

## Pensions and Employment: Pensions Bulletin

Legal and regulatory developments in pensions

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For details of our work in the pensions and employment field [click here](#).

For more information, or if you have a query in relation to any of the above items, please contact the person with whom you normally deal at Slaughter and May or [Rebecca Hardy](#).  
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## Stop press

### PPF long-term funding strategy

On 25th August, 2010, the PPF published its first formal funding strategy, in which it announced its aim to become fully-funded by 2030. By that date, the PPF believes that:

- the number of defined benefit schemes will have reduced as they transfer their liabilities to the insurance regime, and
- the risk that they pose will be much lower, because of intervention by the Regulator and an increase in liability-driven investment.

**Comment:** The PPF appears to believe that increasing numbers of defined benefit schemes will wind up, leaving fewer schemes to pay (higher) levies. The increase in schemes' funding position assumed by the PPF in setting its target suggests that the Regulator will move its funding benchmarks to prescribe schemes to fund well above PPF levels. We will look in more detail at the implications of the PPF's funding strategy, available on the PPF's website ([www.pensionprotectionfund.org.uk](http://www.pensionprotectionfund.org.uk)), in a future issue of the Pensions Bulletin.

## Client seminars

### Equality Act 2010

Our firmwide programme of client seminars for September to December, 2010 is attached. In particular the programme includes a session on 17th November, 2010 on the Equality Act 2010 and an Employment Update, to be given by Roland Doughty and Sandeep Maudgil, partners in our Pensions and Employment Group. If you would like to attend, please contact Angela Bustard in our training department ([angela.bustard@slaughterandmay.com](mailto:angela.bustard@slaughterandmay.com)).

### Pensions Update

Also attached are details of our next Pensions Update client seminar, on 16th November, 2010 from 9.30am to 1pm.

## New law

### Abolition of contracting out on a DC basis: consultation on draft consequential legislation

Provisions in the Pensions Act 2007 and the Pensions Act 2008 provide, respectively, for:

- the abolition of contracting-out on a defined contribution basis, and

- the abolition of rules applying to protected rights that would otherwise continue to apply to protected rights built up before the date of abolition.

On 12th March, 2010, the previous Government confirmed that the abolition date for protected rights will be 6th April, 2012. The new Government has agreed this date.

On 28th July, 2010, the DWP published a consultation paper on the amendments to DWP pensions legislation required as a consequence of the abolition.

The draft legislation published for consultation amends or repeals (where appropriate) all references to "contracted-out money purchase schemes" and "appropriate personal pension schemes" in DWP legislation.

**Transitional Period:** The statutory instruments also provide for a 3-year transitional period, whereby the current automated process of rebate payments and recoveries between HMRC and money purchase schemes which were formerly contracted out can continue as at present, in order to allow for:

- the payment of the final year's rebate (due for the 2011/12 tax year) after 6th April, 2012, and

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- the payment or recovery of rebates which are re-calculated by HMRC as a result of adjustments to individuals' NI records in the 3 years following abolition.

In addition, the legislation that requires minimum payments to be paid by employers to money purchase contracted-out schemes is to be retained for a 3-year period until 6th April, 2015. This is to allow for minimum payments due for the tax year ending 5th April, 2012 to be made, and to allow for any potential late payments or adjustments to minimum payments due for the period before 6th April, 2012 to be made after that date.

**De minimis limit on rebates to individuals:** The legislation also introduces a *de minimis* limit on the amount of rebate required to be paid, where the rebate is to be paid to the individual. This is intended to avoid the cost to the taxpayer of paying sums due where the value is very low. The *de minimis* limit will be published annually by HMRC. The limit does not apply to the current system of automated rebate payments made in bulk to schemes, which will continue for 3 years after the abolition date.

**Existing protected rights:** After 6th April, 2012, there will no longer be a requirement on former contracted-out money purchase schemes to track protected rights separately, as protected rights will no longer exist. As schemes will no longer record former

protected rights, and will not need to notify HMRC if a member has died before or after retirement, HMRC will no longer know if effect has been given to protected rights on the member's death. As a consequence, a 50% contracted-out deduction will be made to the survivor's SERPS in all cases, regardless of whether the survivor is entitled to a survivor's pension from the member's scheme at half the rate of the member's pension.

**Information requirement:** The draft Regulations also require schemes to notify members of the consequences of abolition of DC contracting-out. The DWP is currently working with the pensions industry to determine what further guidance will be helpful in relation to this disclosure requirement.

