TRAVERS SMITH

What's happening in Pensions

Issue 20 *August 2010*

Proposed reduction of annual allowance

The Government has issued a discussion document on its alternative proposal for restricting tax relief for high earners. Its final decision should be known by 30 September 2010 and is intended to take effect from 6 April 2011. The Government's proposal is based on replacing the former Government's proposed high income excess relief charge (see **WHiP Issue 18**) with a significantly reduced annual allowance (in the region of £30,000 to £45,000). The proposals envisage that employers will wish to restrict or abolish DB accrual so as to avoid scheme members incurring a tax charge.

The following are the headline points.

- The annual allowance charge of 40% would be replaced with a charge that varies according to the individual's marginal rate (similar to the current special annual allowance charge). The charge for basic rate tax payers might be nil.
- Exemptions for pension input in the tax year benefits are taken and for those with enhanced protection would cease to apply.
- The Government intends to exempt members who die or draw a serious ill health lump sum, but not members made redundant or who retire early (even on ill health grounds). The paper says that "*There is scope for employers to redesign benefit packages in these circumstances*", e.g. by replacing redundancy pensions with increased redundancy pay and replacing ill-health pensions with PHI.
- DB schemes:
  - Accrual will probably be valued on a flat rate basis, as at present (rather than on an age-related basis), but the 10:1 ratio for valuing pension accrual will probably be changed to between 15 and 20:1, thereby increasing the number of DB scheme members affected.
  - The Government says that spikes in accrual (e.g. large pensionable pay increases due to promotions and enhanced early retirement benefits) are best dealt with by the employer amending the scheme design (e.g. by capping or smoothing accrual, removing benefits or offering DC for future accrual), although there "*may be a role for the tax system*" to help with this issue. "*The Government welcomes views on legislative action that could facilitate appropriate scheme redesign … without undermining other aspects of the regulatory regime.*"
  - Past service accrual would not be excluded from the calculation and deferred members are likely to be included (e.g. to pick up augmentations and enhanced early retirement pensions).
- The lifetime allowance might be reduced, so as to be coherent with the reduced annual allowance. There would need to be safeguards for those with enhanced or primary protection.
- Consideration will be given to allowing a maximum of 40% tax relief (i.e. 50% tax relief would not be available even for pension inputs up to the reduced annual allowance).
- There might be options for individuals with high annual allowance charges to unwind their pension saving, spread payments of the charge, or reduce their benefits so that the scheme pays the charge.
- Schemes may be required to align their pension input periods with the tax year.

Discussion document:
http://www.hm-treasury.gov.uk/consult_pensionsrelief.htm

- Trustees may be required to give individuals information about the value of their pension inputs, so that they can include the relevant figure in their self-assessment tax returns. They may also be required to tell the individual if his/her scheme input exceeds the annual allowance.

Comments are requested by 27 August 2010.

New Finance Act

Finance (No.2) Act 2010:
http://www.opsi.gov.uk/acts/acts2010/ukpga_20100031_en_1

The Finance (No.2) Act 2010 was rushed through Parliament and received Royal Assent on 27 July 2010. It contains the following pension provisions.

- Power to repeal the high income excess relief charge at any time before 31 December 2010. This will be done if the Government introduces the alternative regime based on a lower annual allowance (see above).
- Pending the abolition of the requirement to annuitise altogether (see below), provisions extending the age by which an annuity or alternatively secured pension must be arranged under a money purchase scheme from age 75 to age 77. This can benefit anyone reaching age 75 on or after 22 June 2010. The effect of these provisions is as follows:
    - Members over age 75 with uncrystallised benefits (i.e. who are deferring the purchase of an annuity or an alternatively secured pension) will be able to take a pension commencement lump sum up to the day before their 77th birthday.
    - Untraceable members with unsecured pensions who are turning age 75 may have their benefits suspended until age 77.
    - An authorised lump sum death benefit may be paid in respect of members with unsecured pensions who die before age 77.
    - There will still be a benefit crystallisation event at age 75, for testing the member's benefits against the lifetime allowance.
    - Where scheme rules refer to age 75 for the above purposes, trustees are given the discretion to allow members to take advantage of these relaxations. No rule amendment is required.
    - The same changes apply to dependants' pensions (except that the lifetime allowance BCE1 test does not apply).
    - Corresponding inheritance tax provisions that refer to age 75 are automatically amended by the proposed changes.

