

PENSIONS

LEGAL

Pilot Project

For the first time, key parts of the scheme funding legislation have been interpreted by a court.

The judgement has significant implications for the balance of power between the trustees and the employer when they are finding it difficult to agree funding arrangements.

In the *Pilots National Pension Fund* case, the judge held that:

- under the law before 6 April 2008, the section 75 employer debt was triggered in a multi-employer scheme when an employer ceased to employ both active members and anyone eligible to join the scheme. By contrast, the *Cemex* decision at the end of last year said that an employer also had to cease to employ deferreds and pensioners. *Pilots* is likely to be accepted as the authoritative view.

This may affect employers that ceased to be involved in a multi-employer scheme before 6 April 2008 (when the trigger changed). Some will think they cleared any s.75 liability when they did not; others will have failed to pay up when they should have done. Companies that have been involved in a restructuring that entailed a multi-employer scheme may want to review past events. On future restructurings, the employer debt position should always be looked at closely.

- the funding legislation underpins a scheme's own contribution rule. If it allows the trustees to ask for higher contributions than the scheme rule, they can

make the higher demand. This is uncontroversial.

The big question is the converse: can trustees rely on a scheme contribution rule that allows them to demand more than the legislation? The judge was unwilling to give an answer because the Pensions Regulator was not present to make arguments about its key power to impose schedules of contributions. The judge saw this power as the backbone of the funding legislation. Nevertheless, his provisional (and non-binding) view was that trustees could rely on such a rule. If that view became law in future, trustees would be able to base their funding demands on the legislation or their scheme rules according to which would give them the better result. That would be controversial.

More generally, the judge reconciled the funding legislation with the s.75 debt so that an employer will normally be subject to one regime or the other. Earlier case law appeared to leave a gap between the two with the result that an employer might be able to escape all statutory funding obligations.

Pilots was heard by the most experienced pensions judge, Warren J. His decision in this very technical case is thorough and well reasoned.

The full implications of the case will become clearer over time as schemes work with it in practice. Meanwhile there may be more moves in court and/or steps in Parliament to fine-tune the legislation.

REGULATORY

The Pensions Enforcer

The Pensions Regulator (TPR) is on its way to issuing its first Contribution Notice (CN) and its second Financial Support Direction (FSD). Education has now moved on to enforcement.

The CN will require a parent company to pay £5 million into its subsidiary's DB scheme. The reason for the CN is that the parent withheld information from the trustees and TPR as plans were made for a pre-pack administration (i.e. insolvency) of the subsidiary designed to free it of its pension liabilities. This denied the trustees the chance to enforce the subsidiary's funding obligations.

The focus on the lack of engagement with the scheme

rather than the more obvious target of its planned insolvency underlines TPR's message that what protects schemes finally is day-to-day good governance.

The FSD will be against 25 companies in the international Nortel group. It will require them to provide financial support of £2 billion for the UK company's pension liabilities. The reason for the FSD is that financial arrangements within the group left the UK company financially weak and unable to fund its pension deficit.

It is not yet certain that either sanction will go ahead. In both cases, the recipients have the right to appeal.

continued overleaf

Welcome

Welcome to **Pensions**, our bimonthly update keeping you informed of developments in pensions law.

To find out more about how we can help you with your occupational pension scheme, please email tim.illston@burges-salmon.com or call him on 0117 939 2284.

The Pensions Enforcer

Setback

Meanwhile, TPR has had a setback. In the early moves towards another FSD (in the Lehman bank group), it was faced with judicial review proceedings questioning its right to set a (tight) timetable for prospective recipients to answer

Incentive exercises

New draft guidance* from the Pensions Regulator (TPR) on incentivised transfer exercises underlines its concern that members' interests can be at serious risk. It sets out five principles of transparency and fairness that should govern any such exercise.

A joint statement from TPR and the Financial Services Authority** accompanies the draft guidance. This addresses advisers over the quality of their advice and the handling of conflicts of interest.

The draft guidance also covers other exercises in which members are given a choice e.g. where they are invited to forfeit one benefit for another. To give up non-statutory pension increases for a higher base pension, say.

TPR wants all parties – employer, trustees and advisers – to work to these principles.

- An offer should be made in a clear and fair way so members can understand the implications and make decisions that are right for them.

key allegations. Faced with legal action of this kind for the first time, TPR withdrew the timetable. The case did not go to court. Challenging TPR's procedures in this way could develop into an important check on its powers.

- An offer should be open and transparent so that all parties are made aware of the reasons for the exercise and the interests of the other parties.
- Conflicts of interest should be identified and managed in a transparent manner and, where necessary, eliminated.
- Trustees should be consulted and engaged at the outset. Any concerns they have should be addressed before the exercise goes any further.
- Fully independent and impartial financial advice should be made accessible to all members and be promoted in the strongest terms. In almost all circumstances, the offer should require that members take financial advice.

* www.thepensionsregulator.gov.uk/docs/transfer-incentives-consultation-document-july-2010.pdf

** www.thepensionsregulator.gov.uk/docs/transfer-values-joint-statement-july-2010.pdf

POLICY

RPI RIP

Next year CPI – the consumer prices index – will replace RPI as the measure of inflation for revaluing deferred benefits and for statutory pension increases.

CPI largely excludes housing costs and is normally lower than RPI. But it can be higher and during the recession it has been. The general effect will be to reduce private sector DB pensions over the long term with a corresponding cost saving for employers.

It is not yet clear how the change will be made. According to government statements, revaluation of deferred benefits will be split. If a member leaves before the change, revaluation will be based on RPI until the change and then on CPI. For a member who leaves after the change, it will be based on CPI.

On the other hand, it appears that CPI will apply for increases to pensions in payment whether they were earned before or after the change. This contrasts with the approach taken when the cap on increases was reduced from 5% to 2.5%: the lower ceiling was confined to accrual after the change. As it works out the detail, the government may think again on this.

Devil in the detail

The plan is to change the statutory minimum requirements for revaluation and indexation but not to impose them by

overriding scheme rules. The devil will be in the detailed interaction between scheme rules and the amended statutory requirements.

If your rules say simply that "revaluation / indexation will track statutory requirements", the change to CPI will apply automatically. But if they refer expressly to RPI – e.g. "revaluation / indexation will be RPI up to a maximum of 2.5%" – the question will be whether they can be amended. This depends on the scope of available amendment powers, the meaning of any express restrictions on them, whether the trustees will agree, and any application of section s.67 of the Pensions Act 1995.

Schemes that want to continue to link to RPI will be free to do so. The switch to CPI will also apply to GMPs, payments by the PPF and the Financial Assistance Scheme (FAS), and to pension schemes in the public sector.

You can begin to plan your general response now by considering whether you would like to switch to CPI and looking at your rules. But detailed planning and action need to wait until we see exactly how the legislation will be amended.

News in Brief

- The coalition government is going ahead with the previous government's plan to abolish contracting-out on a DC basis on 6 April 2012. Benefits that would have counted as protected rights will become ordinary DC benefits.
- The government plans to abolish the default retirement age (DRA). Today employers can require employees to retire at age 65 but there will be no fixed retirement age from 1 October 2011. The DRA will cease to apply from 6 April 2011, though retirements notified before then can still take effect in the run up to 1 October. Dismissals from 1 October 2011 will have to be in accordance with normal unfair dismissal principles. There should still be scope – albeit very limited – for employers to impose a compulsory retirement age where this can be objectively justified.

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