MAYER • BROWN

Pensions Legal Update

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Legal Update Contents

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Do one thing this month

The 2009/2010 Pension Protection Fund levy deadline is 5pm on Tuesday 31 March 2009. Certifying and re-certifying contingent assets to obtain a levy reduction must be done by this date. If your scheme is planning to put in place a contingent asset before this deadline you need to start the process now.

Contingent asset certificates can now be submitted online, via "Exchange", the online service operated by the Pensions Regulator (see below). Where the PPF has approved a contingent asset for a scheme in 2008/2009, a certificate for 2009/2010 containing the same information will be pre-populated in Exchange, making it easier to re-certify.

It is important to note that the Pensions Regulator will not be reminding schemes to re-certify their contingent assets this year. Additionally, although a contingent asset certificate can be submitted online, any hard copy documents needed to support the certificate still have to be delivered to the PPF by 5pm on 31 March 2009.

PPF Exchange announcement

Summary. The Pension Protection Fund recently issued guidance on Exchange, the online service operated by the Pensions Regulator.

Background. The PPF has issued guidance on Exchange, the online service operated by the Regulator through which schemes provide information to the Regulator such as the annual scheme return and certificates to the PPF.

The PPF guidance sets out the items that schemes need to remember when submitting data as well as highlighting deadlines schemes need to meet to ensure that their PPF levies are calculated using the most accurate and up to date information.

Facts. The aims of Exchange are to make it easier to update the Pension Schemes Registry, and to make sure that the Regulator holds the most current records of pension schemes. It allows you to, in particular:

- register any new occupational schemes
- make any changes to scheme details
- complete scheme returns and access previous versions
- submit voluntary certificates for contingent assets (See "Do one thing this month" above)
- submit deficit reduction contributions certificates
- notify a full or partial block transfer.

Comment. Exchange should mean easier and more reliable filing, due to pre-populated certificates and returns and having a single place for schemes to provide all the information needed by the Regulator and the PPF.

Equalisation of pension benefits

Summary. The High Court has provided further guidance on how pension benefits should be equalised and how to give effect to such rights.

Background. Before *Barber v Guardian Royal Exchange Assurance Group*, it was common for schemes to have a normal retirement age (NRA) of 60 for women and 65 for men. The *Barber* judgment established that having different NRAs for men and women amounts to sex discrimination because it provides more favourable benefits to one sex than the other.

The High Court has provided further guidance on how pension benefits should be equalised and how to give effect to such rights.

Subsequently, in 1995, *Coloroll Pension Trustees Ltd v Russell* established that:

- Benefits earned through service up to 17 May 1990 (the date of the Barber judgment) do not have to be equalised.
- Schemes could "level down" NRA for benefits earned through service after 17 May 1990 (typically by increasing the female NRA to be equal to the male NRA).
- For benefits earned through service in the period between 17 May 1990 and the date on which schemes were amended to level down, benefits must be "levelled up". Typically, that means lowering the male NRA to the female NRA. The period between 17 May 1990 and the date on which the rules are amended is referred to as the "Barber window".

In recent years the consequences of *Barber* and the extent of the rights of members with *Barber* service have come before the court on several occasions, with certain schemes discovering that they were not equalised, or not from the date previously understood, leading to unsuspected, and often significant, additional liabilities.

Facts. The employer asked the High Court to resolve a number of questions about equalising pension benefits under its scheme, which originally had an NRA of 60 for females and an NRA of 65 for males, including whether members had a right to early retirement from age 60 - whether or not the employer agreed – where the effect of the Barber judgment was to mean that the member had a right to any part of their pension paid unreduced from age 60.

Attempts were made to close the *Barber* window with effect from 1 June 1992 by an announcement changing the NRA to 65 for all members. The scheme rules were amended by deed on 16 August 1993 to provide for a single pension from an NRA of 65, without making express provision for the right of members with pension accrued by reference to an NRA of 60 to take that pension from age 60. The rules also provided for early retirement before age 65 – but only with employer consent. A later amendment in

2003 made it clear that, at least for post 2003 service, an actuarial reduction could be applied to take account of early payment before age 65.

A critical question in *Foster Wheeler* was whether a member with some pension accrued by reference to an NRA of 60 could take all of his or her pension from age 60 (including pension accrued by reference to an NRA of 65 after equalisation) without the need for employer consent. If so, there was a further question about whether, on the basis of the rules as drafted, pension accrued by reference to an NRA of 65 after equalisation was to be, or could be, reduced for early receipt (i.e. for the fact that it was taken before 65).