**Comment (1):** One of the consequences of the abolition of contracting out on a money purchase basis is that it will no longer be possible to transfer contracted out benefits from a contracted out salary related scheme to a contracted-out occupational money purchase scheme or an appropriate personal pension scheme. Such transfers have, in the past, been effected by members to make use of the additional flexibility of money purchase schemes (for example, in relation to income drawdown) or to reduce the risk of loss where a scheme transfers to the PPF.

**Comment (2):** Although the draft regulations will remove the statutory obligation to treat protected

rights separately, these obligations are, in some cases, set out in scheme rules. Section 67 will make it difficult for rules to be amended to remove any such restrictions. Although the draft regulations remove restrictions that apply to the amendment of contracted-out schemes under Sections 37 and 38 of the Pension Schemes Act 1993, they do not address Section 67.

**Action point (1):** Identify any schemes that are currently contracted-out on a money purchase basis and start considering the options in the run up to April, 2012 and thereafter.

**Action point (2):** Schemes that were formerly contracted-out on a money purchase basis should consider the options for simplification post 5th April, 2012. These will depend on the extent to which the trust deed and rules can be modified, which will in turn depend on the Government passing legislation to address Section 67 issues.

The consultation paper, on which comments are invited by 19th October, 2010, is available from the [DWP website](#).

**Switch from CPI to RPI (1): Regulator's statement**

On 21st July, 2010, the Pensions Regulator published a statement on how trustees and employers should manage the impact of the proposed move from RPI

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to CPI, and outlining how the Regulator will deal with the issue in its regulatory processes.

The Regulator recommends that trustees give “serious consideration” to sending members an interim communication about their intentions. However, there is no legal duty on trustees to communicate with members on this topic until the change takes effect.

The statement is available from the Regulator’s website ([www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk)).

**Action point:** The DWP is being lobbied to ensure that the proposed switch does not operate in an arbitrary manner, depending on the wording in scheme rules. Await further developments before issuing announcements to members about the consequences for your scheme.

#### Switch from CPI to RPI (2): Regulations implementing the change for FAS and PPF

On 12th August, 2010, the DWP published for consultation draft Regulations which deliver the proposed change from RPI to CPI for the PPF and FAS.

In particular, changes are proposed to:

- the PPF and FAS Rules so that accrued pensions will be revalued by reference to the RPI for periods on or before 31st March, 2011 and by reference to the CPI after that date. Relevant caps<sup>1</sup> to revaluation increases will continue to apply as they do under current rules,
- the FAS so that the CPI is used for the annual increase that will be made in April, 2011 and subsequent years, and
- the Section 143 funding test (the test that decides whether an insolvency event in relation to the scheme will cause a scheme to enter the PPF) applied by the PPF to schemes that have entered a PPF assessment period but have not yet completed the funding test.

**Comment (1):** The Section 143 valuation compares the value of scheme assets immediately before the insolvency event against the amount of PPF liabilities calculated in line with PPF legislation at the time. The switch from RPI to CPI is expected to have the effect of reducing the amount of PPF liabilities.

<sup>1</sup> 5% per annum compound for rights accrued by reference to pensionable service before 6th April, 2009, and 2.5% per annum compound for rights accrued in respect of pensionable service on or after that date.

Schemes that have entered an assessment period prior to the switch will be obliged under current law to conduct the Section 143 valuation by reference to RPI not CPI. The DWP is proposing to change the legislation to prevent such schemes entering the PPF unnecessarily.

**Comment (2):** The reduction in PPF liabilities will also have a knock on effect on Section 179 valuations, used to calculate schemes’ PPF levies.

The changes are intended to take effect on 31st March, 2011.

Changes are also proposed to the indexation of relevant FAS payments so that such increases are undertaken in line with the CPI. These changes will not take effect until 31st December 2011, in order to dovetail with equivalent changes to the PPF, which require primary legislation. The PPF changes will be made in the Pensions and Savings Bill, referred to in the Queen’s Speech, that the Government expects to introduce after the summer recess.

Note that the draft Regulations do not refer to the CPI specifically, rather they refer to the “*general level of prices in Great Britain estimated in such manner as the Secretary of State thinks fit, as published by the Secretary of State from time to time*”. The wording is very similar to that used in the legislation governing revaluation of deferred pensions<sup>2</sup>.

According to the consultation paper this wording is used in order to provide greater flexibility to make changes to inflation measures in the future, should they be needed. If the draft Regulations come into force, the Government expects to announce that the CPI will be the measure that will be used as the general level of prices for FAS and PPF purposes from the date the Regulations come into force.

