MAYER • BROWN

Autumn 2009

Quarterly Review

Trustee Quarterly Pensions Review

In this edition we discuss:

- Proposals to change the employer debt legislation
- Certifying PPF contingent assets – a reminder
- Compulsory pension provision after 2012
- Guidance on promoting DC schemes
- The latest additions to company law
- The PPF's views on GMP equalisation
- The Pensions Ombudsman's decision on conflicts of interest
- A case about pensions and unfair dismissal
- Whether the default retirement age of 65 will last

1. The DWP proposes further changes to the "employer debt" legislation

Following an informal consultation in late 2008, the DWP is now consulting formally about changes to the Employer Debt Regulations made under s75 Pensions Act 1995. The consultation document can be found at www.dwp.gov.uk/consultations/2009.

The main proposed changes are intended to facilitate corporate restructurings, but other changes are designed to address some technical problems with the Regulations.

CORPORATE RESTRUCTURINGS

Restructurings typically involve one employer transferring all its employees to another employer in the same group. Currently, where the transferring employer participates in a multi-employer defined benefit pension scheme, the transfer of employees would be an employment-cessation event under the Regulations, meaning that it could trigger a s75 debt from the transferring employer.

The DWP recognises that a restructuring might not have an adverse impact, or a material impact, on the employers' combined ability to support their pension scheme. It therefore proposes to introduce two new easements – "general" and "de minimis" – to make s75 less of an obstacle in appropriate cases. The proposed easements would be available only where the parties to a restructuring are associated employers which both participate in the same scheme. If the restructuring comes within one of the easements, then the transfer of employees will not count as an employment-cessation event, and no debt will arise.

The "general" easement will apply if a so-called "restructuring test" is met. This will involve a transfer of all of the assets, as well as a transfer of all the employees, from one participating employer to another. Additionally, the trustees will need to be satisfied that, after the restructuring, the receiving employer is at least as likely to be able to meet the scheme's liabilities (for its own employees and those of the transferring employer) as it and the transferring employer would have been beforehand.

The "de minimis" easement will apply only if the scheme is fully-funded on the PPF basis, and only if the transferring employer accounts for less than 2% of the scheme's membership and less than £100,000 of its PPF liabilities. Again, all the transferring employer's assets and employees will need to pass to the new employer.

Both easements will be subject to various other conditions:

- The transferring and receiving employers will have to provide certain confirmations as to solvency.
- Pensionable service with the transferring employer will have to be attributed to the receiving employer for s75 purposes, and the receiving employer will have to take on all the transferring employer's liabilities under the scheme.

CHANGES TO ADDRESS TECHNICAL PROBLEMS

The most notable change under this heading relates to scheme apportionment arrangements (**"SAAs"**) – arrangements which, in a multi-employer scheme, change the share of deficit for which an employer is liable under s75.

The existing Regulations are unclear about a crucial issue: if an SAA reduces employer X's share of deficit, what (if anything) must be "reapportioned" from X to another employer? The lack of clarity has deterred some employers from using SAAs.

The DWP proposes that, in future, any SAA will have to provide for there to be a reapportionment of X's s75 debt to another employer. The other employer will become liable to pay the debt if certain events happen (for example if the scheme goes into winding-up), or on an earlier date specified in the agreement. The SAA may provide either for the debt to be fixed at the date when X withdraws, or for it to be calculated by reference to the scheme's funding position at the date when the debt becomes payable.

The DWP say the proposed change reflects its original policy intention. But the change is more significant than that comment suggests. Many SAAs put in place in the past have provided, not for a reapportionment of X's *s75 debt*, but for a reapportionment of X's *liabilities*. That meant that future s75 debts would be calculated as if pensions earned in service with X had been earned

instead in service with the other employer: the other employer could simply "step into X's shoes". It is not clear that the DWP intends this sort of straightforward and intuitive arrangement to be available in the future.

The draft amending Regulations would also leave it unclear whether – for s75 purposes – an employer still employs "active members" if its employees have stopped accruing additional years of pensionable service but their pension rights still depend on their future earnings. (Recent scheme closures have left a number of members in this "semi-active" position). This is an important question for those multi-employer schemes which have closed to future accrual on this basis. Under the Regulations, a s75 debt is triggered whenever one employer ceases to employ active members in a scheme which still has other active members (employed by someone else). If these semi-active members are still active members for this purpose, a s75 debt might arise in the future each time the last such member employed by a participating employer eventually leaves service. If they do not count as active members, no debt will arise. In our view, the law should give a clearer answer to a question with such big implications.

