Pensions and Employment:
Pensions Bulletin

Legal and regulatory developments in pensions

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Countdown to Auto-enrolment

Transitional provisions for DB/hybrid schemes: loophole closed

*Background*

A number of large schemes have been making use of the transitional provision that allows defined benefit and hybrid schemes to defer to September, 2017 auto-enrolment for existing employees at the staging date:

- who were eligible to become members but who had opted not to join, and

- who continued to have the right to become members of the scheme since they first became eligible to join it.

The provision applies even where the benefits on offer are DC benefits, but in a hybrid scheme.

*The change*

In a written ministerial statement on 19th December, 2012, Steve Webb, Pensions Minister, announced that the legislation will be amended to make it clear that only defined benefits (whether offered under a hybrid scheme or a defined benefit scheme) will satisfy the pre-conditions for employers to defer automatic enrolment in this way.

The DWP intends the change to have retrospective effect to the date of the announcement so that any employer who offers only money purchase benefits to a jobholder and has issued a notice to them to defer automatic enrolment will need automatically to enrol that jobholder, and backdate employer contributions to 19th December, 2012.

From the date the legislation comes into force, any employers who will be affected by the change will be required to make back payments covering the period from the date of the announcement. It will be up to the jobholder as to whether or not they wish to pay their own contributions for this period. Where jobholders wish to make contributions, employers and schemes will need to allow these to be made over an extended period.

Employers offering money purchase benefits will still be able to use the transitional phasing-in provisions.

The written ministerial statement is here.

*Comment:* It is important to proceed with care in managing the employer’s automatic enrolment duties in terms both of legal risk and political risk.

Automatic enrolment earnings thresholds review and revision 2013/14

On 13th December, 2012 DWP published its response to its September, 2012 consultation on proposed revisions to the automatic enrolment earnings trigger and the qualifying earnings band.

The *earnings trigger* is the level of earnings from which people are automatically enrolled. The *qualifying earnings band* sets the minimum contributions levels for money purchase schemes. The legislation requires these thresholds to be reviewed each year, and revised if appropriate, taking into account the prevailing rates of NICs, the PAYE personal tax allowance, basic state pension, inflation and any other factors that the Secretary of State considers appropriate.

The Government proposed that, with effect from 6th April, 2013:

- the automatic enrolment earnings trigger should continue to be aligned with the PAYE threshold and so should rise to £9,205,

- the lower limit of the qualifying earnings band should continue to be aligned with the lower earnings limit for NICs (at £5,668), and
• the upper limit of the qualifying earnings band should be aligned with the upper earnings limit for NICs (£41,450).

In his Autumn statement on 5th December, 2012, the Chancellor of Exchequer announced that the PAYE threshold will be raised to £9,440.

The DWP has decided to retain the link with the PAYE threshold so that the automatic enrolment earnings trigger will also rise to £9,440.

The DWP confirms that the lower and upper limits of the qualifying earnings band will align with the lower earnings limit and upper earnings limit for NICs.

The consultation response is here.

**Action point:** Take into account these changes in implementing compliance with an employer’s automatic enrolment duties.

**Regulator updates 5-step trustee checklist**

The Pensions Regulator announced on 13th December, 2012 that it has updated its 5-step checklist on auto-enrolment for trustees of occupational pension schemes.

The checklist, which was first published in June, 2011, has been updated in advance of a significant increase in the number of employers reaching their staging dates.

The checklist outlines the 5 key activities that may involve trustees where their scheme is to be used for automatic enrolment. These are:

• to consider whether the scheme can be use for auto-enrolment,
• to review existing governance standards and consider whether the scheme meets the Regulator’s 6 DC principles and quality features,
• to review the default investment strategy,
• to examine administrative processes to check whether they can cope with the increase in membership, and
• to assist with member communications where requested by the employer.

The updated checklist is here.

**Comment:** The 5 step checklist is a useful starting point for trustees. It is also important for employers and trustees to remember that adding a defined contribution section to an existing occupational pension scheme creates a different, although perfectly manageable, set of legal risks from those in a defined benefit section. Further information on these legal risks and ways in which they can be managed is available on request.

**New Law**

**State Pension Reform: White Paper**

**Overview**

The DWP published its White Paper (CM8528) on its proposals for reforming state pension on 14th January, 2013.

As widely trailed, the White Paper announces the Government’s intention to replace the existing state pension system with a single-tier state pension. The effective date of the change is likely to be 6th April, 2017.