The consultation paper, on which comments are invited by 3rd November, 2010, is available from the DWP website ([www.dwp.gov.uk](http://www.dwp.gov.uk)).

**Action point:** For noting.

<sup>2</sup> Schedule 3, paragraph 2(3) to the Pension Schemes Act 1993.

## Tax

### Restricting pensions tax relief: informal public consultation

On 27th July, 2010, HM Treasury and HMRC jointly published a discussion document with their alternative proposals for restricting pension tax relief. The discussion document proposes the adoption of a significantly reduced annual allowance. Written submissions on the document are invited by 27th August, 2010.

Final policy decisions will be taken in September with draft legislation expected to follow thereafter. The new rules are expected to take effect from 6th April, 2011, so there is limited time to plan.

The Government expects employers to adapt benefit provision and scheme design, limiting contributions and benefits so that employees stay within the reduced allowance. For defined benefit arrangements, this may be complex. Identifying which members are likely to be affected (based on working assumptions sourced from the discussion document) is a sensible first step which can be put in motion now.

The Government's proposal would include:

- reducing the annual allowance from £255,000 to between £30,000 and £45,000,
- increasing the factor used to value defined benefits for annual allowance calculation purposes from 10 to somewhere between 15 and 20, implying an overall annual cap on defined benefit pension growth of somewhere between £1,500 and £3,000 p.a.,
- continuing to value defined benefits for general annual allowance calculation purposes using a “flat” (i.e. not age-related) factor, but finding a mechanism also to capture within the annual allowance the value of effective augmentations which flat factors would not measure (most obviously, where pensions are paid early without a full actuarial reduction applying),
- removing the “final year exemption” (which currently allows ill-health and redundancy pensions to be augmented by “added years” without reference to the annual allowance) other than in cases of death or “serious ill-health” (life expectancy of 12 months or less),
- (possibly) reducing the lifetime allowance level or changing its valuation factors, and

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- (possibly) freezing the value of rights currently covered by primary and enhanced protection, with subsequent increases in value being subject to the lifetime allowance charge.

**Comment:** This would be an unwelcome and retrospective step.

[Click here](#) for a focus (previously circulated on 5th August, 2010) that goes into more detail, and that suggests topics for submissions and possible “next steps”.

**EFRBS: potential application of anti-avoidance rules**

The March, 2010 Budget announced action to tackle tax and NI avoidance, including restrictions on pensions tax relief, through the use of trusts and other vehicles to reward employees.

The legislation is expected to take effect from April, 2011. The new Government has confirmed that employer-financed retirement benefit schemes (“EFRBS”) are within its scope.

The discussion paper issued by HM Treasury on 27th July, 2010 made no mention of how it intends to treat EFRBS once the proposed restrictions on pensions tax relief come into effect.

A number of clients have lobbied HMRC requesting clarification of the Government’s intentions, in particular requesting that grandfathering provisions be included to protect existing accrual in EFRBS and also that a reasonable lead in time be allowed before any new tax charges take effect to enable alternative arrangements to be put in place.

**Action point:** If you currently use EFRBs and have not already made submissions to HMRC, we recommend that you do so. For further information, please get in touch with your normal pensions contact at Slaughter and May.

**Removing the requirement to annuitise by age 75: consultation paper published**

On 16th July, 2010, HM Treasury published a consultation paper on its proposal, announced in the emergency Budget on 22nd June, 2010, to remove the requirement to purchase an annuity by age 75, from April, 2011.

Under the Government’s proposals, the main options for taking an income in retirement will be:

- purchasing an annuity, or
- purchasing a series of short-term annuities of up to 5 years duration, or

- entering a “capped drawdown” arrangement, which is similar to the existing unsecured pension but available beyond age 75. The Government invites views on the appropriate level for the annual drawdown cap for this new arrangement.

In addition, individuals who are in a capped drawdown arrangement and who want to take more income than the permitted maximum annual limit will be able to draw down unlimited lump sums, subject to their having secured a minimum income, the “minimum income requirement”. This option is described as “flexible drawdown”.

The current option of an alternatively secured pension (“ASP”)<sup>3</sup> will cease to exist. The new capped and flexible drawdown limits and rules will apply to existing members with ASP from April, 2011.

Individuals will not be restricted to a single option, and will be able to make different choices about their retirement income over time. For example, an individual could choose to annuitise part of their pension pot and invest the remainder in a capped or flexible drawdown arrangement.