Decision. The High Court held that:

- The *Barber* window was not closed with effect from 1 June 1992 and members were not prevented from claiming that they had a NRA of 60 after this date. The NRA of 65 was effective from the date of the scheme amendment, that is, 16 August 1993.
- Some members had mixed NRAs, that is, some members had accrued benefits by reference to a NRA of 60 and 65 for different periods of service.
- In the context of the rules of the scheme, Mixed NRA members could not split their pension into two tranches so that a member with any pension accrued by reference to an NRA of 60 was entitled to take the entirety of his or her pension from age 60 under the early retirement provision in the scheme rules, without the need for employer consent. Imposing a split pension in this case would require a radical and complete re-write of the scheme rules and, in the Judge's view, there was a simpler way to enforce equalisation.
- The particular terms of the early retirement provisions of this scheme did not allow any reduction for early receipt in relation to the period between the member in question's 60th and 65th birthdays except in relation to post 2003 service.

Recognising the fact that the additional liabilities to the scheme are substantial and the significance of the issues raised, the judge gave permission to appeal.

Comment.
The decision in this case cannot be considered good news for any scheme which finds itself with similar circumstances to those of the Foster Wheeler plan.

The case is highly likely to go to appeal, but on the basis of this decision:

1. Achieving changes to benefits (including equalisation), on the basis simply of announcements issued to members with retrospective amendments made later, looks increasingly unlikely to be successful in general.
2. Trustees and sponsors should check their scheme rules. Schemes which retained a company consent requirement in their early retirement rule in the belief that this might control the cost of Barber equalisation for members retiring without reduction at age 60, will need to consider the implications of this decision.

3. As this judgment currently stands, with consent requirements overridden by Barber rights, schemes with rules similar to those of the Foster Wheeler scheme will have to pay members their full pension unreduced (to some extent at least) at age 60.

Case: *Foster Wheeler Ltd v Hanley & Ors [2008] EWHC 2926 (Ch).*

The Pensions Act 2008

Summary. The Pensions Act 2008 (2008 Act) has received Royal Assent.

As the detail of the new personal accounts requirements become clearer, employers will need to review their existing pension arrangements to ensure they meet the new requirements.

Facts. The 2008 Act provides that, from a future date (expected to be in 2012), employers will be required to enrol "jobholders" automatically in a new personal accounts scheme or their own qualifying scheme with minimum mandatory pension contributions. The new personal accounts scheme will be a trust-based, *defined contribution* occupational pension scheme into which employers and employees will be required to pay minimum contributions. These requirements will cover most employees above the age of 22, as well as temporary and agency workers.

The 2008 Act also extends the powers of the Personal Accounts Delivery Authority (PADA) to implement the new scheme. The Pensions Regulator will be given a key role in policing employers' compliance with the new requirements.

Other measures included in the 2008 Act are:

- Changes to the Regulator's powers, including the introduction of new anti-avoidance powers. The 2008 Act introduces a new test allowing the Regulator to issue a contribution notice if it considers that an act or failure to act is materially detrimental to the likelihood of a person receiving their accrued scheme benefits. Not all of these changes have yet been brought into force, but they will apply retrospectively from 14 April 2008. (See below for more details on the Regulator's published approach to the new material detriment test.)
- Revaluation of deferred pensions. The cap on the revaluation of deferred pensions subject to limited price indexation will be reduced from 6 April 2009 from 5% to 2.5% a year for benefits earned from that date. (See our December 2008 Update for more details.)
- Allowing for compensation paid by the PPF to be included in a pension-sharing order on divorce.
- There are further changes to the Financial Assistance Scheme (FAS). The temporary ban on annuitisation has been made permanent, and the FAS has been extended to cover a small number of schemes that had previously failed to qualify for either the PPF or the FAS.

Comment. As the detail of the new personal accounts requirements become clearer, employers will need to review their existing pension arrangements to ensure that they meet the new requirements.

Source: *The 2008 Act, www.opsi.gov.uk/acts/acts2008/ukpga_20080030_en_1.*

Employer debt

Summary. The Department for Work and Pensions (DWP) has published another informal discussion paper on proposed amendments to the employer debt rules.

Background. Significant changes to the employer debt regime came into force on 6 April 2008. Since then, many commentators have raised a number of technical issues concerning the drafting of the Occupational Pension Schemes (Employer Debt) Regulations 2005 (2005 Regulations), as amended by the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2008. The DWP has acknowledged that the 2005 Regulations, as amended, do not meet its stated policy intentions.

Facts. The DWP proposed a number of changes, including:

- Amending the definition of a scheme apportionment arrangement to make it clear that such an arrangement can be used to apportion a departing employer's residual debt on a floating basis (that is, where the exact amount of the departing employer's residual share actually paid in due course by the other employer depends on changes in the scheme's solvency position).
- Amending the definition of an employment cessation event, as it applies in transitional provisions and to frozen schemes to ensure that the relevant provisions work consistently while ensuring that no scheme or employer falls between the different provisions.
- Confirming that the effective date of relevant accounts does not have to be the same as the scheme year-end.

Many commentators have raised a number of technical issues concerning the employer debt rules. The DWP has proposed a number of amendments to rectify these.

A full consultation on draft regulations will follow in early 2009, with amending regulations planned to come into force in October 2009.

