

TRUSTEE INSIGHT

Welcome

Welcome to the winter edition of our newsletter about pensions law.

For more information on pensions law issues, please e-mail tim.illston@burgess-salmon.com.

Green Policy - Soft for hard

In line with our environmental policy we are working to switch our pensions publications from hard copy to electronic form. If you receive this in hard copy but are happy to switch to a pdf, please email paul.kitson@burgess-salmon.com. Thank you to those who agree to swap.

Inside information

- Floored cap p2
- Before and after p2
- Bridging the gap p2
- News in brief p2
- Taking ages p3
- Actuary rules p3
- News in brief p3
- Actuary rules *cont...* p4
- PPF assumes risk p4

Act out

The Pensions Act 2008 passed into law at the end of last year.

It is mainly about the new system of Personal Accounts due to come into effect in 2012. But it also has provisions to:

- reduce the cap on the revaluation of deferred benefits in DB schemes (April 2009) (*see Floored Cap*);
- extend the Pensions Regulator's (TPR) moral hazard powers, in particular by allowing a contribution notice where an act – say, a corporate transaction – is materially detrimental to a scheme (to be backdated to April 2008). *See Notices and Directions* in the autumn 2008 issue of our sister publication, *In Focus*. The government must review these extended powers within 4 years;
- lower the threshold for TPR to appoint independent trustees to a scheme (January 2009). Today the purpose of an appointment must be to ensure the

competence of the trustee board or to safeguard the scheme assets. In future the more general purpose of protecting the interests of the scheme members will be available. In addition, making an appointment will only need to be a "reasonable" thing for TPR to do; today it must be satisfied that the move passes the tougher test of being "necessary";

- allow the PPF to charge interest on late levy payments;
- remove all restrictions on the use protected rights after DC contracting out is abolished (probably 2012). This extends the provisions in the previous Pensions Act – of 2007 – that will abolish DC contracting out; and
- on divorce and the dissolution of civil partnership, to abolish restrictions on shared contracted out benefits and to allow PPF compensation to be shared.

Different parts of the Act will come into effect at different times. The dates in brackets are a rough guide.

Hot Topics seminar 2009

We would like to welcome you at our annual seminar, Hot Topics in Pensions Law. Looking back to 2008 and ahead to 2009 we will be covering:

- **Assessing the employer's covenant: a legal perspective**
Covenant review is not simply a financial question. Addressing key legal issues can add to certainty and reduce risk for trustees and employers.
- **The Regulator and the recession: regulating pension schemes in tough times**
A buoyant economy gave the Pensions Regulator an easy ride for its first three years. Now we are seeing a change in its approach and would like you to be aware of it.
- **A topical round-up, including case law**

- **S.75 Pensions Act 1995: managing the employer debt in practice**

What are the pros and cons of the new options for managing the debt? Our experience has given us a practical insight into the ones that work for the employer and for the trustees.

We are holding the seminar at:

- our **Bristol office on Thursday 5 February** (4.30pm for a 5pm start) and
- our **London office on Thursday 12 February** (4.00pm for a 4.30pm start).

There is no charge. To register, please go online to www.burgess-salmon.com and take the News & Events tab.



Happy New Year

Visit our website at www.burgess-salmon.com



News in brief

Bartsch v Bosch asked the ECJ whether it was age discrimination for a scheme to deny a survivor's pension if the age gap was more than 15 years. But the ECJ will not answer for want of jurisdiction: the member died before EU states had to implement the age discrimination Directive. A decision might have thrown light on whether the exception in the UK regulations for young spouse reductions is consistent with the Directive.

Trivial commutation is likely that to be easier from 6 April. In the budget 2008 HMRC proposed to deal with "stranded pots" by allowing schemes to pay a lump sum up to £2,000 without regard to benefits the member might have in other schemes. Draft regulations are now circulating from HMRC and the DWP to amend their respective strands of legislation. 6 April is the target date.

The government will adopt most of the reform proposals in the NAPF's 2007 review of the Myners principles on trustees' investment processes. The current 10 principles will reduce to six less prescriptive ones supported by best practice guidance. A new Investment Governance Group with members from TPR, the DWP, the Treasury and the industry will monitor compliance. There will be a voluntary "comply or explain" disclosure regime for trustees.