TIMETABLE

The consultation process runs until 19 November 2009. We will send clients a more detailed update once the amending legislation has been finalised.

2. Schemes should certify/recertify their contingent assets before the PPF deadline

Schemes looking to reduce their PPF levy for the year 2010-2011 should be aware that, if they want the PPF to take a contingent asset (e.g. a parent company guarantee) into account when it sets the levy, all necessary documents and certificates will have to reach the PPF by **5p.m. on Wednesday 31 March 2010**.

We would suggest, therefore, that trustees include any contingent asset proposals as an agenda item at their next trustee meetings.

NEW CONTINGENT ASSETS

Trustees should allow plenty of time to agree the precise terms of any new contingent assets with the other parties concerned and to prepare all the supporting documentation that the PPF requires.

In particular, if trustees want to use a new charge over real estate to reduce their levy, their application to the PPF must include a valuation of the property from a RICS chartered surveyor. The valuation must be dated at most three months before the contingent asset is certified to the PPF. Title to the property will also need to be investigated legally, to satisfy the PPF that the person giving the security has power to do so and that there are no other legal problems which might reduce the value of the security. Trustees should not underestimate the time these processes might take.

RE-CERTIFICATION OF EXISTING ARRANGEMENTS

If the trustees already have any type of contingent asset arrangement in place which the PPF has previously accepted, they will need to re-certify it for the levy year 2010-2011 (via "Exchange", the PPF's online registration service) by **5.p.m. on Wednesday 31 March 2010.** If they do not, the PPF will not take the asset into account.

If the contingent asset which needs to be recertified is a charge over real estate, trustees may also need to provide an updated valuation. That will be the case if the effective date of the most recent valuation supplied to the PPF was more than 3 years before the date of the new contingent asset certificate. For this purpose, however, the PPF will accept as an "updated valuation" the previous full valuation which the valuer has updated by an e-mail or similar correspondence. Again, though, trustees must allow time to obtain this.

If you require any help putting in place a new contingent asset arrangement or re-certifying an existing arrangement, please speak to your usual contact in the pensions team.

3. More news on compulsory pension provision in the UK from 2012

The Government has published a new batch of draft legislation about the requirement for employers to enrol jobholders automatically into qualifying schemes from the autumn of 2012. It has also responded to the March consultation on its first batch of draft legislation.

IMPLEMENTATION OF THE REFORMS

The Government has decided not to implement the new requirements for all employers at once. Instead

implementation will be staggered over three years beginning in October 2012, starting with the largest employers and moving to the smallest over at least 25 stages. The Pensions Regulator will write individually to all employers twice in advance of the date when they are required to introduce automatic enrolment (known as the "staging date"). The first reminder will be sent twelve months, and the second three months, before the deadline.

TRANSITIONAL PERIODS

The Government also intends to phase in the minimum contribution requirements, in order to give employers and individuals longer to adjust to the additional costs. It has proposed that the minimum contributions made by employers using qualifying DC schemes will be increased progressively over five years, while employers will be allowed to delay automatic enrolment until three years after their staging date for jobholders who are still entitled to join a qualifying DB scheme. (Where an employer des not enrol jobholders automatically into any other qualifying scheme, it will have to enrol them into the new Personal Accounts arrangements instead).

SELF-CERTIFICATION AND QUALITY REQUIREMENTS

The Pensions Act 2008 outlines a mechanism for schemes to certify that they meet the qualifying requirements. The new draft regulations set out more of the detail, as follows:

DB schemes

Where employees are contracted-out on the reference scheme test basis, the scheme will automatically qualify.

Other final salary schemes will qualify if they provide benefits at least as good as a "test scheme". This is a scheme providing accrual of 1/120th of qualifying earnings (see below), which allows members to build up 40 years of pensionable service, and which has a pension age equal to State Pension Age. (This will increase from age 65 to age 68 for younger employees). An employer will be allowed to self-certify if the scheme is better in all respects than the test scheme. In other cases, the scheme actuary will need to be satisfied, in accordance with guidance, that the scheme is at least actuarially equivalent to the test scheme.

