MAYER BROWN

Strictly Private & Confidential
November 2013

Trustee Quarterly Review

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Definition to come into force on 6 April 2014 with retrospective effect from 1997

New definition of "money purchase benefits": consultation on implementation

*The Department for Work and Pensions (**"DWP"**) has published its long-awaited consultation on draft regulations governing how the new statutory definition of "money purchase benefits" will apply in practice. The draft regulations provide a series of helpful measures to lessen the impact of the new definition, particularly on past events, but some aspects remain unclear and schemes may need to revisit some past decisions.*

In July 2011, the Supreme Court gave its decision in the case of *Houldsworth v Bridge Trustees*. The case considered, among other things, whether:

- DC benefits where the scheme had promised a guaranteed interest rate; and
- money purchase benefits which had been converted into a scheme annuity,

counted as defined benefits or money purchase benefits. Although the case was concerned with a winding-up, in principle the decision was relevant for other statutory purposes too: tax aside, the same definition of "money purchase" is used throughout pensions legislation.

The DWP had argued in the case that benefits should count as money purchase only if the scheme's benefits liability is automatically matched by corresponding assets. However, the Supreme Court decided that in both cases the benefits were money purchase benefits because their amount was calculated by reference to contributions previously paid, even though there was no necessary exact match between the size of the benefit and the assets the scheme held to secure them.

On the same day as the Supreme Court decision, the DWP announced its intention to change the statutory definition of money purchase benefits to make it clear that, until it comes into payment, a benefit can be money purchase only if it is not possible for a deficit to arise in respect of it. Moreover, if a scheme provides pensions internally, when money purchase benefits come into payment, those pensions will count as money purchase only if they are secured through policies bought from an insurer. In other words, liabilities count as money purchase only if they are necessarily matched by the assets held to meet them. The statutory definition was subsequently enacted in s29 Pensions Act 2011 (**"s29"**).

Under the draft regulations, s29 will come into force on 6 April 2014 and will have retrospective effect from 1 January 1997. As a result, some schemes with benefits previously thought to be money purchase benefits will be considered to have held non-money purchase benefits since that date.

The draft regulations provide for a number of easements which will prevent such schemes from revisiting certain decisions that they have made in relation to those benefits in the period between 1 January 1997 and 5 April 2014. Generally speaking, where the period prior to 6 April 2014 is concerned, the issues which schemes will need to revisit are relatively limited, but will include:

- winding-ups completed between 28 July 2011 and 5 April 2014 if certain conditions are not met; and

- employer debts triggered between 28 July 2011 and 5 April 2014 unless certain conditions are met.

From 6 April 2014, schemes will need to be administered on the basis that any benefits which are currently considered to be money purchase benefits but which fall outside the new definition are defined benefits. (We understand from the DWP that it does not intend to change some existing exemptions in the funding and PPF legislation under which schemes that otherwise meet the new definition will count as money purchase even if they provide defined lump sum benefits on death, provided that those liabilities are matched by insurance policies.)

Schemes that are currently considered to be wholly money purchase but that hold benefits which fall outside the new definition will become subject to a range of new requirements. These include appointing a scheme actuary, carrying out an actuarial valuation and agreeing a schedule of contributions, and paying PPF levies. These requirements will be phased in from 6 April 2014.

While the Government's main concern in changing the money purchase definition was to ensure that employers have a duty to fund all benefits in relation to which deficits could arise, the term "money purchase" also crops up in legislation about members' rights to transfer between schemes, and in legislation that governs the benefits that schemes must provide. Examples include the rules about revaluing early leavers' benefits, about increases to pensions in payment, and about the types of benefit that can be provided by a scheme that formerly contracted out on a money purchase basis. The reclassification of what used to be money purchase benefits as non-money purchase could in principle mean that different requirements apply in these areas too.

