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Pensions Legal Update

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Do one thing this month

The Chancellor announced in the 2009 Budget that higher rate tax relief on pension contributions for individuals who earn £150,000 or more (high earners) would be restricted from 6 April 2011.

High earners need to ensure that they are aware of this tax charge and that they take it into account in their pension planning.

Equalisation

Summary. The Court of Appeal has held that the court should give effect to *Barber* rights by adhering to pension scheme's provisions where possible.

The Barber judgment established that having different normal retirement ages for men and women amounts to sex discrimination because it provides more favourable benefits to one sex than the other.

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 (*[1991] QB 344*). The Barber judgment established that having different normal retirement ages (NRAs) for men and women amounts to sex discrimination because it provides more favourable benefits to one sex than the other.

Facts. F's pension scheme (the scheme) is a defined benefit scheme which before the *Barber* decision in 1990 had an NRA of 60 for women and 65 for men. The scheme rules were amended in August 1993 so that a single NRA of 65 was imposed on both sexes for future service from that date. This meant that some members had built up pension entitlements, from different periods of pensionable service, by reference to NRAs of both 60 and 65 (the mixed NRA members).

The key question in the case was whether a mixed NRA member could, without employer consent, take the whole of his or her pension unreduced from age 60 (including the elements which had been earned by reference to an NRA of 65).

The High Court held that: mixed NRA members could not split their pension into two tranches (that is, one tranche payable from 60 and the rest from 65); mixed NRA members could take their whole pensions at 60, without employer consent; and the scheme rules did not allow any part of a mixed NRA member's pension to be reduced for early receipt if it was paid at 60 or later.

F appealed, asking the court to choose between:

- A single pension calculated on the basis that all the member's benefits had fallen due on the early retirement date (option 1).
- A single pension with the element that had accrued on the basis of a NRA of 65 reduced for early payment (option 2).
- Two separate pensions, payable from each NRA respectively (option 3).

Decision. The court upheld the appeal, holding that the court should give effect to *Barber* rights by adhering to the scheme's provisions where possible. If a departure from the provisions was required, it should represent the "minimum interference" necessary. In determining what amounted to minimum interference, the court should consider the extent of any textual amendment and the substantive effect of the amendment. But the scheme should only be treated as amended to the extent necessary to give effect to *Barber* rights.

Under option one, a mixed NRA member who retired between age 60 and 65 would have received a windfall. In the absence of a consent mechanism, the member received an "uncovenanted benefit" and the company and trustees were required to provide it. This constituted a "fatal flaw" in the High Court's decision.

Option two was the preferred approach. The scheme rule which gave deferred members the right to take an early retirement pension discounted for early payment could be used to give effect to the part of the pension to which an NRA of 65 applied. In both form and substance this approach represented the least interference with the scheme's provisions.

Option three would involve a more substantial interference with the scheme's provisions than required by option two. The payment of a single pension would more closely track the scheme rules than split pensions.

Under this remedy, the court will "correct" the deed to reflect the parties' intention if the moving party can show clear and convincing evidence of what the parties intended at the time the deed was drafted

Comment. A number of High Court judgments since 2006 had concluded, for a variety of reasons, that a pension scheme which thought it had closed the *Barber* window had actually failed to do so. This decision has effectively told the High Court not to reach that conclusion if there is a reasonable alternative which avoids giving a windfall to members.

There may be no alternative in some cases; for example, if the scheme's rules have not been validly amended at all, or where the rule change was clearly intended to enhance members' benefits for the future. But where there is a good case that a scheme's rules (as amended) have closed the *Barber* window, and where they were clearly meant to close it, the lower courts have now been told that that is the conclusion they should try to reach.

Case: Foster Wheeler Limited v Hanley and others [2009] EWCA Civ 651.

Defined contribution schemes: governance

Summary. The Pensions Regulator (the Regulator) has issued a statement about higher standards of governance for defined contribution (DC) pension schemes (the statement).

Facts. The statement emphasises the importance of enabling informed member choices at the time of retirement from a DC scheme, and encourages employers to engage responsibly with staff about pension arrangements.

The Regulator is looking at three ways to improve standards: through updating its publication on retirement choices; through a report later this year regarding a sample it has taken of the processes and literature currently used by trust-based DC schemes; and by referring trustees to the relevant parts of the trustee toolkit (the Regulator's online learning tool).

On employer engagement, the Regulator notes employers' reluctance to engage with their workforce owing to concerns about potential liability for poor investment performance. It therefore plans to produce guidance with the Financial Services Authority to help employers provide information to support pension saving by employees.

The Regulator wishes to ensure that the responsibilities of employers, trustees, providers and advisers in relation to DC arrangements are clearly defined

The Regulator wishes to ensure that the responsibilities of employers, trustees, providers and advisers in relation to DC arrangements are clearly defined. This includes responsibility for regularly monitoring charges, reviewing scheme administration, investment options, member communications and checking that the scheme continues to meet the needs of their workforce. The Regulator says that in trust-based schemes, there is a clear responsibility for the trustee to take lead responsibility for these activities, but in contract-based arrangements, this is less clear. In contract-based arrangements the Regulator refers employers to its guidance on voluntary employer engagement.

The Regulator also notes the new requirements in 2012 for the automatic enrolment of employees into a qualifying pension will have a bearing on DC provision.

Comment. The statement reflects the Regulator's intent to focus more on DC arrangements and employer engagement in personal pension arrangements.

Source: The Pensions Regulator's statement – Engaged employers and informed retirement choices – key to good outcomes for members of defined contributions pensions, July 2009, www.thepensionsregulator.gov.uk/pdf/DCstatementJuly2009.pdf.

Anti-forestalling

Summary. The Finance Act 2009 has introduced a new tax charge to restrict higher rate tax relief on pension contributions for high earners, otherwise known as the "anti-forestalling" provisions.

Background. The Chancellor announced in the 2009 Budget that higher rate tax relief on pension contributions for individuals who earn £150,000 or more (high earners) would be restricted from 6 April 2011.

Facts. The Finance Act 2009 has introduced a number of transitional provisions to prevent high earners unfairly taking advantage of higher rate tax relief before the new provisions take effect in 2011.

With effect from 22 April 2009, any pension contributions or pension accrual in excess of the special annual allowance and which are not considered to be protected pension input will be subject to a special annual allowance charge (currently set at 20%) (the charge). The individual scheme member is liable to the charge.

The special allowance is set at £20,000 for each of the 2009/10 and 2010/11 tax years, but in some cases, where irregular contributions are made, the special allowance will be £30,000

The charge applies to high earners who change their normal ongoing pension savings from 22 April 2009 and who have pension savings which exceed the special annual allowance (the special allowance). The special allowance is set at £20,000 for each of the 2009/10 and 2010/11 tax years, but in some cases, where irregular contributions are made, the special allowance will be £30,000.

Pension contributions or pension accrual which exceed the special allowance will not be subject to the charge if they are "protected pension inputs". These are normal, regular ongoing contributions or benefit accruals that were in place before 22 April 2009, or where the individual joins an occupational pension scheme or group personal pension scheme after that date.

Protection from the charge is lost if the main purpose or one of the main purposes is to avoid liability for that charge.

HM Revenue & Customs (HMRC) has issued technical guidance and produced a Questions and Answers document to explain how the anti-forestalling measures will work in practice. For instance, HMRC has provided examples of what it considers to be normal regular contributions.

Comment. High earners need to ensure that they are aware of this tax charge and that they take it into account in their pension planning.

Source: The Finance Act 2009, www.opsi.gov.uk/acts/acts2009/ukpga_20090010_en_1.

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