MAYER • BROWN

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Trustee Quarterly Review

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Finalised amendments to the Employer Debt Regulations

New regulations, which are now in force, introduce an alternative mechanism to restructure and defer statutory debts which would otherwise become due when an employer in a multi-employer scheme ceases to employ active members. These debts can be significant as their calculation is based on a share of the buy-out deficit of a scheme. The trustees of the scheme have an important role in supporting this mechanism, known as a flexible apportionment arrangement ("**FAA**").

Unlike scheme apportionment arrangements, no employer debt calculation is required for an FAA because the departing employer apportions its scheme liabilities (not its share of the employer debt). In addition, in an extension from the draft regulations, an FAA can now also apply to a scheme that is frozen to future accrual.

Under an FAA, one or more of the remaining employers must take over responsibility for all of the departing employers' scheme liabilities, as those liabilities stand immediately before the FAA takes effect. Alternatively, part of the debt can be paid at the time (with other employers taking over responsibility for the liabilities of the departing employers which the payment does not cover), but this is not a requirement.

The consent of the trustees of the scheme will be needed, and the trustees must be reasonably satisfied that the "funding test" is met (which means broadly that the remaining employers are able to fund the scheme).

The trustees must also be satisfied that an assessment period (for the purposes of the Pension Protection Fund) is unlikely to be triggered in relation to the scheme within the period of 12 months beginning with the date on which an FAA takes effect. An assessment period is generally triggered on the insolvency of the employers in the scheme. While this requirement may appear to be easy to satisfy in some cases, it is likely that trustees will want some reassurance, perhaps from a covenant assessor, before entering into an FAA.

The other noteworthy change in the new regulations is the extension of the period of grace during which an employer can employ no active members of the scheme without becoming liable to pay a debt from 12 months to 36 months. And the period within which an employer must give notice to the trustees that it has ceased to employ active members has increased from one month to two months.

Sally Taylor

Section 251 Pensions Act 2004

In the run-up to 6 April 2011, section 251 created a concern that, unless certain trustee resolutions were passed before that date, schemes might lose all powers to make payments to an employer. The Government has now changed the legislation to confirm that schemes only need act to preserve any power they contain to pay a refund of surplus from an ongoing scheme. Power to refund surplus on winding up is not affected; nor are powers to make administrative payments to employers, for example to reimburse expenses.

Section 251 sets out a three-stage process to preserve the power to pay a refund while the scheme is ongoing. This involves an initial trustee decision, notice to the members and employers, and a confirmatory trustee resolution. Where the process had not been completed by the original deadline of 6 April 2011 it has been on hold, pending new legislation. That legislation has now come into force and the deadline for passing a s251 resolution has now been extended until 5 April 2016. The effect is that:

- For those schemes with a power to pay surplus to an employer while the scheme is ongoing, the trustees can now complete the s251 process if they have not already done so, even if it was not started before 6 April 2011.
- For those schemes with a power to make payments to an employer only on winding-up, or only in connection with administration, it is now clear that no action is needed.

Beverley Cox

New PPF levy framework

In December 2011, the Pension Protection Fund ("**PPF**") published the 2012/13 Levy Determination, which set out a new levy calculation framework for 2012/13. The key elements of the determination are set out below.

- Data available on Exchange immediately before the start of the levy year will be used rather than the historical data position.
- There is a revised ten band framework for determining an employer's insolvency risk, based on D&B scores (being the probability of insolvency estimated by Dun and Bradstreet), averaged over a year.
- The scheme funding measure will use financial data averaged over a five-year period to reduce volatility.
- The investment risk of a scheme can be taken into account to some extent, with special rules for schemes with protected liabilities exceeding £1.5 billion.
- Under new rules about Type A contingent assets (i.e. arrangements whereby an associated entity provides a guarantee to support a scheme), trustees need to certify that there is no reason to believe a guarantor cannot meet its liabilities. The certification may relate to a capped sum only (i.e. not the full guaranteed amount). In addition, the PPF will carry out its own assessment of the strength of a guarantor to ensure that the certification given by the trustees is appropriate. This is very important because it shows that the PPF recognises that the negative certification required from trustees is limited in its scope. However, it does mean that if the PPF is not satisfied with a guarantee, it is unlikely to be accepted.

  For this levy year, the PPF will consider partially recognising guarantees if the circumstances justify it and the trustees are not trying to seek an unfair levy advantage. However, in future years, partial guarantees will usually be rejected, even where the contingent asset has some value.

Beth Brown

GMP equalisation consultation

The Government has published a consultation which arguably confirms that schemes are required to equalise guaranteed minimum pensions ("**GMPs**") and suggests a possible equalisation methodology. Under this methodology, schemes would have to carry out dual male and female calculations on an annual basis for each member, and then pay the higher benefit. It ignores the issue, normally fundamental in discrimination law, of whether an actual comparator exists.

Following the European Court of Justice's decision in the 1990 Barber case, schemes took action to equalise the overall benefits payable to male and female members. It was not, however, clear from the Barber decision whether schemes were also required to equalise the GMP element itself and, until now, schemes have generally taken the view that no such requirement applied.

