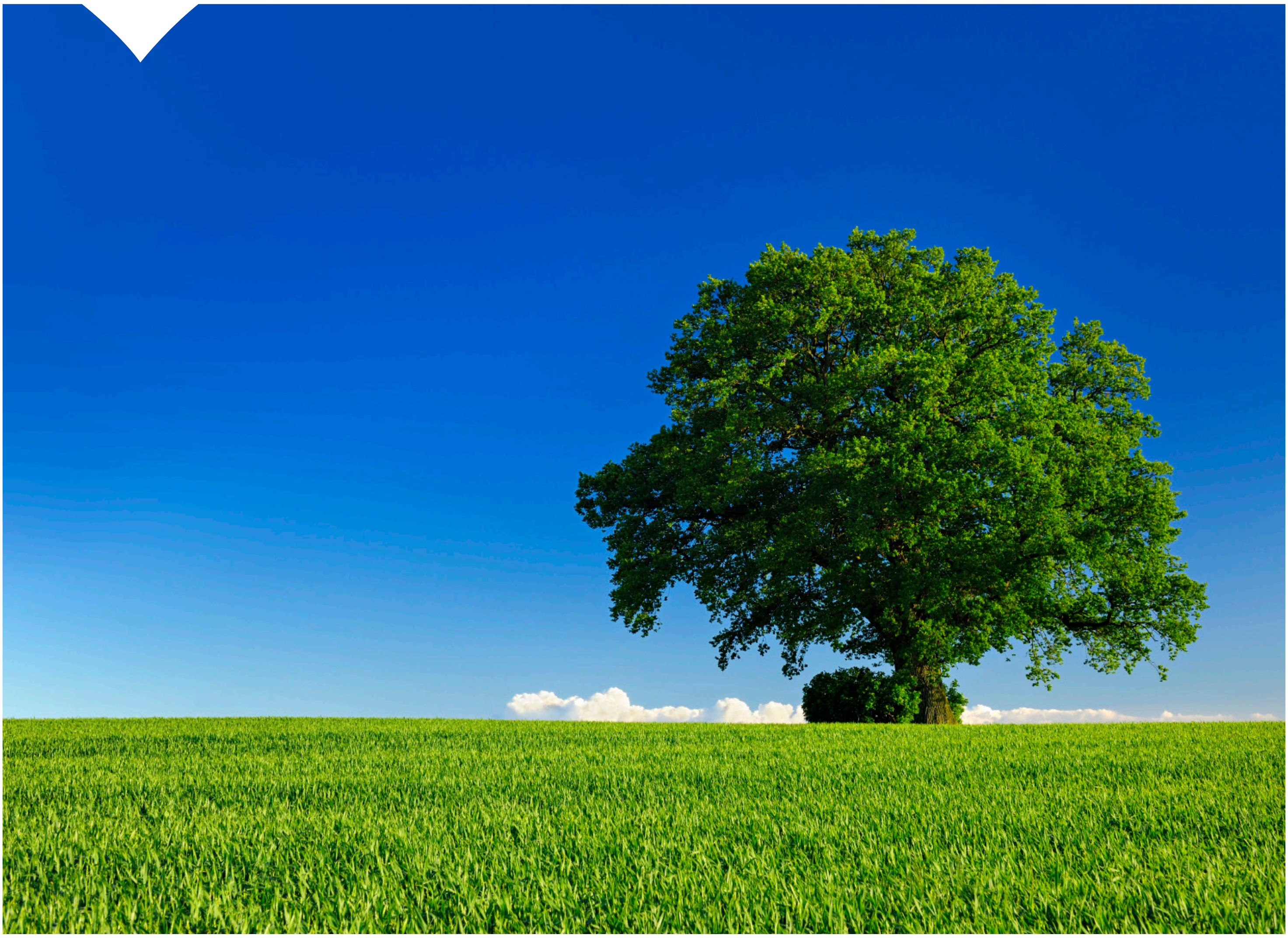
MAYER • BROWN

February 2015

Trustee Quarterly Review

Quarterly update for pension scheme trustees



Introduction

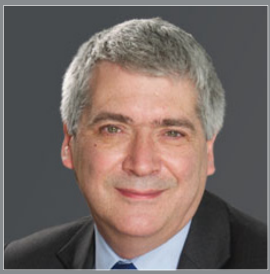
Welcome to the February 2015 edition of our Trustee Quarterly Review. This edition covers what has been a spectacularly busy period in pensions law with important forthcoming changes to rules about charges and governance in money purchase schemes and about transfer rights, and important decisions from the Pensions Ombudsman and the Courts, in addition to all the detail of the new flexibilities in relation to DC benefits outlined in the 2014 Budget.

Trustees of schemes offering only defined benefits could be affected by the developments discussed in sections A and C, while trustees of schemes offering money purchase benefits (including money purchase AVCs) could be affected by the developments discussed in sections B and C. Trustees of schemes offering cash balance benefits and schemes which have both DB and money purchase sections could well be affected by the developments discussed in all three sections!

Please note that some of the legislation discussed here is still going through the Parliamentary process and therefore may not be in completely final form. However, most of it is expected to come into force in April 2015 and the near final legislation is therefore the best guide to what schemes will have to work with.