As well as the detail of the single-tier pension, the White Paper sets out the case for change, transitional arrangements, how the end of DB contracting-out will be managed, and how changes to state pension age will be made in future.

The legislation will be contained in a Pensions Reform Bill, expected to be published in May, 2013 with the aim of obtaining Royal Assent in Spring, 2014, giving the Government and affected COSR schemes 3 years to implement any necessary changes.
**Single-tier pension (Chapter 2 and annex 3)**

The maximum single-tier pension will be set at the basic level of means-tested support, currently £142.70 per week (although, for simplicity, the White Paper assumes £144 a week throughout).

The maximum level is based on 35 years of NICs (i.e. 5 more than the existing state pension). Once 35 years of NICs have been paid, there will be no further accrual of state pension. There will be a minimum qualification period of between 7 and 10 years (for simplicity, the White Paper assumes 10 years). The state pension of anyone paying NICs for between 10 and 35 years will be pro-rated.

Although the White Paper assumes that the pension once in payment will be uprated annually by the “triple lock” that currently applies to basic state pension (i.e. the greater of the increase in earnings, the increase in prices and 2.5%) the fine print notes that the method of uprating (which will not be less than the increase in earnings) will be decided upon shortly before implementation.

The single-tier pension will be based on an individual’s qualification; there will be no facility to inherit or derive rights from a spouse/civil partner as with the existing state pension (although there are complex transitional arrangements which, broadly, protect spouses’/civil partners’ pensions where both reach state pension age before the single-tier pension is introduced).

It will still be possible to postpone payment of single-tier pension beyond state pension age in return for a higher pension later on, but there will no longer be the option to receive a lump sum on postponement. The rate of increase applicable to postponed pensions will be finalised closer to the implementation date.

**Transitional arrangements (Chapter 4)**

Current pensioners (including those reaching state pension age before April, 2017 i.e. men over 65 and women over 63.5 at that date) will be unaffected by the change.

Future pensioners (i.e. anyone under state pension age at the date of the change) will have their existing accruals under the basic and state second pensions “locked down” (“foundation pension”). If they have reached the maximum single-tier pension level at April, 2017, any excess will be “protected pension” which will be revalued and uprated by reference to CPI. Such individuals will not accrue any further state pension (although they will be required to pay full NICs).

**Contracting-out (Chapter 3)**

Contracting-out on a DB basis will be abolished when the change is implemented. In 2011, there were 5.3 million active members of public sector COSRs and 1.6 million active members of private sector COSRs.

Future pensioners who are contracted-out at the changeover date will be contracted back in and will contribute towards extra state pension through NICs. A deduction will be applied to their foundation pension to reflect the fact that they have paid a lower rate of NICs. They will have the opportunity to accrue additional single-tier state pension to the extent they have not already reached the maximum. Going forward, they will lose their 1.4% NIC rebate.

Employers with COSRs will see their rate of NICs increase by 3.4%. The reference scheme test will no longer apply. There will be an employer override to allow employers to make changes to their scheme rules to recoup their share of the lost NIC rebates (by increasing contribution rates or reducing future benefits) but employers will need to inform and consult affected members if they propose to make such a change. There will be no requirement to inform or consult on the ending of contracting-out generally. The employer override will be time limited, will be able to be used once only and will not be able to affect accrued benefits.
Comment: The override was the subject of a separate informal consultation by the DWP in January, 2012. The Association of Pension Lawyers, in their response, highlighted problems with the DWP’s approach but there is insufficient detail in the White Paper to see whether the problems have been addressed.

The DWP will be publishing factsheets to assist employers in communicating the change.

The Government says it is happy to discuss any aspects of ending DB contracting-out with employers and the pensions industry. The White Paper (paragraph 78) includes a specific email address for this purpose.

It will also be interesting to see whether the Government will recoup the extra costs for public sector schemes currently contracted-out by reducing benefits or increasing member contributions.

Other issues

The Government is considering whether to introduce an override to the “protected persons regulations” that protect employees in formerly nationalised industries. They restrict the ability of employers and trustees to change scheme rules for such employees. It will consult further on this issue.

Respondents to the Green Paper requested simplification of the GMP legislation. The Government says (paragraphs 67 and 68) that it believes it is not possible to make any further significant simplifications, beyond in relation to the GMP conversion legislation introduced in 2009, without interfering with employees’ property rights.

State pension age (Chapter 6)

The Government will carry out a review of state pension age every 5 years, with the first review taking place in the next Parliament. The review will be informed by:

• analysis from the Government Actuary’s Department on increases in life expectancy, and
• an independently-led review body, commissioned to produce a report on the wider factors that should be taken into account when setting state pension age.