The draft regulations go some way towards ensuring that the new retrospective definition will not force schemes to revisit benefits that have already crystallised or transfers that have already been made. But unless these easements are further extended so as to cover future transfers and future pensions coming into payment, schemes that fall foul of the new definition will have to think, not just about their new funding obligations, but also about whether the actual benefits and transfer amounts they pay must meet new requirements from next April.

We understand from discussions with the DWP that the new regulations are generally not intended to affect the previous statutory treatment of "underpin benefits" where members are promised the greater of a money purchase benefit and a defined benefit – a common arrangement, particularly in defined benefit schemes that contracted out on the money purchase basis from April 1997. However, we do not think it is clear that the draft regulations fully reflect that intention, and this is a further point where we will be asking the DWP to clarify their drafting.

The final version of the regulations may well differ in many ways from the current consultation draft. However, there are less than six months until April 2014, so schemes would be advised to start considering whether they hold any benefits which will be recategorised in light of the new definition and, if so, what action they may need to take in respect of those benefits.

Jonathan Moody

Requirements consolidated into single set of regulations

New disclosure of information regulations finalised

Regulations designed to harmonise, consolidate and simplify the disclosure requirements for occupational pension schemes have been finalised and will come into force on 6 April 2014. The regulations also introduce some new disclosure requirements.

The current disclosure regime is widely considered to be inconsistent and hard to navigate, as the requirements are contained in several different sources, and there have been numerous changes in the law since the requirements first came into force. The Department for Work and Pensions (**"DWP"**) therefore consulted in February 2013 on a draft version of regulations designed to tackle these criticisms. The final version of the regulations has now been published and will come into force next April.

In addition to consolidating the existing disclosure requirements in a single set of regulations and making their wording clearer, the new regulations make various changes to the substance of the disclosure regime including:

- Requiring schemes which operate a "lifestyling" strategy to inform members about the strategy as part of the basic scheme information and also 5-15 years ahead of retirement. (Lifestyling is where the investment strategy in a DC scheme changes as a member gets closer to retirement – generally a gradual move from riskier to less risky investments. Lifestyling is not compulsory.)
- Changing the requirements that statutory money purchase illustrations (**"SMPIs"**) must meet, in order to give schemes more flexibility to tailor SMPIs to the individual needs of their members. Schemes will no longer need to provide a large amount of accompanying information that is currently required to be provided with an SMPI. The regulations will also remove some of the specific annuity assumptions that are currently required for SMPIs to allow for more meaningful annual projections based on members' individual circumstances. (An SMPI is part of an annual benefit statement which provides personalised information to members with money purchase rights, including an illustration of their likely projected pension at retirement using today's prices.)
- Extending schemes' ability to provide information electronically (i.e. by email and/or website). Broadly, electronic disclosure will be possible in most contexts as an alternative to providing information in hard copy if the member has not asked to receive the information in hard copy, and, for certain members, has been told that he or she can ask in writing to receive information in hard copy. Disclosure via a website will also be possible if the member has not asked to receive the information in hard copy, has been asked in writing three times for an email address, and has been told that he or she can ask in writing to receive information in hard copy.

Katherine Dixon

Double counting "not permitted by pensions legislation"

Double counting: Regulator statement

The Pensions Regulator has issued a statement warning schemes against "double counting" whereby employer debt payments are used to settle payments due under the schedule of contributions or vice-versa.

The Regulator's view is that the scheme funding and employer debt regimes are entirely separate, and that double counting is not permitted by pensions legislation and presents unnecessary risks to members. A decision to double count therefore may trigger a whistle-blowing and/or notifiable events duty. The statement notes that the Regulator will expect any instances of double counting (whether future or past) to be addressed and may consider exercise of its powers under the scheme funding, anti-avoidance and governance regimes if they are not addressed.