The Trustee Quarterly Review is published by the Mayer Brown Pensions Group each quarter, and looks at selected legal developments in the pensions industry over the previous quarter that we believe are of particular interest to trustees of occupational pension schemes. Each article summarises the relevant development and provides a short commentary on its likely implications for trustees. The Review also includes details of upcoming Pensions Group events at Mayer Brown, and a timeline of important dates and expected future developments.

Please speak to your usual contact in the Pensions Group if you have any questions on any of the issues in this edition of the Review



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Section A – defined benefit schemes

PPF levy deadlines: don't forget them!

The relevant deadlines for submitting information and documents for the purposes of the 2015/16 Pension Protection Fund levy are set out below. There are various submission requirements including a number that are "new" for the 2015/16 levy year. Details of the new requirements flagged below can be found in the November 2014 edition of our Trustee Quarterly Review.

31 MARCH 2015 (5PM)

- submission of scheme return data (including any new s179 valuations)
- submission of contingent asset certificates (and of any accompanying hard copy documents)
- submission of asset-backed contribution arrangement certificates – **NEW REQUIREMENT**
- submission of mortgage exclusion certificates and supporting evidence – **NEW REQUIREMENT**

30 APRIL 2015 (5PM)

- submission of deficit reduction contribution certificates

29 MAY 2015

- submission of confirmation that scheme has legal advice that it is a last man standing scheme – **NEW REQUIREMENT**

30 JUNE 2015 (5PM)

- submission of full block transfer certificates

Annual allowance regime: corrective changes

While numerous changes to tax rules are being made to cover the Budget flexibilities for money purchase benefits announced last year, the annual allowance regime is also being changed in relation to defined benefits, mainly to correct some problems that have emerged since 2011. The most important change clarifies the treatment of underfunded transfers made on a "mirror image" basis, i.e. where benefits are the same before and after the transfer.

Underfunded transfers

On a transfer into a DB or cash balance scheme, the current law would seem to let the receiving scheme award a disproportionately large transfer credit that does not count towards the annual allowance. HMRC does not accept this reading of the law. On its reading, if a member receives a transfer credit in the receiving scheme which is bigger than the transfer payment justifies, the excess is an augmentation which counts towards the annual allowance. HMRC's reading could have serious implications for normal pension scheme mergers where transferring members are promised "mirror image" benefits, i.e. the same past service benefits in the new scheme as they had in the old scheme. If the transferring scheme is underfunded, the mirror image benefits for the transferring members would be more valuable than the assets that the transferring scheme paid across. As a result, on HMRC's view of the current law, there could be an annual allowance charge even though no-one has accrued any new benefits. Many scheme mergers have been cautiously put on hold waiting for clarification.

The legislation is being corrected to ensure that underfunded block transfers will not count towards the annual allowance provided that the receiving scheme promises mirror image benefits, or benefits that are "virtually the same" as in the transferring scheme. Although this correction to the legislation was only enacted from 29 January 2015, it will apply to all block transfers from 6 April 2011 onwards.

But this exemption for "mirror image" transfers applies only on block transfers, i.e. where a group of members are being transferred in a single exercise. It does not apply to individual transfers. The rules about individual transfers will be clarified in the opposite direction, though only for the future, so that the transfer credit awarded to a transferring member will count towards the member's annual allowance where it exceeds what the transfer value alone justifies. In other words, for individual transfers, there is no exemption just because the benefits awarded are the same as the member had before the transfer.

Augmentations to pre-A Day deferred pensions

Current tax legislation also has an unintended impact on individuals who became deferred members before 6 April 2006 and who later receive a benefit augmentation, or who rejoin the scheme and accrue additional pension. As the legislation stands, the total value of the member's accrued "pot" could count towards his or her annual allowance in the year of augmentation or rejoining, not just the increase in the value of the member's pot in that year.

This error is also being corrected with effect from 6 April 2011 to ensure that only the increase in the value of the member's "pot" in any year counts towards the member's annual allowance.

Statutory increases to deferred pensions

Another correction will bring the law into line with HMRC's practice of treating most forms of statutory increase to a deferred member's pension as invisible for annual allowance purposes. This change will apply to statutory revaluation of GMPs, statutory revaluation of non-GMP pensions, statutory increases to postponed GMPs and increases required by the "anti-franking" legislation. It too applies retrospectively to cover increases in pension input periods ending on or after 6 April 2011. However, this series of corrections will not extend this treatment to late retirement uplifts applied to deferred pensions which are first drawn after a scheme's normal pension age.

Annual allowance impact of the DC flexibilities

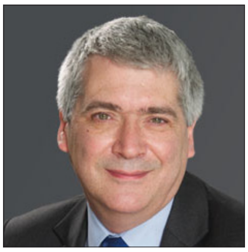
A member's annual allowance in DB arrangements is not changed just because he or she "flexibly accesses" money purchase or cash balance benefits (i.e. takes an uncrystallised funds pension lump sum or accesses funds designated for drawdown). However, there is an impact if a member flexibly accesses benefits and subsequently has money purchase or cash balance pension savings for a given tax year that exceed £10,000. The detail is complex. Broadly, though, in that situation the member's annual allowance for DB pension savings for that tax year is reduced by the amount of the member's money purchase/cash balance savings for the same tax year.

Members who flexibly access money purchase or cash balance benefits will be required to notify the administrators of all other registered pension schemes which they join in future or of which they are already active members.

