

IN FOCUS

PENSIONS & INCENTIVES NEWS

Welcome

Welcome to the summer edition of **In Focus**, our quarterly update keeping you informed of the latest developments in pensions and incentives law.

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Work before play

Trustees need to work at setting genuinely prudent technical provisions. Then there is room for play in the recovery plan. This is how the Pensions Regulator (TPR) sees defined benefit schemes and employers getting through the recession.

TPR is telling trustees that if they set a prudent funding target after giving careful consideration to the employer covenant, they can be flexible over the recovery plan. Its code of practice allows this balance between the interests of members and employers.

The underlying message is a tough one: the starting point for funding negotiations is being frank about scheme liabilities and the strength of the employer.

In a series of workshops and a new statement* TPR has explained its approach to scheme funding during the recession:

- recession means many employers have little cash in the short term and face an uncertain longer term future. But TPR's approach to scheme funding is flexible enough to cope,

- if the basis for technical provisions is genuinely prudent, there can be flexibility over the recovery plan e.g. recovery periods are not limited to 10 years, and back-end loading, contingent assets, and agreements on profit sharing between shareholders and creditors can all be used,
- any risk margin in the basis for technical provisions must be justified by the strength of the employer's covenant,
- FRS 17 alone is unlikely to be prudent enough at the moment,
- the recovery plan should be set according to what the employer can reasonably afford,
- assessing the employer's covenant is a complicated business with legal and financial aspects.

*Scheme funding and the employer covenant: prudence, affordability, applying flexibility through the economic cycle – www.thepensionsregulator.gov.uk/pdf/EmployerCovenantStatementJune2009.pdf

Not so happy, not so few

You need £150,000 a year to be in the frame for the anti-forestalling tax charge. But this Budget headline is not the full story.

If your earnings are below £150,000, you can still be caught by the Budget measures intended to deter those with large incomes from boosting their pension saving significantly before they start losing higher rate tax relief from 2011.

This is because it is not just earned income that counts. Also included are interest on savings, dividend income, income from letting property, most pensions and income from trusts. The long list of possible deductions includes pension contributions (up to £20,000 in most cases but £30,000 for some irregular savers) and payments under gift aid. Any salary sacrifice agreed on or after Budget day is added back.

You also have to look back two years. Whatever your income in the current tax year, you are treated as being above the threshold if your income in either of the previous two tax years was £150,000 or more.

So employers should consider alerting anyone with, say, six figure earnings (now or in the recent past) that they might be affected.

The extra tax charge applies if you alter the pattern of your pension saving and your saving is worth more than £20,000 (or £30,000 in some cases).

Exemptions

The Finance Bill creates a number of exemptions by saying that certain events that happen over members' heads do not break an established pattern of saving e.g. scheme mergers when members can be moved between schemes with different benefits. But these important exemptions are briefly stated and may be difficult to apply in many circumstances. The Bill will be law by late July.

On dismissals it can be tax efficient for a payment to be made into a pension scheme. But the anti-forestalling measures now mean that this might not be a good idea for those with higher incomes. Employers also need to be alert to anti-forestalling in relation to salary sacrifice arrangements generally.

Summer special

The Pensions Regulator (TPR) is now able to issue a contribution notice (CN) when a corporate transaction is "materially detrimental" to the ability of a defined benefit scheme to pay its benefits. Unlike in the past, TPR does not need prove that the detriment was intentional.

Until now a CN could only be issued if there is a deliberate attempt to avoid the statutory debt under s.75 Pensions Act 1995. This debt is the often large amount to top a scheme up so it can afford to buy full benefits on the insurance market.

A code of practice explains the circumstances in which TPR might use its new power. Actions since 14 April 2008 (sic) when the Government first announced the idea are open to a CN.

Briefly, the code says that TPR may consider issuing a CN if:

- a scheme or the sponsoring employer is moved out of the UK,
- sponsor support is cut substantially,
- liabilities are transferred to a scheme with significantly less sponsor support, or
- a transaction is designed to turn the scheme to the financial benefit of its sponsor or a third party without proper consideration of members' interests.

Defence

You have a defence if you can show you acted reasonably by considering in advance whether your action might be materially detrimental. If you thought it might be, you must show you took all reasonable steps in mitigation. The key to the defence is creating evidence (like correspondence and notes of meetings with advisers) that you acted reasonably.

TPR must also be satisfied that it is reasonable to issue a CN. This is a significant hurdle. An important consideration is how far the potential recipient benefited from the scheme and the events that proved detrimental.

In principle, the new ground is a tool for regulating the emerging non-insured buy-out vehicles that TPR fears could be a risk to scheme members and the Pension Protection Fund. But it is widely drawn and could be used in other contexts.

The voluntary clearance procedure that TPR will not use its powers on a given transaction remains available.

TPR can issue a CN to the employer that sponsors a scheme and to persons connected or associated with it. "Connection" and "association" are widely defined.

Financial support directions (FSDs)

Where there is a group of companies TPR can issue a financial support direction if the employer sponsoring the pension scheme is weak financially compared to other group companies. In the past, the strength of the sponsor was tested against one other group company but now comparison is with the strength of the group as a whole. This lower threshold is also backdated to April 2008. Connected and associated persons (other than individuals) can receive an FSD. The recipient of an FSD must arrange long-term financial support for the scheme e.g. through guarantees.

Said but not done - yet

All that said, in the four years TPR has had these "moral hazard" powers it has issued only one FSD and no CNs. But media reports have suggested that successful informal approaches for cash injections may have pre-empted CNs in some cases. The new ground of "material detriment" makes CNs more likely.

In the office

We welcome **Alistair Rattray** who will join the pensions team when he qualifies as a solicitor in September. Alistair is with the team while he completes his training.

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News in brief

- The Court of Appeal has issued its decision in the important sex equalisation case of *Foster Wheeler v Hanley*. See our separate briefing. If you have not received a copy, visit www.burges-salmon.com and go to Practices, then Pensions and Incentives, then Publications.

- HMRC regulations allowing trivial commutation of "stranded pots" of up to £2,000 come into effect in December. The new authorised payment comes in two forms. One is for schemes of any size and requires (among other things) the individual's saving in all related schemes to be aggregated for the £2,000 limit.

The other is for schemes with 50 or more members and does not require aggregation. But one of three conditions must be met: the scheme existed in July 2008; the payment relates to defined benefits and at least half the scheme assets support defined benefits; or at least 20 members have pensions worth over £2,000.

The December start date allows time for the contracting out regulations to be amended so that contracted out schemes can take up the new options. **Schemes may well need to amend their rules before they can make the new payments.**

- The PPF has confirmed that it is sticking to its already announced plan of holding its levy estimate for 2010/11 at £700m (the current year's figure), indexed to pay. Schemes will not be able to calculate their payments until later in the year.
- The Equality Bill going through Parliament will bring together and harmonise a lot of the discrimination law that applies to occupational pension schemes. The Bill is expected to become law next year (though an election could delay it). The general aim is not to change discrimination law but to streamline it after 40 years of piecemeal development.