The review framework will seek to provide a minimum of 10 years’ notice for individuals affected by changes to state pension age.

The White Paper is here.

PPF Levy 2013/14: final determination issued

Overview

On 17th December, 2012 the PPF published its 2013/14 pension protection levy policy statement, alongside its final determination for the 2013/14 levy and the final versions of its levy practice guidance and its investment risk, contingent asset and block transfer guidance.

The policy statement confirms that:

• the levy estimate will be £630 million,
• the risk levy scaling factor will be reduced from 0.89% to 0.73%,
• the levy cap will remain at 0.75% of PPF liabilities, and
• the scheme base levy multiplier will be reduced from 0.000085 to 0.000056.

All other rules used to set the levy will remain the same, except for a relaxation in the requirements for a guarantee from a bank or from a custodian, so that in future an A- credit rating for the guarantor will be sufficient.
**Contingent assets**

The contingent asset guidance has been redrafted with a particular focus on trustees’ assessment of the ability of guarantors of Type-A contingent assets to meet the guarantee.

The PPF says that dealing with the issue of the strength of guarantors in a proportionate way has been of the trickiest levy-related issues it has had to contend with recently. It is to investigate whether it can bring the trustee certification requirement more in line with the way that the PPF itself assesses the strength of guarantors.

One change to the contingent asset guidance relates to the need to recognise that contingent assets are called in response to the insolvency of the sponsoring employer and so it may be necessary to discount the value of the guarantor if its value will be affected by that insolvency. The PPF plans to publish some case studies shortly to show how it has assessed whether a contingent asset is acceptable.

Although last year’s guidance said that trustees would not generally need to undertake a formal covenant review, the PPF’s experience has suggested that, even if trustees undertake a less formal process, similar considerations ought to be addressed, and should be documented.

**Action point:** Trustees who are obtaining a new Type-A contingent asset, or re-certifying an existing one, will need to take specific advice as to whether the certificate as to the guarantor’s financial strength can be given.

**Submitting information**

The PPF notes that schemes should make sure that the information that they provide in their returns to the Pensions Regulator’s Exchange system are as accurate and up to date as possible. Exchange is now available for schemes to complete.

The introduction of investment risk means that the asset breakdown reported on Exchange may have a significant impact on levy bills. The PPF recommends that schemes that are considering reporting substantial allocations to the “insurance” or “other” categories consider seeking to record the underlying assets held if, for example they are held in a pooled fund. The split of bonds and equities in a pooled fund could have a significant impact on the levy.

**Key deadlines**

In completing the investment information on Exchange, pension managers should check that they are clear as to the legal nature of the investment which the plan holds.

It is not uncommon for an investment described as an investment in a “managed fund” or an “index tracking fund” to, in fact, be structured as a contract of insurance between the trustee and the insurance company with the trustee holding a unit-linked life policy.

<table>
<thead>
<tr>
<th>Item</th>
<th>Key dates</th>
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<tbody>
<tr>
<td>Submit scheme returns on Exchange</td>
<td>By 5pm, 28th March, 2013</td>
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<tr>
<td>Reference period over which funding is smoothed</td>
<td>5-year period to 29th March, 2013</td>
</tr>
<tr>
<td>Certification of contingent assets</td>
<td>By 5pm, 28th March, 2013</td>
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<tr>
<td>Certification of deficit-reduction contributions</td>
<td>By 5pm, 30th April, 2013</td>
</tr>
<tr>
<td>Certification of full block transfers</td>
<td>By 5pm, 28th June, 2013</td>
</tr>
<tr>
<td>Invoicing starts</td>
<td>Autumn, 2013</td>
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The policy statement, appended to which are the final version of determination and appendices, the levy practice guide and the investment risk transfers and contingent asset guidance are here.

**Action point:** Trustees and employers should take particular note of the deadlines. Failure to meet them
can be extremely costly in terms of impact on the size of the PPF levy.

Tax

VAT on funded pension schemes


VAT Notice 700/17 provides guidance on the circumstances in which employers and trustees of funded pension schemes can reclaim VAT.

Paragraph 2.9 of the notice has been amended to include guidance on the recovery of VAT on management costs by professional trustees who are appointed to run a pension scheme on the insolvency of a participating employer following a recent decision of the First Tier Tribunal."}

1 JJB Group v HMRC [2012] UK FTT 547

The revised notice is here.

Action point: For noting.