Comment

Employers and trustees planning underfunded transfers or scheme mergers where the transferring scheme is underfunded, for example as part of an exercise to consolidate several legacy schemes, will be relieved that these amendments are finally being made, and that they have confirmation that the transfer should not trigger an accrual for annual allowance purposes for the transferring members.

We will shortly be sending out a publication which summarises the annual allowance changes and their implications for schemes in more detail.



Jonathan Moody

Section B – money purchase schemes

DC governance and charges: new statutory requirements from April 2015

Legislation has been laid before Parliament that imposes minimum governance standards and charging restrictions on occupational pension schemes that provide money purchase benefits. The new requirements will largely come into force on 6 April 2015.

Action is needed before 6 April 2015 to ensure that contributions are not paid to "default arrangements" which have charges that exceed the new charges cap. "Default arrangements" include the default fund that new joiners go into if they do not expressly choose otherwise, but the definition is a wide one, and the cap may apply to other investment options too.

The changes described in this section apply to pure money purchase schemes, and to schemes that have a money purchase section. However, they do not apply to a scheme just because it provides AVCs on a money purchase basis.

Charging restrictions

There will be a cap on charges in "default arrangements" that receive new contributions on or after 6 April 2015 in schemes that are "qualifying schemes" for automatic enrolment purposes (i.e. schemes that an employer is using in order to meet its automatic enrolment duties for any of its employees). Trustees do not have any power to make a provider reduce its charges. The trustees' duty is to ensure that investment options where charges exceed the cap are not used as default arrangements on or after that date.

For these purposes, a "default arrangement" includes:

(a) traditional default arrangements, i.e. funds to which contributions are paid automatically unless the member expressly chooses a different investment option;

(b) even where members have chosen a fund, any fund to which 80% of active members are contributing on 6 April 2015 or to which 80% of active members are contributing at any time after 6 April 2015; and

(c) apparently also any investment option that a member has been switched (or "mapped") into without his or her express request, following a fund review where a previously chosen option was replaced – but only if the replacement fund accepts a new contribution on or after 6 April 2015 for a member who has not actively chosen it.

Where a scheme offers "white-labelled" investment options, in other words where members choose the generic type of fund they want their contributions to be invested in, but others can decide from time to time which particular fund is used behind that "wrapper", these too may be caught by (c) above. Whether they are caught will depend on the way that the investment option is structured.

If an investment option becomes a default arrangement, the cap will apply to pre- and post-April 2015 funds in it that relate to active members whose contributions go into it after 5 April 2015. That is the case even if they have chosen it – once an option becomes a default arrangement, it remains a default arrangement indefinitely. On a literal reading of the legislation, the charges cap may also apply to other scheme members' funds invested in that option.

Where the cap applies, the only permitted charge structures are:

- an annual charge equal to at most 0.75% of funds under management;
- a combination of a percentage charge plus a percentage of the value of new contributions; or
- a combination of a percentage charge plus a flat fee.

(The legislation sets out detailed rules on the maximum level for combination fee structures.)

The cap applies to annual management costs, but not to transaction costs. Charge structures can only be changed at the end of a 12 month "charges year".

Other charging restrictions in qualifying schemes will take effect from 6 April 2016. These include a ban on active member discounts in all funds in money purchase qualifying schemes.

Minimum governance standards

All registered pension schemes that provide money purchase benefits (unless exempt, e.g. a life cover-only scheme) will be required to appoint a chair of trustees if they do not already have one.

The chair will have to sign an annual chair's statement that will form part of a scheme's annual report for any scheme year ending on or after 6 April 2015. It must include, among other things:

- a statement that default funds are designed in members' interests;
- a report on costs and charges;
- a report on any review of the default fund; and
- a statement that the trustees have satisfied themselves that core financial transactions, including the attribution of contributions to the relevant funds, have been processed promptly and accurately.

Schemes will have three months from the later of 6 April 2015 and the date on which the scheme is established to appoint a chair. The scheme's annual report, including the chair's statement, must be published within seven months of the end of the scheme year to which it relates. The first chair's statement need only cover the period from 6 April 2015 to the end of the scheme year.

Similar minimum governance standards and charging restrictions will also be imposed from 6 April 2015 for workplace personal pension schemes.

Comment

We advise trustees of money purchase qualifying schemes to check urgently whether any of their investment options are potential "default arrangements" and if they are, whether the charges in those arrangements breach the charges cap. If they do, and the trustees cannot get them reduced to below the cap, from 6 April 2015 they should divert contributions for members who have not expressly chosen that option to a different option whose charges are below the cap. If scheme rules do not permit such diversion, they will need to be amended.

Trustees will also need to put arrangements in place for the preparation of the chair's statement and to enable the chair to sign it off. Trustees may want to take professional advice in relation to the various confirmations they will be required to make.

The new governance requirements overlap to an extent with the provisions of the Pensions Regulator's code of practice on the governance and administration of trust-based DC schemes. The Regulator has said that it will review the code in light of the 2014 Budget reforms and the new statutory requirements on DC governance and charges.

We will shortly be sending out a publication which summarises the DC charging and governance reforms and their implications for schemes in more detail.

