemes has also been extended and aligned.
- HMRC has updated its guidance[3] on salary sacrifice in line with the automatic enrolment requirements to confirm that any reversion to a higher salary will be possible for jobholders who opt-out of a salary sacrifice pension arrangement, and that no minimum period will apply to a period of salary sacrifice for this purpose.[4]

1 Workers between the ages of 22 and SPA, who earn more than £8,105

2 Published 13 July 2012

3 Salary Sacrifice Q&A

4 Please see our Newsletter: "Automatic enrolment and salary sacrifice" (August 2012)

Pensions reform (continued)

Qualifying schemes

The DWP has published detailed guidance for employers[5] on certifying DB and hybrid pension schemes as qualifying schemes for automatic enrolment. This follows the guidance on certifying DC schemes, which has recently been revised.[6]

Average salary schemes may revalue benefits in line with the general level of prices (CPI capped at 2.5%). Subject to certain conditions being met, CARE schemes with a discretion to revalue, or a mix of guaranteed revaluation below the minimum rate and a discretionary power to revalue at a higher rate, may now be capable of counting as qualifying schemes.

New guidance published

Additional guidance for employers and others includes:

- detailed guidance from TPR for in-house pensions professionals and others;[7]
- an online tool[8] from TPR to help employers check whether their existing DC scheme meets the minimum criteria for an automatic enrolment scheme;
- an updated version of the DWP's pensions language guide;[9]
- NAPF leaflets[10] offering step-by-step guidance on what employers have to consider in the run-up to automatic enrolment.

Communications

NEST has launched[11] eight "golden rules" for talking about pensions in the automatic enrolment context. These include the use of examples that people can relate to, as opposed to abstract concepts, and making pensions relevant to people's lives now.

In addition, changes have been made to the disclosure regulations[12] to allow a one month period for pension schemes to issue basic scheme information to jobholders, to ensure that as far as possible, this information is received before the end of the automatic enrolment opt-out period.

Compliance

TPR publishes compliance strategy

TPR has published a "compliance and enforcement strategy"[13] for employers who are subject to automatic enrolment duties. The policy document explains how TPR will use its powers and includes details of the approach it will take to prosecutions and inspecting business premises.

TPR will provide information and support to enable employers to fulfil their new duties. However, statutory notices, penalties or escalating fines of up to £10,000 per day may be imposed on those who fail to comply.

5 Published 3 July 2012

6 Published 2 July 2012

7 Updated August 2012

8 DC qualifying scheme tool (launched June 2012)

9 Automatic enrolment and pensions language guide (July 2012)

10 NAPF: New rules for pension saving made simple (various dates)

11 On 22 May 2012

12 The Occupational Pension Schemes (Disclosure of Information) Regulations 1996 (SI 1996/1655)

13 Published 20 June 2012

Asset-backed contributions

Finance Bill gets Royal Assent

Finance Act 2012[14]

The Finance Act 2012 received Royal Assent on 18 July 2012, bringing into force legislation on employer asset-backed contributions (ABCs) to occupational pension schemes which aims to clamp down on arrangements that deliver excessive tax relief.

The Act includes provisions to align the tax treatment of ABCs with the accounting rules for structured finance arrangements, limiting tax relief to reflect the value of the assets received by the scheme. Draft HMRC Guidance[15] explains the availability of upfront tax relief.

Incentive exercises

New code of practice

Code of practice

A non-statutory code of good practice[16] has been introduced to help "crack down" on bad practice in relation to incentive exercises (IEs). It covers two types of IE:

- "transfer exercises", for example, involving a transfer out of a DB scheme on an enhanced basis or in return for some other inducement; and
- "modification exercises", such as a pension increase exchange involving the enhancement of pension income in return for surrendering all or part of future pension increases.