Cases

Extent of employer’s "Imperial" duty of good faith: IBM Pensions Trust Limited v. IBM Limited and others

Overview

On 13th December, 2012, Warren J gave judgment on whether IBM owed an "Imperial" duty of good faith to consent to deferred members taking unreduced benefits at age 60. He decided it did not.

Background

The judgment follows on from Warren J’s 12th October, 2012 decision (Pensions Bulletin 12/17) when he decided that deferred C Plan members of the IBM Pension Scheme had the right to take unreduced benefits only at age 63. This compared with the right of active C Plan members, following rectification of the trust deed to reflect what Warren J found were the parties’ true intentions, to take unreduced benefits at age 60.

Warren J accepted that his decision meant that the trustees had been in breach of the preservation requirements in the period up to 6th April, 2005. At that time, they required that deferred pension had to be payable at the same time as ordinary pension. The trustees argued that IBM was required by virtue of its "Imperial" duty of good faith to consent to an amendment of the trust deed to permit deferred members to retire in the period up to 6th April, 2005 at 60 on unreduced benefits. At the time, Warren J was unable to reach a view on this "difficult" issue, and invited the parties to provide further written argument if they wished him to do so.

This they did and the latest judgment is the outcome.

The "Imperial" duty of good faith was stated by Browne Wilkinson V-C in that case as the employer’s duty not, without reasonable and proper cause, to act in a way "calculated to damage the relationship of confidence and trust between employer and employee".

The arguments

Clause 13 of the IBM trust deed and rules stated that, in order to comply with the preservation requirements, the trustee may, with the consent of the principal employer, make any necessary changes.

The trustee argued that IBM’s "Imperial" duty of good faith obliged it to consent to an amendment to the trust deed under clause 13 to bring the C Plan into conformity with the pre-April, 2005 preservation requirements. If the Plan had been rectified in, say 1993, rather than in 2012, IBM would have been obliged, pursuant to clause 13, to give its consent to the amendment which the preservation requirements required the trust company to effect. The trustee
argued that, by failing now to consent to such an amendment, IBM was in breach of its "Imperial" duties.

IBM argued that, following the High Court decision in *Prudential* (Pensions Bulletin 11/06), when considering the scope of an employer’s "Imperial" duties, the test was whether a decision to take a particular course of action would be irrational or perverse.

**The judgment**

Warren J extracted 4 principles from the judgment in *Prudential*:

• the exercise of a discretion such as that in this case requires "a genuine and rational as opposed to an empty or irrational, exercise of the discretion" i.e. IBM must consent if to refuse consent would be irrational or perverse,

• the correct test is not one of fairness i.e. assessing whether a decision is irrational or perverse is not to be equated with the application of an objective standard of reasonableness,

• whatever the test is it is a "severe" one i.e. the conduct must be such to destroy or seriously damage the relationship, and

• the test is objective.

Applying these principles here, Warren J concluded that:

• in deciding whether to consent to a particular amendment requested by the trustee, IBM would be subject to an "Imperial" duty; it could not simply refuse to consent to a proposed amendment without even giving it due consideration,

• neither the trustee nor IBM intended the C Plan to provide for payment of an unreduced pension at age 60 to deferreds. Provision of such a benefit was a consequence, unforeseen by either of them, of a lack of understanding of the preservation requirements,

• there was no breach of the "Imperial" duty on the part of IBM in refusing consent to an amendment which was not required to give effect to the preservation requirements as they stood at the date of the request (i.e. post-6th April, 2005). It was not unreasonable for IBM to refuse to give its consent; it was not irrational or perverse for it to refuse to do so, nor, on an objective view could it be said that such a refusal would destroy or seriously damage the relationship of trust and confidence between IBM and the beneficiaries. To refuse consent would be to give effect to the intention of IBM and the Trustee when the C Plan was introduced, and to the announcements to staff made before commencement of the scheme and to the various iterations of the trust deed and rules and the handbook, and

• although it is arguable that IBM could have been compelled to consent prior to 6th April, 2005 to such an amendment (and Warren J did not need to decide that) that would be because IBM would then have been under an obligation, whether contractual or pursuant to its "Imperial" duty, to comply with the preservation requirements as they then stood.

**Comment:** Warren J’s decision will come as a relief to IBM, who estimated that the cost to it of permitting deferred to take benefits unreduced at age 60 would be £240 million. It is also a useful restatement of the "Imperial" test, which is the subject of further litigation in relation to the IBM pension scheme. The case is due to be heard by Warren J in May, 2013.

