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Pensions Legal Update

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Employer Debt legislation. The DWP is consulting on amendments to the legislation dealing with statutory debts from employers to their pension schemes. **p.1**

Winding-up priority order. The Court of Appeal has clarified the treatment of equalised benefits on a winding up. **p.4**

Pensions Act 2007. The Pensions Act 2007 received Royal Assent on 26 July 2007. **p.5**

EMPLOYER DEBT LEGISLATION

The DWP is consulting on amendments to the legislation dealing with statutory debts from employers to their pension schemes. The changes may take effect in December 2007.

Summary. The DWP is consulting on amendments to the legislation dealing with statutory debts from employers to their pension schemes. The changes may take effect in December 2007.

Background. Legislation provides that an employer under a defined benefit scheme is liable to pay a debt if:

- it ceases to employ active members
- it becomes insolvent
- the scheme is wound-up *(s75 and 75A Pensions Act 1995, Occupational Pension Schemes (Employer Debt) Regulations 2005 (SI 2005/678))*.

The debt is normally calculated by reference to any deficit on a "buy-out" basis, i.e. a basis which reflects the cost of securing benefits by the purchase of annuities.

Consultation. The Government does not propose to change these basic principles. It does however propose a number of changes which are potentially important where a corporate transaction or restructuring is proposed. The key changes are:

- **Triggering events.** The Government proposes to make two significant changes as to the circumstances in which an employer debt is triggered:

Where an employer ceases to employ active members under a multi-employer scheme, there will be a 12-month period of grace, so that a debt will not be triggered if the employer expects to take on a further active member within that period.

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A debt will be triggered where all employers under a multi-employer scheme cease to employ active members at the same point. (Under the existing Regulations, a debt is triggered only if an employer ceases to employ active members at a time when at least one other employer continues to do so.)

- **Calculation of deficit.** Many actuaries have said that the calculation mechanism specified in the existing Regulations is unworkable. The Government proposes to introduce greater flexibility. In particular, it will be possible to calculate the deficit using the estimated cost of buying annuities in cases where a quotation as to the actual cost cannot be obtained.
- **Employer's share of the deficit.** The Government proposes new rules for determining an employer's share of the deficit in a multi-employer scheme:

Much as under the existing legislation, the default will be the employer's share of the total buy-out deficit (a "Liability Share"), the share being calculated by reference to liabilities attributable to the employer. There will however be greater clarity as to the treatment of transferred-in liabilities, and more flexibility to cater for cases where there are gaps in scheme records.

It will be possible to put in place an apportionment which allocates a different share of the deficit to an employer (an “Apportionment Share”). However, apportionment will be permitted only under one or other of the following arrangements:

- A "Scheme Apportionment Arrangement". This will require the approval of the trustees. The trustees will have to be satisfied that the remaining employers will be willing and able to fund the scheme in accordance with the Pensions Act 2004 funding regime (or, if the scheme has not yet moved onto the Pensions Act funding regime, that the arrangement will not adversely affect members' chances of receiving full benefits). The Government hopes that this will prevent apportionments from being used for the purpose of "scheme abandonment".
- A "Regulated Apportionment Arrangement". This will be an option only where a scheme is expected to enter the Pension Protection Fund (PPF) within the following 12 months. The arrangement will require the approval of the Pensions Regulator and the PPF.

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Different rules will apply as to the calculation of an employer's share where an Approved Withdrawal Arrangement or Cessation Agreement is put in place (see below).

- **Approved Withdrawal Arrangements**

Two major changes are proposed as to Approved Withdrawal Arrangements – the arrangements permitted under the existing legislation where the debt due from a withdrawing employer is reduced but a guarantor gives the trustees a long-term guarantee:

The debt due from the withdrawing employer will be the “Withdrawal Arrangement Share”. This will be:

- the employer's share of the total deficit on the Pensions Act 2004 funding basis (or, if the scheme has not yet moved onto the Pensions Act funding basis, the valuation basis used for PPF purposes), the share being calculated by reference to liabilities attributable to the employer; or
- some other amount agreed by the employer and the trustees and approved by the Pensions Regulator.

