

Trustee Knowledge Update

Welcome to the first edition of our Trustee Knowledge Update. The purpose behind our publication is to update trustees quarterly on changes in the law to help them comply with the duty under the Pensions Act 2004 for each trustee (or trustee director) to have knowledge and understanding of the law relating to pensions and trusts.

Legislation

Pensions Act 2007 has completed its progress through Parliament, and while most of the provisions relate to the state pension system (S2P) the main relevant points are as follows:

- it allows schemes to convert Guaranteed Minimum Pension benefits (GMPs) into normal pension savings if they comply with certain safeguards
- defined contribution schemes will no longer be able to contract out of S2P (although existing protected rights will continue to be protected)
- proposals had been made during the Bill's passage through Parliament to amend it to offer increased support where sponsoring employers have become insolvent and the scheme is not eligible to enter the PPF, but these have been opposed and defeated by the Government.

Work and Families Act 2006 changes (among other things) the law relating to maternity leave. Women who qualify for statutory maternity pay are now entitled to receive it for 39 weeks (as opposed to 26 weeks for babies due on or before 31 March 2007). This has implications for occupational pension schemes as accrual of benefits must generally continue whilst a woman is on paid leave.

www.opsi.gov.uk/legislation

Cases

Robins v Secretary of State for Work and Pensions (ECJ): The ECJ found that the UK Government was in breach of the Insolvency Directive in failing to take steps to ensure that the benefits of two former ASW employees had been adequately protected when their employer became insolvent. However, the Court said that the Directive "*cannot be interpreted as demanding a full guarantee of the rights in question*", although guaranteeing less than half of the promised entitlement would not constitute "*protection*". However, it left open the question of what percentage, between 50% and 100%, would be sufficient protection for these purposes. What is clear is that 100% protection is not required. It seems unlikely in most cases that the level of benefits

guaranteed under the PPF would fall foul of the Directive, so, in the short-term, the Government is unlikely to take action in relation to changing the shape of the PPF. The High Court will now have to decide whether the breach of the Directive described by the ECJ was "*sufficiently serious*" to warrant compensation from the Government for insolvencies in the past. The transcript of the decision can be found at:

www.eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62005J0278:EN:HTML

British Vita v British Vita Pension Fund Trustees (High Court): This raised the question of how the scheme-specific funding regime relates to a scheme's contribution rules and in particular whether, once a schedule of contributions is in place, the trustees are able to require additional contributions to be paid in accordance with the scheme rules. As the demand for additional contributions was made before a schedule of contributions was in place under the new scheme-specific legislation, the Court did not actually have to decide on this issue. Nevertheless, if trustees are considering demanding contributions in excess of those set out in a schedule of contributions under the new scheme-specific regime, they should consider the arguments set out in this case.

A F Blakemore & Son Ltd v Machin (High Court): An employer and employee entered into a compromise agreement in relation to severance terms which was said to be "*in full and final settlement of all his claims*" against the employer. The Court held that this could not possibly affect rights under the scheme and in particular rights to pension benefits upon retirement, whatever they might be.

Ombudsman

R J Clark (P01373) concerned a prolonged ill-health claim where the member had obtained counsel's advice on the basis that he was in poor health and unused to legal documents. The Ombudsman declined to award the member costs on the basis that legal representation was not a required or normal feature of applications pursued through his office. The Pensions Advisory Service was available to provide appropriate advice without charge and the involvement of lawyers was not therefore "*reasonably necessary*".

J L Birtwistle (L00418) turned on the meaning of an exoneration clause that restricted personal trustee liability to *“breach of trust knowingly and wilfully committed”*. Despite an actuarial valuation showing a deficit, the trustee decided (without taking any legal or actuarial advice) to give the employer a *de facto* contribution holiday by failing to collect employer contributions due. They also disinvested £1m into cash, without making any record of how that money had been applied. In addition, the trust fund then bought the employer’s premises (using 20% of scheme assets) and leased the property back to the employer, but never received any rent. The scheme went into wind-up in 1992. In 2000, the employer was dissolved. After securing pensioner and GMP liabilities, the remaining members found their entitlements scaled back by some 97%.

These actions unsurprisingly amounted to negligence, but the Ombudsman nevertheless felt unable to say that the trustee had been *“consciously negligent”*. As such, he held that the trustee’s actions, and failures to take actions, fell short of being *“knowing or intentional”*.

J Waugh (N00827) concerned an investment switch agreed in December 2000, but implemented just after 9/11, by which time the assets of the scheme had shrunk by 35%.