In the consultation the Government proposes a number of legislative changes which make it clear that schemes cannot get out of any duty to equalise GMPs accrued in the period between 17 May 1990[1] and 5 April 1997[2], merely on the basis that there may not be an opposite sex comparator with the higher benefit.

Under the Government's suggested equalisation methodology schemes would, on an annual basis:

- compare the age at which benefits are payable to the member and the age at which the benefits would be payable if the member were of the opposite sex and pay the benefit from the earlier of the two ages (resulting in GMPs becoming potentially payable at age 60 for both men and women); and
- compare the amount of the overall pension to be paid to the member and the amount of the overall pension which would be payable if the member were of the opposite sex and pay the higher of the two amounts.

The Government emphasises that this methodology is simply a suggested approach and that schemes will not be legally bound to follow it nor should they consider it a definitive statement of how equalisation should be effected. It therefore remains open to schemes to use alternative equalisation methods.

The proposed legislative amendments would take effect from a date to be determined in 2012. The consultation period runs until 12 April 2012.

The consultation will come as a disappointment to those who consider the Government's view that schemes are required to equalise GMPs to be incorrect. Whilst it is helpful that the Government has chosen to suggest an equalisation methodology, the cost of equalising GMPs using this methodology will be high and, in the vast majority of cases, entirely out of proportion to the value of any additional benefits payable to scheme members as a result of the equalisation.

Once the Government announces the outcome of the consultation, trustees will need to discuss with their advisers and administrators what action they should take.

Katherine Dixon

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1 The date of the *Barber* decision.

2 GMP accrual ceased with effect from 6 April 1997.

Tests-Achats – one year on

It has been almost a year since the *Tests-Achats* ruling was made by the European Court of Justice ("**ECJ**"). Whilst the ruling has no direct effect on UK occupational pension schemes, speculation continues about possible knock-on effects for the use of sex-specific actuarial factors. There have been some recent developments - responses to the *Tests-Achats* ruling from both the Government and the European Commission ("**EC**").

Background to Test-Achats

In *Tests-Achats*, the ECJ ruled that, from 21 December 2012, the use by insurers of sex-specific actuarial factors to deliver differences in premiums between men and women will be prohibited. The ruling does not of itself prevent UK occupational pension schemes from using sex-specific actuarial factors. UK law allows this in a number of situations (particularly transfers, commutation and early retirement) and the ECJ has previously ruled that pension schemes can use sex-specific factors where the differences reflect differences in the actuarial cost of the benefits. But the ruling sparked speculation about possible knock-on effects for UK occupational pension schemes.

Responses from the Government and the EC

There were two developments in December 2011:

- The Government published its response to the *Tests-Achats* ruling, together with a consultation on changes to UK law to implement the ruling.

  No mention is made of any proposed change to the UK law which allows occupational pension schemes to use sex-specific actuarial factors. The consultation closes on 29 February 2012 and it remains to be seen whether this is raised in any of the consultation responses.

- The EC issued a communication containing guidelines on certain matters arising from the *Test-Achats* ruling.

  The EC considers that the ruling has no legal implications for the existing EU Equal Treatment Directive provision allowing the use of sex-specific actuarial factors by occupational pension schemes when justified by actuarial data. The EC says this is the case even where schemes rely on an insurer to pay out member benefits.

Comment

- Although the views of the Government and the EC offer some comfort to trustees on the continued use of sex-specific actuarial factors, ultimately these views have no legal force and cannot be relied on. However, any UK legislation is likely to follow the EU law position. The fact that the EC is of the view that the *Test-Achats* ruling had no legal implications for the relevant pensions directive provision may indicate that EU law will remain unchanged for pension schemes.

However, trustees cannot afford to be complacent. Change may still follow in the occupational pensions context - there is a deadline of 15 February 2013 for review of the EU Equal Treatment Directive. It seems reasonable to assume that any change would be required from a future date. At present, we recommend trustees using sex-specific factors think about how they would implement a change, and what lead time their administrators and actuaries would need if this was required.

Giles Bywater

Short service refunds and dealing with small pension pots

The implementation of auto-enrolment is expected to prompt an increase in the number of small DC pots. At the end of last year, the Government published a consultation document, seeking views on how to deal with this.

Three approaches have been suggested:

- Make it easier and more attractive to transfer small pots. Ideas include using standardised forms for transfers, requiring schemes to accept transfers (no matter what the size) and encouraging people to transfer their pots.
- Automatically move small pots to an "aggregator" scheme (possibly to NEST, or a default scheme or schemes) when an individual leaves their employer.
- For pension pots below a certain amount (such as £10,000) to move with people from job to job automatically – the most ambitious (and expensive) approach.

For both types of automatic transfer, the consultation suggests an opt-out system to overcome individual inertia, with no requirement to obtain financial advice.

At the same time, the Government confirmed that short service refund rules for DC (but not DB) occupational schemes will be abolished.

The aim is to ease administrative burdens associated with small pots and prevent pensions being lost through people losing track of them, encountering barriers to transfers, and the difficulty of buying an annuity with a small pot.

