Planned changes for internal dispute resolution procedures

The DWP has published draft regulations on internal dispute resolution procedures (IDRPs). At the same time, the Pensions Regulator has issued a consultation document on a draft code of practice setting out reasonable periods for IDRPs. The planned effective date for the new regulations is April 2008. Once they come into effect schemes will have the choice of either a two-stage procedure (as at present) or a one-stage procedure. The consultation paper places particular emphasis on telling claimants about The Pensions Advisory Service and the Pensions Ombudsman (although requirements in relation to this already exist in the current regulations). The draft regulations add a further category of exempted scheme, which is one where there is a sole corporate trustee and all members of the scheme are directors of that company – the exemption in the current regulations applies to individual trustees, as opposed to directors of a trustee company

The draft code of practice says that disputes considered by trustees should be decided, and the applicant notified of the decision, within four months of receipt of the application. There is a further requirement that applicants should be notified of the decision no later than 15 working days after the decision has been made. Where trustees can reach a decision sooner than that time limit then they should do so. Equally, if the dispute is particularly complex then a longer time may be taken, if appropriate. Claimants with an interest in the scheme must apply within six months of the date on which they cease to be, or claim that they cease to be, a person with an interest in the scheme (but the timeframe can be longer if the person could not reasonably have known about the matter in dispute within the six months).

Transfer value regulations delayed

Our Autumn Review mentioned that the Government had issued a consultation on draft regulations which would govern how transfer values are calculated. The DWP has announced that the introduction date will be put back from April 2008 to 1 October 2008, in response to requests for more time to prepare for the changes.

Government announcement on employer debt draft regulations

Our Autumn Review described how the Government plans to amend the laws on employer debts which arise under s75 Pensions Act 1995. The DWP has since issued a statement of its intentions regarding the provision in the draft regulations under which a s75 debt would be triggered in a multi-employer scheme where all employers cease to have active members at the same time. Unfortunately, the announcement does not go into any detail and simply says that the draft regulations will be reviewed because the DWP did not intend the provision to affect legitimate scheme mergers or transfers, or schemes where future accrual ceases whilst the scheme continues to be funded. The DWP identifies tackling scheme abandonment (where an employer avoids responsibility for its funding obligations under a defined benefit scheme) as its main concern.

Revised clearance guidance issued in draft

The draft revised clearance guidance promised by the Pensions Regulator last Spring has now been published. The draft guidance no longer refers to Type B and Type C events since these types of event were deemed to be events for which clearance applications were not appropriate. The draft splits Type A events into those relating to the scheme (which, amongst other things, will always include compromise agreements and sometimes include apportionments) and those relating to the employer. Employer-related events will only count as Type A events where the scheme has a "relevant deficit". The general rule is that a "relevant deficit" is the highest deficit produced by using FRS17/IAS19, s179 Pensions Act 2004, the scheme funding regime or the scheme's ongoing basis of calculation (although a higher basis is to be used in particular circumstances, for example where there is scheme abandonment). The draft guidance lists examples of what might count as employer-related events and scheme-related events.

Concerns have been raised by many in the pensions industry about the proposed revised guidance. The draft guidance assumes that the employer will provide the trustees with full information about its current and future plans and that the trustees will be able to negotiate with the employer on equal terms.

VAT on fund management charges

HMRC has issued a Brief about claims made in respect of VAT charged on fund management services. The Brief says that the recent ECJ ruling which held that investment trust companies should be exempt from paying VAT on fees charged to them by third parties for managing their assets applies solely to investment trust companies and not in respect of the management of other types of fund. There are reports in the pensions industry press that the NAPF is thinking of launching a test case against HMRC on this point, arguing that pension schemes should be allowed to claim a similar exemption.

Age discrimination in the courts

Laws governing age discrimination are now being tested in the courts.

