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# Pensions Legal Update

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## Do one thing this month

**From 6 April 2009 the "Upper Accrual Point" will replace the "Upper Earnings Limit" as the top earnings threshold used to calculate contracted-out rebates and the band of earnings used in respect of the reference scheme test (see below).**

**Scheme rules should be reviewed to check that there will not be any unintended benefit changes because of this.**

### Upper Accrual Point

**Summary**. From 6 April 2009, the "Upper Accrual Point" will replace the "Upper Earnings Limit" as the top earnings threshold used to calculate contracted-out rebates and the band of earnings used in respect of the "reference scheme test". Scheme Rules may need to be amended to prevent unintended benefit changes.

**Background**. Under the Pensions Act 2007, the Government is reforming the second tier of the state pension ("**S2P**") so that in future it becomes a flat rate benefit instead of continuing with the current earnings related benefit. At present, contracting-out rebates (used to calculate the "minimum payments" which must be paid to money purchase contracted-out schemes) and the "band earnings" used in the reference scheme test for salary-related contracted-out schemes are based on earnings between the Lower Earnings Limit and the Upper Earnings Limit. The Upper Earnings Limit (which is currently index linked) works as a cap. Earnings above that limit are not taken into account in calculating those payments and contracted-out benefits.

*Scheme rules will need to be checked to see whether there is a risk that the change in terminology will cause unintended benefit changes.*

**Facts**. To tie in with a move to a flat rate based S2P, a new fixed top earnings threshold is being introduced called the Upper Accrual Point. For tax years from 2009/10 onwards, this will replace the Upper Earnings Limit when determining contracting-out rebates (and minimum payments to contracted-out money purchase schemes) and the benefits required under the "reference scheme test". Originally, the Government planned to introduce the Upper Accrual Point on 6 April 2012 but that has now been brought forward to 6 April 2009. The Upper Accrual Point is set at a fixed weekly amount of £770.

However, the term "Upper Earnings Limit" will continue to be used in legislation. But it will refer to a rather higher level of earnings (initially £844 a week) than the Upper Accrual Point.

**Comment**. Scheme rules will need to be checked to see whether there is a risk that the change in terminology (and in particular the new meaning for "Upper Earnings Limit") will cause unintended benefit changes. This is likely to be an issue only in schemes whose rules expressly refer to the Upper Earnings Limit.

## Trustee good practice

**Summary**. The Pension Protection Fund (PPF) has published good practice guidelines for trustees managing pension schemes through the assessment process (the guidelines).

**Background**. A draft of the guidelines was published for consultation in May 2008. The final version aims to help pension scheme trustees understand what is needed to complete the PPF's two-year assessment period in a timely and effective way.

The assessment process begins when there is a qualifying insolvency event in relation to an employer of an eligible scheme. While assessment takes place, trustees remain in day-to-day control of the pension scheme and payments. The PPF takes over this responsibility when assessment is complete, if the scheme cannot afford to pay out more than PPF levels of compensation.

*The final version aims to help pension scheme trustees understand what is needed to complete the PPF's two-year assessment period in a timely and effective way.*

**Facts**. The guidelines are aimed at helping trustees understand more about:

- The assessment period.
- What the PPF expects from trustees and their advisers, and their key roles and responsibilities.
- The information that trustees are required to provide to the PPF under the Pension Protection Fund (Provision of Information) Regulations 2005 (*SI 674/2005*).
- What the trustees can expect from their caseworker.
- How the PPF will monitor the scheme.
- The tools available to help the trustees progress the scheme through the assessment period.

The PPF has said that it will consult further with the industry to develop a mechanism to measure trustees' performance during the assessment period in a transparent and consistent way.

*Source: PPF: Trustee Good Practice Guide, 9 February 2009, www.ppftrusteegoodpracticeguide.org.uk/downloads/PPF_TGPG_complete.pdf; PPF press release, 9 February 2009, www.pensionprotectionfund.info/news-details.htm?id=7004.*

## Employers: defined benefit schemes

**Summary**. The Pensions Regulator (the Regulator) has issued a statement to employers sponsoring defined benefit pension schemes concerning the current economic downturn (the statement).

**Background**. The funding regime for defined benefit pension schemes is contained in Part 3 of the Pensions Act 2004 and underlying regulations (funding regime). Where a scheme is in deficit, a recovery plan must be agreed for addressing the deficit (recovery plan).

