Pensions Legal Update

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s75 debt. The High Court has ruled that an agreement to determine a debt due under s75 of the Pensions Act 1995 does not result in exclusion of a pension scheme from the Pension Protection Fund, if it is made before that debt is triggered. **p.1**

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s75 DEBT

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Background. Where a defined benefit pension scheme begins to wind-up, a debt becomes due from the participating employers calculated by reference to the cost of buying-out benefits with an insurance company (the **"s75 debt"**) (s75 and 75A Pensions Act 1995 and the Occupational Pension Schemes (Employer Debt) Regulations 2005) (SI 2005/678) (the **"Employer Debt Regulations"**). The rules of the scheme can set out how the total deficit in the scheme is to be apportioned between the participating employers in order to establish the amount of the s75 debt due from each employer (Regulation 6(2)(b), Employer Debt Regulations).

Case law has said that a s75 debt does not arise until the overall deficit in the scheme has been ascertained by the actuary (*Phoenix Venture Holdings Limited v Independent Trustee Services [2005] PLR 379*).

The Pension Protection Fund (**"PPF"**) is a statutory insurance scheme which pays benefits where an employer becomes insolvent and its defined benefit pension scheme is unable to pay members' benefits in full. A scheme can cease to be eligible for the PPF if the trustees "enter into a legally enforceable agreement the effect of which is to reduce the amount of any debt due to the scheme under s75 of the Pensions Act 1995 which may be recovered by, or on behalf of, those trustees" (Regulation 2(2) of the Pension Protection Fund (Entry Rules) Regulations 2005 (SI 2005/590) (**"Regulation 2(2)"**).

Facts. As part of a restructuring of M Limited's liabilities it was agreed that a new employer (Newco) should become a participating employer in M Limited's defined benefit pension scheme, in addition to M Limited.

The scheme rules would then be amended to provide that £1 of the total deficit in the scheme should be apportioned to M Limited and the balance to Newco, if a s75 debt is triggered.

The scheme would then start to wind-up triggering a s75 debt. M Limited would pay £1. Newco would be liable to pay the balance of the total deficit which it could not afford. Newco would then suffer an insolvency event.

Warren J held that the proposals did not amount to an agreement which would "reduce the amount of any debt due to the scheme". The triggering event for a s75 debt (winding-up) had not occurred.

The scheme would then be assessed for entry into the PPF. The ultimate aim was to enable the scheme's liabilities to be taken on by the PPF. The PPF would take an equity stake in M Limited in return.

The trustees of the scheme sought guidance from the High Court on whether these transactions would result in the scheme ceasing to be eligible for the PPF under Regulation 2(2).

Decision. Warren J held that the proposals did not amount to an agreement which would "reduce the amount of any debt due to the scheme". The triggering event for a s75 debt (winding-up) had not occurred. Accordingly, the scheme would not be excluded from eligibility for the PPF under Regulation 2(2).

A scheme could only be excluded if a debt is due at the time of the agreement. It is not enough that the agreement reduced a s75 debt that will or may become due as a result of a triggering event in the future.

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The judge rejected arguments from counsel that Regulation 2(2) should be given a wide meaning, encompassing an agreement which would reduce the amount of any debt which would otherwise have become due after the agreement was made.

However, the judge left open whether Regulation 2(2) could cover agreements made when a debt has fallen due for quantification (e.g. after a triggering event such as winding-up) but before the debt is calculated.

It remains unclear whether an agreement to apportion a deficit can be made after a triggering event for a debt has occurred but before the debt is calculated.

Comment. The decision provides helpful clarification that PPF eligibility is not compromised by an agreement made before a triggering event for a s75 debt occurs. However, it remains unclear whether an agreement to apportion a deficit can be made after a triggering event for a debt has occurred but before the debt is calculated. It seems likely that a further decision from the courts will be needed to resolve this outstanding issue.

Source: Transcript of the judgment of Warren J in L and Others v M Limited, issued on 27 October 2006, neutral citation number [2006] EWHC 3395 Ch.