<sup>3</sup> An ASP is available to individuals who reach age 75 without having secured their benefits. Individuals must draw down between 55 and 90% of the amount of an equivalent annuity each year. Funds remaining on death are subject to both income tax and inheritance tax.

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The Government proposes that amounts received by individuals under any of the above arrangements will be taxed at income tax rates. A single flat rate recovery charge of around 55% is proposed to apply to unused lump sums remaining on death. However, death benefits for those who die before age 75 without having accessed their pensions savings will remain tax-free. IHT will not ordinarily apply to unused pension funds remaining after death which are subject to the recovery charge. Further details on proposed tax charges will be published in draft legislation later this year.

75 will remain the latest age on which tax relief is available on pension contributions and the age at which an individual's pension savings must be tested against the Lifetime Allowance. However, the Government proposes to remove the age 75 limit on payment of pension commencement lump sums and trivial commutation lump sums.

The consultation, on which comments are invited by 10th September, 2010, is available from HM Treasury's website ([www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)).

**Comment:** The Government expects that the majority of personal pension and SIPP providers will choose to take advantage of the new rules, but that relatively few occupational DC scheme providers will choose to make the required changes to their rules in the short term. This assumption is based on the

fact that many occupational DC scheme providers will either choose not to offer the new flexibility (for example if they expect few members will wish to access it) or else will offer it on a case by case basis without changing their scheme rules. Further, occupational schemes may prefer their members to access additional flexibility through specialist providers.

**Action point:** For noting, unless you have members with money purchase benefits approaching age 75. Note that transitional arrangements in the Finance (No. 2) Act 2010 allow unsecured pensions to continue to be paid up to age 77 for a member under age 75 on 22nd June, 2010.

## Regulator

### Statement on regulated apportionment arrangements and employer insolvency

On 12th August, 2010, the Pensions Regulator published a statement on regulated apportionment arrangements ("RAAs").

The RAA is one of 4 bases for apportioning employer debt in a multiemployer scheme where one employer ceases to participate. It must be approved by the Pensions Regulator and the PPF and applies only where the trustees are satisfied that it is likely that

the scheme will enter into a PPF assessment period in the next 12 months. The Regulator may approve such an arrangement if it is of the opinion that the arrangement will result in better funding for the scheme than if an insolvency event occurred in relation to one of the employers.

The Regulator's statement notes that RAAs are extremely uncommon. The statement describes the process to be followed for RAA applications, noting the Regulator's expectation that applications will be accompanied by clearance applications, although the Regulator should already have been involved in earlier discussions around the possible options. Relevant information should be submitted to the Regulator in a draft clearance application and draft RAA, including the level of mitigation proposed.

The statement also sets out the relevant circumstances which the Regulator will consider when judging whether it is reasonable to approve the RAA. These will include whether the scheme might receive more from an insolvency, and the outcome of the proposals for other creditors.

The Regulator emphasises that approval of an RAA will only be considered in circumstances where the scheme will enter a PPF assessment period in any case, so the Regulator's decision is unlikely that have any impact on the level of benefits that members will receive.

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The statement is on the Regulator's website ([www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk)).

**Action point:** For noting, unless you are contemplating applying for an RAA.

**Pensions Regulator's Annual Report and Accounts 2009/2010**

This, covering the financial year ending 31st March, 2010, was published on 22nd July 2010.

According to the press release accompanying publication, unprecedented economic conditions tested the resilience of the UK's pensions regulatory framework during this period. The year saw an increase in the Regulator's casework, with more than 30 "anti avoidance" cases being investigated at the end of March, 2010, including cross-border insolvencies and complex restructurings.

The report provides extensive information on the Regulator's work over the course of 2009/2010 including:

- attempting to raise standards of record keeping, ahead of new auto-enrolment duties,
- free workshops on DB funding, internal controls and record keeping, attended by over 1500 industry representatives,

- encouraging trustees to follow good practice by reviewing documentation provided for members at retirement, including raising awareness of the open market option,
- the expansion and revision of the TKU<sup>4</sup> Code of Practice,
- new modules relating to buy-outs and buy-ins for the trustees' tool kit,
- case work during the period led to the recovery of £35 million of previously misappropriated scheme funds,
- the prohibition of 4 individual and 4 corporate trustees,
- the use of powers to suspend trustees in more than 100 DC schemes, and
- consideration by regulatory teams of over 2,500 cases, including 2,000 involving the scrutiny of recovery plans for DB schemes.

The Annual Report and Accounts are available from the Pensions Regulator's website ([www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk)).