However, exactly what the Regulator means by "double counting" remains unclear. On one reading of the statement, the Regulator is saying that it is unlawful in principle for a scheme's schedule of contributions to provide for higher or lower employer contributions, depending on whether another employer makes a specified payment under the employer debt regime. If that is what the Regulator is saying, we do not consider it to be correct in law. It seems to us that the Regulator's legitimate concern is where trustees informally treat an employer debt payment as settling contributions that remain due under the schedule, or informally treat an employer's regular contributions under the schedule as settling part of its employer debt payment.

The statement also sets out the approach that trustees should adopt on an employer cessation, and notes that the Regulator expects trustees to consider whether an employer departure requires mitigation over and above payment of the employer debt as a result of any change to the employer covenant e.g. changes to the investment strategy.

Katherine Dixon

The Regulator's decision to publish the statement indicates that it is concerned that double counting is becoming increasingly widespread. Schemes that have previously double counted employer debt payments, or are intending to do so, may wish to review their decision in light of the statement.

Private sector employers to participate in public service pension schemes

Treasury publishes New Fair Deal guidance

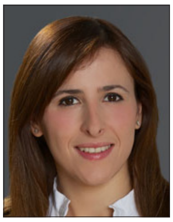
In October 2013 HM Treasury published new guidance setting out a revised Fair Deal policy (the ***"New Fair Deal"****). The New Fair Deal will allow private contractors to participate in public service pension schemes so that transferring staff can remain members of their existing public service scheme.*

The Fair Deal policy was introduced in 1999 to provide pension protection for public sector employees who were compulsorily transferred to independent providers delivering public services.

Under the old Fair Deal regime, where staff were compulsorily transferred from the public sector, their new employer was required to give them access to an occupational pension scheme which was "broadly comparable" to the public service scheme that they were leaving. Staff were also to be offered the choice of becoming a deferred member in their former public service scheme, or transferring their benefits to the new employer's broadly comparable scheme under a bulk transfer arrangement.

The new guidance applies to central government departments, agencies and the NHS as before, as well as maintained schools, academies and any other parts of the public sector under the control of Government ministers where staff are eligible to join a public service scheme.

Under the New Fair Deal, staff who are compulsorily transferred from the public sector to a private contractor will be entitled to continue to be members of the public service scheme they were in immediately prior to the transfer, and will also remain eligible to continue their membership of the public service scheme on any subsequent compulsory transfer. In addition, staff previously transferred out of the public sector under the old Fair Deal regime will normally be given the opportunity to rejoin their original public service pension scheme on a re-tendering process.



Abigail Cohen

The New Fair Deal came into force with immediate effect and, whilst it is not legally binding, it is usually adhered to in the public sector. While the old Fair Deal regime can continue to apply for procurements which are already at an advanced stage, the New Fair Deal should be followed in all cases by April 2015 at the latest.

It is hoped that the New Fair Deal will lead to the desired increase in competition on outsourcing which should lead to cost savings for the Government.

Raft of recommendations to improve value for money

OFT study into DC workplace pensions market

*The Office of Fair Trading (**"OFT"**) has published a study into whether there is sufficient competition in the DC workplace pensions market to deliver value for money for scheme members. It has recommended that the Government should establish minimum governance standards for all DC workplace schemes, whether trust-based or contract-based schemes. The OFT also wants to ensure that DC schemes provide information in a way that makes it easier to compare their costs and quality.*

The study broadly concluded that employees' and employers' lack of understanding of pensions and the complexity of the pensions market combine to reduce competition on charges and quality. It also found that these weaknesses have already created a risk of savers losing out in small trust-based schemes, and in older and high-charging contract-based and bundled trust schemes (where the pension provider also administers the scheme).

