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Law . Tax

Trustee Knowledge Update

CMS Cameron McKenna

Welcome to the Autumn 2011 edition of our Trustee Knowledge Update. The purpose behind this Update is to inform trustees about changes in the law to help them to comply with the legal requirement for each trustee (or trustee director) to have knowledge and understanding of the law relating to pensions and trusts. This Update focuses on the key legal developments over the last three months that trustees may need to be aware of.

Legislation (http://www.legislation.gov.uk)

Pensions Bill 2011

A provision has been included in the Bill which says that where scheme rules provide for revaluation by reference to RPI but in all other respects reflect the statutory requirements on revaluation, the provisions of the Rules will apply. However, the Government has also confirmed that it will not be adopting either a compulsory or optional override, even for schemes that could prove that they adopted RPI with the intention of following statutory minima.

Abolition of defined contribution contracting-out – various regulations

Protected rights will be abolished with effect from 6 April 2012. There are statutory requirements in relation to notifying members about this change which trustees should be considering now. Draft regulations have been issued which will allow trustees to amend provisions in scheme rules dealing with protected rights without having to consider whether the change would amount to a detrimental modification under section 67 Pensions Act 1995.

The Registered Pension Schemes (Modification of Scheme Rules) Regulations 2011

These relate to the new "scheme pays" provisions allowing schemes to meet the annual allowance charge (or requiring them to do so where at least £2000 of the charge relates to the scheme) and modify the member's benefits as a result. The regulations provide that "*The rules of the scheme shall be modified so as to allow for a consequential adjustment to be made to the entitlement of the member to benefits under the scheme on a basis that is just and reasonable having regard to normal actuarial practice*".

The Registered Pension Schemes (Provision of Information) (Amendment) (No 2) Regulations 2011

Trustees will be required to provide an active member whose benefits in the scheme exceed the annual allowance, with information to work out if the annual allowance charge will be payable and if so, how much. The information must normally be provided by the 6 October following the end of the tax year. However, for the 2011-12 tax year, it need not be provided until 5 October 2013. The trustees must provide a member or former member with similar information (within prescribed time limits) if a written request is made by the member.

Employers must supply the trustees with the information required to calculate the pension input amount relating to an employee or director for a tax year, no later than 6 July following the end of that tax year. However, for the tax year 2011-12, the employer has until 5 July 2013 to supply the information. If the trustee makes a written request to the employer, the employer must supply the trustees with the information required to calculate the pension input amounts for the periods ending in the tax years 2008-09 to 2010-11. Such information must be supplied within 3 months of receipt of the written request or by 6 July 2013.

Government

Consultation on draft employer debt regulations

The Government has delayed the introduction of these Regulations which were due to come into force on 1 October 2011. The key proposal is to introduce a new kind of apportionment arrangement: "flexible apportionment arrangements". Under these arrangements, some or all of the remaining employers will agree to be responsible for the scheme liabilities of the departing employer. Where a flexible apportionment arrangement is in place, no employment cessation event triggering a section 75 debt will be treated as occurring when an employer ceases to employ active members. The trustees will still need to agree to such arrangements and be satisfied that the funding test is met.

The amendments also deal with the situation where an employer changes its legal status, the new entity can be treated as a "staying" employer and assume responsibility for the former entity's scheme liabilities. There are also proposals to allow trustees to extend time periods in which an employer who temporarily ceases to employ active members can avoid triggering a debt if he tells the trustees he intends to employ an active member within 12 months to up to 36 months at the trustees' discretion.

Tax (www.hmrc.gov.uk/pensionschemes/index.htm)

Finance Act 2011

The key provisions of the Finance Bill were set out in our last Update. It has now been enacted and reduces the annual allowance to £50,000 from 6 April 2011 and will reduce the lifetime allowance to £1.5 million from 6 April 2012. It also relaxes the restrictions on members being able to take lump sum benefits after age 75 (although in some cases there will be tax consequences in doing so).