  Only DC arrangements are affected. So, for example, a lump sum benefit on death after age 75 will still be an unauthorised payment in a DB arrangement.

HMRC guidance:
http://www.hmrc.gov.uk/pensionschemes/new-interim-tax-rules.htm

HMRC has published technical guidance in relation to the Bill's age 75/77 provisions.

DC benefits: Removing the requirement to annuitise

Consultation:
http://www.hm-treasury.gov.uk/consult_age_75_annuity.htm

The Government has published a consultation on removing the requirement for DC members to annuitise by age 75. Responses are requested by 10 September 2010.

Currently, DC members (including DB members with DC AVC pots) must, before reaching age 75, use their DC pot to buy an annuity or arrange an alternatively secured pension ("ASP"). Under an ASP, the member must draw down between 55% and 90% of the annual amount of a Government Actuary-calculated notional annuity.

If the individual dies after age 75 with an ASP arrangement, an unauthorised payment charge of up to 70% applies, unless the funds are used to provide a dependant's pension or paid to charity. There is also an inheritance tax charge (which can make the tax rate as high as 82%).

Until age 75, DC members who do not buy annuities may defer bringing a pension into payment or can enter into an unsecured pension arrangement ("USP"). Under a USP, up to 120% of the Government Actuary-calculated notional annuity may be drawn down each year.

If the individual dies before age 75 with a USP arrangement, any remaining funds may be paid out as a dependant's pension or (subject to a 35% tax charge) as a lump sum. There is no inheritance tax charge.

A member may stop an ASP or USP at any point by buying an annuity with his/her remaining funds.

Under the consultation proposals, from 6 April 2011:

- There will be no requirement to annuitise by any particular age.
- USPs (with "capped drawdown" as described above) will be permitted even after age 75. The 120% limit will be reviewed: views are requested on the appropriate level.
- Drawdown without a cap ("flexible drawdown") will be permitted by "*individuals who can demonstrate that they will not be able to exhaust their pension savings prematurely and subsequently fall back on the state*". To do so, they will need to satisfy a "minimum income requirement" ("MIR"). Only pension income already in payment will be considered, but the basic and additional state pension will count, as will any occupational pension that is increased annually at least in line with the lower of price inflation and 2.5%. The level of the MIR is not yet decided. It may depend on age and marital status.
- ASPs will cease to be necessary and so will no longer be available.
- On the individual's death, remaining funds will be taxed at a rate designed to recover tax reliefs (55% is mooted) unless they are used to provide a dependant's pension. However, lump sum death benefits in respect of those who die before age 75 without having accessed their pension savings will be tax-free (subject to the lifetime allowance test). In any event, no inheritance tax will be due.
- The restrictions on taking pension commencement, trivial commutation and value protection lump sums after age 75 will be removed.
- It will, however, remain the case that tax relief on pension contributions is not available beyond age 75 and the lifetime allowance test will still be applied at age 75.

Scheme rules would need to allow the permitted alternatives to annuitisation and some employers/trustees may decide not to offer the new options, particularly as they would need to take on the role of checking that the flexible drawdown MIR test is met. Members could, if they wished, transfer out to an external arrangement that does offer these options.

Revaluation and indexation: CPI instead of RPI

The Government has announced that it will use CPI instead of RPI when measuring inflation for the purpose of calculating state pensions and benefits under public sector pension schemes and for the purpose of prescribed minimum levels of revaluation and indexation of benefits under private sector schemes.