The OFT has surprised the industry by deciding not to recommend the imposition of a cap on charges, even in automatic enrolment schemes. However, it has made a number of other recommendations, in particular that:

- The Department for Work and Pensions (**"DWP"**) should:
  - establish a minimum governance standard for all DC schemes;
  - consult on improving the transparency and comparability of information about the cost and quality of schemes, so as to make employers' choice of scheme easier;
  - consider preventing schemes being used for automatic enrolment that contain built-in adviser commissions or active member discounts;
  - consider whether a greater onus should be put on trustees to prove their compliance with value for money standards; and
  - consider whether the Pensions Regulator's current enforcement powers are sufficient.
- Providers of master trust schemes (multi-employer DC schemes for non-associated employers, set up under a single trust and with one trustee board, under which different employers have their own separate sections) should demonstrate to the Regulator that they can deliver ongoing value for money for members on the basis of realistic growth plans and contingencies.
- The Government and regulators should aim to ensure that there is an equivalent level of protection between master trust and contract-based products.

The OFT has secured the cooperation of a number of bodies including the Association of British Insurers (**"ABI"**), the Regulator and the DWP to address the concerns raised by the study. The ABI will carry out an audit of old and high-charging contract-based and bundled trust schemes aimed at ensuring savers are getting value for money. The Regulator will assess which smaller trust-based schemes are not providing value for money, and what the key barriers are to closing trust-based schemes that offer poor value for money.

Helen Parrott

Although the OFT did not recommend a cap on charges in automatic enrolment schemes, the DWP has separately launched a consultation on charging in DC schemes, which includes a proposal to cap charges. Whatever the outcome of this consultation, it is clear that changes to the DC market are around the corner and trustees – and other pension providers – will need to be alive to them.

Regulator to launch DC thematic reviews

Compliance and enforcement policy for DC schemes: Regulator consultation

The Pensions Regulator has consulted on its compliance and enforcement policy for DC trust-based schemes. Central to the policy are new thematic reviews of particular issues or segments of the DC market, where some schemes will be required, initially on a voluntary basis, to provide information relating to scheme governance, and which could lead to case investigations by the Regulator.

The policy covers wholly DC schemes and DC sections of hybrid schemes, including DC AVCs provided by DB schemes. The Regulator will target its resources at the risks that it identifies as posing the greatest threats to members, including:

- Poor governance standards: where, for example, there is a lack of internal controls or the fitness and propriety of the trustee board is called into question.
- Poor investment governance and decision-making: where assets are lost or reduced through, for example, inappropriate investment objectives, or failure to review a default strategy or otherwise monitor investments.
- Poor administration practices.
- Fraud.

In addition to the existing whistle-blowing obligations on trustees and advisers, the Regulator will conduct new thematic reviews of small schemes and master trusts.

The Regulator expects schemes to provide information on a voluntary basis, with the provision of routine documents, but it may also require a more in-depth review of a particular scheme's processes and practices. Following a review, the Regulator will provide the scheme with a report confirming its findings and, where relevant, requiring further actions to be taken. Where necessary, the Regulator may open a case investigation and require further evidence. The Regulator may request trustee minutes, service agreements with advisers, risk registers and any governance statements. The Regulator has power to demand information within certain time frames and, if necessary, to enter premises and carry out an inspection.

The policy sets out a non-exhaustive list of factors that the Regulator will consider when assessing a breach including whether the problem is systemic; the financial impact on members; the trustees' conduct; and whether the scheme has deliberately sought to conceal the breach.

Melissa Pullen

This consultation is a further clear statement of intent from the Regulator that it is turning its focus to DC schemes. The Regulator is keen to highlight its armoury of powers to investigate non-compliance and the sanctions at its disposal, including improvement notices and civil penalties. Trustees will want to ensure that sufficient time is spent at trustee meetings to address DC governance, focusing on the Regulator's new code of practice on the governance and administration of DC trust-based schemes and accompanying guidance which came into force on 21 November.

Estimated 10% levy increase

2014/15 PPF levy: consultation

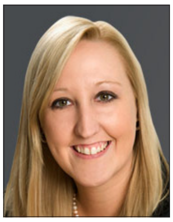
The PPF has published its estimate for the 2014/15 PPF levy together with a consultation on the levy itself. There are no changes to the levy framework, but the levy estimate has increased by 10%.