Forms and guidance on applying for fixed protection

Fixed protection (which protects members from the reduction in the lifetime allowance which applies from 6 April 2012) should not be applied for by anyone wishing to retain enhanced or primary protection. Individuals with enhanced protection can give it up and apply for fixed protection (by 5 April 2012). The form should be with HMRC by 5 April 2012 and contains a warning that if the employer auto-enrols an employee under the new auto-enrolment requirements, the employee must opt-out within 1 month or fixed protection will be lost.

Form for reporting flexible drawdown payments
This is a form for trustees to report the value of payments made under flexible drawdown pension arrangements by the pension scheme to an individual in the tax year to 5 April 2012 only. In subsequent years, the information should be submitted electronically via an Event Report.

Pension Schemes Newsletter 47
This provides more information on how the "pension input amount" (used to determine whether an annual allowance charge arises) should be calculated in defined benefit schemes. It also contains provisions on how pension input periods will be determined in the future and information about how the Equitable Life Payments Scheme will work.

Pension Schemes Newsletter 48
Summarises the regulations and guidance which have been issued in relation to the Finance Act 2011 and sets out the procedures for applying for fixed protection and notifying flexible drawdown.

In addition, the Finance Act 2011 also introduced a change of tax rate from 35% to 55% for the special lump sum death benefits charge (which will generally be payable on lump sum death benefits payable after age 75) and a charge of 55% for lump sums on serious ill health paid to a member who has reached the age of 75. Trustees must account for each of these tax charges using the online Accounting for Tax form. This provides some guidance on doing that.

Pension Schemes Newsletter 49
Notes that the Registered Schemes Manual has been amended to reflect the changes introduced by the Finance Act 2011 (including the reduction of the annual allowance, fixed protection, scheme pays, the new lump sum tax charges and flexible drawdown) and contains links to the amended sections.

It also contains further guidance as to what schemes should require from members who are requesting flexible drawdown when determining whether they satisfy the minimum income requirements (MIR). The newsletter says "*As a minimum, it would be reasonable for scheme administrators to ask members for a description of the particular source they wish to count towards the MIR, to state which category of income each source used in the MIR declaration falls under and why the member believes this to be the case*".

Regulator (www.pensionsregulator.gov.uk)

Identifying the statutory employer
A statutory employer for these purposes is the entity responsible for meeting the scheme specific funding requirements, paying the section 75 'buy-out' debt, and triggering entry to the PPF assessment period on insolvency.

The guidance has been prompted by the fact that as more schemes close to future accrual, the risk of a situation arising which may leave the scheme without a statutory employer increases. From November 2011, the scheme return will require trustees to identify its statutory employer(s). The guidance sets out the information that trustees should consider and ask for and that they should be "vigilant" about detecting changes. If a new employer takes over in relation to a closed scheme, the Regulator says that the "most robust way" of making sure they have a statutory employer "*is to ensure that the new employer employs an active DB member, even if this means amending a scheme (for example, by re-opening it) to admit such an active member*".

The Regulator has also designed an e-learning module for trustees to complete to help them work out who the statutory employers are in relation to their scheme.

Bonas contribution notice
The case eventually settled rather than going to a full hearing. The Contribution Notice issued to the Belgian parent was reduced to £60,000. The Regulator also issued a report commenting that "*It is plain that the jurisdiction of the regulator's power to issue a CN in a particular sum is not limited to compensation for the detriment caused (although this will often be one of the factors that the regulator will take into account when assessing reasonableness*".

Auto-enrolment checklist for trustees
Sets out a 5 step checklist for trustees to ensure they are on top of the new requirements:

- Know when you need to act (understand when the employer's staging date is);
- Start the planning process (look at whether your scheme meets the qualifying scheme requirements and determine whether it can or will be used to auto-enrol new members);
- Consider impact on your scheme (will employer support be affected; will administrative processes still work, are DC default options appropriate);
- Mobilise implementation team;
- Communicate changes to all scheme members (employers may ask trustees to communicate on their behalf).