Beth Brown

April 2015 reforms: tax legislation for DC flexibilities finalised

The Taxation of Pensions Act 2014 (the "**Act**") will take effect from 6 April 2015. It will implement the tax aspects of the changes announced in the 2014 Budget under which members with DC benefits (meaning money purchase or cash balance rights) will be able to draw down all their benefits as cash from age 55 if the trustees decide to allow this.

The Act's provisions remain broadly the same as when it was laid before Parliament as a Bill (see the November 2014 edition of our Trustee Quarterly Review). Under it, trustees will have a statutory power, but no statutory obligation, to offer a number of new options in relation to DC benefits at retirement, including:

- Flexi-access drawdown – this is where members designate their DC benefits as flexi-access drawdown funds and can then make as many uncapped withdrawals as they wish (and the scheme allows) from those funds. (The member can still later use those funds to buy an annuity.)
- Uncrystallised funds pension lump sums – these are a cash lump sum comprising all or part of a member's uncrystallised DC benefits. 25% of this sum is tax-free and the remainder is taxed at the member's marginal rate. There is no limit (unless the scheme imposes one) on the number of such lump sums which can be paid to a member provided that they are paid from a member's uncrystallised DC benefits.
- Tax-free pension commencement lump sums where a member designates funds as available for flexi-access drawdown.

The statutory power under the Act for trustees to offer the flexibilities does not depend on employer consent. Nor does it include any express power for the trustees to recharge any additional administration costs to the member.

However, separate legislation will give trustees a statutory power to amend their scheme rules to provide the new flexibilities on a basis which does allow them to pass on a charge to the member. This separate amendment power will be exercisable only with employer consent.

Trustees will still be able to offer annuitisation (some of the current restrictions on annuities, e.g. that they may not decrease once in payment, will be removed), standard pension commencement lump sums and small pot ("de minimis") commutation payments of up to £10,000 if their scheme rules provide for them. However, trustees will no longer be able to pay *trivial commutation* lump sums from small DC pots (i.e. where the member's savings across all registered schemes are valued at under £30,000). (Trivial commutation of DB benefits will still be possible.)

If a member accesses a drawdown fund or takes an uncrystallised funds pension lump sum, he or she will be subject to a new £10,000 annual allowance for DC savings only. This will apply to DC savings across all registered schemes that a member belongs to. A range of new information provision obligations will apply to scheme administrators in connection with the new annual allowance.

A range of new disclosure obligations will also be imposed on schemes in connection with the new DC flexibilities. In particular, the Government has announced that the "second line of defence" protection to be introduced for contract-based schemes through the Financial Conduct Authority rules will be extended to cover trust-based schemes. It has said that the DWP and the Pensions Regulator are working together on how this is to be achieved, but as yet no details are available even though the intention is for this to apply from April 2015.

Changes are also being made to the tax treatment of unused drawdown funds and uncrystallised DC benefits on a member's death, including changes to make it easier for members to nominate the individuals to whom they wish such funds to be paid. In addition, the tax charge payable on "serious ill-health lump sums" paid after age 75 to members who have less than 12 months to live is being reduced.

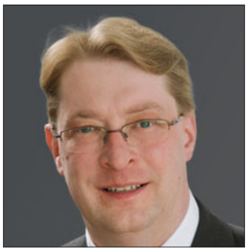
The changes apply to money purchase AVCs, and other DC pots held in DB schemes, not just to benefits held in pure money purchase or cash balance schemes.

Comment

DC schemes will need to consider the extent to which they wish to offer the new flexibilities to members. Whether or not schemes intend to offer the new flexibilities, they will need to start planning well ahead of April 2015 what changes they will need to make to scheme processes and administration in light of the reforms – for example to reflect the new money purchase annual allowance information provision requirements.

Schemes should also consider what member communications they should make in connection with the reforms. Even if they do not plan to change the retirement options available under the scheme, it may be sensible to let members know this so as to manage their expectations given the level of press coverage of the new freedoms being introduced.

We will shortly be sending out a publication which summarises the April 2015 DC reforms and their implications for schemes in more detail.



Ian Wright

Section C – all schemes

April 2015 reforms: changes to transfer rights

Members' statutory rights to transfer their benefits from one pension arrangement to another will be changing from 6 April 2015. These changes are set out in the Pension Schemes Bill 2014/15 (the "**Bill**").

Three benefit categories of benefit

The Bill defines three categories of benefit:

- money purchase benefits;
- flexible benefits that are not money purchase benefits (i.e. cash balance benefits and other benefits calculated by reference to a "pot" available to provide benefits for a member); and
- defined benefits (i.e. benefits which are not flexible benefits).

Expiry of statutory transfer right

Currently, a deferred member of any occupational pension scheme has a statutory right to take a cash equivalent transfer of their accrued benefits to another occupational pension scheme or a personal pension scheme. In most cases, the member must apply for a transfer at least one year before reaching normal pension age. The transfer request must usually apply to all of a member's benefits under the scheme (other than contracted-out rights if the receiving scheme will not accept them).

From 6 April 2015, this age limit for exercising a statutory transfer right will only apply to transfers of defined benefits.

Members wishing to transfer benefits in the money purchase category, or in the "other flexible benefits" category, will have a statutory right to do so until benefits in the relevant category first "crystallise". This will happen when a member starts to draw a pension, designates funds for drawdown, or buys an annuity from a personal pension scheme.