Olivia Mylles

Indexation: lawful index switch and potential scrapping

Following a challenge brought by a number of unions, the High Court ruled in December 2011 that the Government had acted lawfully in deciding to increase public sector pensions in line with the Consumer Prices Index ("**CPI**") rather than the Retail Prices Index ("**RPI**"). However, one of the three judges hearing the case dissented from his colleagues' view on one point: he took the view that the Government had wrongly taken general economic conditions into account in deciding what was the appropriate measure of inflation to use for this purpose. The unions have been given leave to appeal the High Court's decision, and the appeal is due to be heard on 20 February 2012.

If the unions succeed in their appeal, and the Government has to revert to increasing public sector pensions in line with the RPI, there will be a direct impact on some private sector schemes – those whose rules expressly require pensions to be increased by the same percentage as official pensions. However, the court's decision either way will not directly affect the majority of private sector schemes, whose rules typically require either increases in line with the RPI or increases in line with the Pensions Act 1995.

As DB schemes continue to close to future accrual, the Pensions Minister Steve Webb has also said that abolishing statutory indexation requirements could make DB pension provision more attractive for employers. The Department of Work and Pensions followed up his statement by confirming that it was indeed considering the possibility of abolishing those requirements. However, it added that any change would not affect existing pensioners or the pensions that active and deferred members have already built up. The focus was on "future pension provision, not today's pensioners".

Devora Kirk

Reform of EU data protection laws

The EC has proposed a comprehensive reform of EU data protection laws designed to substantially enhance data protection compliance throughout Europe. The proposals include organisations being required to obtain explicit consent to the processing of personal data, rather than being able to infer or assume consent, and giving individuals the right to ask businesses to move their records to alternative service providers.

As they currently stand, some of the EC's proposals may present issues for pension schemes, such as the requirement to obtain explicit consent to the processing of personal data. Where schemes rely on member consent to the processing of personal data, they would need, under the current proposals, to review their systems to ensure such consent is explicit.

However, the proposals are subject to consideration and potential amendment by the European Parliament and the European Council and will not therefore take immediate effect.

The proposals do not therefore have immediate implications for pension schemes, and no action needs to be taken at the present time. Trustees and administrators will, however, want to keep an eye on further developments on this issue to ensure that they have sufficient time to make any changes necessary to ensure compliance with the final version of the revised laws.

Katherine Dixon

6 April 2012 – don't forget...

Abolition of protected rights

From 6 April 2012 the concept of "protected rights" will be abolished with protected rights potentially becoming ordinary scheme benefits. Schemes will also no longer be able to contract out of the state second pension on a protected rights basis. Schemes which are currently contracted-out on this basis will automatically be contracted back into the state second pension with effect from 6 April, unless they elect to become contracted-out on a reference scheme basis. A number of procedural steps must be taken and various conditions satisfied if a scheme wishes to elect to contract out on a reference scheme basis.

Schemes which currently hold protected rights on behalf of members are also required to provide certain information regarding the abolition of protected rights to members. This information must be provided to members within one month following 6 April.

Reduction in lifetime allowance

From 6 April 2012 the lifetime allowance will be reduced from £1.8m to £1.5m. The lifetime allowance is essentially the maximum amount of pension benefits which an individual may accrue over his or her lifetime without suffering a penalty tax charge.

Individuals who already have accrued benefits with a value in excess of £1.5m will be able to retain a lifetime allowance of £1.8m by applying to HM Revenue & Customs for "fixed protection" by 5 April 2012 and satisfying certain conditions such as (broadly speaking) ceasing to accrue any further benefits.

Katherine Dixon

Dates and deadlines

1 April 2012
New PPF Levy framework takes effect

5 April 2012
Deadline for members to apply for “fixed protection” before reduction in lifetime allowance to £1.5 million

6 April 2012
- Contracting-out abolished for DC schemes
- Lifetime allowance reduced to £1.5 million

Ocotber 2012
Auto enrolment into NEST or better alternative arrangement starts for large employers - 1% employer contributions required

21 December 2012
Gender based insurance premiums become unlawful for individual contracts

December 2012
TPR’s target for data cleanse

January 2013
New IAS19 comes into force affecting how employers account for pension liabilities

6 July 2013
New tax regime - deadline for employers to provide scheme administrators with information about members’ pensionable pay and benefits and length of service

6 October 2013
New tax regime - deadline for schemes to provide members with information about last 3 years’ pension savings

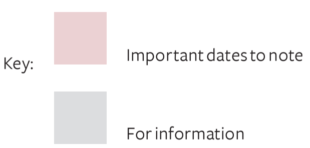
31 December 2013
First deadline for members requests for “scheme pays”

6 April 2016
Revised deadline for making resolution under s251 to retain scheme rules allowing surplus payments to employer

October 2017
NEST or better alternative arrangement - 2% employer contributions required (proposed new date)

October 2018
NEST or better alternative arrangement - 3% employer contributions required (proposed new date)

Key:



Important dates to note

For information

Katherine Dixon

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