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Pensions Legal Update

Legal Update Contents

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Do one thing this month

The 2011/2012 Pension Protection Fund levy deadline is Wednesday 31 March 2010. 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 be submitted online, via "Exchange", the online service operated by the Pensions Regulator.

The Regulator's review of pre-retirement literature for occupational DC schemes

Summary. The Pensions Regulator (Regulator) has published a report (Report) on its review of pre-retirement information for members of occupational defined contribution schemes.

Background. The Occupational Pension Schemes (Disclosure of Information) Regulations 1996 (Disclosure Regulations) give trustees of an occupational pension scheme a legal duty to disclose certain information to members at least 6 months before their intended retirement date. Under the Finance Act 2004 members must also be offered the open market option (OMO) (i.e. the option of buying an annuity from a provider of the member's choice).

30% of the schemes surveyed breached at least one of the requirements in the Disclosure Regulations

The Regulator contacted a random sample of 97 occupational defined contribution schemes to monitor whether the pre-retirement literature sent to members satisfied the Disclosure Requirements and to see whether the literature helped members make an informed choice about their retirement options. The Report sets out the Regulator's findings and offers guidance on how to improve pre-retirement communications with members as a matter of good practice.

Facts. Some of the key findings of the Regulator are:

- 30% of the schemes surveyed breached at least one of the requirements in the Disclosure Regulations, although only 6% were considered to be material breaches. The most common breach was the failure to satisfy the 6 month deadline for providing pre-retirement information to members. The Regulator suggested that trustees should refer to its booklet "Making your retirement choices – Think before you choose" to help them satisfy the disclosure requirements and this can be found at: *www.thepensionsregulator.gov.uk/pdf/MakingYourRetirementChoicesJuly2009.pdf.*

- Trustees have an important role to ensure that pre-retirement communications are effective because this may significantly affect the financial outcomes for members at retirement. The Regulator expects trustees to take an interest in the scheme retirement process, even if they delegate their responsibilities to their insurer, administrator, or adviser, and to be familiar with the communications issued on their behalf.
- Communications should be member friendly so that members can understand their rights and choices.
- The Regulator has provided examples of what it considers to be poor practice, such as providing pre-retirement information too late.
- However, some examples of good practice are:
  - Contacting members at least 5 years before retirement with investment information and pre-retirement considerations and options
  - Issuing a "wake up" pack 6 months before retirement with a short covering letter which explains the member's key choices and the potential impact of those choices.
  - Explaining the OMO in a clear and fair manner and the benefits of "shopping around" for an annuity.
  - Providing clear illustrated explanations of the retirement process.
  - Highlighting the importance of seeking independent financial advice and informing members about the Pensions Advisory Service online annuity planner.

Trustees should review the Regulator's Report to see whether their pre-retirement literature is adequate.

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Source: A review of retirement information for DC members, published by the Pensions Regulator in October 2009. http://www.thepensionsregulator.gov.uk/pdf/RetirementInfoDCMembers.pdf

Trustee knowledge and understanding

Summary. A revised Pensions Regulator (Regulator) code of practice (Code of Practice) has come into force.

Background. Trustees of occupational pension schemes are required to have knowledge and understanding of pension and trusts law and of principles of pension scheme funding and investment. The degree of knowledge and understanding required is that which is appropriate to enable a trustee to perform their functions properly. Trustees are also required to be familiar with their trust deed and rules and with written statements of the funding and investment principles which they have applied to their scheme.

Facts. The Code of Practice, which came into force on 26 November 2009, is designed to set out how trustees should comply with the legislation. It includes the following:

- The detailed scope of the trustee knowledge and understanding requirements is set out in three guidance documents (Guidance). Trustees should consider the Guidance and determine which parts are appropriate for their circumstances and whether knowledge of additional matters would be appropriate. The level of knowledge and understanding required for individual trustees will vary according to the role and expertise of that trustee and the circumstances of the scheme. Trustees should have a check list of the appropriate knowledge and experience for them from which they can create a training plan.

Trustees can use the Regulator's free e-learning programme, the Trustee Toolkit.