Trustees of DB schemes can nevertheless continue to allow members to take a (non-statutory) transfer of their cash equivalent up to (or beyond) normal pension age if their scheme rules allow.

Partial transfers

If a member has more than one category of benefits under a pension scheme, they will have separate statutory transfer rights in relation to the benefits in each category. Schemes will not be able to make a transfer of one category conditional on the transfer of another. So, for example, a member wishing to transfer their AVC account cannot be forced to transfer their defined benefits as well.

However, members will not have any new right to take partial transfers of their benefits within a single category, e.g. to transfer some of their money purchase benefits to a new scheme while leaving others behind. (The only exception is where the member has a GMP and/or post-1997 contracted-out rights, and is transferring to a scheme which will not accept them.) Schemes can nevertheless allow members to take a partial transfer from a category.

Independent advice requirement

Where a member has defined benefits in a pension scheme, the trustees must check that the member has received "appropriate independent advice" from an authorised independent financial adviser (**"IFA"**) before:

- converting any of the benefits into flexible benefits within the scheme;
- making a transfer to another scheme under which the member would acquire flexible benefits; or
- paying an uncrystallised funds pension lump sum in lieu of those benefits.

The same requirement applies in respect of a survivor of the member, who is entitled to benefits from the scheme.

This requirement will not apply to benefits valued at less than £30,000.

Trustees will be required to ensure that the member has provided them with a signed confirmation from the IFA, and to check that the IFA is authorised by the Financial Conduct Authority. Trustees will not have to check the substance of the advice that the member has received.

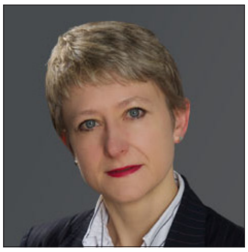
Failure to carry out a check may lead to a penalty being imposed on the trustees, but it would not invalidate the transfer. If trustees have not been able to carry out a check due to factors outside their control, or their check did not confirm that the member had received appropriate independent advice, then the usual six month time limit for making the transfer does not apply.

The Bill also envisages that an employer will be required to arrange or pay for a member or survivor to receive appropriate independent advice in certain circumstances such as for an employer-led transfer or conversion exercise. Regulations will set out these circumstances. The member will not be taxed on the value of any advice paid for by the employer under these provisions.

Comment

The Bill is not yet in final form and there may therefore be further adjustments to the new transfer rules and advice requirements. However, trustees should start considering what changes they will need or may wish to make to their scheme rules, administration processes and member communications. The Regulator is currently consulting on draft guidance to help trustees of DB schemes manage transfer requests and their impact on the scheme.

We will shortly be sending out a publication which summarises the transfer reforms and their implications for schemes in more detail.



Beverly Cox

Pensions liberation: Ombudsman determinations

The Pensions Ombudsman has published three determinations dealing with complaints relating to pensions liberation. The complaints were about transfer requests which the schemes in question had refused to pay. The Ombudsman rejected the members' complaints on the grounds that in all three cases, the members did not have a statutory transfer right. The onus is on schemes to establish whether a transfer right exists. If it does, the Ombudsman noted that suspicion that the receiving scheme is a liberation vehicle will not be sufficient grounds to refuse to pay.

Background

As of late October 2014, the Ombudsman had received over 140 complaints relating to pensions liberation. Almost 90% of those complaints were from members whose scheme had refused a transfer request because the scheme believed that its purpose was pension liberation (known as "blocked transfers").

A deferred member of an occupational or personal pension scheme generally has a statutory right to transfer the cash equivalent of his or her pension benefits to another occupational or personal pension scheme. Currently, this right generally lapses once the member gets to within a year of normal pension age, but please see the article on page 8 for some forthcoming changes to these rules. Schemes have six months following receipt of a statutory transfer request to make the transfer payment. Failure to comply with a statutory transfer request or delaying the making of a statutory transfer payment beyond the six month deadline without reasonable excuse can result in civil penalties for the scheme trustees/ provider.

Some schemes will also have a rule giving deferred members a non-statutory right to transfer their benefits, though often only with trustee consent. The extent of this right will depend on the wording of the rule.

The Ombudsman's decision

All three complaints related to blocked transfers from personal pension schemes. All three receiving schemes were registered pension schemes and, in their governing documentation, purported to be occupational pension schemes.

In two of the cases, the Ombudsman decided that the members did not have a statutory transfer right as the receiving schemes were not occupational pension schemes. In order to be an occupational pension scheme, a pension scheme must be established "for the purpose of providing benefits to, or in respect of, people with service in employments of a description". The Ombudsman considered that this provision meant that it must be possible to identify "a closed list of classes of employment to which the scheme relates". In these two cases, the Ombudsman said that the provisions governing membership of the scheme were either too wide or too unclear to meet that requirement, that the schemes were not therefore occupational pension schemes, and that the members had no right to transfer into them as a result.

In the third case, the Ombudsman decided that the receiving scheme was an occupational pension scheme. However, he went on to say that, nonetheless, the member had no statutory right to transfer into it because the transfer payment would not be used to secure "transfer credits" in the receiving scheme. This was because transfer credits are defined as rights allowed to an "earner" under the receiving scheme. The Ombudsman decided that, although the legislation does not expressly say so, the member's status as an earner must be in relation to an employer in the receiving scheme. The member in the third case was not employed by one of the receiving scheme's employers and therefore was not an earner for the purposes of acquiring transfer credits.