The Freshfields case

John Bloxham (a former Partner at law firm Freshfields) lost his Employment Tribunal claim alleging that Freshfields had breached the age discrimination regulations. Under the Freshfields arrangement points were awarded to partners for years of service with the firm. The points were then used as a way of calculating how much of the total profits distributed to all partners (including current partners) would be paid out to the pensioners. This 'pay as you go' system meant that, as the number of retired partners increased, the younger partners were financing more pensioners than previous generations of partners had had to finance. To address this, changes were made to the arrangement. One change involved reducing early retirement pensions for partners retiring before age 55.

Whilst this case largely turns on its facts, there are some points of more general application that can be drawn from the decision. The Tribunal stressed that "it is an error of law to focus solely upon the treatment and not consider the context in which the treatment occurs". Here, removing the discount that was applied to the claimant's benefits would result in a disadvantage to others since a defined pot - of Freshfields profits - was being distributed. Whilst the treatment was potentially discriminatory the circumstances meant that it was justified. There were conflicting interests in an arrangement where younger partners were paying the "pensions" of an increasing number of older partners and the firm's aim of addressing this "intergenerational unfairness" was legitimate. The decision often refers to the consultation process and it is clear that the Tribunal considered the lengthy and thorough consultation undertaken by Freshfields to be particularly important when assessing whether the firm used proportionate means to achieve a legitimate aim.

The Heyday challenge

The UK's age discrimination laws are the subject of a judicial review in the High Court, sought by Heyday (an organisation backed by Age Concern). The High Court has now referred specific questions to the ECJ. The main concerns raised are:

- whether Directive 2000/78 (which imposes the requirement for Member States to introduce age discrimination laws) allows Member States to say that employers can dismiss employees aged 65 or over on age grounds and
- does the Directive require national legislation to define the kinds of differences of treatment that may be justified and is there any practical difference between the test for justification in relation to indirect discrimination and that in relation to direct discrimination?

The Spanish case

Also in the ECJ, the Spanish age discrimination case of *Palacios (C-411-05)* has now been decided. Spanish legislation had been used as a mechanism to combat unemployment, through the compulsory retirement of older workers in order to make way for the younger generations. Directive 2000/78 explicitly recognises that age discrimination can be justified by "legitimate

employment policy, labour market and vocational training objectives". The Spanish Government passed laws over a 25 year period that, by turns, either required a link between compulsory retirement and employment policy/labour market control, or did not require such a link (depending on the performance of the Spanish economy). The collective agreement governing Mr Palacios' employment was subject to a law that did not require such a link (although the agreement itself set a retirement age of 65 "in the interests of promoting employment").

The ECJ said that the mere fact that a national law does not expressly refer to the objective of promoting better access to employment does not necessarily mean that the treatment cannot be justified. Instead, the court should look at the general context, to identify the underlying aim. In the context of the other Spanish laws on this topic, the aim of the law in question was to regulate the Spanish labour market, so the treatment (the compulsory retirement of Mr Palacios) was objectively justified. The ECJ thought that it would not be unreasonable for Spain to view the measure as appropriate and reasonable, especially since the law required workers to have made enough contributions to become entitled to a pension before they could be compulsorily retired.

The ECJ also looked at one of the recitals in the Directive which says that the Directive applies without prejudice to national provisions laying down retirement ages. The court ruled that this simply meant that Member States could choose a retirement age - the rest of the Directive's provisions then applied to (amongst other things) the conditions set by each State for the termination of employment contracts. It will be interesting to see how this decision might impact on the Heyday challenge.

Flexible retirement consultation

The DWP has issued a consultation document about flexible retirement and pension provision. The document gives very little away since it is, essentially, a list of questions about how schemes currently deal with flexible retirement in practice and also seeks views on what practices might amount to age discrimination. Points to note:

- Flexible retirement should be regarded from when the employee has reached the age at which s/he is entitled to take an actuarially unreduced pension;
- The DWP does not plan to alter primary legislation on preservation to take account of flexible retirement, but suggests possibly adding to the list of alternatives to short service benefits in the regulations;
- Where an employee has a Normal Retirement Age which exceeds the minimum age at which an employee can be dismissed legally on the basis of retirement, set under the UK's age legislation as age 65, dismissal before the employee has reached his NRA may amount to unfair dismissal; and
- If the NRA is below age 65, dismissing employees before they reach age 65 may be directly discriminatory.