The consultation period on draft regulations to allow contracted-out occupational pension schemes to convert GMPs to scheme benefits (from April 2009) has ended. To make decisions schemes need to see the final regulations.

Floored cap

The new 2.5% cap on the revaluation of deferred benefits in DB schemes is now due to come into effect on 6 April 2009. Originally the proposed start date was 1 January. The new maximum applies to future service after it comes into force.

As we have reported before, the figure is a floor rather than a ceiling. It will not override scheme rules that say explicitly that the limit is 5%. On the other hand, it will apply automatically where the rules track the legislation e.g. by saying that "revaluation will be in line with statutory requirements from time to time". Whether or not they want the new cap to apply, all schemes should review their rules to see if amendments are needed.

Some schemes have limited amendment powers that prevent them from adopting the lower figure.

To address this the government proposes to create a statutory power for trustees to make rule amendments by resolution. Draft regulations on this are out for public consultation. The aim is for this amendment power to be available from 6 April.

Pensions in payment

For the same reason some schemes have been unable to limit increases to pensions in payment to LPI. There will be a similar new amendment power to help them.



Time for a new one?

Before and after

The government is reviewing the way the employer debt legislation (s.75 Pensions Act 1995) applies to multi-employer schemes.

One criticism has been that the legislation hinders group reorganisations unnecessarily. The government's main proposal in response is that a debt should not arise if, taken overall, financial support for the scheme (sometimes called "the covenant") is as strong after the event as it was before. This is an idea from the Lewin / Sweeney report on the deregulation of pension schemes issued 18 months ago.

An informal consultation on a discussion paper has now closed. Any proposals for amending the legislation that emerge will go to public consultation in February. Any changes will come into effect in October 2009.

Changing the default position

Today an employer in a multi-employer scheme becomes liable to fund its pension liabilities up to buy-out level if it ceases to have any active scheme members without being the last employer to do so. What normally triggers the liability on a reorganisation is the transfer of a business from one group company to another.

Since April 2008 there are new ways to reallocate and defer the debt. But these all require the consent of the trustees and sometimes of the Pensions Regulator (TPR). If none of the management options is agreed,

the buy-out debt is payable immediately. The bargaining power that this gives the trustees is what makes the debt legislation such a challenge on reorganisations.

The proposal is that if the covenant is as good or better after the event, no debt would arise. Instead the group company that acquires the business would become liable to fund the benefits of its expanded workforce over time on the normal scheme basis. Or the wider group could assume the obligation.

If the before-and-after funding test is satisfied, this reallocation of the funding liability would be mandatory. This change in the default position represents a major loss of power to the trustees and could make many reorganisations easier for company managers to carry through.

Other options

The discussion paper floats two other options: smaller employers could pay a debt calculated on the scheme's own funding basis (or PPF if higher) rather than buy-out basis, or the legislation could stay as it stands.

Clearly, the government favours reallocation. Certainly it would make the debt legislation more coherent because it builds on the idea familiar from TPR's moral hazard powers and its clearance guidance that an event should only need a regulatory or funding response if it is "materially detrimental" to the scheme.

Bridging the gap

New regulations coming into effect on 1 January 2009 make it easier to end bridging pensions without turning the pension into an unauthorised payment on which tax is due. The general rule is that scheme pension becomes unauthorised if it is reduced.

The original exception that allowed the ending of bridging pensions was too narrow to cater for the various ways schemes calculate them. A new, wider exception will cover more cases.

Taking ages

New government proposals to square flexible retirement with the age discrimination regulations will disappoint many pension scheme trustees and employers.

In broad terms, "flexible retirement" means drawing pension from your employer's occupational pension scheme without leaving your job.

But in a new consultation paper the government defines it much more narrowly. In addition, the proposed exemptions from the regulations are very specific and would be of limited use. For the most part, trustees and employers would be left to argue objective justification for their practices case by case.

The government accepts that its proposals do not address all the concerns so it is offering to develop non statutory guidance in consultation with interested parties. But its timid start suggests that any guidance is unlikely to give wide-ranging comfort.

Since the age discrimination regulations came into force, pension schemes have been uncertain what they can and/or must do in relation to flexible retirement in order to stay within the law. Can they refuse to allow any form of flexible retirement? Can they offer a one-off, all or nothing choice – take all your pension now but at the price of foregoing further pension accrual? These are just a couple of the many possible permutations.