The announcements (see links in right column) leave many questions unanswered. We have written to the Pensions Minister highlighting some of the issues that will arise for some schemes and seeking clarification of his intentions. For example, it is not clear whether (and, if so, how) schemes with rules that currently refer to RPI are expected or able to switch to CPI, and it is possible that some schemes might have to pay the better of RPI and CPI increases. We have not yet received a reply to our letter.

The Pensions Regulator has issued a statement on the proposed change. It says that "*Trustees should plan to communicate with members on the impact, as soon as possible, once known, even if the impact is likely to be negligible" and "should give serious consideration to an interim communication, to assist members who may be faced with decisions on transfers or retirement planning, or may be concerned about press coverage*".

If the proposed changes lead to reduced liabilities, the Regulator expects this to lead to shorter recovery plan periods rather than reduced contributions.

Ministerial statement:
http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm100708/wmstext/100708m0001.htm

Press release:
http://www.dwp.gov.uk/newsroom/press-releases/2010/july-2010/dwp088-10-120710.shtml

Pensions Regulator statement:
http://www.thepensionsregulator.gov.uk/docs/consumer-prices-index-statement-july-2010.pdf

Successful claim for estoppel by representation

In *Catchpole v Trustees of the Alitalia Airlines Pension Scheme*, Mr Catchpole and Ms Brahja were long-term cohabiting, unmarried partners. Ms Brahja was a member of the Alitalia pension scheme. She asked the trustees about her partner's status in the event of her death. The secretary to the trustees wrongly told her that, in their circumstances, Mr Catchpole would qualify for a spouse's pension in the event of her death regardless of whether or not they were married. Ms Brahja subsequently died without having married.

Case report:
http://www.bailii.org/ew/cases/EWHC/Ch/2010/1809.html

Mr Catchpole gave evidence that they would have married if they had been told that it would qualify him for a lifelong pension in the event of Ms Brahja's death and that, at the time of the correspondence, they had been considering getting married in connection with Ms Brahja's 50th birthday. This was why Ms Brahja had asked the trustees about his status if she died while they were unmarried. The trustees argued that they would not have married even if Ms Brahja had been correctly informed that Mr Catchpole would not otherwise qualify for a spouse's pension.

The Pensions Ombudsman accepted that the misinformation gave the couple "*an unwarranted degree of comfort*" but he found on the balance of probabilities that they would not have married if the correct information had been given, partly because at the time of the correspondence Ms Brahja's death was not expected. The maladministration had therefore not caused a financial loss.

The High Court, however, has now held that the decision of the Ombudsman on the evidence before him was not one which he could properly have reached. There was nothing to justify rejecting Mr Catchpole's evidence.

The judge saw the issue as one of estoppel by representation. The necessary elements were satisfied as follows.

- There was a clear representation on behalf of the trustees.
- The incorrect information resulted in the couple not marrying: "but for" the misrepresentation, they would have married.
- Mr Catchpole had suffered a detriment.

The fact that the representation was made to Ms Brahja and not to Mr Catchpole was irrelevant. Either (a) the request was made by both of them and/or the response was intended to be one on which both of them could rely or (b) it was unconscionable for the trustees to assert against Mr Catchpole that he is not to be treated as a spouse when Ms Brahja, being deceased, is not in a position to eliminate the adverse consequences of the misrepresentation.

There was therefore an estoppel preventing the trustees from denying that Mr Catchpole was the surviving spouse of Ms Brahja for the purpose of the spouse's pension rule.

The Ombudsman's decision was therefore overturned. There was no discussion of what the scheme booklet said. Neither the trustees nor the employer were represented in the appeal. This is the first successful pensions estoppel claim since 1989.

Default retirement age of 65

Seldon: Court of Appeal judgment

The Court of Appeal has issued its judgment in *Seldon v Clarkson Wright & Jakes*. It has held that a firm of solicitors was justified in enforcing a provision in the partnership agreement requiring Mr Seldon to retire from the partnership at the end of the year following his 65th birthday. (Note that the age 65 default retirement age in the Employment Equality (Age) Regulations 2006 does not apply to partnerships.) The reasons were as follows.