**Pensions Ombudsman’s jurisdiction:** *Pensions Ombudsman v. EMC Europe*

**Overview**

On 14th December, 2012, the High Court (Briggs J) held that the Pensions Ombudsman could not assume jurisdiction over complaint that, if successful, would
have an adverse effect on the contractual rights of the US parent of the participating employers.

Background

A scheme member, D, complained to the Pensions Ombudsman about a compromise agreement made in 2002 in relation to the Data General Employee Benefits Plan, a DB occupational pension scheme currently being wound up. D sought directions for the compromise to be set aside and the scheme to be administered as if the agreement had never been made.

The compromise agreement had been reached between the trustees and the principal and participating employers of the scheme (the “Participating Employers”). An additional contractual party was EMC Corporation (“EMC”), incorporated in Massachusetts, US, which had never participated in the scheme but which provided the funds for the other companies to pay the consideration for the compromise. The Participating Employers were subsidiaries of EMC.

The “employers” (defined for the purposes of the compromise agreement to include EMC as well as the Participating Employers) agreed to pay £1.2 million to the trustees in exchange for a release from any further obligation to the scheme (which was in deficit to the tune of approximately £5 million). Following payment of the funds, the scheme was put into winding-up.

The Ombudsman accepted D’s complaint for investigation on 18th April, 2008. The EMC companies challenged his jurisdiction. In February, 2010, the Ombudsman acknowledged his lack of jurisdiction over EMC and it was common ground that EMC would not be bound by his determination on the complaint (as it had never been a participating employer).

The EMC companies went on to argue that the Ombudsman should not accept jurisdiction over the complaint at all on the basis it fell foul of the principle in Edge v. Pensions Ombudsman [1999] EWCA Civ 2013 that the Ombudsman was not entitled to pursue an investigation where his determination would affect a wider class of beneficiaries than the complainant, who might be adversely affected by the determination, and who were not parties to the dispute.

EMC would not be bound by the Ombudsman’s determination if D were successful yet its rights as a party to the compromise agreement would be adversely affected, specifically because of the detrimental effect of any determination on the value of its shareholding in the Participating Employers.

The High Court decision

In March, 2011, the Ombudsman issued an application to the High Court under Section 150(7) Pension Schemes Act 1993, seeking a ruling on a point of law regarding his jurisdiction over the complaint.

The Ombudsman argued that the loss caused to EMC was not a form of loss or invasion of legal rights which should be recognised as impeding his jurisdiction.

The High Court held that the Ombudsman did not have jurisdiction. The principles in Edge were fully applicable to the complaint. The judge rejected the Ombudsman’s submission that any resulting adverse impact on EMC’s rights was not of the type that might impede the Ombudsman’s jurisdiction. He said:

"Where, as here, the parent company has a contractual right of its own adversely affected by the pursuit of the complaint to a successful determination, then it is, just like the employers in the Edge case, entitled to complain that its rights should not be overridden in proceedings to which it is either not (as in Edge) or cannot (as in the present) be made a party and therefore bound".

But the judge drew a distinction between the position of EMC, which had provided consideration for the promises received, and the position of a hypothetical parent company added to a compromise agreement without providing any such value, in which case he suggested that the Court should prevent the

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SLAUGHTER AND MAY
Ombudsman’s jurisdiction from being “artificially undermined”.

**Comment:** It is not clear why the Pensions Regulator chose to take no action in relation to the compromise. The judge made it clear that his decision was confined to the situation where a parent company had funded the compromise.

**Propriety of switch from RPI to CPI: Ombudsman’s determination in relation to Mr Houghton (88880/2)**

On 7th December, 2012, the Pensions Ombudsman found it was reasonable for the trustees of a private sector pension scheme to switch from RPI to CPI-based increases to pensions in payment even though the scheme’s explanatory booklet stated that RPI-based increases were “guaranteed”.

A pensioner member of the Innospec Limited Pension Plan (“H”) complained that the switch from RPI was maladministration.

The Deputy Pensions Ombudsman held that the scheme booklet (which stated that, while it set out the main features of the scheme, it was not intended to replace the rules governing the scheme) did not override the scheme rules, which required increases to be calculated according to the trustees’ assessment of the yearly increase in the “cost of living”. The booklet did not amount to a binding promise by the trustee always to pay RPI-based increases and, at most, set out the trustees’ understanding of current practice.

The Deputy Ombudsman also held that there was no breach of contract by the employer, who had put forward a pension increase exchange offer only a year before the switch to CPI. Representations contained in the offer about the use of RPI did not have contractual force, since H had not accepted the offer. In any event, the offer related to the right to receive non-statutory increases in general, not increases calculated according to the RPI in particular.