- Trustees can use the Regulator's free e-learning programme, the Trustee Toolkit.
- A well thought out learning programme will allow trustees to "dip in and out" to remind themselves of what they learned previously and to bring themselves up to date with changes.
- Any learning programme should be designed to deliver either specific elements of the Guidance or more advanced scheme specific learning. Trustee training providers should check the current level of understanding of trustees at the start. They should be able to certify attendance, subject matter and understanding.
- Professional trustees should be able to demonstrate appropriate qualifications from appointment. Particular responsibility also falls on the chair of the trustees who may need to have a deeper level of learning.
- Trustees need to have a working knowledge of their trust deed, statements of investment and funding principles and other scheme documents. They will need to read them thoroughly.
- Newly appointed trustees have six months from appointment to be conversant with their documents and to obtain the appropriate levels of knowledge and understanding.

Comment. The Code of Practice provides useful guidance for trustees who wish to understand the Regulator's expectations for trustee knowledge and understanding. It also provides useful guidance for trustee training providers.

Source: The Pensions Regulator Code of Practice No. 7 – Trustee Knowledge and Understanding (TKU), www.thepensionsregulator.gov.uk/pdf/codeTkuFinal.pdf.

Occupational pension plan: unlawful conversion

Summary. The High Court has held that the conversion of a pension plan (Plan) from a final salary scheme (DB scheme) to a money purchase scheme (DC scheme) was unlawful.

The high court has held the conversion of a pension plan from a DB scheme to a DC scheme was unlawful.

Background. Benefits in occupational pension schemes may be altered using the scheme's amendment power and having regard to section 67 of the Pensions Act 1995 (section 67). Section 67 imposes restrictions on amending past service benefits. In some cases, the employer may also be able to agree a variation to an employee's pension benefits through a contractual arrangement.

Facts. By way of a deed dated 3 March 1992 (the 1992 deed), the Plan was purportedly converted from a DB scheme to a DC scheme. The trust deed establishing the Plan (the 1977 deed) contained a different and inconsistent amendment power to the rules adopted in 1981 (the 1981 rules). The 1977 deed provided that no amendment could have the effect of reducing the value of benefits secured by contributions already made. However, the amendment power in the 1981 rules did not have this restriction and was followed in drafting the amendments in the 1992 deed.

The employer (Employer) sent out a staff memorandum announcing the conversion to money purchase benefits, staff presentations were given and an explanatory booklet was circulated. The Employer also sent an application form to existing members of the plan asking them to confirm that they had read the booklet and wished to participate in the new arrangement.

The Plan's independent trustee brought the claim to resolve uncertainties about the validity and effect of the attempted conversion of the Plan in 1992.

Decision. The court held that:

- The 1981 rules did not replace the 1977 deed. The correct amendment power that should have been followed for the 1992 deed was in the 1977 deed.
- It was not possible for trustees to remove the restriction in the amendment power of the 1977 deed, which was clearly designed to prevent amendments which had a detrimental effect on the members' interests.
- The amendments made by the 1992 deed were invalid in so far as they reduced the value of benefits secured by contributions already made, which was prohibited by the 1977 Deed.
- The Plan's conversion to a DC scheme was only permissible subject to an underpin which preserved the future monetary value of the final salary benefits which members had accrued in respect of their service before the 3 March 1992.

- Signing of application forms by members, receipt of the explanatory booklet and attendance at staff presentations did not give rise to a contractual agreement or an estoppel argument. The Employer was not able to argue that the changes to benefits purported in the 1992 deed had been implemented outside the Plan rules through a contractual arrangement.
- Compromise agreements signed by employees several years later did not constitute a binding waiver of any pension rights. Such a waiver would not be possible under s91 Pensions Act 1995 which prevents alienation of pension rights.

Comment. This case emphasises the importance of applying the correct amendment power and highlights the need to take care if changing benefits through a contractual route.

Case: HR Trustees v German (IMG Pension Plan) [2009] EWHC 2785 (Ch).

Employer debt

Summary. The High Court has clarified when a statutory debt becomes due from an employer.

Background. Before 6 April 2008, an employer was required to pay a statutory debt to the trustees of its pension scheme if the employer ceased to be "an employer employing persons in the description of employment to which the scheme relates" at a time when another employer continued to employ such persons (*regulation 6(4), Occupational Pension Schemes (Employer Debt) Regulations 2005 (SI 2005/678)*) (Regulation 6(4)) (the Employer Debt Regulations). There have been different legal views as to the meaning of these words.

trustees and employers may wish to revisit debts triggered before this date as they may have been triggered at a later point, or no debt may yet have been triggered.