PENSIONS REFORM

Background. The government has published a new Pensions Bill containing a number of reform proposals and a White Paper setting out its proposals for Personal Accounts.

Pensions Bill. The government's new Pensions Bill will implement the following government reform proposals:

The Pensions Bill will increase the State Pension Age to 66 for those born after 5 April 1960 but before 6 April 1968, 67 for those born after 5 April 1969 but before 6 April 1977 and 68 for those born after 5 April 1978.

- The basic State Pension will be uprated annually in line with earnings rather than prices. This change will probably be implemented in 2012 but the government is committed to achieving it by the end of next Parliament, at the latest.
- Raising the State Pension Age. There is already legislation in place raising the State Pension Age to 65 for men and women born after 5 April 1955. The Pensions Bill will increase the State Pension Age to 66 for those born after 5 April 1960 but before 6 April 1968, 67 for those born after 5 April 1969 but before 6 April 1977 and 68 for those born after 5 April 1978.
- The Bill makes another attempt to allow contracted-out salary related schemes to convert the GMPs they have to provide for members who were contracted-out between 6 April 1978 and 5 April 1997 to ordinary scheme pensions of equal actuarial value. This would make it easier to administer or to wind-up such schemes. The detail will all be in regulations so that it has yet to be seen whether the government has now come up with a workable method of converting GMPs.
- Contracting-out by the money purchase route (i.e. through contracted-out money purchase schemes or appropriate personal pension schemes) is to be abolished for employment after a specified date. This will probably be in 2012.
- The Internal Dispute Resolution Procedure legislation will be made more flexible so that schemes can have either a one-stage or a two-stage procedure. This provision will be implemented as soon as possible after the Bill has been enacted.
- The Bill sets up a Personal Accounts Delivery Authority to oversee the introduction of Personal Accounts (see below) although a different body (the Personal Accounts Board) will administer the system once it has been established.

Contracting-out by the money purchase route (i.e. through contracted-out money purchase schemes or appropriate personal pension schemes) is to be abolished

Source: The Pensions Bill published on 29 November 2006

Personal Accounts. The White Paper sets out the government's decisions on a number of features of its proposed system of Personal Accounts although there will still be a number of important details to be settled by the proposed Personal Accounts Delivery Authority. The White Paper contains the following proposals:

- Personal Accounts will be a money purchase scheme designed to fill the gap between State Benefits and good occupational pension schemes.
- From 2012, employees between age 22 and State Pension Age will be automatically enrolled into either an occupational pension scheme of a minimum standard provided by their employer or into a Personal Account.
- Contributions to Personal Accounts will be based on earnings within the "Personal Accounts Earnings Band" which will initially match National Insurance Band Earnings (between £5,200 and £34,840 a year for 2007/8). Minimum contributions will be 8% in total (3% from the employer, 4% from the employee and 1% from the government, representing tax relief). Employers and employees can pay more, up to a maximum combined contribution of £5,000 a year (inclusive of tax relief). In the first year, though, the maximum will be £10,000 to enable people to roll over savings they have made in anticipation of the new Personal Accounts.
- Employers will not have to contribute to Personal Accounts where they automatically enrol employees between age 22 and State Pension Age into an occupational pension scheme of a minimum standard as follows:
  - Contracted-out defined benefit schemes must meet the "reference scheme test"
  - Contracted-in defined benefit schemes must have a minimum accrual rate of 120ths
  - Defined contribution schemes must require employer contributions of at least 3% and combined employer and employee contributions of at least 8%.
- Currently, the government is not proposing to allow waiting periods for exempt occupational pension schemes, so that employees can be automatically enrolled into either the exempt occupational pension scheme or a Personal Account on starting work. However, they are to consult on whether to allow a short waiting period (not more than six months) for "high quality" occupational pension schemes.
- The aim is that the charges for a Personal Account should be 0.5% of funds invested, in the short term, falling to 0.3%, in the long term. No cap on the charges made by exempt occupational pension schemes is proposed but the government could review this if charges rise significantly over the maximum allowed for Personal Accounts.
- Individuals will have a choice of funds in which their Personal Account can be invested, including a default fund of the lifestyle type. Personal Accounts will have a central administration rather than being provided by private sector providers. However, the investment of the various funds may well be outsourced to the private sector.
- As regards benefits, Personal Accounts will resemble the personal pension schemes currently available. Individuals will be able to take their pension between ages 55 and 75, to commute 25% of their Personal Account for a lump sum and there will be a provision for a lump sum to be paid on death before age 75. Pensions will be provided by the purchase of annuities.
- No transfers into or out of Personal Accounts will be permitted.