Government response to the deregulatory review

The Government's response to the deregulatory review has now been published. The key points are:

- Indexation for pensions in payment will remain unchanged.
- The revaluation cap will be reduced from 5% to 2.5% in respect of rights earned after that change is made.
- Statutory overrides (legislation enabling a scheme to take action that would otherwise be unavailable because of restrictions in the scheme documentation) should be available in respect of specific legislative relaxations (for example indexation and revaluation) for pension accrued in the future – the Government is seeking views on whether such overrides should be available only where the trustees and employer agree or where just the employer agrees.
- The Government wants views on whether to introduce a third layer of legislation so that risk sharing schemes could be excused from, say, indexation and revaluation requirements (the independent reviewers – Chris Lewin and Ed Sweeney - were concerned that doing so would introduce more complexity and inhibit innovation in the creation of such schemes). The Government considers it too early to assess the impact of s67 Pensions Act 1995, but acknowledges concerns that it inhibits the establishment of risk sharing schemes where the normal pension age would be fixed by reference to a longevity index.
- On surplus refunds, the Government will remove the requirement for trustees to first satisfy themselves that the refund would be in the interests of members but will keep the requirement for schemes to be funded on a buy out basis before a refund can be paid (the Government acknowledges concerns about funds building up in pension schemes which are then hard for employers to access).
- The Government advocates a principles-based approach to regulation and aims to start with the main disclosure regulations (disappointingly, it will not look at all the other pieces of legislation that contain disclosure requirements, at this stage).
- At the next "suitable" opportunity, the Government plans to repeal the safeguarded rights provisions contained in the legislation governing the contracting-out aspects of pension sharing on divorce. Also planned is a consultation on pension credit benefits but there is no hint as to how the laws on these might be changed.
- The Government rejects the reviewers' suggestions that the trustee knowledge and understanding requirements should apply to the knowledge of the trustee board as a whole, rather than the knowledge and understanding of individuals on the board. Also rejected are the suggestions that schemes should reimburse the reasonable personal legal expenses of trustees and that there should be a broad statutory indemnity for pension trustees.
- HMRC is taking forward discussions with interested parties on the challenges posed by administering trivial commutations under the new tax regime.

ECJ ruling on sex-based actuarial factors

The ECJ has decided (in the case of *Lindorfer - 227/04 P*) that using sex-based actuarial factors when calculating transfer credits in the EU's own staff pension scheme amounts to sex discrimination. This judgment appears to be of limited application and is particularly difficult to follow without also reading the Advocate General's opinion.

European laws on equal treatment allow the use of sex-based actuarial factors in defined contribution schemes and for the funding purposes of defined benefit schemes. However, the ECJ was keen to point to a particular provision in the scheme documentation which stated that officials were entitled to equal treatment without reference to sex. Having an absolute right to equal treatment deriving from an express provision in the scheme meant that the case did not need to be decided by reference to EU equal treatment laws.

Following on from another ECJ decision (*Neath v Hugh Steeper*) which ruled that sex-based actuarial factors could be used in funded schemes, the UK introduced laws expressly allowing the use of such factors. The EU Equal Treatment Directive (2006/54/EC) also reflects *Neath* by expressly allowing funded schemes to use sex-based factors. The scheme under discussion in *Lindorfer* was an unfunded arrangement, in that any funds transferred into the scheme were simply added to the EU budget. Therefore, the situation in *Lindorfer* differed materially from that of the *Neath* case. The ECJ in *Lindorfer* did not say that other unfunded schemes should not use sex-based factors and we consider that such schemes do not have to stop using those factors as a result of this ruling. However, we think that a watching brief would be prudent.