However, in the third case, the scheme had discretion to make a non-statutory transfer and the Ombudsman decided that the scheme provider had not considered the existence of that discretion before rejecting the transfer request. The Ombudsman therefore directed the provider to reconsider the member's transfer request on these grounds.

Comment

The Ombudsman's careful analysis of the tests for whether a scheme is an occupational pension scheme, and whether transfer credits will be provided, will be helpful to trustees considering transfer requests that raise pensions liberation concerns. However, the decisions underline the fact that trustees do need to analyse whether or not a member making a transfer request to a suspected liberation vehicle has a transfer right or not, rather than just rejecting the request on the grounds that they suspect the receiving scheme is a liberation vehicle. They should also ensure that they consider whether the member has a non-statutory transfer right.

Anna Rogers

High Court guidance on trustee duties and whether a scheme is "open" or "frozen"

In *Merchant Navy Ratings Pension Fund Trustees Ltd v Stena Line Ltd and others*[1], the High Court has given important guidance on what the well-known phrase "acting in the best interests of the beneficiaries" means in the context of pension scheme trustee duties, and whether a scheme which has closed to accrual, but which provides enhanced revaluation for deferred members is "open" or "frozen" under the employer debt legislation. Mayer Brown acted for the trustee of the Fund.

Acting in the best interests of the beneficiaries

After a detailed analysis of the relevant trust law principles, the judge held that "acting in the best interests of the beneficiaries" should not be regarded as a standalone trustee duty, but must instead be considered in the context of the purpose of the scheme and the benefits it has been established to provide.

The purpose of a pension scheme is to pay members the benefits due under the scheme rules. As long as the primary purpose of securing those benefits is furthered and the employer covenant is sufficient to fulfil that purpose, it is reasonable for trustees to take into account the employers' interests when exercising their powers. It was therefore legitimate in this case for the trustee of an industry-wide scheme to take into account the relative burdens placed upon employers when deciding on the design of a new deficit contribution regime.

"Open" or "frozen"

Whether or not a scheme is open or frozen under the employer debt legislation depends on whether accrual of benefits in the scheme is continuing. The judge decided that as the accrual of years of pensionable service had ceased, the Fund was therefore frozen, even though certain members continued to benefit from enhanced revaluation. This may also have implications for schemes which have ceased accrual of pensionable service, but where existing pensionable service remains linked to final pensionable salary.

Comment

This is a very helpful judgment for trustees and will reassure trustees that if they exercise their powers for the purpose of their schemes (which is essentially to provide members with their promised benefits) and follow an appropriate decision-making process, their decisions will not be second-guessed by a Court. Also, it is entirely appropriate for them to consider their sponsoring employers' interests, should they decide that this is the right thing to do.

The ruling on whether the Fund is open or frozen is also of importance to the wider pensions industry. Although the judge was deciding the question in the context of a rule providing enhanced revaluation for members who remained in "seagoing employment", the way in which she determined the question would apply equally to schemes which have closed to accrual but retained a final salary link. Essentially, the question of whether a scheme is open or frozen comes down to whether members are accruing additional years of pensionable service. If they are not, then the scheme is frozen irrespective of any additional benefits that members may enjoy by virtue of still being employed.

Philippa James

1. [2015] EWHC 448 (Ch)

Overpayments: change of position defence and limitation periods

The High Court has held that where a member was aware that he might be receiving an overpayment and could have made a simple enquiry to confirm whether or not this was the case, he could not defeat a later attempt to recover the overpayment by saying that he had changed his position on the assumption that he was entitled to the money.

Background

Where a pension overpayment is discovered, trustees' primary obligations are (a) to reduce the pension to the correct level for the future and (b) to take appropriate steps to recover the overpayments made. Defences may be available to a member facing a claim for recovery of overpayments. These include that the member has so changed his or her position that it would be inequitable to require him or her to repay the overpayments.

In addition, under the Limitation Act 1980, the usual time limit for recovery of an overpayment is six years from the date of the overpayment. However, the start of this period is postponed until the overpayment is discovered or could have been discovered with reasonable diligence.

The Teachers Pension Scheme (the **"Scheme"**) has certain features that would not be common in private sector schemes. In particular, where a member draws a pension from the Scheme and later re-enters pensionable service, that pension will be reduced (or "abated") broadly so that the member's pension and salary do not together exceed the member's salary in his or her last employment (adjusted for inflation).

The facts

Mr W was a member of the Scheme. He took early retirement in April 1997 aged 50 but he later returned to work in September 2001, retiring again in August 2010. In May 2001, he contacted the scheme administrator, Teachers Pensions (**"TP"**), to ask how becoming re-employed would affect his pension. He was sent a leaflet which referred to the abatement rules and to a requirement to submit a "certificate of re-employment" to TP. The covering letter stated that he should contact TP if his circumstances changed during a tax year and that, if his employment continued into the next tax year, he should contact TP and a new certificate of re-employment would be issued.

Mr W completed the certificate of re-employment and returned it to TP in September 2001. TP later sent him a letter dated October 2001, informing him of his annual earnings limit for that year (pointing out that it would be reduced when he reached 55), and instructing him that he should complete a certificate of re-employment if his circumstances changed (including by reaching 55), to avoid an overpayment which he would be required to repay. Mr W did not submit any further certificates of re-employment.

