Newsletter

BURGES SALMON

Pensions

November 2013

Welcome

Welcome to Pensions, our bimonthly newsletter keeping you informed of developments in pensions law.

To find out more about how we can help you with pensions issues, please email richard.knight@burges-salmon.com or call him on 0117 939 2259.

Legal

Pension liberation

The court has cleared up a doubt by confirming that schemes established using a fairly typical form of documentation are subject to the Regulator's enforcement powers. This will allow the Regulator to move against them where they are used for liberation.

The question was whether the schemes were "occupational pension schemes" and therefore subject to the Regulator's powers or "personal pension schemes" and under the jurisdiction of the Financial Conduct Authority. The court found them to be occupational schemes.

This is the result the Regulator and the industry would have wanted. It does not mean that all liberation schemes are under the Regulator's jurisdiction but it is likely to mean that many are.

Even so, there is a lot for the Regulator to do. It has to tackle each scheme individually and needs evidence before it can take steps to e.g. appoint independent trustees or freeze bank accounts. But where a number have been set up by the same people (as in the court case) it might be able to close them down in a batch.

Meanwhile HMRC has moved to restrict liberation by:

- no longer giving new schemes registered status automatically and instead making enquiries into applications and
- only giving transferring trustees confirmation of the registered status of a prospective receiving scheme where it is unaware of any liberation risk.

None of these developments will bring an end to liberation fraud but they are significant steps in that direction.

Criminal law enforcement agencies have also been active against fraudsters.

New definition of DC benefits

The change to the definition of DC or "money purchase" benefits affects schemes with benefits that were previously considered to be DC but will cease to be DC when the new definition comes into effect.

The simplest example is a DC pot with a guarantee as to its amount e.g. a minimum investment return.

The definition is important because it is only schemes that, apart from death benefits, provide exclusively DC benefits that escape the statutory funding requirements and employer debt applicable to DB schemes.

But the change to the definition is going to be less disruptive than it might have been because it will have limited backdated effect in key areas like funding.

The DWP is working to bring the new definition into force on 6 April 2014 when, as planned since 2011, it will have retrospective effect to 1 January 1997 (sic). But wide exceptions will allow many past decisions on headline issues to stand.

Transitionals

The DWP has issued a consultation on draft transitional regulations setting out the exceptions. These are lengthy and complicated, and make April look optimistic as the start date.

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The transitionals mean that in many respects the new definition will have exclusively future effect or will only be retrospective to 27 July 2011. That is when the Supreme Court decided the *Houldsworth v Bridge* case and the DWP declared its intention to redefine DC benefits.

Broadly, the new definition will apply:

- scheme funding - from 6 April 2014 onwards with no need to revisit the past,
- PPF eligibility and levy - from levy year 2015/16 onwards with no revisiting of the past, including levy bills,
- employer debt - trigger events after 27 July 2011 need to be reviewed and might require action, but earlier ones need not be revisited and
- winding-up - a winding-up begun before 28 July 2011 need not be revisited but any that began later and is complete by 6 April 2014 needs to be reviewed and might require action.

The final version of the transitional regulations is unlikely to be published until well into January at the earliest.

If you would like more detail, see the longer version of this article at: **http://www.burges-salmon.com/Practices/pensions_and_incentives/Publications/New_definition_of_DC_benefits.pdf**

Age-related DC contributions

Age-related contributions in DC schemes can be justified on fairly broad social grounds, the European Court (ECJ) has held in a Dutch case.

UK equality legislation says age-related contributions are not age discriminatory where the aim is to generate similar amounts of pension for people with similar periods of service regardless of their age. This is a narrower and more technical basis for justification than the ECJ has now allowed.

UK schemes will welcome the ECJ's decision because it gives them wider grounds on which to defend their age bands if they were ever challenged.

> *"Treating people differently because of their age is not unlawful if it is a proportionate means of achieving a legitimate business aim."*

Justification
Treating people differently because of their age is not unlawful if it is a proportionate means of achieving a legitimate business aim. The ECJ recognised these as legitimate aims for age-banded DC contributions:

- to allow younger members to take home a higher proportion of their pay in cash,
- to allow new employees who are older to build a reasonable pension in a shorter time and
- to recognise the greater health risks older people face.

Proportionate
The bands in the case were: under age 35 - 9%; age 35 to 44 - 12% and over age 45 - 15%. The employer paid two thirds.