DC schemes

Many DC schemes use pensionable pay definitions which do not correspond exactly to the definition of "qualifying earnings" in the legislation. ("Qualifying earnings" include all remuneration between £5,035 and £33,540, while many scheme rules calculate contributions by reference to basic salary only). Draft guidance sets out sampling techniques that can be applied for the purpose of certifying that the employer has nonetheless met its obligations.

Hybrid schemes

For many types of hybrid schemes, the guidance suggests that the normal DB or DC test will need to be satisfied. In some cases, such as for career average schemes, a modified version of the test scheme will apply.

For cash balance schemes, the Government currently proposes a minimum requirement of either (A) an annual credit of 16% of qualifying earnings together with annual increases in line with price inflation capped at 2.5%, or (B) an annual credit of 8% of qualifying earnings together with annual increases of 3.5% over and above price inflation capped at 2.5%.

INFORMATION AND RECORDS

Employers will be required to provide information about how they have met their automatic enrolment duties, and to register within nine weeks of their staging date.

Employers and schemes will need to keep records about their pension arrangements (including details of the opt-out and opt-in arrangements and contributions paid) for a period of six years.

RESPONSE TO THE MARCH CONSULTATION

In response to industry concerns, the Government has decided to extend the period in which employers will have to enrol a jobholder into a qualifying scheme. It now proposes to allow a month for this, rather than the 14 days it initially suggested.

Also where a member opts out, schemes will be given longer to pay refunds, so that they can be paid at the same time as regular salary.

However, despite strong criticism from the pensions industry, the proposed opt-out process remains very rigid. The opt-out form:

- will still have to be provided in a prescribed form;
- will still have to be obtained from the scheme (and not the employer) but returned to the employer (and not the scheme); and
- could still be invalidated for technical reasons such as failure to include a member's middle name.

On the second point, the Government's response accepts that, if scheme administration is delegated to a dedicated person employed by the employer, that person should be able to provide the opt-out forms. However, the draft legislation does not yet reflect this.

4. Joint guidance on member communication

The Pensions Regulator and the Financial Services Authority (**"FSA"**) published joint guidance on member communications in September. The guidance aimed to address a concern that employers are not "engaged" with promoting their pension schemes, and in particular contract-based DC schemes.

The Regulator and the FSA believe that one reason for lack of engagement is employers' fear of falling foul of financial services legislation by giving "investment advice" when promoting a scheme. The guidance does not actually provide with employers with any more powers to promote their schemes than they already have. However, it does usefully summarise some of the "cans" and "cannots" of scheme promotion.

The guidance confirms that employers cannot provide financial advice about specific investments. But it says that employers can:

- provide factual information about the scheme including who is eligible to join, as well as the costs and benefits of the scheme;
- provide generic information about the scheme, including explaining that DC benefits are determined by the investment performance of assets and the prices of annuities;
- promote the pension scheme, including arranging the scheme provider to hold a presentation about the scheme;
- highlight the importance of independent financial advice – the employer can pay for the advice, and if it costs less than £150 it will not be taxed as a benefit in kind; and
- help employees understand their retirement options.

5. The Companies Act 2006

The Companies Act 2006 has come into force in stages, and the last provisions came into effect on 1 October 2009. Although the latest changes will have some implications for all companies, only two areas are likely to be or become relevant for corporate pension trustees.

MEMORANDUM AND ARTICLES

For an existing company, the Act automatically imports into its Articles of Association almost all of the clauses which were previously contained in its Memorandum i.e. the statement of the company's objects, the location of its registered office, its limited liability status and its authorised share capital. The only item which will remain in the Memorandum is the "subscriber information" (which says who its original shareholders were).

Whenever the Articles have to be filed at Companies House, or displayed or made available for inspection, they must now be accompanied either by the old Memorandum, marked up to show which of its provisions are deemed to have been incorporated into the Articles, or by a separate copy of the relevant clauses.

Companies do not need to amend their Articles purely as a result of the 1 October changes. However, they may wish to bring their Articles completely up-to-date next time they make amendments by incorporating the relevant provisions of the Memorandum into the Articles proper. This is clearly the tidiest alternative over the long run.