Case report:
http://www.bailii.org/ew/cases/EWCA/Civ/2010/899.html

- The objective justification defence was satisfied. The Government's legitimate social aims in allowing the derogations for objective justification and (in the employment context) a default retirement age were (a) to provide employment prospects for young people and encourage young people to seek employment by holding out good promotion prospects and (b) to allow people to retire with dignity. Where an employer (or here a partnership) was acting consistently with the social aim which has justified the legislative provision, it would be to contradict that aim to render such an act unlawful if the clause was a proportionate means of achieving that aim.
- All that mattered was that the employer did actually have that aim. It did not matter whether this was consciously recognised or specified at the time of the decision in question.
- It was legitimate to take into account the fact that the individual had agreed to the term in question (here, a term in the partnership agreement) but it did not mean that the clause could be assumed to be justified.
- Once the clause or rule is justified, its applications will need little justification. It would be rare for a justified rule to be unjustified in its application and this was not such a case.

- The fact that it would be less discriminatory to some to have chosen a default retirement age of, say, 66 cannot render the clause unlawful. The fact that the firm might have justified any one of a number of default ages did not mean that it was unable to choose one at all.

Consultation on phasing out the default retirement age
As previously reported (see **WHiP Issue 19**), the Government has decided to phase out the default retirement age under the Employment Equality (Age) Regulations 2006. It is proposing to do so from April 2011. There will be a transitional period permitting the enforcement of retirement for retirements before 1 October 2011 that are initiated before 6 April 2011. The details are in a consultation paper, to which responses are requested by 21 October 2010.

Consultation:
http://www.bis.gov.uk/retirement-age

Employers will still be able to operate a compulsory retirement age if they can objectively justify it. The Court of Appeal decision in *Seldon* (see above) and the European and High Court decisions in *Heyday* (see **WHiP Issues 9** and **13**) indicate that this can be done. In particular, the *Seldon* case was one in which the Age Regulations' default retirement age did not apply and the policy of retiring partners at age 65 was objectively justified by reference to the previous Government's social policy aims, which had been established as objectively justified by the European and High Courts.

It is also proposed that the six months' retirement notice requirement and right to request working beyond the default retirement age (which the employer has a duty to consider) will be abolished.

There will be Government guidance on managing without retirement ages and perhaps on how to discuss retirement without the employer attracting an age discrimination claim or the employee prejudicing his/her career prospects.

There is a short section of the consultation paper on possible unintended consequences of removing the default retirement age (e.g. the implications for life assurance, medical cover and PHI). Respondents are asked to raise any concerns in this area. Pension schemes are not mentioned.

Pensions Regulator

Nortel financial support direction
The Regulator has been authorised by its determinations panel to issue a £2.1 billion (calculated on a section 75 buyout basis) financial support direction against 25 Nortel companies worldwide, on the grounds that the UK company (Nortel Networks UK Limited - now in administration) that sponsored its UK scheme is insufficiently resourced.

Press release:
http://www.thepensionsregulator.gov.uk/press/pn10-13.aspx

The panel was satisfied that it was reasonable to issue the FSD because:

- the group companies operated globally on "business lines" rather than as separate legal entities;
- the UK companies were controlled at Canadian parent company board level (e.g. they were required to make interest-free loans to the Canadian companies and the parent made decisions about contributions to the UK pension scheme);
- the Canadian parent company had the benefit of control of the global group and a financial benefit from failing to remedy the UK pension scheme deficit, which had partly arisen due to a 13 year contribution holiday; and
- the UK company engaged in research, development, sales and marketing activities which benefited the global group and for which it was not adequately rewarded. The global companies had therefore benefited in this way, as well as indirectly from the group's financial position being eased by the failure to remedy the UK pension deficit.