Comment. With the employer debt legislation, the devil is in the detail. The continued uncertainty about what is and is not acceptable in terms of managing employer debts under this legislation is not helpful to trustees or employers. The Government's continued attempts to clarify drafting ambiguities is therefore to be welcomed, although the sooner changes are made the better.

The material detriment test

Summary. The Pensions Regulator has published a draft code of practice on material detriment for consultation.

Background. The Pensions Act 2008 amends the Pensions Act 2004 to allow the Regulator to issue a contribution notice when a sponsoring employer's actions or failures have a materially detrimental effect on the likelihood of members receiving their benefits. A contribution notice is an order which requires a person to make a payment to an occupational pension scheme.

Facts. The draft code (which will have legal force) sets out the circumstances in which the Regulator expects to use this power to issue a contribution notice. It aims to provide greater certainty on its use to help trustees, employers and other related parties to understand the practical application of the new ground for contribution notices.

The draft code, which will have legal force, sets out the circumstances in which the Regulator expects to use this power to issue a contribution notice.

The circumstances in which the Regulator expects to issue contribution notices on the grounds of material detriment are any of the following:

- The transfer out of the jurisdictions of the UK of the scheme.
- The transfer out of the jurisdictions of the UK of the sponsoring employer, if by doing so there is a material reduction in the level of employer support or legal and regulatory protection for scheme members.
- The severing of employer support for the scheme so that employer support is removed, is substantially reduced or becomes nominal.
- The transfer of liabilities of the scheme to another scheme or arrangement that does not have sufficient employer support or is not sufficiently well funded.
- Operation of the scheme in a way that is designed to create a financial benefit for the employer or some other person from the scheme, but where inadequate account has been taken of the interests of the members of the scheme, including where risks to members are increased.

Parliament is to issue a "commencement order" which formally brings the "material detriment" legislation into effect, but this will operate retrospectively so that the legislation itself applies to events occurring since 14 April 2008. The new code of practice will come into force only when that commencement order is issued. The Regulator will be bound by the statement it issued on 25 April 2008 when it decides whether to issue a contribution notice under the "material detriment" legislation in relation to events between 14 April 2008 and the date when the new code comes into force.

Comment. The new test in the legislation is very wide and had the potential to catch many forms of corporate activity. The Government felt that it was impossible to draft an appropriate definition in primary legislation. The draft code of practice goes some way to limiting the wide scope of primary legislation, although in practice the new test may mean that employers will need to obtain expert pension advice before engaging in many forms of corporate activity, including internal restructuring, as well as managing pension scheme liabilities.

Source: *www.thepensionsregulator.gov.uk/pdf/MaterialDetrimentCOPConDoc.pdf. Responses are requested by 6 February 2009.*

Flexible retirement

Summary. The DWP has issued a response to its consultation on flexible retirement and draft regulations.

The DWP is now consulting on options for a further exemption from the prohibition on age discrimination in respect of flexible retirement arrangements.

Background. In October 2007, the DWP consulted on the age discrimination implications of flexible retirement (allowing an employee to draw pension benefits while continuing to work) and providing death benefits beyond a scheme's normal pension age, in the light of the Employment Equality (Age) Regulations 2006.

Facts. In response to key issues raised by the pensions industry, the DWP is seeking views on the next steps to take. The DWP has accepted that many stakeholders are unclear as to how the concept of flexible retirement interacts with the general prohibition against age discrimination.

The DWP is now consulting on options for a further exemption from the prohibition on age discrimination in respect of flexible retirement arrangements. The exemptions would be permissive, not mandatory, so that employers and schemes would continue to consider their individual position to determine the extent to which they wish to rely on any exemption. The proposed exemptions would engage at men's state pension age, or normal pension age, if higher.

The two options are:

- A wide exemption for flexible retirement arrangements. This exemption would render lawful any rule, practice, action or decision that halted the accrual of or entitlement to any further rights or benefits under the scheme during the flexible retirement arrangement. Schemes would be allowed to stop providing further pension accrual in the same scheme, stop uplifting pensions paid late and no longer provide death in service benefits or ill health benefits to those in flexible retirement arrangements.
- An narrower exemption for death in service benefits. There is concern that the survivor of a member in a flexible retirement arrangement may be entitled to death benefits that would normally accrue in respect of an active member and a pensioner member, and would therefore be in a materially better position than the survivors of other members. This option would enable the trustees or managers of an occupational pension scheme to treat the survivor of a member who dies during a period of flexible retirement as a survivor of a pensioner member. Trustees or managers could refuse to provide death benefits that are payable in respect of active members without the need to objectively justify age discrimination.

Comment. The Government's recognition that these issues continue to cause some unease and uncertainty for employers, trustees, professional advisers, members and their representatives alike is to be welcomed. However, neither of the suggested approaches would apply to members who have already taken flexible retirement and they would only cover situations where there was a reduction in the member's hours or grade. In practice, the suggested exemption may be of only limited help.

Source: *www.dwp.gov.uk/consultations/2008/flexible-retirement-next-steps.pdf. Responses are requested by 10 March 2009.*

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