The code consists of seven principles, supplemented by detail as to how they should be applied, including a specific procedure for providing financial advice and guidance.[17]

In the light of the code, TPR has reviewed and replaced its own incentives guidance with a short principles-based statement focusing on the overarching principles from its December 2010 guidance. The Board for Actuarial Standards has also consulted[18] on proposals to bring actuarial work on incentive exercises into the scope of the Financial Reporting Council's technical actuarial standards (TASs) and on whether TASs should include specific principles to be followed when providing actuarial advice on IEs.

Protected rights

Consequential amendments to legislation

Short service refunds

One of the conditions for paying a "short service refund lump sum" is that it has to extinguish all of the member's entitlement to benefits under the scheme. An exception existed to allow schemes to retain protected rights, but when DC contracting-out was abolished from 6 April 2012 and protected rights became ordinary scheme benefits, schemes could no longer rely on this exception in order to pay a short service refund lump sum. HMRC has therefore introduced regulations to allow the partial payment of former protected rights benefits, to assist schemes whose rules reflect the effect of the protected rights legislation.

14 Please see our Alert: "Employer Asset-Backed Contributions: The final piece of the ABC jigsaw?" (20 July 2012)

15 Published on 13 June 2012

16 Published on 8 June 2012

17 Please see our Alerts: "TPR Statement on incentive exercises" (25 July 2012) and "New Code of Practice on Incentive Exercises" (11 June 2012)

18 Published on 11 June 2012

Public sector

Public service pensions

Agreement reached on public sector pensions

Following agreement in December 2011 on the main elements of the new public service pension scheme designs, Government departments continue to engage with trades unions to finalise the remaining details of the new schemes. The Government intends to take forward legislation on the basis of the final agreements during the current Parliamentary session.

The Government has also reviewed the Fair Deal policy[19] and agreed to retain it but allow transferring staff to preserve membership of their current public sector pension arrangements. These arrangements will replace the current broad comparability and bulk transfer approach. Detailed proposals are expected in the autumn.

Small pots

Small pots to follow members

As the Government expects the introduction of automatic enrolment to lead to the proliferation of small dormant DC pots, it consulted in 2011 on options for improving transfers and dealing with small pension pots.

Automatic transfer system to be introduced

It has now decided[20] to introduce a system of automatic transfers so that, when an individual changes employment, their pension pot will automatically follow them to their new employer's scheme. At first, the new system will only apply to DC pots created in automatic enrolment schemes. However, the DWP and a new pensions industry working group will consider further improvements to the current voluntary transfer framework.

State pensions

Flat rate pension and increases in SPA

Detailed proposals awaited on state pensions

In the 2012 Budget, the Chancellor confirmed[21] that a flat rate state pension would be introduced in the next Parliament and that the Government would introduce a mechanism to allow future increases in SPA to take account of changes in longevity. The Pensions Minister, Steve Webb, has since announced[22] that the DWP is still working on details of the changes and that it intends to publish further information on both developments in a White Paper in the autumn.

19 The Fair Deal is a policy applying to public sector staff who are compulsorily transferred to a private sector employer that requires the new employer to provide a "broadly comparable pension scheme for the transferred staff"

20 Please see our Alert: "Improving transfers and dealing with small pension pots" (26 July 2012)

21 Please see our Alert: "Budget 2012: The Pensions Story" (22 March 2012)

22 In a Written Ministerial Statement on 12 July 2012

Regulatory

Department for Work and Pensions

Contracting-out: DB schemes

The DWP is consulting[23] on draft regulations:

DWP consults on consequential amendments

- to clarify its policy intention on satisfying the regulation 42 certification requirements[24] for making changes to rules in relation to DB schemes that have ceased to contract-out; and
- to allow bulk transfers without consent in certain circumstances that are currently not permitted.

European Union

Pensions Directive

The European Commission is in the process of reviewing the existing EU Pensions Directive. The Commission had initially intended to deliver a new draft directive in 2012 but has announced that this will now be tabled "before summer 2013".[25]

Draft pensions directive delayed

The Commission wishes "to maintain a level playing field between insurance companies and pension funds when they supply similar and interchangeable products". A key feature of the proposals is to provide a system that would allow pension schemes to be valued on the basis of the "Holistic Balance Sheet" (HBS). The HBS would require liabilities to be balanced by a mixture of assets, contingent assets, sponsor support and possible access to compensation schemes.

