

PENSIONS

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.

REGULATORY

PPF Levy 2011/12: Consultation

In a new consultation paper the PPF is again proposing changes to its risk-based levy. If confirmed, they will apply for the April 2011–March 2012 levy year.

The amount it proposes to collect is reduced to £600m (2010/11 £720m). This is on the assumption that the government will bring in the switch it has proposed to index benefits and PPF compensation by CPI rather than RPI.

The PPF is also proposing changes to the formula that plays a large part in distributing the burden of the total levy. The levy cap (the maximum a scheme can pay in risk-based levy) is proposed to rise to 0.75% of liabilities (0.5%). This will cap about 10% of schemes, which is about the same proportion as in 2010/11. The proposal for the taper (which limits the risk-based levy of better funded schemes) is that it will move up to apply from 135-155% funded (120-140%). The scaling factor is 2.07 (1.64).

The overall effect will vary from scheme to scheme; some levies will rise and others fall. As before, schemes that have worked to reduce the risk they pose to the PPF may find that they do not reap the reward.

The final rules will be published in December and are likely to be substantially as proposed.

These changes on insolvency risk will definitely apply for 2011/12 following an earlier consultation:

- a new table of assumed insolvency probabilities will be used. The PPF says the table is fairer because it is closer to the rates of insolvency it has seen in practice;
- where the employer is a charity, D&B will approach the Charity Commissioners for its accounts;
- where an employer wants to argue for a reclassification (e.g. of industry or geographic location), D&B will ask for more evidence. The aim is to limit manipulation;
- PPF compliant contingent assets will be ignored when the effect of charges on a company's assets is assessed; and
- the failure score of a subsidiary of a weak parent will be capped at that of the parent if it is higher.

PPF Levy 2011/12: Data deadlines

A reminder that you can still influence your 2011/12 PPF risk-based levy.

Under the PPF's usual system of working a year in advance, the initial deadline for data (31 March 2010) has already passed. The deadlines still to come are:

- 31 March 2011 for (re)certifying contingent assets like parent company guarantees and charges over property,
- 7 April 2011 for certifying contributions reducing a scheme's deficit, and
- 30 June 2011 for certifying block transfers made on or before 31 March 2011.

You should consider whether contingent assets or extra contributions could help to reduce your risk.

PPF Levy: Long term

For levy year 2012/13 onwards the PPF is proposing to create a more stable and scheme-specific levy formula that would be fixed for three years at a time. Underfunding and insolvency risk would be measured over a period rather than at a single point in time.

The proposal in a new consultation paper aims to align a scheme's levy bill with the risk it poses. To give trustees greater control it also attaches more weight to a scheme's funding position and less to the risk of the employer becoming insolvent.

One of the main criticisms of the current system has been that it produces unpredictable levy bills that are largely dictated by the aggregate risk posed by all DB schemes and by the varying formula for redistributing the total levy that the PPF imposes year by year. Result: a scheme's levy bill can go up even though it has reduced its underfunding and insolvency risks.

Three year cycle

Every three years the PPF would decide the amount it wants to collect according to its published investment strategy. This has the aim of achieving self-sufficiency by 2030 i.e. having close to zero exposure to risk of whatever kind (interest rates, inflation, longevity etc) and little need for further levy income. By that time the PPF's mean projection for its liabilities is a huge £80bn.

In each three year period, the levy cap and the scaling factor would be fixed (but open to change if the total that would be collected was expected to vary by more than 25% from one year to the next). There is no mention of a levy taper.

Instead of depending on a snapshot, underfunding would

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be measured by valuing assets and liabilities according to market averages over five years (roughly the economic cycle for investment markets).

In most cases, investment strategy would be taken into account by stress testing (with a hypothetical change in value) the scheme assets as reported to the PPF. Schemes that use strategies to alter the sensitivity of their portfolio to particular risks would be able to do the tests themselves.

There would only be six bands of insolvency risk, each corresponding to a range of D&B failure scores. In addition, an employer's probability of insolvency would be less volatile, being taken as the average of twelve monthly D&B assessments rather than on a single date. The PPF argues that the net effect of the changes will be that if a scheme reduces its risk to the PPF, its levy will go down.

The proposal for the scheme based levy is that it should

meet the full cost of the cross subsidy between schemes that results from the caps in the risk-based levy formula. This would make its role more transparent.

Impact

The PPF's modelling suggests that the impact of its proposal compared to 2010/11 would be:

- a lower levy (by 10-95%) for well funded schemes at all levels of insolvency risk and
- a higher levy (by 26-75%) for poorly funded schemes where there is a low risk of insolvency.

Trustees and employers will welcome greater control and predictability, though the price for some will be much higher bills. The acceptability of the package overall is likely to depend on the stability of the total levy the PPF decides to raise from one three year period to the next.

LEGAL

All things being equal

The new Equality Act was headline news when it came into force on 1 October 2010 but will make limited difference to the way equality law applies to pension schemes.

Trustees of occupational pension schemes and/or sponsoring employers were already subject to wide non-discrimination requirements under the old law. These protected a person in relation to these characteristics: sex, age, disability, religion or belief, sexual orientation, marriage or civil partnership, and maternity.

The piecemeal old law has now been replaced by a single non-discrimination rule that is implied into all schemes. This says it is unlawful for the trustees or the employer to discriminate on the grounds of any of the protected characteristics. On sex and maternity there are also implied rules that impose a positive requirement for equality.

Exceptions

Generally speaking, the exceptions under the old law still apply. These include established time limits (e.g. sex equal benefits are only required for post 17 May 1990 accrual) and specific benefits (e.g. bridging pensions are still allowed).

But there are some changes. For example, the long list of exceptions in relation to age still applies to pension schemes but the handful that previously applied to schemes that only provide death benefits no longer do.

Disability law is now clearer. The definition has been relaxed, making it a bit easier for a person to show they are disabled. And, for the first time, indirect disability discrimination has been introduced. Indirect discrimination happens when an apparently neutral rule or practice puts persons with a disability at a particular disadvantage and the rule or practice cannot be shown to be a proportionate means of achieving a legitimate business aim. In principle, this could make it easier to allege disability discrimination.

Codes and guidance

A draft code of practice on equal pay and another on employment have been prepared by the Equality and Human Rights Commission (see its website). They provide a basic commentary on sex equality in pension schemes and are expected to come into force by the end of the year. Complying with a code will help a board of trustees or an employer defend a claim for discrimination. A court or tribunal handling a claim is obliged to take these codes of practice into account (which explains why they are quite long and detailed). The EHRC has also published less formal guidance on equal pay. Many of the changes under the new Act are technical e.g. standardising core concepts like indirect discrimination across all the protected characteristics and generally simplifying the old law.

TAX

Annual allowance

The government is reducing the annual allowance (AA) for tax relieved pension saving from £255,000 to £50,000 from April 2011. This replaces the last government's more complicated proposals for limiting tax relief for high earners. The new limit can be carried forward for three years and will not apply on retirement for serious ill health. The government will consider indexing the limit, but not before 2016. From April 2012 the lifetime allowance will come down from £1.8m to £1.5m.

For AA the value of DB benefits will be calculated using a standard factor of 16. For high earners who exceed the limit, a year's accrual could result in a very high marginal rate of tax. Some employers might want to review their executive remuneration packages.

News in Brief

As we continue to expand, we are delighted to welcome three newly qualified lawyers to our pensions team.

Louise Brown and **Michael Dando** join us after training with the firm.



Mark Greatholder joins after training at a major City firm.



The team now consists of 23 solicitors, a consultant, two trainees and a paralegal.

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