REGISTER OF DIRECTORS/SECRETARIES

In the past, companies have had a register of directors and secretaries. In future, they should have three registers: a register of directors, a register of secretaries and a register of directors' residential addresses. The register of directors and the register of secretaries must name all the directors and the

company secretary, and must show an address for service for each individual, which could be the company's registered office. (A register of secretaries must be created even if no secretary is appointed. It will be blank unless and until a secretary is appointed).

The third register must contain the directors' (but not the secretary's) residential addresses. This information needs to be filed with Companies House like the information in the other registers but, unlike the others, it will not be available for public inspection.

Married women who have used their maiden name for business purposes during the last 20 years will now need to put this information on the register. The same applies to other directors who have used different names during the last 20 years.

This new name and address information does not need to be filed with Companies House until the company makes its first annual return to a date after 1 October 2009 or notifies another change of the relevant director's details.

6. The PPF sets out its approach to equalising GMPs

So far, the courts have not yet decided whether occupational pension schemes should "equalise" the guaranteed minimum pension ("**GMPs**") benefits that they pay to men and women in respect of service from 17 May 1990. (Broadly, GMPs are the minimum pensions that salary-related schemes are required to provide in respect of contracted-out service before April 1997; this minimum rate of pension is different for men and women because it is designed to compensate contracted-out members for not receiving the earnings-related component of the state pension – which is itself different for men and women). Whether schemes have to "equalise" GMPs can be argued both ways. Most occupational pension schemes are therefore waiting to address the issue until they know what obligations, if any, the courts decide they have.

But the Pension Protection Fund ("**PPF**") does not have this luxury. It has a statutory duty to equalise compensation so as to allow for different treatment of men and women in the GMP formula. Following its consultation in April 2008, the PPF has now published its initial conclusions on how to satisfy its duty. Broadly, the method it has chosen provides that each pensioner will be paid the higher of the total male or female pension, as calculated once the pension is in payment (and at least annually thereafter) as at each pension payment date.

The PPF has decided that this calculation approach will only apply to schemes which it is actually assessing following an employer's insolvency. It is not seeking to impose any new obligations on trustees of ongoing schemes. In particular – trustees may be relieved to hear – it has said that it does not expect schemes undertaking s179 (or "PPF") valuations to value their GMP liabilities as if they had to be equalised in this way. The PPF has however said that trustees might want to consider, with legal advice as necessary, whether to make a voluntary rule amendment along these lines – possibly contingent upon PPF entry – so that the scheme rules equalise benefits to the level the PPF would require.

7. The Pensions Ombudsman issues a determination about conflicts of interest

A recent decision by the Pensions Ombudsman (in the case of *Rath*) has emphasised the importance of the role of an independent trustee in addressing conflicts of interest. He decided in effect that the appointment of an independent trustee company fully addressed concerns that the trustees of a scheme who were also directors of the employer had a conflict of interest.

Members were given notice that the trustees intended to pay the employer a surplus of £160,000 on the scheme's winding-up, rather than use it to augment member benefits. An objection to this proposal was raised, alleging that the trustees had a conflict of interest and had not considered using the surplus to enhance member benefits. An independent trustee was subsequently appointed and this issue was discussed at a later trustee meeting.

Although the independent trustee was not present when the final decision to proceed was reached, the Pension Ombudsman still held that its earlier appointment had concentrated the trustees' minds on whether a conflict existed and on whether the option of augmentation had been properly investigated, resulting

in both issues being addressed. As the scheme rules and statutory requirements required the Trustees only to consider distributing the surplus to members, the Pensions Ombudsman held that "the outcome was a decision that the Trustees could properly reach taking relevant factors into account" and the complaint was dismissed.

8. The Court of Appeal rules on the treatment of pensions on unfair dismissal

It is a well-established principle of employment law that, if an employee is unfairly dismissed, he/she can be entitled to compensation from his/her former employer.

The Court of Appeal has confirmed (in the case of *AEGON v Roberts*) that, when calculating compensation for unfair dismissal, pension accrual should be treated in the same way as the rest of the employee's remuneration package. Pension accrual is simply one part of an employee's overall remuneration package – it is in essence deferred remuneration, and it should not be given any special treatment for unfair dismissal compensation purposes.

The Employment Appeals Tribunal had previously decided that pension accrual under a DB scheme was a unique type of benefit and that therefore, if an employee was unfairly dismissed, compensation for loss of future DB accrual should be calculated differently, and more generously, than compensation for other parts of the remuneration package. That surprising initial decision caused some alarm among employers with DB schemes. In overturning it, the Court of Appeal has restored the previously accepted position.