**Comment:** This is the fourth determination from the Ombudsman arising from schemes’ decisions to switch to CPI-based indexation or revaluation. None of the complaints has been upheld. It is hard to think of a situation now where such a switch will, if allowed by the Trust Deed and Rules (and Section 67 of the Pensions Act 1995 as amended) amount to maladministration.

**Points in Practice**

Regulator’s consultation on defined contribution schemes

On 11th January, 2013, the Pensions Regulator published for consultation a new Code of Practice, accompanying regulatory guidance and a document setting out its regulatory approach, together establishing a framework for the regulation of defined contribution (“DC”) schemes.

The framework applies to occupational DC trust-based schemes but the Regulator is working with the FSA to ensure that the regulation of work-based personal pension schemes delivers comparable outcomes.

The Regulator’s publication is underpinned by its 6 DC principles (published in December, 2011 (Pensions Bulletin 11/19)) and 31 DC quality features which represent the standards and behaviours the Regulator expects trustees to attain (published in draft in June, 2012 (Pensions Bulletin 12/10)).

**Document setting out the Regulator’s DC regulatory approach**

This describes how the Regulator will approach educating, enabling and enforcing the underlying legal requirements for the DC quality features.
The Regulator last consulted on its regulatory approach for DC schemes in 2007. Since then, DC provision has become increasingly prominent and, as a result of the automatic enrolment regime, between 5 and 8 million people will be joining work-based pension schemes.

The Regulator expects trustees voluntarily to disclose information to demonstrate consistency with the DC quality features. It also expects trustees to disclose potential inconsistencies between their DC scheme and the DC quality features.

The Regulator’s enforcement approach will consist of:
• monitoring: gathering information to help it identify and monitor risks of non-compliance with legal requirements,
• investigating: assessing what it finds is a potential breach of the law and requires further action, and
• putting things right: measures the Regulator can use to resolve problems it has identified.

Monitoring will take place by way of targeted scheme governance reviews, by asking trustees and providers for evidence of whether their practices are consistent with the Regulator’s Codes and guidance, by analysing information collected from a variety of sources to detect for behaviours and assessing new products, and by establishing partnerships with other regulators and enforcement bodies to strengthen its intelligence gathering.

Enforcement options open to the Regulator include:
• informal action such as a warning letter,
• formal requests for information,
• inspection powers,
• the appointment of “skilled persons”,
• issuing statutory notices such as an improvement or third party notice,
• publishing reports about cases where the Regulator has considered using its powers,
• issuing civil penalties of up to £5,000 in the case of an individual and up to £50,000 in any other case for any breach of law that is identified,
• appointing trustees,
• prohibiting a person from being a trustee, and
• applying to court to restrain misuse and misappropriation of assets.

According to the Regulator, there are particular DC-specific governance issues to be addressed in large occupational DC trust-based schemes that are hybrid schemes, where trustees may find it difficult to dedicate sufficient time to DC issues. Such schemes are expected to adopt a voluntary disclosure framework that will enable them to demonstrate consistency with standards in the DC code and DC guidance.

So far as personal pension schemes are concerned, the Regulator believes that the regulatory framework should offer similar levels of member protection and therefore expects the DC quality features to be present in work-based personal pension schemes.

Draft Code of Practice 13 on governance and administration of occupational DC trust-based pension schemes

The draft Code of Practice is also built around the Regulator’s 6 DC principles and DC quality features. It builds on requirements in existing Code of Practice 7 on trustee knowledge and understanding and Code of Practice 9 on internal controls.

It sets the DC quality features in the context of their legal framework and describes how trustees can...
demonstrate that they have achieved the relevant standard.

Knowledge and understanding: The Code addresses the requirement that trustees of occupational DC trust-based schemes have knowledge and understanding of:

- the law relating to pensions and trusts, and
- principles relating to investment matters.

It suggests that trustees should read the rules, deeds of amendment, statement of investment principles, member booklets and other key member communications in enough detail to know where to find a particular provision if an issue arises. A trustee's breadth of knowledge and understanding should be sufficient to allow it to understand fully any advice it is given. The Regulator expects trustees to be able to challenge any advice if it seems sensible to do so.