As part of the review process, the Commission requested a quantitative impact study to determine the impact of applying the HBS proposal. This is due to take place in autumn 2012, following an initial consultation on the draft technical specifications to be used.

The Pensions Minister, Steve Webb, has confirmed[26] that "the Government remains resolute it will fight EU plans to apply Solvency II funding to pensions".

Amendments to IAS 19

The amendments made by the International Accounting Standards Board to IAS 19 "Employee Benefits" have been incorporated into EU law.[27] The changes, for annual periods beginning on or after 1 January 2013, include the:

Changes to accounting rules from 2013

- introduction of enhanced disclosures about DB pension schemes;
- modification of the accounting for termination benefits, including a distinction between benefits provided in exchange for service and those provided in exchange for the termination of employment; and
- clarification of the classification of employee benefits, current estimates of mortality rates, tax and administration costs, as well as features of risk-sharing and conditional indexation.

23 Please see our Alert: "Consultation on miscellaneous amendment regulations" (31 July 2012)

24 The Occupational Pension Schemes (Contracting-Out) Regulations 1996 (SI 1996/1172)

25 Announced by Commissioner Michel Barnier in a speech to the Insurance Europe Conference in Amsterdam on 1 June 2012

26 DWP Press Release 21 June 2012

27 Commission Regulation (EU) No 475/2012 of 5 June 2012

Kay Review

Final report

Professor John Kay has published the final report[28] of his independent review to examine investment in UK equity markets and its impact on the long-term performance and governance of UK quoted companies.

Recommendations to affect institutional investors

The review notes the changing role that pension funds have had in equity markets. For example, recent increased regulation and the maturity of pension funds has led both pension fund trustees and insurers to reduce their exposure to equity markets, whereas, in the 1990s, UK insurance companies and pension funds accounted for around half the total holdings (in percentage terms).

Professor Kay makes a number of recommendations, including:

- developing the Stewardship Code (which governs stakeholder engagement, typically a low priority for pension scheme investors) to focus on strategic issues as well as on questions of corporate governance; and
- a review by the Law Commission of the legal concept of fiduciary duty as applied to investment, to address uncertainties and misunderstandings on the part of trustees and their advisers.

HM Treasury

Test-Achats: Sex-based actuarial factors

In the *Test-Achats*[29] case, the ECJ ruled that, with effect from 21 December 2012, an exemption in the Gender Directive[30] permitting insurers to use sex-based actuarial factors to assess risk will no longer be valid.

Exemption for occupational pension schemes remains

HMT's recent consultation response[31] confirms how the law will be changed in order to implement the decision but that, crucially, occupational pension schemes should be able to continue taking advantage of a similar exemption in the Equal Treatment Directive.[32]

In relation to pensions and annuities, the Government:

- notes the confusion as to whether the Directive covers annuities bought using money from an occupational or workplace pension scheme;
- acknowledges, and will keep under review, concerns that the judgment will result in a "two tiered" annuity market, to the detriment of consumers; and
- states that, until the position becomes clearer, providers should calculate the maximum drawdown pension for both men and women aged 23 and over using the higher rates from the GAD drawdown tables from 21 December 2012.[33]

28 The Kay Review of UK equity markets and long-term decision making (23 July 2012)

29 *Association Belge des Consommateurs Test-Achats* (Case C-236/09)

30 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

31 UK response to the 1 March ECJ ruling that insurance benefits and premiums after 12 December 2012 should be gender-neutral – Government response, 17 July 2012

32 Directive 2000/78 EC establishing a general framework for equal treatment in employment and occupation

33 HMRC guidance (8 August 2012)

Banking White Paper

The Government has published a White Paper[34] setting out proposals for fundamental reform of the UK banking structure, following the recommendations of the Independent Commission on Banking. The White Paper includes further detail on plans to separate retail and investment banking through a ring-fence and increasing competition in the banking sector.