Annual recovery plan analysis
Analyses recovery plans for valuations ending on or before 21 September 2009. At the end of March 2009, around 85% of all PPF-eligible schemes were in deficit on a section 179 (PPF) basis. The average assets to liability funding ratio was 71.3% on a technical provisions basis, 76.9% on an s179 basis, and 51.6% on a buyout basis. 17.4% of schemes hold contingent assets (10.3% hold PPF-compliant contingent assets). The most common form of PPF-compliant contingent asset is Type A (parent/group guarantees), which is held by 9.0% of schemes. A further 1.1% of schemes hold security over real estate.

PPF (www.pensionprotectionfund.gov.uk)

Draft levy determination for 2012/13
The final version of the levy determination is due to be published in December. However, because of the far reaching changes being made to the way in which the risk based levy is calculated, early consideration needs to be given to the levy calculation and the information that will be required. The main changes being made are:

- Underfunding risk will take into account the investment risk in a scheme. For most schemes, this will be based on the asset split that is reported on Exchange. Schemes with PPF liabilities of £1.5 billion or more will be required to carry out a detailed exercise to provide a more precise measurement of the level of investment risk. Other schemes may choose to report this additional information, but the PPF expects that once a scheme does so, it will continue to do so each year.
- Insolvency risk will be measured by placing sponsoring employers into one of ten Levy Bands, based on their average monthly Failure Score as measured by D&B over the preceding year. All information provided to D&B will be used to update the scores in the following month.
- For Type A contingent assets (guarantees), schemes will be required to certify on Exchange that guarantors could be expected to meet their full commitment under the contingent asset if called upon to do so as at the date of the certificate. The PPF says that it may reject a contingent asset if it appears "*that it does not reduce the risk of compensation being payable to the extent that is consistent with the levy reduction secured*" and may request additional information to determine what the guarantee is worth.

Revised Commutation factors, Early Retirement factors and Annualised Value of Lump Sum factors
Sets out the commutation factors which should be used for all PPF compensation calculations effective on or after 1 August 2011. Also provides early retirement factors which should be used for early retirements effective on or after 1 August 2011 and the factors for lump sum compensation payable on such early retirements (where the lump sum is separate from the pension under a scheme, rather than the result of commuting the pension entitlement).

Cases

Houldsworth v Bridge Trustees (Supreme Court)
This is a judgement from the Supreme Court on the interpretation of the phrase "money purchase benefits" under pensions legislation. The key questions decided by the Court (upholding the decision of the Court of Appeal) were:

- benefits subject to a guaranteed rate of investment return can still be considered to be money purchase benefits; and
- where money purchase pots were used to provide pensions from the scheme, rather than to purchase annuities from an insurer, the conversion process did not mean that they ceased to be money purchase benefits.

This judgement leaves the possibility that a money purchase scheme can be underfunded.

The Government responded to the Supreme Court's decision immediately, saying that it is considering the implications of the case carefully as it "*will result in some schemes being regarded as providing money purchase benefits under the current legislation, even if it is possible for funding deficits to arise in respect of those benefits*". The Government intends to introduce amending legislation as soon as possible with the intention "*that the legislation will have retrospective effect at least from the date of the judgment. The legislation will make it clear that benefits cannot be regarded as money purchase benefits if it is possible for a funding deficit to arise in respect of any of those benefits. The Government will consider transitional protection in respect of events occurring between the date from which the legislation is effective and the date of this statement if, for example, this retrospective change would have adverse consequences for individuals*".

Ombudsman (www.pensions-ombudsman.org.uk)

Phillips - 80933/2: incorrect information in relation to lump sum commutation
The member chose to become a deferred member of the defined benefit (DB) section of a scheme when it was closed to accrual in 1997, instead of taking enhanced transfer terms to the new defined contribution (DC) section. Both at the time and again in 2005, he was told by the trustees that deferred members of the DB section could take unreduced pension from age 60 (in fact, only active members could do so, and with trustee and employer consent). In addition, in 2006 the member was told by the administrators that he could take his maximum pension commencement lump sum from his DC section fund alone, leaving the DB section funds untouched. In fact, he could not do so, as he found out when he sought to retire in 2007.

The member said that in reliance on the wrong information he had used his life savings to buy a house for his in-laws. He also said that if he took the maximum PCLS from the DB section only, the cost of buying an annuity to replace his lost pension income would be over £100,000.