"The risks we face as an organisation remain high, with low bond yields and substantial scheme deficits still part of the landscape. Our intention to leave the levy rules unchanged means that the levy estimate for 2014/15 has therefore increased, something we signalled to levy payers was likely when announcing last year's levy estimate and, again, in June."

Chris Collins, PPF Chief Policy Adviser

In September 2013, the PPF launched a consultation (now closed) on its levy for 2014/15. This consultation sets out the levy parameters for 2014/15 which is the last levy year in the current levy framework. For 2015/16 a new levy framework will apply, although the PPF has said it will only change the rules where there is clear evidence to support the change.

The 2014/15 consultation announced the levy estimate (i.e. the amount which the PPF expects to collect) at £695 million, roughly a 10% increase on the 2013/14 levy estimate. The increase is largely due to the predicted increase in underfunding risk and the transformation methodology, including the smoothing of scheme funding, now applied. The PPF has emphasised that the increase to the levy estimate is not a response to individual claims, nor has it taken account of potential industry changes, such as the proposed change to the PPF compensation cap, the Pension Regulator's new objective to minimise adverse impact on the sustainable growth of employers or the proposed change to the definition of money purchase benefits. The PPF acknowledges that any regulations addressing the new money purchase benefits definition may mean that some schemes will have to have their levies recalculated.



Beth Brown

In the consultation, the PPF has also sought to address certain concerns raised by trustees. In particular there are proposals which would address some of the current obstacles to certification of "contingent asset" arrangements such as parent company guarantees which may serve to reduce a scheme's levy.

Age discrimination, pensions liberation, member disputes and data protection

Case law round-up

HK Danmark v Experian

The Court of Justice of the European Union (**"ECJ"**) has held that an age-related contribution scale in a Danish DC pension scheme was capable of objective justification. The ECJ held that the reasons given for using an age-related scale, such as helping older workers build up retirement savings more quickly, were legitimate, but that it was for the national court to decide whether the difference in treatment that arose as a result was proportionate and necessary to achieve the legitimate aim.

The ECJ also held that the exemption in the EU Framework Directive that permits the use of age-related criteria in actuarial calculations does not apply to age-related contributions in DC schemes.

UK legislation allows age-related contributions to DC schemes where the aim is to equalise or make more nearly equal the eventual pension.

Pi Consulting (Trustee Services) v Pensions Regulator

The High Court has held that nine pension schemes suspected of being pension liberation schemes fall within the statutory definition of "occupational pension scheme". As a result, transfers into those schemes should be authorised transfers for tax purposes, and the schemes will come within the scope of the Pensions Regulator's powers. The judgment is likely to be of only limited assistance to schemes considering transfer requests to other schemes which they suspect may be pension liberation schemes. The judgment relates only to the nine schemes in question and, although the Regulator intervened in the schemes due to pension liberation concerns, the parties agreed that the Court would only be asked to consider whether the schemes were within the statutory definition of occupational pension schemes, and not whether they were shams.

We understand that the Pensions Ombudsman is expected to decide shortly on a number of cases involving pensions liberation, including examples both where the trustees refused or delayed a transfer and where the transfer was made and the member has complained that the trustees should not have made it. Although the Ombudsman's decisions are only directly binding in relation to the individual parties to the complaint, schemes may find his decisions in these cases, and in particular any general principles that emerge from them, a useful practical guide to how to approach future transfer requests where the trustees suspect that the underlying motive is pensions liberation.

Pell Frischmann Consultants v Prabhu

The High Court has held that an employer could launch High Court proceedings to determine a member's disputed pension rights before the end of the scheme's internal dispute resolution procedure (**"IDRP"**) and thereby effectively pre-empt the member's complaint to the Pensions Ombudsman.