In November 2009, TP wrote to Mr W to say that he had exceeded his earnings limit in each tax year from 2002/03 to 2008/09 and that his pension should therefore have been reduced. The overpayments sought totalled just over £36,000.

The complaint to the Pensions Ombudsman

Mr W complained to the Ombudsman's office on the basis that he had done his best to follow the rules and had believed that he only needed to submit a certificate of re-employment at the start of his re-employment. He also argued that he had changed his position in reliance on the overpayments and that the recovery claim was time-barred under the Limitation Act 1980 because TP could with reasonable diligence have discovered the overpayment earlier than it did.

The Deputy Pensions Ombudsman (the **"DPO"**) rejected his complaint. She decided that:

- Mr W was told that he was required to complete a certificate of re-employment each tax year and he knew (but chose to ignore) that he would need to do so when reaching 55.

- The information provided by TP was not misleading, but if there was any uncertainty it was for Mr W to check the position with TP rather than assume that there was no requirement for him to provide further information – he had instead "turned a blind eye" and could not rely on the change of position defence.
- TP had acted reasonably and could not have discovered the overpayment earlier than it did. The recovery claim was not therefore time-barred.

Mr W appealed to the High Court.

The High Court's decision

The judge decided that the DPO was entitled to conclude that Mr W must have been aware that there was a possibility of an overpayment. It was not necessary to show that Mr W actually *knew* there was an overpayment, but it was sufficient that the DPO had found that he knew that there was a possibility of an overpayment and did nothing about it in the hope that it would go unnoticed.

The October 2001 letter from TP referred to the need for Mr W to complete a further certificate of re-employment if he reached age 55 in that tax year. Although Mr W stated that he received this letter after his 55th birthday in February 2002 and did not think the requirement to complete the further certificate applied to him, the judge said that he should still have contacted TP to query why the reference to age 55 was important.

On the basis that Mr W must have been aware that there was a possibility that he was receiving an overpayment, it was reasonable for the DPO to conclude that his failure to check must have been a conscious one, at least in the sense of deciding not to check. In circumstances where he had "turned a blind eye" when a simple enquiry could have been made, the change of position defence was not available to him. As the judge put it: "He knows that there is a risk that he may not be entitled to the money, but is willing to take the risk".

However, the judge did accept Mr W's argument that TP could have discovered the overpayment earlier than it did with reasonable diligence. Recognising that "reasonable diligence" did not require exceptional or excessive measures to be taken, the judge held that by the time of the October 2001 letter, TP had all the relevant information that it needed to identify that, unless Mr W's circumstances changed, he would breach the earnings limit in that tax year by virtue of reaching age 55. As the judge said: "If a person knows (or has the information to enable him to know) that unless circumstances change he will inevitably be making an overpayment, I do not think he can escape a finding that he could have discovered the mistaken overpayment with reasonable diligence by saying he did not know, and did not trouble to inquire, whether circumstances had indeed remained the same".

It followed from the above conclusion that the limitation period starting running as soon as TP started making overpayments in the 2002/2003 tax year. This meant that TP could only reclaim overpayments made in the six years before the complaint to the Ombudsman was made.

Comment

The judge's conclusion that a change of position defence is not available where a member knows he or she might be receiving an overpayment, and could make a simple enquiry to check but chooses not to do so, is a helpful decision from trustees' perspective as it sets a high bar for members seeking to use a change of position defence to defeat a repayment claim.

However, although what constitutes "reasonable diligence" will depend on the facts in each case, scheme administrators should bear in mind that if they have information in their possession which they could use to identify an overpayment but fail to do so, any subsequent attempt to recover the overpayment may be time-barred. Also, it is prudent (where possible) to ensure that steps are taken to stop time running for limitation purposes before the sixth anniversary of the first overpayment, rather than rely on the start of the limitation period being postponed.

Stuart Pickford

Bank ring-fencing: pensions regulations finalised

As part of the fall-out from the financial crisis, banks are going to be required to restructure in order to "ring-fence" their retail activities. New regulations will allow pension schemes in which ring-fenced banks participate to be restructured to ensure that the banks' pension liabilities are also ring-fenced.

From 2026, banks will be required to ring-fence certain core services in separate, financially independent legal entities. Regulations have now been laid before Parliament dealing with related issues for their pension schemes. These will:

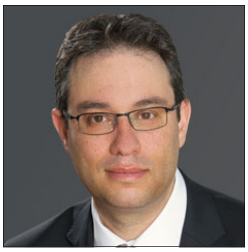
- prohibit ring-fenced banks from participating in a multi-employer scheme (or section of a segregated multi-employer scheme) in which employers outside the ring-fenced bank's group also participate;
- prohibit ring-fenced banks from being a party to an arrangement under which the bank is liable for all or part of the pension liabilities of a wholly-owned subsidiary of another ring-fenced bank in the same group, unless the liabilities relate to a scheme (or section of a segregated scheme) in which both ring-fenced banks participate and in which no employers outside the ring-fenced banks' group participate;
- prohibit ring-fenced banks from being party to a "shared liability arrangement" (an arrangement under which the bank provides a guarantee, indemnity or bond in respect of the pension liabilities of a company which is not part of the ring-fenced bank's group or under which the bank is otherwise liable for the pension liabilities of such a company);
- provide for a procedure whereby, if another party to a shared liability arrangement refuses to release a ring-fenced bank from the arrangement or will release it only on unreasonable terms, the bank can ask the courts for an order releasing it;
- give the trustees of a multi-employer scheme in which a ring-fenced bank participates power to modify the scheme (with employer consent) to allow the ring-fenced bank to meet its obligations under the regulations; and
- require a ring-fenced bank to make a clearance application to the Pensions Regulator before making restructuring arrangements that are likely to be materially detrimental to a pension scheme of which the bank is an employer.