Proposals to separate schemes

For pensions, the Government's preferred option is to separate the pension schemes for employees of ring-fenced banks from the pension schemes of other group entities "to ensure that the ring-fenced bank cannot be made jointly and severally liable for any pension deficit arising elsewhere in the group". The Treasury proposes to give banks until 2025 to fully separate their schemes. Draft legislation is due in the autumn, with the Government intending that all legislation should be in place by the end of this Parliament (May 2015).

Pension Protection Fund

Schemes in assessment

The PPF has been consulting on certain changes to:

- allow the PPF to use a funding determination (under which an estimate of the protected liabilities and assets is provided) in place of a section 143 valuation where a scheme in an assessment period is either very underfunded or very overfunded;
- amend the process for reconsideration of applications for PPF entry, to allow a scheme to make an application for reconsideration if they are unable to obtain a protected benefits quotation;[35]
- the way in which the assets and liabilities of an occupational pension scheme can be valued as part of the assessment process; and
- the information a scheme must provide when making an application to be reconsidered for entry to the PPF.

Assessment process

In addition, the PPF has launched a Specialist Administration Services Panel which is designed to reduce the time spent by schemes in assessment or wind-up.

The Pensions Regulator

Statement on FSDs and insolvency

TPR outlines approach

In July 2012, TPR published a statement[36] to help banking, insolvency and restructuring professionals understand its approach to FSDs in insolvency situations, and its obligation to ensure that regulatory powers are used reasonably in the interests of both schemes and the PPF.

The statement is made in the light of the Court of Appeal decision in *Bloom v TPR*,[37] which held that FSD liabilities rank as an expense in an administration. The statement aims to allay fears that the judgment could frustrate the administration process and make banks more reluctant to lend if their debt did not have priority.

34 Published on 14 June 2012

35 A quotation from an insurance provider of the costs of buying an annuity policy to secure scheme members' benefits at the level of compensation they would receive if the scheme transferred to the PPF

36 Financial support directions and insolvency (July 2012)

37 [2011] EWCA Civ 1124

DC Pensions

Following the publication[38] of TPR's six principles for good workplace DC pension provision, TPR has issued a statement[39] to give feedback to those providing and running DC schemes. The statement also sets out TPR's plans for developing its regulatory approach for DC schemes.

Employer debt guidance

TPR updates guidance

TPR has published revised guidance[40] on multi-employer schemes and employer departures. The guidance includes new information on:

- flexible apportionment arrangements[41] which allow an employer to exit a multi-employer scheme without triggering a section 75 debt; and
- changes to the "period of grace" conditions.

TPR report on the BMI Group

TPR has published a report[42] setting out the background to, and reasoning for, its decision not to issue an FSD or CN to Lufthansa following a clearance application to substitute Lufthansa for a shell company and to discharge the BMI Group under an apportionment arrangement. In the circumstances, TPR concluded that its moral hazard powers were not available to it. An "important factor" in TPR's decision was the support provided to the pension scheme during Lufthansa's ownership which had enabled BMI to continue as a going concern and fund the scheme.

The Takeover Panel

Issues for pension scheme trustees

Extension to pension scheme trustees?

As part of the ongoing review of certain aspects of the regulation of takeover bids, the Takeover Panel's "Code Committee" notes[43] that a number of responses to its 2011 consultation from pension scheme trustees and their advisers requested that the provisions of the Takeover Code that apply to the employee representatives of the offeree company pension scheme should be extended to apply to the trustees of the offeree company's pension scheme.

The Code Committee is now consulting[44] on proposals to amend the Code, including a requirement for the offeror to include a statement in the offer document as to its intentions with regard to the offeree company's pension scheme and the likely repercussions of its strategic plans for the offeree company on the scheme. As drafted, the offeree company would be required to append to its circular an opinion from the trustees of its pension scheme giving its views on the offer.