Separately, the Pensions Regulator has failed in its appeal against a Canadian court decision that its warning notice to Nortel in Canada breached the stay on proceedings in relation to the company. The Regulator was ordered to pay the costs of Nortel's administrators and other group companies. Notwithstanding this decision, the scheme trustees and the PPF will claim alongside Nortel's other creditors in the various insolvency proceedings (subject to the outcome of a US appeal). The Regulator considers that its FSD will be a way of quantifying the trustees' and PPF's claim.

Multi-employer schemes: employer departures

The Pensions Regulator has issued a consultation (closing on 23 September 2010) on draft guidance for trustees of multi-employer DB schemes about what can happen when an employer leaves the scheme, or when an employer group is restructured, after 5 April 2010. The draft guidance notes that trustees will normally need to seek independent professional advice in such situations.

Press release:
http://www.thepensionsregulator.gov.uk/press/pn10-12.aspx

Draft revised guidance on inducements

The Pensions Regulator has issued draft revised guidance on transfer incentives (which now also covers pension increase conversions). The consultation closes on 5 October 2010. The revised guidance adopts a principles-based approach, seeking to avoid a "box-ticking exercise".

Consultation:
http://www.thepensionsregulator.gov.uk/docs/transfer-incentives-consultation-document-july-2010.pdf

According to the new draft guidance:

- Trustees should be consulted and engaged in any such exercise from the very beginning.
- Trustees should start from the presumption that such exercises are not in members' interests.
- Information given to members should be "*clear, fair and not misleading*"
- "*Fully independent and impartial financial advice should be made accessible to all members and promoted in the strongest possible terms; in almost all circumstances, the structure of the offer should require that members take financial advice.*"
- The employer should pay for such advice if it "*has any concerns about the scheme members' ability to understand the structure and implications of the offer*". The employer should then "*require that members take advantage of this advice before making a decision. Each member should be able to choose whether he or she takes advice from any appointed adviser, or takes advice from one of his or her own choosing*".
- "*Cash incentives distort the members' decision making process in respect of their retirement provisions. The regulator finds it difficult to see how an offer involving cash incentives would lead to sound decisions being made.*"

TPR/FSA statement:
http://www.thepensionsregulator.gov.uk/docs/transfer-values-joint-statement-july-2010.pdf

A statement has been issued jointly by the Regulator and the FSA to accompany the new draft guidance.

Annual report and accounts

The Regulator has published its annual report and accounts for 2009/10.

Press release:
http://www.thepensionsregulator.gov.uk/press/pn10-15.aspx

Stena/MNRPF case

In *Stena Line Limited v MNRPF Trustees Limited and P&O Ferries Limited*, the High Court was asked to rule on possible arrangements for the reparation of a sizeable deficit in the Merchant Navy Ratings Pension Fund.

Case report:
http://www.bailii.org/ew/cases/EWHC/Ch/2010/1805.html

The Fund is an industry-wide DB pension scheme. The rules provided no mechanism for employers to terminate their participation, even after ceasing to employ active members. The rules also gave the trustee a unilateral power of amendment. In the late 1990s, the Fund was found to have a deficit. In 2001, the remaining employers at that time, and some of the former employers, agreed a funding programme which was expected to eliminate the deficit by 2006. That funding programme proved to be inadequate and the Fund continues to have a large deficit despite the 2001 funding programme being extended beyond 2006.

The High Court has confirmed that the trustee may now introduce a new funding programme which requires contributions from former employers as well as remaining employers. In particular, the High Court has confirmed that the arrangements made in 2001, including amendments to the Fund's rules, did not permanently release former employers from potential funding obligations. The High Court also ruled that there was insufficient evidence to support an estoppel by convention (i.e., common understanding) that would prevent the trustee from amending the rules in order to require contributions from former employers.

Travers Smith acted for Stena Line, representing the current employers.