The tests which the Pensions Regulator applies when deciding whether to approve an Approved Withdrawal Arrangement will be relaxed. Most importantly, the Regulator will no longer have to be satisfied that the Arrangement makes it "more likely" that the debt will be paid. Instead, the Regulator will have to consider a variety of factors relevant to the proposed Arrangement, including the financial circumstances of the guarantor and how the Arrangement will affect members' chances of receiving full benefits.

- **Cessation Agreements**

The Government proposes to allow a simpler alternative to an Approved Withdrawal Arrangement – a “Cessation Agreement”. This will be an arrangement where the debt payable by a withdrawing employer is reduced but a guarantor gives the trustees a long-term guarantee. The key proposals are as follows:

a simpler alternative to an Approved Withdrawal Arrangement – a “Cessation Agreement”. This will be an arrangement where the debt payable by a withdrawing employer is reduced but a guarantor gives the trustees a long-term guarantee.

The debt due from the withdrawing employer will be the “Cessation Agreement Share”. This will be the employer’s share of the total deficit on the Pensions Act 2004 funding basis (or, if the scheme has not yet moved onto the Pensions Act funding basis, the valuation basis used for PPF purposes), the share being calculated by reference to liabilities attributable to the employer.

The amount to be guaranteed by the guarantor will be calculated much as under the existing Regulations as to Approved Withdrawal Arrangements, on either a fixed or a floating basis.

The Cessation Agreement will not need to be approved by the Regulator.

However, the trustees will be able to enter into the Agreement only if they are satisfied that the remaining employers’ ability and willingness to fund the scheme is not adversely affected, and that the guarantor’s assets are such that the guarantor is “likely to pay” the guaranteed amount.

- **Tax**

At present there is a concern that, in some cases, a payment made by a guarantor under an Approved Withdrawal Arrangement may not be tax-deductible. The Government is going to take this issue up with HM Revenue & Customs.

Comment. Under the existing legislation, Approved Withdrawal Arrangements are difficult to obtain. The proposal to relax the tests which the Regulator has to apply when considering a proposed Approved Withdrawal Arrangement is welcome, as is the proposal to introduce a simpler alternative, the Cessation Arrangement. In suitable cases, Cessation Arrangements will mean that employers and trustees need not involve the Regulator.

Some of the Government’s other proposals may be less welcome. It seems that apportionment arrangements may be harder to put in place in future, and existing arrangements may cease to be valid. Problems may also be caused by the change to the trigger events so that any subsequent freezing of accrual for members of a multi-employer scheme would trigger statutory debts for all employers.

Source. DWP consultation document dated 7 August 2007 on Amendments to the Occupational Pension Schemes (Employer Debt) Regulations 2005 available at http://www.dwp.gov.uk/consultations/2007.

WINDING-UP PRIORITY ORDER

Summary. The Court of Appeal has clarified the treatment of equalised benefits on a winding up.

Background. In *Barber v Guardian Royal Exchange* the European Court of Justice (ECJ) ruled that European law prohibited pension schemes providing men and women with benefits payable on different normal retirement ages (NRA), typically 60 for females and 65 for males.

In the subsequent decision in *Coloroll Pension Trustees Ltd v Russell* the ECJ confirmed that for service after 16 May 1990, until benefits were properly amended, male members were entitled to be treated as if their NRA was the same as for female members.

Prior to 6 April 2005 higher priority for distributing assets on a scheme wind up is given to benefits for which a person has an *entitlement*, at the start of wind up, than for most other benefits *(section 73 of the Pensions Act 1995) (s73)*.

Facts. A pension scheme wound up on 15 February 2002 with a substantial deficit.

The court had to consider whether male members between age 60 and 64 on that date received higher priority for their benefits, under s73, in respect of service before 17 May 1990 (relevant benefits). As a result of the ECJ judgements the NRA for male members reduced from 65 to 60 for service after 16 May 1990.