Narrow definition

The consultation paper has its own narrow definition of "flexible retirement". A member must:

- switch to reduced hours or to a lower job grade when he begins to receive some or all of his occupational pension and
- have reached state pension age.

By contrast, pension schemes generally take the term to cover any arrangements for a member to draw some or all of his pension from his employer's scheme without leaving its service. So, for example, it would cover drawing pension while continuing on exactly the same terms and conditions, and drawing an early pension before the scheme's normal retirement age.

Actuary rules

The Court of Appeal (CA) has upheld the High Court's decision in the Allied Domecq case that the scheme actuary is in control of the company's contribution rate.

The general rule for scheme specific funding is that the company and the trustees agree the rate. But if the scheme rules give the actuary power to set the rate without the company's agreement, there is an underpin: the agreed rate cannot be lower than the actuary would have stipulated.

Two rules

The scheme was in deficit. It had a rule about setting future service contributions and a separate rule about

Alternative exemptions

The paper invites views on alternative exemptions for flexible retirement (as narrowly defined).

■ General exemption

A general exemption from the regulations would allow schemes to withdraw the following from a member who takes flexible retirement:

- further accrual of pension,
- death in service and ill health benefits, and
- a late retirement increase on undrawn pension.

But, the paper points out, from 2012 the member would be able to require his employer to enrol him in a scheme under the legislation on Personal Accounts.

■ Limited exemption

If the government decides against a general exemption, it proposes a specific one to allow a scheme to withdraw death in service benefits from a member who takes flexible retirement. The consultation asks whether this exemption should also cover ill health benefits.

Both exemptions are highly specific. They would be little use in practice.

As today, the general defence for trustees and employers facing an age discrimination challenge over flexible retirement would remain objective justification i.e. showing that their practice is a proportionate means of achieving a legitimate business aim.

The consultation runs until 10 March 2009. There is no mention of an implementation date but October 2009 looks the earliest candidate.

Background

The new consultation paper follows one that the government issued in October 2007. This asked what problems people saw with flexible retirement and what legislative solutions they would like.

The new paper is at www.dwp.gov.uk/consultations/2008.

making up a deficit. This required employers to pay such amount "as .. will in the opinion of the Actuary restore the solvency of the Fund; such amount to be paid .. within such period as the Trustees .. agree with the .. Company." The company argued that its right to agree the catch-up period meant that the actuary did not have power to set the recovery rate without its agreement and so the underpin did not apply to the scheme.

The High Court disagreed. Its decision rested on close textual analysis of the deficit rule. The company appealed.

Continued overleaf



News in brief

There is little time left for anyone who wants to shelter pre A Day rights by registering with HMRC for primary or enhanced protection from the lifetime allowance charge. The freezing of the lifetime allowance at £1.8m from 2011-16 could be a relevant consideration. The deadline is 5 April 2009.

The government plans to make communication about work-based group personal pension schemes easier. Employers already have an exemption (on conditions) from the general ban under financial services legislation on unauthorised persons issuing promotional material about personal pensions. The proposal is to add a similar exemption for third party administrators of a GPP.

The government has responded to views received during its summer 2008 consultation about risk-sharing pension schemes. It will not make the indexation of pensions in payment conditional on scheme funding. But it plans to look further at collective DC schemes and at whether s.67 Pensions Act 1995 (protecting accrued rights) hampers schemes that want to increase retirement age for future accrual.

TPR is consulting on a draft code of practice on its power to issue contribution notices where a corporate transaction, say, is "materially detrimental" to a scheme. The code lists the same circumstances for the use of the power as the announcement last April. Consultation closes in February. The new power will come into force (backdated to last April) when the code is finalised.

Different reasoning

Rather than use a linguistic approach, the CA interpreted the rule in the context of the statutory funding regime in force at the time the deed and rules was executed. This was the minimum funding requirement (MFR). Trustees with a deficit had to prepare a contribution schedule to restore MFR within 5 years. It would conflict with the legislation to read the deficit rule as allowing the company to decide the recovery period. The correct interpretation was that

the rule required the company's consent only to the catch-up period (5 years or a shorter period?), not to the contribution rate itself. So the underpin applied.