Facts. The employer (Cemex) ceased to employ any active members in the scheme (that is, those employees earning benefits from the scheme). B was the last remaining active member but became a deferred member when he reached normal pension date. Cemex continued to employ four people who were eligible for membership but who had not joined the scheme (Officers). Two of the four Officers had previously been members of the scheme but had withdrawn.

Decision. The Court held that Regulation 6(4) requires more than ceasing to employ active members. No statutory debt was triggered on the basis either that Cemex continued to employ the officers, even though it was unlikely that the Officers would have applied to become members of the scheme, or B, even though, having reached normal pension age, B was no longer eligible for membership of the scheme.

Comment. Since 6 April 2008, the Employer Debt Regulations have been amended to clarify when the statutory debt is triggered. This case is an interesting interpretation of the meaning of Regulation 6(4) as it applied before 6 April 2008. It is unclear how far this decision is specific to the facts of the case. However, trustees and employers may wish to revisit debts triggered before this date as they may have been triggered at a later point, or no debt may yet have been triggered.

Case: Cemex UK Marine Limited v MNOPF Trustees Limited [2009] EWHC 3258 (Ch).

Pension Protection Fund

Summary. The High Court has ruled that a proposed buy-out arrangement which would have "selected against" the Pension Protection Fund (PPF) would not be a proper exercise of a trustee's powers.

Facts. A pension scheme had a substantial deficit and an employer which was effectively insolvent. The scheme was likely to fall into the PPF - the safety net arrangement for paying compensation to members of a defined benefit scheme which is wound up with insufficient assets to meet its liabilities. If the scheme fell into the PPF, the compensation which members would receive would be lower than their entitlements under the scheme. The members hardest-hit would be those below normal pension age who would receive only 90% of their entitlements and would be subject to the PPF annual cap (currently £28,742).

In a bid to minimise the adverse impact on members, the trustee proposed to arrange a substantial buy-out of benefits with an insurance company, using a power in the scheme's rules:

- All benefits would be bought out for those members who were below normal pension age (and so would be hardest-hit under PPF rules)
- There would be partial buy-out for those members over normal pension age, to cover the expected shortfall between PPF compensation and their scheme entitlements.

The buy-out would improve the position of all members, but would worsen the position of the PPF. The PPF would have to take on significant liabilities but most of the scheme's assets would have been consumed by the buy-out.

The trustee asked the High Court for directions on whether it could exercise its power to buy out benefits under the scheme's rules in this way.

Decision. The Court ruled that the proposed buy-out went beyond the purposes for which the buy-out power was intended, and therefore could not properly be effected. The trustees had submitted that the purpose of the buy-out was to "secure for members as high a proportion as is possible of the benefits that they were promised under the scheme". The judge said that this might have been the reason behind the proposal, but it was not the purpose. The purpose was to apply a disproportionately large, and therefore unfair, share of the scheme assets in the purchase of buy-out policies. A "share of fund" limit was implicit in the buy-out provision, and the proposed buy-out would have breached that limit.

The Court further ruled that the availability of compensation under the PPF was not a relevant factor for the trustee to take into account when exercising the buy-out power. For the trustee to take account of the PPF safety net in this context would be contrary to public policy. The judge did however acknowledge that, in certain contexts, it might be appropriate (or even necessary) for trustees to have regard to the safety net.

Comment. The judge indicated that it will not normally be appropriate for trustees to make decisions in reliance upon the existence of the PPF safety net. For example, the safety net would not justify trustees in choosing a high-risk investment which they would not otherwise choose.

The judge's comments about the implied "share of fund" limit in the buy-out provision may be relevant where trustees are contemplating a buy-out or buy-in. It may well be possible to conclude that there is no such limit in the context of a buy-in, not least because (unlike a buy-out policy) a buy-in policy will be an asset of the scheme.

Case: Independent Trustee Services Limited v Hope & others, Neutral Citation Number [2009] EWHC 2810 (Ch)

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