The Regulator issued a statement to trustees on 24 October 2008, drawing their attention to circumstances under which they should consider reviewing recovery plans. The Regulator now seeks to reassure employers who may feel that increasing deficits are compounding current economic difficulties.

**Facts**. The Regulator points out in the statement that there is the potential to renegotiate recovery plans with trustees. The intention of the funding regime is not to push an otherwise viable employer into insolvency. However, the trustees must be treated in the same way as any unsecured creditor, and the recovery plan should not be amended simply to allow a company to continue paying its shareholders a dividend.

The Regulator notes the following concerning renegotiation of recovery plans:

*The intention of the funding regime is not to push an otherwise viable employer into insolvency.*

- Recovery plans of longer than ten years trigger greater scrutiny. However, the Regulator explains that a recovery plan of greater than ten years may be entirely appropriate for some schemes.
- There is an important distinction between the temporary impact of the economic cycle and longer-term structural changes to the sponsoring employer. Short-term concerns over affordability could be addressed by back-end loading the recovery plan rather than extending its length, whereas long-term concerns may lead trustees to review investment assumptions in their funding plans.
- Trustees should consider alternative security, such as the use of contingent assets.
- The revised recovery plan must be sent to the Regulator.

*Source: Pensions Regulator's Statement to employers sponsoring DB pension schemes, February 2009, www.thepensionsregulator.gov.uk/pdf/StatementToEmployersFeb2009.pdf.*

## Pension sharing: early retirement

**Summary.** The High Court has held that a pension sharing order (PSO) did not apply to early retirement benefits under an early retirement agreement between a member and his employer as the benefits did not form part of the claimant's shareable rights for pension sharing purposes.

**Background**. Pension sharing on divorce was introduced by sections 27 to 31 of the Welfare Reform and Pensions Act 1999. Where a PSO is made against a pension scheme member, the value of the member's benefits is calculated. This is generally done on the principles that would apply if the member had left pensionable service and had applied to have the value of his rights (the cash equivalent transfer value (CETV)) transferred to another pension scheme. A percentage of the CETV is then credited to the ex-spouse and a "pension debit" is applied to the scheme member's benefits.

**Facts**. A PSO awarded a credit to the ex-wife (EW) of 50% of the husband's (H) CETV, calculated as at the date of the PSO. H later came to an agreement with his employer under which he retired at 57 rather than at his normal retirement age of 60. Shortly after retirement, H was told that, as a result of the PSO, his pension payments had to be reduced. EW would receive no benefit from the deductions. H argued that pension debit deductions should not be made until he reached his normal retirement age of 60.

The Pensions Ombudsman (the Ombudsman) decided that the PSO affected H's rights under the early retirement agreement. H appealed, arguing that there was a fundamental difference between the right to a pension payable at the age of 60 (on which the calculation was based in the CETV) and the right to a pension payable at an earlier age (which was not factored into the CETV). The Cabinet Office argued that H's actual pension was the same as the hypothetical pension calculated in the CETV; the only difference was that the pension was accelerated.

**Decision**. The court allowed H's appeal. The Ombudsman had made an error of law in deciding that the PSO affected H's rights under the early retirement agreement because:

*The PSO was concerned with shareable rights, not with actual benefits payable.*

- The PSO was concerned with shareable rights, not with actual benefits payable.
- H's entitlement to early pension benefits was a separate benefit, and was not taken into account by the CETV because the right to it was not in contemplation at the time of the PSO.
- If a benefit had not been taken into account in the CETV, it was not a qualifying benefit to be reduced by the PSO.

The court concluded that the PSO only applied to reduce H's annual pension from November 2009, when he reached his normal retirement age of 60, and so the PSO would not reduce the early retirement benefits.

The court noted that, if advantageous early retirement terms may be a real possibility at the time of a PSO, then a solution is to ask the divorce court to reflect those possible future benefits in the PSO by granting the ex-spouse a greater percentage of the CETV.

**Comment**. This case clarifies that, if a new benefit is granted that was not in contemplation at the time the CETV was calculated, that benefit will not be affected by the PSO.

*Case: Slattery v Cabinet Office (Civil Service Pensions) and another [2009] EWHC 226 (Ch).*

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