<sup>4</sup> Trustee Knowledge and Understanding.

**Cases**

**Mistake: Catchpole v. Trustees of Alitalia Pension Scheme**

On 16th July, 2010, the High Court (Warren J) decided that, where a pension scheme member had mistakenly been told by the scheme's trustees that she did not need to be married to her long term partner for him to be eligible for a spouse's pension on her death, and had acted on that advice (by not marrying him), her partner had a claim for estoppel by representation after being refused a spouse's pension on grounds he was not a "spouse" within the terms of the scheme rules.

C had appealed against the Pensions Ombudsman's dismissal of his complaint about the trustees' refusal to pay him a spouse's pension on the grounds the rules only allowed a spouse's pension to be paid to a person who was "legally married" to a member.

A few years before her death, the member, B, had sought clarification as to the definition of "spouse" and the trustees had mistakenly told her that C, as her long term partner, would be eligible for a spouse's pension in the event of B's death. C claimed that, as a result of that advice, he and B had decided it was not necessary for them to marry. Had they known of the need to marry for C to be entitled to the spouse's

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pension, they would have done so. The trustees accepted this.

The Ombudsman held that the trustees had been guilty of maladministration, but that this had not caused loss to C as it could not be concluded that, on the balance of probabilities, B and C would have married had they known the true position. B and C had lived together for 20 years without feeling the need to marry, B was in good health when she made her enquiry, and they would have avoided inheritance tax had they married.

Warren J held that the Ombudsman's decision was not one he could properly have reached on the evidence before him. Given that the only proper conclusion that could be drawn from the evidence was that B and C would have married had they known the true position under the scheme rules, the necessary ingredients for estoppel by representation were established (**Steria v. Hutchinson**). The trustees had made a clear representation, which bound them to paying a spouse's pension to C. The fact that the erroneous information was provided to B not C did not prevent C from claiming estoppel.

**Action point:** Ensure that answers to queries from scheme members are correct, taking legal advice where necessary!

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This Bulletin is prepared by the Pensions and Employment Group of Slaughter and May in London.

We advise on a wide range of pension matters, acting both for corporate sponsors (UK and non-UK) and for trustees. We also advise on a wide range of both contentious and non-contentious employment matters, and generally on employee benefit matters.

Our recent work includes advising:

- Uniq plc on a funding agreement (subject to clearance by the Pensions Regulator) with the trustees of its pension fund, linking future contributions to the company's future EBITDA growth
- Gatwick Airport Limited on the establishment of a new defined contribution scheme for 2000 active members
- Cadbury plc on changes to its £1.6 billion defined benefit pension scheme to move to career average pension benefits
- RSA Insurance Group on a derisking arrangement for RSA's 2 main defined benefit pension schemes involving a fully collateralised asset swap and longevity insurance contracts with Goldman Sachs and its insurance subsidiary, Rothesay Life, resulting in removal of a significant proportion of the schemes' longevity, inflation and interest risk
- Royal Mail in its negotiations with its pension trustees over the Government's investment in the Royal Mail and the Post Office and on its consultation over changing the terms of its defined benefit pension scheme
- HM Treasury on pension issues in connection with the taking into temporary public ownership of Northern Rock and Bradford & Bingley
- Marks and Spencer on its substantial contributions to its UK defined benefits pension scheme by an interest in a property-backed partnership, and on changes to benefits under that scheme, affecting 21,000 employees
- Prudential on a group bulk annuity buy-in policy purchased by the trustees of the Cable & Wireless Superannuation Fund for a premium in excess of £1 billion, covering approximately 5,000 members of the pension scheme.

If you would like to find out more about our Pensions and Employment Group or require advice on a pensions, employment or employee benefits matter, please contact one of the following or your usual Slaughter and May adviser:

**Jonathan Fenn**      [jonathan.fenn@slaughterandmay.com](mailto:jonathan.fenn@slaughterandmay.com)  
**Roland Doughty**      [roland.doughty@slaughterandmay.com](mailto:roland.doughty@slaughterandmay.com)

|                       |                      |                  |                    |
|-----------------------|----------------------|------------------|--------------------|
| <b>London</b>         | <b>Brussels</b>      | <b>Hong Kong</b> | <b>Beijing</b>     |
| T +44 (0)20 7600 1200 | T +32 (0)2 737 94 00 | T +852 2521 0551 | T +86 10 5965 0600 |
| F +44 (0)20 7090 5000 | F +32 (0)2 737 94 01 | F +852 2845 2125 | F +86 10 5965 0650 |

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