The rights in question had been the subject of a protracted IDRP dispute, and the employer applied to the High Court for a declaration that the member was not entitled to the rights in dispute. The application was made prior to a final decision in the IDRP being made, and had the effect of suspending the IDRP proceedings and preventing the member from complaining to the Ombudsman. The employer acknowledged that it had launched the proceedings at that point because it wished the dispute to be resolved by the High Court rather than the Ombudsman – firstly because it wanted the case to be heard in a jurisdiction where it could seek to recover costs from the member, and secondly because it wanted an oral hearing where witnesses could be cross-examined on their evidence (the Ombudsman generally does not agree to this).

The member applied for the application to be struck out on the grounds that its timing was an abuse of process. The High Court held that the timing did not amount to an abuse of process and did not breach the overriding objective of the Civil Procedure Rules.

Scottish Borders Council v Information Commissioner

The First Tier Tribunal has overturned a fine of £250,000 imposed by the Information Commissioner on the Scottish Borders Council for a serious breach of the Data Protection Act 1998. The breach arose out of a security failure by a subcontractor of the Council who had been engaged to scan pension records. Original files containing the pension records were found in and around a supermarket recycling bin.

Andrew Block

The Tribunal agreed that the breach was serious but, unlike the Information Commissioner, it considered that the breach was not likely to cause substantial damage or substantial distress since there was little likelihood that the data would fall into the public domain and/or that it would be used to effect identity theft. While it therefore concluded that no fine could be imposed, the Tribunal was not prepared to simply allow the appeal by the Council. Instead it said that it was going to consider issuing an enforcement notice or taking some other action.

Upcoming Pensions Group events at Mayer Brown

If you are interested in attending any of our events, please contact Katherine Dixon (kdixon@mayerbrown.com) or your usual Mayer Brown contact. All events take place at our offices at 201 Bishopsgate, London EC2M 3AF.

TRUSTEE FOUNDATION COURSE

10 December 2013
25 February 2014
20 May 2014
16 September 2014
9 December 2014

Our Foundation Course aims to take trustees through the pensions landscape and the key legal principles relating to DB funding and investment matters, as well as some of the specific issues relating to DC schemes, in a practical and interactive way.

TRUSTEE BUILDING BLOCKS CLASSES

17 June 2014 – topic to be confirmed
18 November 2014 – topic to be confirmed

Our Building Blocks Classes look in more detail at some of the key areas of pension scheme management. They are designed to be taken by trustees who have already taken our Foundation Course.

ANNUAL PENSIONS FORUM

2 April 2014

Our Annual Pensions Forum takes a look back at some of the key developments over the last 12 months and looks forward to expected developments in the coming year.

Dates and deadlines

31 December 2013

First annual allowance deadline for member requests for "scheme pays"

5 April 2014

Lifetime allowance deadline for members to apply for fixed protection 2014

6 April 2014

- New definition of "money purchase benefits" expected to come into force
- New disclosure of information regulations come into force

- Lifetime allowance reduces to £1.25m
- Annual allowance reduces to £40,000

5 April 2016

Revised deadline for making resolution under s251, Pensions Act 2004 to retain scheme rules allowing surplus payments to employer

5 April 2017

Proposed lifetime allowance deadline for members to apply for individual protection

October 2017

- Automatic enrolment - 2% employer contributions required for DC schemes
- Automatic enrolment - end of transitional period for DB schemes

5 April 2018

Deadline for making resolution under s68, Pensions Act 1995 to remove protected rights provisions from scheme rules

October 2018

Automatic enrolment - 3% employer contributions required for DC schemes

Key:

Important dates to note

For information

About Mayer Brown

Mayer Brown is a global legal services organisation advising clients across the Americas, Asia and 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 banks. We provide legal services in areas such as banking and finance; corporate and securities; litigation and dispute resolution; antitrust and competition; US Supreme Court and appellate matters; employment and benefits; environmental; financial services regulatory & enforcement; government and global trade; intellectual property; real estate; tax; restructuring, bankruptcy and insolvency; and wealth management.

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