The case now goes back to the Dutch court to decide whether these particular bands were a proportionate means of achieving the aims the ECJ endorsed.

Policy

Defined ambition

The DWP's proposals for defined ambition schemes could change the game fundamentally for future service in DB schemes.

A consultation paper outlines the DB and DC scheme designs the DWP is minded to make available.

The paper does not give a timetable. In practice the changes are likely to be a year or two away at least because pensions legislation will need substantial alteration.

Two proposals look certain to go through: ending the need for DB schemes to index future accrual or to provide a survivor's pension once contracting-out ends. For schemes hard-wired to these requirements, the DWP will consider a statutory override to facilitate rule amendments.

More flexible DB designs
Four flexible DB designs are proposed. They would be available for future service.

- Fluctuating benefits - schemes would have the option to provide extra benefits as and when funding permits e.g. occasional or fluctuating indexation and one-off payments with no obligation to repeat them. As discretionary payments, these would be excepted from regulation on funding, the employer debt and preservation, for example. Tax legislation would be aligned.
- Converting early leavers to DC - benefits for early leavers would be converted to DC and transferred to a DC fund chosen by the member (or in default to one nominated in advance by the employer). The paper discusses a number of possible bases for conversion.

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The calculation and transfer processes would be regulated in a way that reflects the significant loss of security to the member. A requirement for independent financial advice is being considered.

The DWP has rejected the more radical idea of allowing a higher proportion of DB pension to be converted to cash at retirement.

- Changing NRD - schemes would be able to change normal retirement date to reflect improvements in longevity. So if average life expectancy increases over a period by, say, two years, NRD could be increased by the same amount to maintain a constant expected time on pension. Employers would be free to set their own starting NRD but would then follow an official index of longevity published by the Government actuary.

  Anyone within 10 years of the existing NRD would be excluded from any increase. All accrual after a scheme adopts this design would be subject to the member's highest (last) NRD. Accrual before adoption would be based on the original NRD.

  The DWP is considering a statutory override to allow this design to be adopted without trustee or member consent.

The DWP believes that current protections for past service benefits should continue to apply, which means it would be unusual for these designs to operate retrospectively. However, it will consider allowing past service changes subject to the sort of best practice requirements that now apply to incentive exercises.

Greater certainty with DC

The DWP asks for views on four models for giving greater certainty to DC members. They are all subject to issues of member perception, cost and market appetite. They are also variously subject to governance questions and hurdles in current legislation, including the tax rules.

"On the whole, DWP favours models that seek to guarantee an income that grows during the accumulation phase, not least because this scores well with consumers..."

On the whole, the DWP favours models that seek to guarantee an income that grows during the accumulation phase, not least because this scores well with consumers (a key consideration for the DWP) and helps employers manage their staffing needs. It also favours spreading the risk of conversion at retirement.

- Money-back guarantee - would ensure the size of a DC pot on retirement or transfer would not be below the nominal value of the contributions made to it. The guarantee would be provided by the market and not by government or a PPF style fund. This model is particularly aimed at the early stage of accumulation, including auto-enrolled savers new to pensions.

  The DWP observes that this covers an eventuality that is low probability and low priority compared to income.

- Capital and investment return guarantee - aimed at a later phase of saving when a member wants to protect existing gains but still grow their fund. It would be provided by the market in a standardised form. The DWP acknowledges significant governance challenges.

- Retirement income insurance - to provide certainty about income before a member retires. Each year from, say, age 50 a fiduciary would use part of a member's fund to buy an insurance product (in a standardised form) that guarantees a minimum income. The minimum would grow each year as more insurance is purchased. Pension would be paid from the member's fund at a rate no greater than the guaranteed minimum. Only if the fund was exhausted would the income insurance kick in.

  The DWP thinks this model is unlikely to develop in the near future because of particular cost and scale issues.

- Pension income builder - each year part of a member's contributions would be used to buy a deferred annuity at the available rate. The balance would go into a collective pool invested in risk-seeking assets that would provide future indexation, subject to its funding position. This model is based on a Danish template.

Collective DC schemes

A collective DC - or CDC - scheme would have fixed employer contributions but would pool all its assets and pay pensions from the pool. A member's rights would not relate solely to contributions paid in for them and the return on those amounts. Advantages to the member include exposure to a wider range of investments and less risk of volatility.