Meetings: The Regulator suggests that certain key DC issues be included as a standing agenda item at trustee meetings, including:

- investment monitoring, to facilitate discussion around how funds are monitored. Trustees should invite managers to attend meetings to discuss reports and evaluate market conditions and movements,
- scheme risks, to understand the key risks facing the scheme and how these have changed since the last trustee meeting. Trustees should discuss corporate activity affecting the scheme and how and when an employer's automatic enrolment duties apply to it,
- scheme costs and charges,
- administration, to ensure the administration services provided to the scheme are of a good standard. In-house and third party administrators should be asked to attend meetings and to provide regular updates,
- communications, to ensure that information sent or to be sent to all members (active and deferred) is accurate, clear and understandable, and engaging,
- a legal update, to understand any changes in the law (including legislation, case law and Ombudsman determinations) which affect DC provision, and
- trustee training, to ensure that trustees understand relevant issues.

For hybrid schemes, the Regulator does not consider it sufficient to devote a short amount of time at the end of a trustee meeting to DC matters. Trustees should set aside full meetings to discuss DC issues in detail.

The Regulator highlights that trustees should understand a scheme's history, for example in relation to bulk transfers in and out and special risk benefits provided on closure of a historic DB section pension provided to affected members, and suggests that schemes with complex histories create a scheme history document so that detailed knowledge is not lost on a change of trustees.

For new trustees, the Regulator suggests that trustees consider offering pre-appointment training and require candidates to attain sufficient levels of knowledge and understanding before appointment.

Trustees with a specialist role are expected to acquire detailed additional knowledge to enable them to meet the requirements of their role.

Risk management: The section on risk management largely replicates the Regulator's internal controls Code of Practice, including recommending the use of a risk register.

Conflicts: The section on conflicts of interest again replicates the Regulator's guidance, noting that trustee conflicts of interest in occupational DC trust-based pension schemes are less likely to be a risk when compared to those present in DB
schemes. But conflicts could, for example, arise when agreeing operational costs such as those relating to administration or communication with employers.

**Professional advisers:** The Regulator expects trustees to establish controls to manage the appointment of professional advisers and the delivery of information, advice and services provided by them, and to document these clearly. The Regulator says trustees should find out what professional indemnity cover their advisers have, what qualifications and accreditations they have, how they keep their professional knowledge up to date, and whether they have other pensions clients with schemes of a similar size and type to their scheme.

**Record keeping:** The section on record-keeping largely replicates the Regulator’s guidance on this. So far as administration systems are concerned, the Regulator says trustees should assess how access to systems and data is restricted and how data integrity is maintained. They should also ensure that they have a disaster recovery plan in place, which is reviewed on a regular basis (no less than annually) and which is tested periodically.

**Regulatory guidance**

This is to be read in conjunction with the Code of Practice.

Particular points to note are:

- a recommendation that trustees review value for money provided by their scheme on an ongoing basis. This includes evaluating the scheme overall, as well as the individual components (for example administration or investment). Separately trustees should carry out a strategic review periodically, looking in-depth at the current costs, charges and benefits. Where trustees are not satisfied that their scheme offers value for money for members, they should take action,

- a suggestion that trustees may need to have discussions with employers about potential changes to employment arrangements or scheme rules which affects specific groups of members. The guidance cites as an example schemes that take out annuities in the scheme name and then administer the annuity. The Regulator suggests that trustees may consider that this creates additional cost and risk for the scheme and employer and that they should discuss with the employer whether to redesign the scheme and spend the money saved on other services,

- on costs, the Regulator suggests that, as a minimum, trustees should present information about all costs and charges to members on joining, annually, on request, on leaving the scheme or employer, and before charges or funds change,

- on contributions, the Regulator suggests that trustees should ensure that the scheme is designed to offer contribution flexibility for members, including options to increase and DC contributions.

The draft documents, on which comments are invited by 28th March, 2013, are on the Pensions Regulator’s website.

**Comment (1):** The Regulator’s statement in the impact assessment that “on the basis that the material is either restatement of law, existing guidelines and standards of practice and behaviours, we have concluded that this material does not impose additional costs”. In part there is an element of overstatement of the position as the powers of trustees will be constrained by the terms of the trust deed and rules and so the Regulator’s guidance in this area needs to be read with that in mind.

**Comment (2):** Full compliance with everything indicated by the Regulator is, we suspect, likely to increase costs materially. As always in this area, a proportionate and practical approach is one that is likely to be the most effective solution.
RPI to remain unchanged

On 10th January, 2013, the National Statistician announced the outcome of her October, 2012 consultation on options for improving the RPI.

The consultation set out a number of options ranging from no change, to a change to ensure that the formulae in the RPI were aligned fully with those in the CPI (Pensions Bulletin 12/17).