Automatic enrolment

DWP web page:
http://www.dwp.gov.uk/policy/pensions-reform/workplace-pension-reforms/

The terms of reference for the review of automatic enrolment and NEST have been published. It will consider:

"*Whether the proposed scope for automatic enrolment strikes an appropriate balance between the costs and benefits to both individuals, and employers, or whether the underlying policy objective of increasing private pension saving and balancing those costs and benefits would be better delivered by a different scope for automatic enrolment. In looking for the right group to automatically enrol, the review may among other things explore:*

- *The earnings threshold, above which automatic enrolment applies;*
- *The introduction of a de minimis level for contributions before automatic enrolment applies;*
- *The age group to which automatic enrolment should apply;*
- *The size of firm to which automatic enrolment should apply; and*
- *Whether employees should be automatically enrolled on the day they start work or some later date.*
- *The availability and capacity of pension providers other than NEST to serve the potential automatically enrolled population.*

In the light of these conclusions, whether the policy of establishing NEST, as currently envisaged, is the most effective way to deliver future access to workplace pension saving and income security in retirement."

The review will conclude by 30 September 2010. Contributions to the review were requested by 13 August 2010.

European Commission green paper on pensions

European Commission web page:
http://ec.europa.eu/social/main.jsp?langId=en&catId=89&newsId=839&furtherNews=yes

The European Commission has published a green paper, discussing new possibilities for the regulation of pension schemes and revision of the 2003 EU IORP directive. Areas for discussion include the following.

- Looking at whether "Solvency II" (which applies to insurance companies) should be applied to "IORP"s such as occupational pension schemes (it "*could be a good starting point, subject to adjustments to take account of the nature and duration of the pension promise, where appropriate*")
- Enhancing the protection given to members on the insolvency of their employer (e.g. full protection, protection for unfunded schemes, State guarantees)
- Pension guarantee systems that also protect against excessive losses in DC schemes (subject to moral hazard issues)
- Reassessing the IORP directive to ensure that it covers DC as well as DB pension provision
- Providing information to enable DC members to make informed choices, including investment choices
- The adequacy of pension systems, including state and supplementary pension provision – e.g. automatic enrolment with rights to opt-out
- Increases to state pension ages that rise automatically in line with longevity increases
- Improving the conditions for cross-border activity and mobility
- A European Union level tracing service for pensions
- A European Union body to monitor all aspects of pension policy and regulation

Submissions are requested by 15 November 2010.

Abolition of DC contracting-out: consequential amendments

Consultation:
http://www.dwp.gov.uk/consultations/2010/abolition-contracting-out-dc.shtml

The DWP is consulting on four sets of draft regulations making consequential amendments to various pieces of legislation that refer to DC contracted-out schemes and COMB schemes, in relation to the abolition of DC contracting-out from 6 April 2012. The amendments are intended to remove all legislative references to DC and mixed benefit contracting-out, whilst retaining transitional provisions to allow the payment of minimum contributions and the payment and recovery of contracted-out rebates for three years thereafter (but only in respect of periods before 6 April 2012).

A one-off disclosure requirement to tell members about the consequences of abolition is proposed.

Responses are requested by 19 October 2010.

Transfers for members below age 55

HMRC statement:
http://www.hmrc.gov.uk/pensionschemes/people-aged-50-55.pdf

HMRC has issued a statement announcing forthcoming regulations preventing pension payments made by receiving schemes after a transfer (including a merger) to individuals under age 55 from being unauthorised payments. The amendments are to be backdated to 6 April 2010.

Travers Smith were involved in a scheme merger which prompted this issue to be addressed. We have pointed out to HMRC that the amending regulations should also cover those in receipt of ill health pensions under age 55 (for whom the amendments should be backdated to 6 April 2006).

This and previous issues of WHiP can be found on our website. See: www.traverssmith.com/?pid=24&level=2&eid=17

Hyperlinks in this document can be clicked via an up to date version of Adobe Acrobat Reader. We are not responsible for the contents of external websites to which we provide links.

If you wish to discuss any points arising from this note, please speak to your usual contact in the Travers Smith Pensions team or to one of the Pensions partners: Paul Stannard, Peter Esam, Philip Stear and Andrew Block.

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