A member's entitlement could be defined and managed in a variety of ways. For example, they could be told of a target they could receive, which might include a fluctuating and conditional indexation element. Depending on funding, the target income might be reduced and some designs would allow pensions in payment to be cut too. One way or another, intergenerational risk sharing is a key feature. Scale would have a big influence on cost.

The DWP plans to continue to investigate the viability of CDC in the UK.

Despite the complexity and weight of the ideas, the consultation period is six weeks, ending in mid December.

Regulatory

Contribution notices: six year time limit

The independent trustee of the Desmond & Sons scheme has opened the possibility that a contribution notice (CN) could be issued outside the headline time limit of six years.

Desmond & Sons was a major clothing manufacturer in Northern Ireland, supplying M&S. When it lost the M&S work, the shareholders put the company into members' voluntary liquidation (MVL) at short notice in June 2004. This led to many job losses and left a scheme that could pay only 50% of members' benefits.

In April 2010, the Regulator's Determinations Panel decided to issue CNs to two shareholders, Mr Desmond and Mr Gordon, for a total of £1 million. But it decided not to issue one against Mr Desmond's wife who was also a shareholder. The trustee challenged this decision but was unsuccessful, the Upper Tribunal ruling that, by then, the six year time limit for a CN had expired.

Now the Court of Appeal (N.I.) has overturned that ruling by holding that any decision by the Tribunal to issue CN can take effect from the date the Panel made its original decision (within the time limit).

The Appeal Court's judgment means that the Tribunal proceedings against Mr and Mrs Desmond and Mr Gordon, which have been on hold for two years, will now go ahead. The shareholders will need to convince the Tribunal that avoiding an employer debt to the pension scheme was not among the main purposes of the MVL, as the trustee alleges.

Burges Salmon has acted for Garvin Trustees Ltd, the independent trustee of the scheme, since its appointment in 2004.

New DC code and guidance

The Regulator's Code of Practice no. 13 on the Governance and Administration of Occupational Defined Contribution Trust-based Pension Schemes came into force on 21 November.

The Code was published in final form in July but has waited until now to receive the formal approval of Parliament.

We commented on it in our September newsletter: **http://www.burges-salmon.com/Practices/pensions_and_incentives/Publications/Pensions_September_2013.pdf**

With the Code comes supporting Guidance. This was newly published on 21 November.

For the Code and Guidance, see **http://www.thepensionsregulator.gov.uk/dc-pensions.aspx**

These are important documents for employers and trustees running occupational DC schemes.

At the end of October the Regulator issued a document setting out its compliance and enforcement policy for occupational DC schemes: **http://www.thepensionsregulator.gov.uk/docs/dc-compliance-enforcement-policy-2013.pdf**

In various ways the Regulator is urging DC schemes to set themselves high standards in all areas. Auto-enrolment is clearly a driving force, but not the only one.

Regulator and asset-backed funding

In new guidance the Regulator presses DB trustees to make a comprehensive risk assessment of any proposal for an asset-backed funding arrangement (ABF) with the help of all relevant professional disciplines, including actuarial, asset valuation, covenant and legal advice.

Evidently the guidance is based on the Regulator's experience of ABFs notified to it under statutory reporting requirements over the last three years or so.

An ABF is a contractual arrangement that gives trustees a right to a stream of income from a non cash asset that the employer agrees to dedicate to scheme funding. Normally the arrangement looks to balance the needs of the employer and the trustees.

The Regulator identifies key risks:

- a delay in full funding because the capitalised income stream from the ABF masks the deficit and denies the trustees the chance to negotiate for cash, or because the pace of funding comes to depend on the long term income from the ABF rather than what the employer can afford from time to time;
- the underlying asset or the trustees' legal claim on it is weak e.g. because the asset has scant open market value or might be worthless on the employer's insolvency;
- masking the scheme's overall risk profile - see first bullet;
- a weakened employer covenant from reduced rather than enhanced rights of recourse for the trustees to the asset in the ABF (or to income from it) than they had originally when the employer owned the asset;
- possible illegality if "employer-related investment" restrictions are breached (though typical ABF structures are thought to be the right side of this line).

There are recognised ways to mitigate the risks in ABFs but a degree of risk will be unavoidable.

Trustees should not underestimate the complexity of a typical ABF or the cost of establishing one.

The guidance is at **http://www.thepensionsregulator.gov.uk/docs/asset-backed-contributions-2013.pdf.**

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