High Court. The High Court ruled that relevant benefits had higher priority. On the basis that Revenue practice at the time and the scheme rules would not allow benefits to be paid in tranches, relevant male members were *entitled* at the start of wind up to all benefits including those not yet payable as the NRA is 65.

Court of Appeal. The Court of Appeal held that the higher priority only applied to benefits for service after 16 May 1990 and before the date (if any) on which the rules were amended to take account of the *Barber* decision. Their grounds were that:

- the High Court judge placed too much reliance on the Revenue requirements and scheme rules which did not contemplate the facts arising in this case.
- European law overrides the applicable Revenue limits and scheme rules. The Revenue limits and scheme rules were to be modified accordingly, but only to the extent necessary to give effect to European law.

The Court of Appeal held that the higher priority only applied to benefits for service after 16 May 1990 and before the date (if any) on which the rules were amended to take account of the *Barber* decision.

Comment. The decision confirms the treatment of equalised benefits on a winding up commencing before 6 April 2005.

Case: Cripps v Trustee Solutions Ltd and Dubery [2007] EWCA Civ 771.

MAYER BROWN ROWE & MAW

PENSIONS ACT 2007

Further increases to State Pension Age for anyone born after 5 April 1959

Summary. The Pensions Act 2007 received Royal Assent on 26 July 2007.

Legislation. Key provisions in the Act include:

- Further increases to State Pension Age for anyone born after 5 April 1959 – age 65 increases to age 66 between April 2024 and April 2026; the increase from 66 to 67 happens between April 2034 and 2036; and the increase from 67 to 68 happens between April 2044 and 2046.

Trustees will be able to decide (with the employer's agreement) whether to convert GMPs to ordinary scheme pension.

- Trustees will be able to decide (with the employer's agreement) whether to convert GMPs to ordinary scheme pension. The post-conversion benefit must be at least the actuarial equivalent of the GMP before conversion. Conversion benefits cannot include money purchase benefits and must provide for surviving spouse/civil partner benefits. There will be conditions to be met regarding any transfers of pension rights out of the GMP converted scheme. Trustees will have the power to amend schemes to facilitate the conversion.

Contracting-out on a money purchase basis for occupational and personal pension schemes is abolished (probably from 2012).

- Contracting-out on a money purchase basis for occupational and personal pension schemes is abolished (probably from 2012). Contracting-out certificates will automatically be cancelled and members will be contracted back into the State Second Pension for future accrual. The restrictions on protected rights already built up will go except for the requirement that survivor benefits be provided where the member was married or in a civil partnership.
- Schemes will be able to replace their two-stage internal dispute resolution procedure with a single-stage arrangement (with all decisions taken by the trustees), if they want to.
- The Financial Assistance Scheme's (FAS) extension was recently announced in the Budget. The Act paves the way for this. Regulations will remove the tapered assistance and require annual and initial payments (initial payments are made whilst the scheme is winding up) to be set at 80% of members' expected core pensions, subject to a cap to be set out in the regulations. The level of assistance will be the same, regardless of the member's age. There will also be restrictions on the purchase of annuities by schemes qualifying for the FAS.

Schemes will be able to replace their two-stage internal dispute resolution procedure with a single-stage arrangement (with all decisions taken by the trustees), if they want to.

- The Personal Accounts Delivery Authority is set up by the Act to give advice and recommendations to the Government and to prepare for the personal accounts scheme's implementation.
- Following on from the creation of the Board of Actuarial Standards (set up by the Financial Reporting Council), the Act removes the requirement for the Secretary of State to approve certain actuarial Guidance Notes and the Technical Memorandum.

Source: Pensions Act 2007 at http://www.dwp.gov.uk/pensionsreform/pensions_act_2007.asp

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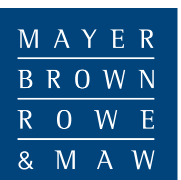

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