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- Once the new Personal Accounts regime is up and running, the requirement for employers with five or more staff and no occupational pension scheme to designate a stakeholder pension will be abolished.

Source: Personal Accounts: a new way to save. Cm 6975 published by the Department of Work and Pensions in December 2006.

AGE REGULATIONS

Summary. Revised guidance on age discrimination in relation to occupational pension schemes has been published by the Department for Work and Pensions and the Department of Trade and Industry.

The DTI and DWP have published joint guidance on the impact of the Regulations on occupational and personal pension schemes.

Background. The pensions aspects of The Employment Equality (Age) Regulations 2006 (*SI 2006/1031*) were amended by The Employment Equality (Age) (Amendment No.2) Regulations 2006 (*SI 2006/2931*) (the Regulations). The Regulations came into force on 1 December 2006. The DTI and DWP have published joint guidance on the impact of the Regulations on occupational and personal pension schemes (the Guidance). It updates DTI guidance originally published in July 2006.

Facts. The Guidance explains the main features of the Regulations. In particular, it provides the DTI's views on the following issues:

- the difference between direct and indirect justification
- how any discrimination can be objectively justified
- which aspects of pension arrangements are covered by the Regulations and who is protected by them
- the "non-discrimination" rule and the powers of the trustees or managers to amend discriminatory scheme rules
- how to bring a claim in the Employment Tribunal and other ways of complaining about unlawful age discrimination in relation to pensions
- how the exemptions for pensions in the Regulations work

The Guidance also includes a case studies chapter which explains how the Regulations might apply in practice.

Comment. The Guidance provides useful interpretation of the Regulations as they apply to pension schemes.

SCHEME BOOKLETS

Summary. The Court of Appeal has held that if a statement in the members' booklet is inconsistent with the trust deed and rules, then the trust deed and rules prevail provided that the booklet is manifestly not intended to override them.

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Facts. A letter inviting H to join Steria's senior management scheme (the **"Scheme"**) and the accompanying members' booklet provided that after 20 years' service H could retire early

at age of 62, without any actuarial reduction in his pension. This was inconsistent with the provisions of the trust deed and rules. The booklet said the trust deed and rules should prevail on any question of interpretation.

H had elected to join the Scheme in place of the staff pension scheme, although the Scheme required higher contributions from members. H claimed he agreed to join the Scheme because he understood he could retire early and that by paying higher contributions he suffered a detriment.

H argued that that he should be able to start drawing his pension at 62 without reduction, because he had relied to his detriment on representations made by the trustees of the scheme with the result that they were estopped from denying him his full pension entitlements at age of 62.

The Pensions Ombudsman and the High Court found in favour of H.

Decision. The Court of Appeal has overturned the High Court decision. It held, firstly, that the letter read together with the booklet said that a member can retire early only with the employer's consent. Secondly, the information notice at the end of the booklet provided that the trust deed and rules should prevail and, therefore, the trustees were not estopped from relying on the provisions of the trust deed and rules. Thirdly, H did not suffer any detriment, since the fact that he paid higher contributions also meant that he was entitled to higher benefits. Therefore, no estoppel had arisen.

Comment. This confirms that a members' booklet cannot override the trust deed and rules of a scheme.

Case: *Steria v Hutchison [2006] EWCA Civ 1551*.

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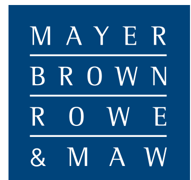

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March 2007