The Ombudsman found that the statutory independent trustee appointed on the employer’s insolvency was guilty of maladministration for its part in the delay, although it was entitled to rely on the trust’s exoneration clause, because its (in)action fell short of *“wilful default”*. Nevertheless, the Ombudsman pronounced himself concerned by the trustee’s *“willingness to shelter behind the exoneration clause in order to avoid providing redress for maladministration on their part”*, adding that *“it does not seem to me to be acceptable for a trustee who is being paid for his professional services to avoid the consequences of maladministration when carrying out such work”*.

R Puddephatt (Q00328) concerned a 2002 change to the early retirement reduction factors to be applied to certain deferred members on retirement (from 4% to 9.5% per annum). The member only became aware of the change in policy when he formally applied for an early retirement quote in 2004. After having retired, on a less generous pension than he had expected, he argued that had he known of the change in reduction factors earlier, he would have invested a substantial amount in additional AVCs to mitigate the change, and benefited from tax relief in doing so.

The Ombudsman accepted that there was no legal obligation on the trustees, who had complied with the Disclosure Regulations, to have notified the member about the change in factors. However, they were still

guilty of maladministration in not having informed him, at least when he had made a previous enquiry in 2003 about taking early retirement, of those changes. Moreover, on the balance of probabilities, the Ombudsman felt that the member **would** have mitigated the change by investing substantially in AVCs, and made an award accordingly. *“Maladministration is a wider concept than unlawfulness and Trustee’s refusal to provide Mr Puddephatt with the means of making an informed decision about his pension provision amounts to maladministration on its part. It would not be appropriate for Mr Puddephatt to lose out because the Trustee adopted an unhelpful policy on providing quotations for deferred members”*.

www.pensions-ombudsman.org.uk

Regulator

Code of practice No 10 – modification of subsisting rights sets out which types of modification the legislation applies to and trustees’ duties and responsibilities in relation to communicating with affected members and what information they need to be given. It also explains how the consent requirements, actuarial equivalence requirement, trustee approval requirement and reporting requirement actually work and what the time periods for complying with these various requirements actually are.

Guidance on inducement offers sets out the Regulator’s view on how employers, trustees and members should deal with financial incentives offered by employers to members, either to transfer out of a scheme or accept a reduction in benefits. The key message is that where employers are planning to offer members incentives to transfer out of the scheme, they should ensure that communications with members contain the information specified in the guidance. Trustees should ask to see the communications before they go to members and satisfy themselves that members are given the required information. Trustees should also ensure that if the employer requests personal data they are satisfied that the Data Protection Act requirements have been complied with.

Guidance on establishing and operating internal controls expands on the Code of Practice and provides an example of how a risk management process might work. It looks at setting objectives, identifying and assessing risk, success criteria and action plans. It also contains a sample risk register which addresses such issues as risk, controls, responsibility etc. Trustees need to consider what they are doing in their schemes in the context of this Guidance and the Code of Practice.

Financial Support Direction: The Regulator has now issued its first FSD requiring a parent company to support the pension scheme of a weak subsidiary, and that illustrating that in the right circumstances it is prepared to use the moral hazard provisions it has been granted under the Pensions Act 2004. This is now being appealed.

www.pensionsregulator.gov.uk

PPF

Newsletter No. 2 says that the PPF is 86% solvent and that 130 schemes and 93,000 members are undergoing assessment by the PPF. The levy estimate for 2007/8 is £675 million.

Determination of levy calculation for 2007/2008 sets out the factors and times by reference to which the levies are to be assessed, the rate of the levies, and when the levies become payable. The section 179 valuation and any contingent asset certificates had to be submitted to the Regulator by 5.00pm on 30 March 2007.

Protecting People's Pensions is a leaflet produced by the PPF aimed at explaining the PPF to members entitled to compensation under it. For anyone looking for a basic introduction to what the PPF provides, this is a good starting point.

www.pensionprotectionfund.gov.uk

Tax issues

Finance Act 2007 makes a number of retrospective changes to the post-A-Day (6 April 2006) tax regime to correct provisions which have turned out to be unduly restrictive:

- the length of time trustees have to pay a pension commencement lump sum is increased from three to twelve months from a member becoming entitled to the related pension, even where this period extends beyond the member's 75th birthday
- the period during which a lump sum death benefit may be paid will now be up to two years from the scheme being notified of the member's death (or from when it "should have reasonably been aware" of the member's death) as opposed to two years from the actual date of death
- ill-health pensions may be reduced as opposed to just stopped
- there is a relaxation of the rules for transfers between schemes which do not result in affected members losing their rights to an enhanced lifetime allowance.

There are also additional restrictions in relation to the conditions which alternatively secured pensions will need to satisfy.