38 On 6 December 2011

39 Enabling a good member outcome in DC pensions (June 2012)

40 Published 16 July 2012

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

42 Report under s.89 of the Pensions Act 2004 (May 2012)

43 Response statement by the Code Committee of the Panel following the consultation on PCP 2011/1

44 Consultation on pension scheme trustee issues published on 5 July 2012

Cases

High Court

The Proctor & Gamble Company v Svenska Cellulosa Aktiebolaget

This case provides guidance on the ECJ's decisions in *Beckmann*[45] and *Martin*[46] regarding the transfer of early retirement pensions under TUPE.

Court confirms extent of transfer obligation under TUPE

Broadly, under TUPE, all of a seller's obligations to the transferring employees are transferred to the buyer, except those relating to an occupational pension scheme in respect of "benefits for old age, invalidity or survivors". The *Beckmann* and *Martin* decisions indicate that liability for early retirement benefits does transfer under TUPE, as such benefits do not fall within the TUPE exemption. However, the cases left uncertainty as to the scope of the requirements to provide those benefits.

In this case, the transferee was only liable for the pension payable from normal minimum pension age (the earliest age from which benefits could be taken) up to the members' normal retirement date (NRD). Pension payments from NRD are "old age benefits" and are therefore covered by the TUPE exemption.

Bradbury v British Broadcasting Corporation (BBC)

This case confirms that an agreement by a member to accept a pay rise on the basis that only part of it will be pensionable is binding on the member and will override the pension scheme's rules if necessary, subject to the employer's implied duty of trust and confidence[47] and/or good faith (the "Implied Duties").

Case sent back to Pensions Ombudsman

The BBC capped increases in pensionable pay to 1%. Members who did not agree to the cap did not receive a pay increase. Warren J was satisfied that the cap on pension increases could be properly implemented by means of a contractual agreement with members giving their informed consent to the changes (following *South West Trains*[48] and *IMG*[49]) and that such an agreement could override a scheme's rules.

Unfortunately, as the Implied Duties issue was not raised by Bradbury until the appeal from the Pensions Ombudsman in the High Court, Warren J was unable to draw any conclusions on this point (not having evidence before him). The case has therefore been sent back to the Pensions Ombudsman and decision on the appeal has been reserved until this point is decided.

Upper Tribunal

The Trustees of the Lehman Brothers Pension Scheme v TPR[50]

In the ongoing Lehmans litigation, the Upper Tribunal held that the trustees were "directly affected" by TPR's determination to issue FSDs. The Tribunal held that it was possible to direct TPR to include the other target companies in the FSD even though the time limit for TPR to do so had passed.[51]

We expect the Supreme Court to hear the appeal on the status of an FSD in a company administration by the end of 2012.

45 *Beckmann v Dynamco Whicheloe Macfarlane* ECJ Case C-164/00

46 *Martin v South Bank University* ECJ Case C-4/01

47 Developed in *Imperial Pension Trust Ltd v Imperial Tobacco Ltd* [1991] 1 WLR 589

48 *South West Trains v Whightman* [1998] PLR 183

49 *IMG v German* [2011] 002 PBLR - [2010] EWCA Civ 1349

50 Reference: FS/2010/0029-31

51 It should be noted that subsequent changes made by the Pensions Act 2011 mean that TPR is now only required to issue its warning notice, rather than the final determination, within the prescribed period

In the pipeline

2012	GMP equalisation: DWP response to consultation awaited
2012	Consultation on the definition of "money purchase benefits" due
Autumn 2012	White Paper on state pension reforms expected
Autumn 2012?	White Paper on "reinvigorating workplace pensions" (incorporating DWP proposals on 'defined ambition' pensions)
1 October 2012	Automatic enrolment starts to be introduced
Autumn 2012	Supreme Court hearing due in Nortel / Lehman FSD appeal
December 2012	TPR's record-keeping target date
Summer 2013	Draft EU Pensions Directive to be published?
2012 - 2014	Legislation to implement changes to public sector pensions

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