The Deputy Pensions Ombudsman (DPO) agreed that there was maladministration in relation to both issues but that the member had not been caused financial loss by

relying on incorrect information to his detriment. She decided that he would probably have chosen to remain as a DB deferred anyway (and in the event, noted that he had applied to retire at age 56 rather than 60). Moreover, the member had bought the house before receiving the incorrect information as to the lump sum. The DPO mentioned that the trustees' policy on where lump sums were taken from was not maladministration, given the funding strain issues: *"As the Scheme rules are silent over this issue, it would not be unreasonable for the Trustees to decide what is in the best interest of the Scheme as a whole"*.

The trustees were ordered to pay what the DPO described as the "relatively high sum" of £700 for the loss of expectation, inconvenience and stress caused by the first error, and the administrators were ordered to pay £100 for their role in the second error. The administrators were also rebuked for having referred the question to the scheme lawyers without going back to the trustee board first (it appears that the question asked of the lawyers was whether the scheme rules prevented what was being proposed). The administrators were "*at fault for providing misleading guidance to the Scheme lawyers, which in turn was passed to Mr Phillips ...* [although they] *referred the matter to the Scheme lawyers ... as administrators they had no authority to offer benefits ... they provided incorrect guidance to the Scheme lawyers, which they should have refrained from providing until they sought clarification from the Trustees*".

Jones – 81625: *undue delay in processing transfer request*
The DPO upheld a complaint of undue delay in processing a transfer, as a result of which payment to a personal pension had not been completed by the time the member died. The initial request for the transfer quote was made on 11 May 2009 with the member dying on 9 October, so the processing did meet statutory deadlines. However, the DPO identified various delays, and held overall that the administrators had been guilty of maladministration. She made an award of £150 for distress and inconvenience.

The DPO commented in passing that "*it should not take more than five working days to raise and issue a transfer value cheque*" from the date that all necessary information was received.

Things to look out for

Pension sharing charges - new guidance: the NAPF has published updated guidance on its recommended scale of charges for occupational pension schemes in relation to pension sharing orders. The guidance also includes a helpful flowchart that shows the circumstances in which charges can be made.

Auto-enrolment: Employers and trustees should be starting to consider what impact auto-enrolment will have on them and their schemes. The first auto-enrolment requirements will apply from 2012. The Regulator expects parties to be putting in place the necessary mechanisms now. Detailed guidance on the requirements is available on the Regulator's website.

Bribery Act 2010: Came into force on 1 July 2011. Trustees should consider the impact the Act will have on them and what if any steps they should take in response to it, in particular whether they need to put in place procedures to deal with it.

Dates for diaries: Trustee training remains one of the most important ways of ensuring that trustees have the knowledge and understanding required to perform their duties. We have a trustee training course taking place on **1 February 2012**. If you have any enquiries about any of these courses or would like to reserve a place, please contact **Karen Mumgaard – E:** karen.mumgaard@cms-cmck.com.

General: For further information on our pension services, please contact **Mark Grant – E:** mark.grant@cms-cmck.com, **T:** +44 (0)20 7367 2325 or your usual pension partner. Please also visit our new website at www.cms-cmck.com.

Get to grips with the requirements of the Pensions Regulator with our **Field Guide for trustees**. You will need to be a subscriber to our Law-Now website (which is free) to access this guide. Register at **http://www.law-now.com/register**. You can also get help here with understanding the Pensions Act 2004 and all related regulatory publications by viewing our online **Plain English guide to the Pensions Act**. 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 HR group and advises employers and trustees of schemes varying 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, insolvency lawyers supporting us on employer covenant issues, and the financial services team which specialises in regulatory and fund management matters.

The information in this publication is for general purposes and guidance only and does not purport to constitute legal or professional advice. It is not an exhaustive review of recent developments and must not be relied upon as giving definitive advice. The Update is intended to simplify and summarise the issues which it covers. It represents the law as at 30 September 2011.

CMS Cameron McKenna LLP is a limited liability partnership registered in England and Wales with registration number OC310335.