9. The default retirement age of 65 remains lawful, but probably not for long

The High Court has decided, in what was known as the *Heyday* litigation, that the Government's default retirement age of 65 is capable of being justified, for now at least. The decision came as a relief to many employers across the country, particularly those who were at the receiving end of one of the 800 age discrimination claims which had been put on hold pending the decision.

However, the High Court judge was at pains to point out that his decision would have gone the other way were it not for two key factors. First, the retirement age of 65 had been set in 2006 when the age discrimination regulations came into force and the economy was in a much better state. Secondly, the Government had announced that a review of the default retirement age, originally earmarked for 2011, would be brought forward to next year. The judge was of the view that a retirement age of 65 is unsustainable over the long term, as it has a greater discriminatory effect than necessary on people who are both able and willing to work longer. He also doubted that a higher age would have a general detrimental effect on the labour market or block jobs for future generations.

Following the *Heyday* decision, the Government has already begun to take informal soundings to assess the case for raising the default retirement age. Doing so, or indeed removing the default retirement age altogether, may be seen as a possible vote-winner ahead of the forthcoming election.

If there is a change here, employers and pension scheme trustees who have not already addressed this issue will have to consider how their scheme rules should cater, on a non-discriminatory basis, for members who stay in service after 65. In practice this is likely to mean offering the over-65s the same choice between continued accrual and opting-out that younger members have.

A further likely issue for employers and trustees if the default retirement age goes is the increasing cost of insuring death-in-service benefits for older employees. Many insurers seem willing to provide life cover for employees up to age 70 under a group policy without a material increase in the premium. But if significant numbers come to be employed after that age – into their late 70s or older – then presumably the premium for insuring a death benefit of say four times salary for someone in this age group could itself become a material fraction of their salary.

About Mayer Brown

Mayer Brown is a leading global law firm with offices in major cities across the Americas, Asia and Europe. We have approximately 1,000 lawyers in the Americas, 300 in Asia and 500 in Europe. Our presence in the world's leading markets enables us to offer clients access to local market knowledge combined with global reach.

We are noted for our commitment to client service and our ability to assist clients with their most complex and demanding legal and business challenges worldwide. We serve many of the world's largest companies, including a significant proportion of the Fortune 100, FTSE 100, DAX and Hang Seng Index companies and more than half of the world's largest investment banks. We provide legal services in areas such as Supreme Court and appellate; litigation; corporate and securities; finance; real estate; tax; intellectual property; government and global trade; restructuring, bankruptcy and insolvency; and environmental.

OFFICE LOCATIONS

AMERICAS
- Charlotte
- Chicago
- Houston
- Los Angeles
- New York
- Palo Alto
- São Paulo
- Washington

ASIA
- Bangkok
- Beijing
- Guangzhou
- Hanoi
- Ho Chi Minh City
- Hong Kong
- Shanghai

EUROPE
- Berlin
- Brussels
- Cologne
- Frankfurt
- London
- Paris

ALLIANCE LAW FIRMS
- Mexico, Jáuregui, Navarrete y Nader
- Spain, Ramón & Cajal
- Italy and Eastern Europe, Tonucci & Partners

Please visit www.mayerbrown.com for comprehensive contact information for all Mayer Brown offices.

© 2009. Mayer Brown LLP, Mayer Brown International LLP, and/or JSM. All rights reserved.

Mayer Brown is a global legal services organisation comprising legal practices that are separate entities (the "Mayer Brown Practices"). The Mayer Brown Practices are: Mayer Brown LLP, a limited liability partnership established in the United States; Mayer Brown International LLP, a limited liability partnership incorporated in England and Wales; and JSM, a Hong Kong partnership, and its associated entities in Asia. The Mayer Brown Practices are known as Mayer Brown JSM in Asia. "Mayer Brown" and the "Mayer Brown" logo are the trademarks of the individual Mayer Brown Practices in their respective jurisdictions.

This Mayer Brown publication provides information and comments on legal issues and developments of interest to our clients and friends. The foregoing is not a comprehensive treatment of the subject matter covered and is not intended to provide legal advice. Readers should seek specific legal advice before taking any action with respect to the matters discussed herein.

0237pen
November 2009