Although the National Statistician has concluded that the formula does not meet international standards, and has recommended that a new index be published, this will be RPI-based. The National Statistician noted there is significant value to users in maintaining the continuity of the existing RPI without major change, so as it may continue to be used for long-term indexation and for index-linked gilts and bonds in accordance with user expectations.

Comment (1): Members whose benefits are linked to RPI will be relieved by this unexpected announcement. The Government, which would have made substantial savings in relation to the benefits it indexes by reference to RPI, was muted in its press release announcing the decision.

Comment (2): Depending on exactly how the pension increase provisions of a scheme’s trust deed and rules are written, it may be that, in some schemes, the trustee or the employer may, in fact, have a right to determine which measure of inflation is used. If so, the trustee or employer will need to consider whether the new index (RPI(i)) should be considered as a more accurate measure of inflation. Legal advice on the scope of the powers of the trustee and the employer in this area should be considered if, on initial review, the scheme rules are not prescriptive as to how increases in inflation are to be measured.

PPF guidance to trustees on member communications

On 8th January, 2013, the PPF published a draft member announcement, and answers to FAQs, for trustees to send to members where schemes enter an assessment period.

The announcement covers what happens during an assessment period, what will happen if a scheme rescue is possible, and a brief explanation of the PPF compensation provisions.

Trustees of schemes with an insolvent employer are required to notify members of the scheme entering the PPF assessment period within 28 days of receiving notification from the PPF that assessment has begun.

The draft announcement is on the PPF website.

Comment: For noting.

Revised version of TM1

Version 3.0 of TM1: statutory money purchase illustrations was published in December, 2012 and is effective for statutory illustrations with an illustration date on or after 6th April, 2013, although providers may comply instead with version 2.0 for statutory illustrations issued before 6th April, 2014.

Changes from version 2.0 include:

• removal of the maximum 7% cap on assumed investment returns,

• clarification that the method used to determine investment returns should be made available to members on request, and

• introduction of a requirement that unisex mortality tables be used, taking account of the ECJ decision in Test-Achats.

Version 3.0 is here.

Automatic transfers and the treatment of “micro pots”

In its response to its December, 2011 consultation on small pots, published on 17th July, 2012
(Pensions Bulletin 12/12), the DWP agreed to explore further a request by respondents that schemes should be allowed to refund “micro pots”.

The DWP announced, on 20th December, 2012, that refunds of micro pots will not be permitted. It has concluded that refunding a micro pot is more complex than first appears, in that any pot has to be separated into employer contributions, employee contributions, and tax relief, and that those contributions then have to be treated differently according to the nature of the scheme. Further, the unequal treatment of trust and contract schemes may throw up legal difficulties which will not easily be resolved.

**Action point:** For noting.

### Miscellaneous

**Client seminars 2013: save the dates**

Our pensions update client seminars will take place on the following dates in 2013:

- Wednesday, 13th February, 2013,
- Wednesday, 19th June, 2013, and
- Wednesday, 13th November, 2013.

Details of the February session are attached.
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 pensions team is described in the 2012 edition of The Legal 500 as “extremely knowledgable” and as having “strength in depth”. Our recent work includes advising:

- The Trustee of the General Motors UK Retirees Pension Plan, on the surrender of 2 insurance policies and the purchase of a bulk purchase annuity policy with Rothesay Life. The transaction covered all or substantially all of the Plan’s benefit obligations and had an aggregate value of approximately £230 million.
- GlaxoSmithKline (“GSK”), in relation to a benefit change exercise involving the application of a pensionable pay cap in relation to 4 of its pension plans. The cap was implemented through contractual agreement with scheme members and involved guiding GSK through their discussions with trade unions and employees and documenting the agreed changes. The change affects more than 4,000 active members of GSK pension plans.
- The Trustee of ConocoPhillips Pension Plan, on the UK pensions issues arising from the demerger of the ConocoPhillips “downstream” oil business, including establishment of a new mirror image defined benefit pension scheme for the “downstream” UK business. ConocoPhillips is a US company and a number of cross-border issues arose from the pension demerger as a result. We coordinated our advice on these issues with legal advice from Cravath Swaine & Moore in the US.
- Global Infrastructure Partners, on the establishment of the Edinburgh Airport Pension Plan.

If you would like to find out more about our Pensions and Employment Group or require advice on a pensions, employment or employee benefits matters, please contact Jonathan Fenn jonathan.fenn@slaughterandmay.com or your usual Slaughter and May adviser.

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