Pre-Budget report

The latest pre-Budget report sets out the following key changes on pensions:-

- In respect of benefit crystallisation event 3, changes will mean that testing against the lifetime allowance will happen less often – for example, exemptions will apply where at least 20 pensioners have been paid an increase to their pensions at the same rate or where pensions are increased by 5% or the increase in the RPI, if greater.
- For payments made on or after 10 October 2007 (except for those under binding obligations entered into before that date), there will be provisions in next year's Finance Act designed to prevent the avoidance of the rules that spread tax relief for large employer contributions by routing them through a new company.
- With effect from 6 April 2006 protected lump sum rights will be calculated differently so that schemes will no longer have to calculate whether "relevant benefit accrual" has happened where additional amounts are put into a scheme or additional benefit accrues.
- With effect from 6 April 2006 the definition of "investment-regulated pension schemes" will be changed so that it does not include schemes where the members could not realistically be expected to influence scheme decisions to invest in taxable property.
- Anti-avoidance rules designed to stop abuse of pensions tax relief through the surrender of rights or through the reallocation of assets after a member's death will be extended under next year's Finance Act.

- Inheritance tax protection to UK tax relieved pension savings held in overseas pension schemes will be restored with effect from 6 April 2006.
- On 6 April 2009 the upper accrual point (UAP) (new upper limit for State pension accruals) will be introduced - from then on employers and employees with contracted-out occupational pension schemes will get rebates on earnings between the lower earnings limit and the UAP and will pay National Insurance Contributions on earnings between the UAP and the upper earnings limit.

Markets in Financial Instruments Directive (MiFID)

The implementation date for MiFID was 1 November 2007 and since then some schemes have had to consider changes to their investment management agreements which have been put to them by their fund managers.

The Investment Management Association has published an updated Pension Fund Disclosure Code, to take account of MiFID. The purpose of the Code is to promote the accountability of fund managers to their clients by increased transparency, so that trustees are better able to monitor costs incurred during the management of the fund's assets.

Proposal for mobility Directive adopted

The EU Commission has adopted a "Proposal for a directive on the minimum requirements for enhancing worker mobility by improving the acquisition and preservation of supplementary pension rights". Excluded from the proposal are transfers of supplementary rights (a right to transfer either within the same Member State or across States was contained in the previous draft but has been dropped because it is no longer viewed as practical due to "technical difficulties"). Also excluded are pension schemes that are already closed to new members on the date the Directive enters into force and it appears that schemes in wind-up and schemes which enter a PPF assessment period would be exempt too.

The draft wording prohibits waiting periods exceeding one year, minimum joining ages above age 21 and vesting periods exceeding one year for people over age 25 (or vesting periods exceeding five years for people under age 25). Money purchase scheme members who leave before acquiring vested rights would be entitled to a refund of contributions plus the investment return. There is also some wording on the preservation of "dormant pension rights" (although Member States would be able to pay a lump sum of equivalent value to the rights if the rights are worth less than whatever threshold the State sets). For various requirements under the draft wording, Member States will be able to give different protections so long as they count as "equivalent protection".

The next steps are for the EU Presidency to seek the EU Council's unanimous agreement and then the majority agreement of the EU Parliament. The question of transfers will be examined by the Commission five years after the Directive's entry into force. If the proposed changes are reflected in the final Directive UK pension law will need to be amended to fall into line with the requirements wherever the existing UK laws do not afford "equivalent protection".

Responses to the Pensions Regulator's governance discussion

The Regulator has published a report of responses received to its governance discussion paper. Respondents want principles, rather than detailed prescription, more help for trustees to understand legislative requirements and recognition that controls and processes for governance should be proportionate to the risks and circumstances in question. The Regulator says that its primary focus will be on education and guidance and that enforcement will only be used in line with a risk-based approach.

The Regulator's plans for the future include:

- reviewing its code of practice and guidance on trustee knowledge and understanding;
- issuing guidance on conflicts of interest;
- revising guidance on clearance to incorporate guidance on monitoring the employer's covenant;
- issuing a checklist of questions for trustees to ask their advisers (to increase trustee confidence);
- giving examples of various processes for investment choice; and
- issuing guidance on how the Regulator will deal with schemes in wind-up.

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