The regulations will come into force once they receive Parliamentary approval. However, the ring-fencing provisions do not apply to banks until the later of 1 January 2026 or the fifth anniversary of the date on which the bank becomes a ring-fenced bank.

Comment

It is helpful that the Government has laid these regulations so long before the ring-fencing requirements come into effect. This will give the affected banks plenty of time to plan the potentially significant pensions restructurings that will be required. In particular, where entities that are ring-fenced and entities that are not currently participate in the same scheme, one group or the other – or potentially both – will have to withdraw and arrangements will have to be made for allocating responsibility for scheme liabilities attributable to employees of the two groups.

It will also be interesting to see how the requirements for ring-fenced banks to also ring-fence their pensions liabilities will tie in with the Regulator's anti-avoidance powers.



Andrew Block

Derivatives – the implications of EMIR for pension schemes: update

The European Commission has recommended that pension schemes should benefit from a further two year exemption from central clearing requirements for their over-the-counter (**"OTC"**) derivative transactions, meaning that the exemption would expire in August 2017.

Background

The European Market Infrastructure Regulation (**"EMIR"**) is designed to improve transparency and reduce the risks associated with the derivatives market by imposing direct obligations on all entities that enter into any form of derivative contract. One such obligation is that certain OTC derivative contracts (i.e. derivative contracts which have been customised to meet the needs of the parties to the contract and which are not traded on a regulated exchange) must be cleared by an authorised central counterparty (known as the "clearing obligation").

EMIR specifically exempts pension scheme arrangements (which encompass all categories of pension schemes) from the clearing obligation of certain derivatives until August 2015.

Update

The European Commission has published a report which recommends that pension schemes should be exempt from the clearing obligation for a further two years.

Under current practices, pension schemes would need to hold significant amounts of cash or generate cash on a short-term basis in order to comply with the clearing obligation. However, pension schemes more commonly hold non-cash assets in order to ensure strong returns for pensioners. The proposed extension would allow central counterparties longer to develop technical solutions that would let pension schemes comply with the clearing obligation without having to hold disproportionate amounts of cash.

Edward Jewitt

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**

  19 May 2015
  15 September 2015
  1 December 2015

  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**

  16 June 2015 – topic to be confirmed
  17 November 2015 – topic to be confirmed

  Our Building Blocks Classes look in more detail at some of the key areas of pension scheme management.

- **Annual Pensions Forum**

  29 April 2015

  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.

Statutory revaluation and pension increases – aide memoire

How does a GMP increase when in payment? When did the cap for statutory revaluation change to 2.5%?

Sometimes it's a struggle to remember all the details of the rules on statutory revaluation and pension increases. We have therefore prepared an aide memoire in sticker form which you may find useful.

If you would like this aide memoire, please contact Katherine Dixon (kdixon@mayerbrown.com) and let her know how many you would like (they come in sheets of 8 stickers).

Dates and deadlines

31 March 2015
Deadline for schemes which have ceased to be wholly money purchase following introduction of the new definition of "money purchase benefits" to submit first s179 valuation to PPF

1 April 2015
Schemes which have ceased to be wholly money purchase following introduction of the new definition of "money purchase benefits" become eligible for PPF

6 April 2015
- Restrictions on drawdown of DC pots (i.e. requirement to annuitise) removed
- Requirement for all DC schemes to offer at retirement guidance to members
- Governance standards for all workplace DC schemes come into force
- Cap on charges in default funds in DC qualifying schemes comes into force

1 October 2015
Abolition of short service refunds from DC occupational schemes comes into force

5 April 2016
Revised deadline for making resolution under s251, Pensions Act 2004 to retain scheme rules allowing surplus payments to employer

6 April 2016
- Introduction of single-tier state pension and abolition of DB contracting-out
- Ban on active member discounts, consultancy charging and commission in DC occupational qualifying schemes comes into force

5 April 2017
Lifetime allowance deadline for members to apply for individual protection

30 September 2017
Automatic enrolment – end of transitional period for DB schemes

1 October 2017
Automatic enrolment - 2% employer contributions required for DC schemes

5 April 2018
Deadline for making resolution under s68, Pensions Act 1995 to remove protected rights provisions from scheme rules

21 May 2018
Deadline for implementation of Portability Directive into UK law

1 October 2018
Automatic enrolment - 3% employer contributions required for DC schemes

5 April 2021
Deadline for employers to exercise statutory power to amend their schemes to reflect increase in employer NICs resulting from abolition of contracting-out

Key:

Important dates to note | For information

About Mayer Brown

Mayer Brown is a global legal services provider advising clients across the Americas, Asia and Europe. Our geographic strength means we can offer 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 and enforcement; government and global trade; intellectual property; real estate; tax; restructuring, bankruptcy and insolvency; and wealth management.

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