Neither court found it easy to interpret the long sentence that made up the deficit rule. But at a practical level the outcome makes sense because it puts the deficit rule in step with the more fully articulated rule about setting future service contributions which, the parties agreed, put the actuary in control of that rate.

PPF assumes risk



The PPF proposes to change its risk-based levy so that a scheme's bill reflects more accurately the long term risk that its members will need PPF protection.

Today the PPF acknowledges a mismatch between the real risk a scheme poses and the amount it pays. This is because the total amount the PPF aims to raise reflects long term funding risks but the share of the total each scheme pays can depend heavily on the short term (one year) risk that the employer will become insolvent.

New proposal

The new proposal for sharing out the total to be raised is:

- to reflect short term risk as now (based on the probability of the employer's insolvency within a year and the scheme's underfunding). But the current standard allowance for short term changes in the scheme's funding position would be replaced by a scheme specific factor based on its own investment risk; and
- a new component would reflect long term risk. This would be based on the probability of the employer's insolvency over 5 years and the risk of underfunding over the same period. The latter would be assessed by comparing how well the proportions of different asset categories the scheme holds match its mix of liabilities for actives, deferreds and pensioners. This assessment would be based on information in the annual scheme return. The PPF accepts that this is an unsophisticated way to measure investment risk but points out that it is simple and draws on existing data.

There would be a scaling factor in both calculations to allocate the overall burden between short and long term risk in a way the PPF decides.

The scheme-based levy (based on a proportion of liabilities) would continue but the proportion of the total levy that it raises (today 20%) might change.

Start date

The proposal is for a new formula to apply from 2011/12.

The PPF says that one in four schemes would see their risk-based levy fall by 25% and one in ten would see it halve. But one in six would face a rise of 25% and one in ten levies would double.

There are concerns that relatively well funded schemes supported by strong employers could be among the losers.

The new ideas are about the distribution of the total levy, not about amount to be raised. On current policy, that will remain £675 million (as at 2007), indexed in line with earnings.

Impact

Having done some modelling, the PPF says this about the expected impact:

- schemes are unlikely to alter their portfolios to reduce investment risk in order to cut their levy because the changes in the levy would generally be small compared to the lost return,
- the proportion of schemes paying a levy of more than 0.5% of liabilities would fall by a third (putting 70% of schemes in the bracket 0.04% - 0.5% compared to 52% today),
- the levy would be more stable and predictable because the new formula would be less likely to need dramatic adjustment than today's, and
- the new formula would not be as sensitive at the top end. Today a D&B failure score that falls from 100 to 99 leads to a tripling of the levy, for example.

About £130m of levy would be reallocated.

The PPF commends its proposal on grounds of fairness, affordability for schemes with weak employers and reduced volatility among others.

Public consultation on the ideas ends on 13 February 2009.

News in brief

Other government consultations are about new powers for TPR to fine employers who fail to consult members about changes to future service benefits as required by legislation, and increasing the look-back period for TPR to issue a financial support direction to 24 months (up from 12).

Narrow Quay House
Narrow Quay
Bristol BS1 4AH
Tel: +44 (0)117 939 2000
Fax: +44 (0)117 902 4400

Chancery Exchange
10 Furnival Street
London EC4A 1AB
Tel: +44 (0)20 7685 1200
Fax: +44 (0)20 7685 1266

www.burges-salmon.com

This newsletter gives general information only and is not intended to be an exhaustive statement of the law. Although we have taken care over the information, you should not rely on it as legal advice. We do not accept any liability to anyone who does rely on its content.

© Burges Salmon LLP 2009.
All rights reserved.
Trustee Insight is printed on 75% recycled paper.

Your details are processed and kept securely in accordance with the Data Protection Act 1998. We may use your personal information to send information to you about our products and services, newsletters and legal updates; to invite you to our training seminars and other events; and for analysis including generation of marketing reports. To help us keep our database up to date, please let us know if your contact details change or if you do not want to receive any further marketing material by contacting marketing@burges-salmon.com

Burges Salmon LLP is a Limited Liability Partnership registered in England and Wales (LLP number OC307212) and is regulated by the Solicitors Regulation Authority.

A list of members, all of whom are solicitors, may be inspected at our registered office: Narrow Quay House, Narrow Quay, Bristol BS1 4AH.