Employer pension contributions – Revenue guidance considers deductibility of employer contributions post-A-Day. Employer contributions are deductible as an expense if they are incurred wholly and exclusively for the purposes of the employer's trade or profession. There is no problem with this test in relation to normal funding contributions, but other payments, for example in relation to section 75 debts, withdrawal arrangements, orphan liabilities, commercial transactions and moral hazard directions made by the Pensions Regulator need more careful consideration. The guidance considers when such payments may be deductible.

Errors and mistakes guidance looks at the tax treatment of overpayments. There are no tax consequences where the payment is authorised under the A-Day regime (irrespective of whether it is permitted under the scheme rules). However, if the payment is unauthorised, an unauthorised payment charge may arise on the recipients.

However, where the unauthorised payment is in the form of pension instalments, which do not in total exceed £250, HMRC will not seek to collect the tax that is strictly due; the scheme administrator does not have to report the unauthorised payment; and the unauthorised payment does not have to be included on the recipient's self-assessment tax return.

Announcement on tax and NI treatment of inducement payments stated that cash inducements to persuade members to accept a reduction in benefits or to transfer out of the scheme (other than in the form of an enhanced transfer value) will be taxable as employment income. HMRC have, however, accepted that there may be exceptions to this rule where a transaction was entered into prior to 22 January 2007 in reliance on previous tax advice stating that such payments were not taxable as employment income.

Simplification Newsletter 25 confirms that the notional earnings cap for the 2007-08 tax year is £112,800.

www.hmrc.gov.uk/pensionschemes/news.htm

Simplification Newsletter 28 deals with a variety of issues including responsibility for making a scheme return, transfers to overseas arrangements, bridging pensions and provision of non-cash benefits on retirement.

Code of Guidance for Independent Trustees sets out guidance as to the conduct expected from independent trustees and covers issues such as investment, terms of appointment, relationships with other parties and risk

management. It provides useful background information for schemes considering the appointment of an independent trustee. A full copy is available at www.pensions-pmi.org.uk/trustees/iptg/codeofguidance.pdf

Model Administration Agreement is an update of an industry standard agreement drafted by various industry bodies. It includes draft schedule of services and timescales. A copy is available at www.pensions-pmi.org.uk/Publications/model.asp

NAPF Review of Myners Principles is intended to be completed by October 2007 and aims at assessing compliance with the principles and obtaining views on their relevance.

Things to look out for

Timetable for implementing the Companies

Act 2006: This Act contains provisions which pension schemes with corporate trustees will need to be aware of (particularly in relation to directors' duties and conflicts of interest) and which will affect any directors of employing companies who are also pension scheme trustees. The majority of the provisions in relation to directors' duties

are due to come into force on 1 October 2008, but are thought to be unlikely to significantly change the position under the current law. Further information on the Act and when it will come into force is available at www.dti.gov.uk/bbf/co-act-2006/index.html.

Member-Nominated Trustees: If schemes' opt-out arrangements do not come to an end earlier, the new MNT provisions set out in the Pensions Act 2004 will apply from 31 October 2007 and schemes will need to take steps to comply with these new requirements.

Financial Assistance Scheme: DWP announced that the cut-off date for scheme members to qualify for benefits under FAS has been extended to cover employer insolvencies up to 31 August 2007, and they have indicated that a further extension is being considered. In addition, the Budget announced that the Government intends to extend the FAS so that the estimated 125,000 affected members of pension schemes will all receive 80% of their "core pension rights" and to increase the maximum pension level available per person to £26,000. A review is underway that may result in this being increased further to 90% of core rights. For further information on the review visit www.dwp.gov.uk/pensionsreform/fas-asset-review.asp.

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Get to grips with the Pensions Act 2004 and all related regulatory publications by viewing our online **plain English guide to the Pensions Act**. You will need to be a subscriber to our Law-Now website (which is free) to access this guide. Register at www.law-now.com/registerpensions

If you are interested in the Pensions Ombudsman's activities, visit our website www.law-now.com/po-info. This site also has links to around 70 useful pensions websites.

The Pensions team is part of the CMS Cameron McKenna's HR group and advises employers and trustees of schemes which vary in size, from a few million pounds to several billion pounds. Additionally, we act for some of the largest firms of administrators, actuaries, consultants, brokers and professional trustees.

We provide a full range of services in connection with occupational pension schemes, including all aspects of employment law and EU law.

The team also works closely with our corporate lawyers, providing support on mergers and acquisitions, our insolvency lawyers on employer covenant issues, and our financial servicesteam which specialises in regulatory and fund management matters.

This bulletin is intended for clients and professional contacts of CMS Cameron McKenna LLP. It is not an exhaustive review of recent developments and must not be relied upon as giving definitive advice. The bulletin is intended to simplify and summarise the issues which it covers.