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2012/13 PPF levy consultation

Almost a year ago, the PPF announced that it planned to overhaul the rules governing levy calculations. A new levy framework would be introduced for 2012/13 and at least the following two years.

The PPF published a policy statement in May 2011, which described its plans in detail. The PPF has now released a formal consultation document.

For the most part, the proposals in the consultation document are in line with those in the policy statement. For example:

- an employer's insolvency risk will still be based on D&B scores, but these will be averaged over a year, and there will be a revised 10-band framework;
- the measure of a scheme's funding level will use financial data averaged over a five year period to reduce volatility; and
- investment risk will, to some extent, be taken into account, with special rules for schemes with protected liabilities exceeding £1.5 billion.

The consultation document does however contain some new proposals about contingent assets.

1. Trustees to certify that Type A guarantors can meet guaranteed liabilities

A Type A guarantee is a group company guarantee whereby an associated entity provides a guarantee to support a scheme. It is proposed that, going forward, trustees will have to confirm on (re)certification that guarantors can meet their full liabilities under the contingent asset as at the certification date.

This might not be an easy call for trustees, who would find themselves having to "look behind" the guarantor's D&B score to assess the real strength of the company. If trustees are unable to provide the requisite confirmation then employers could find that guarantees previously put in place are no longer recognised by the PPF.

2. Definition of "associate" is being broadened

An entity may qualify as an "associate" (and therefore provide a contingent asset which reduces the PPF levy) even if it falls outside the normal legal definition, provided it satisfies the PPF that it has a sufficiently strong connection to an employer, independently of the contingent asset.

This potentially opens the door to an entity providing contingent assets for a scheme even where it is not part of the employer's corporate group.

The consultation closed on 2 November 2011. The final 2012/13 levy rules will be published in December 2011.

Beth Brown

Who is your statutory employer?

From November 2011 the Pensions Regulator's scheme return will include a question on who is/are the scheme's "statutory employer(s)". In most cases, the answer to this question will be straightforward, but if your scheme is long-running and has had multiple participating employers this may require some investigation.

The Regulator issued a statement in July 2011, aimed at helping trustees understand the importance of identifying statutory employers. The reason for this is because statutory employers have legal responsibilities - to meet the scheme's funding obligations and to pay a s75 debt on withdrawal or on wind-up of the scheme. In addition, schemes which do not have a statutory employer will not be eligible for entry into the PPF.

The term "statutory employer" refers to an employer as defined under various pieces of legislation. In order to determine who your statutory employer(s) is/are, you will need to identify who has participated in the scheme and, for those that no longer participate, determine when they stopped contributing and ceased having employees who were members. The general rule of thumb is that an employer who employs or employed active members will be a statutory employer, unless it has discharged its obligations to the scheme. Whether or not it has done so will depend on which statutory obligations applied when the employer left the scheme or ceased to employ active members – this may require legal advice.

While the Regulator's main concern is schemes with no statutory employer, the inclusion of this new question in the scheme return focuses attention, once again, on establishing who the trustees can call on to support their scheme.

Olivia Mylles

Court of Appeal confirms FSDs issued in insolvency have "super priority"

The Court of Appeal has confirmed that the costs of complying with Financial Support Directions ("**FSDs**") proposed to be issued to certain Nortel and Lehman companies by the Pensions Regulator ("**TPR**") qualify as "super priority" administration expenses if the companies go into liquidation, payable in priority to unsecured creditors, floating charge holders and the administrator's own fees.

High Court:

TPR had determined that certain of the Nortel and Lehman companies in administration should be the subject of FSDs. The question then arose as to the ranking of the costs of complying with such FSDs. The High Court held that the costs of complying with an FSD (or a Contribution Notice) are an expense of an administration.

Court of Appeal:

The appeal against the High Court decision was unanimously dismissed. An FSD cannot be a provable debt because it does not satisfy the statutory requirement that it must arise out of a pre-existing legal obligation. The moral hazard regime involves the exercise of discretion by TPR and is too complex a process for a legal obligation to arise pre-administration. It cannot have been intended that the costs of complying with FSDs should effectively fall into a black hole. Those costs, therefore, had to be classified as an expense, meaning that they have to be paid ahead of any other debts.

Comment:

The Court of Appeal's ruling is not surprising, but will disappoint lenders and the insolvency profession. On the other hand, the decision looks, at first sight, like good news for trustees. However, many trustees may end up being losers if the indirect consequences of the case are that scheme sponsors cannot obtain finance and beneficial restructurings are prevented. A further appeal to the Supreme Court seems likely.

Martin Scott

Important change to which schemes count as "money purchase"

Some schemes, and individual members, could be substantially affected by a change to the statutory definition of "money purchase benefits", which is intended to clarify the grey area between money purchase benefits and defined benefits. This change was included in the Pensions Act 2011 at the last minute, only a few days before the Act received Royal Assent. It has not yet come into force, and the Government intends to consult on whether the new definition should be applied across the board, or should be modified in some contexts.

The distinction between money purchase and defined benefits matters from the governance perspective because, if a scheme promises any benefits which do not meet the "money purchase" definition, legislation about benefit security will apply to it as if it was a pure DB scheme. For example, the scheme will be subject to the statutory funding regime and the Pension Protection Fund levy. Schemes which were "money purchase" on the old definition but not on the new one will have statutory obligations which they may have assumed would not apply.

The distinction between money purchase and defined benefits also matters to individual members, as some legislation about benefits themselves works differently depending on which class they fall into. For example, different rules about revaluation and pension increases apply depending on whether the benefit is "money purchase".

Background:

Under the old definition, a benefit was "money purchase" if it was calculated by reference to the contributions which the member had paid into the scheme or which someone else – typically an employer – had paid into the scheme in respect of him or her. A scheme counted as "money purchase" only if all the benefits it provided were money purchase ones.

In its decision this summer in the case of *Houldsworth v Bridge Trustees*, the Supreme Court decided that benefits could still be money purchase if they were calculated by reference to contributions, even if there was no necessary match between the benefits promised and the assets that the scheme held in order to meet that promise. This could happen where:

- a scheme promises a minimum return on the contributions, potentially differing from the actual return; or
- it promises to convert a member's money purchase pot into pension at a particular conversion rate, potentially more generous than an insurer would provide; or
- a scheme pays the pension itself, without buying a matching annuity from an insurer.

The court concluded that arrangements like that did not – under the old law – stop a scheme from meeting the money purchase definition. This meant a scheme could have a deficit and yet not be subject to the statutory funding regime. This was a matter of serious concern to the Government, because money purchase schemes are exempt from current legislation about funding and benefit security: that legislation assumed, wrongly, that money purchase schemes on the statutory definition could not have a deficit and did not need that protection.

The Government's new definition adds a further limb to the current statutory definition of "money purchase benefits" to address that concern. Under the new definition, benefits are money purchase before they come into payment only if there is a necessary match between the assets which the scheme holds to secure them and the amount of benefit which the scheme has promised. If there is the possibility of a mismatch, then the benefit, and the scheme which provides it, will no longer count as money purchase.

Additionally, when a pension derived from a member's money purchase pot starts, it will count as "money purchase" only if it is secured by an annuity which the trustees have bought from an insurance company.

Comment:

This amendment achieves the Government's aim of applying scheme funding legislation to any scheme where a material deficit could arise. However, there is also a concern that, by taking some benefits out of the "money purchase" category, the new definition could also change the benefit promise in some contexts, for example by requiring LPI increases to be paid on a pension after it comes into payment. We hope that the Government will make use of the regulation-making powers in the new legislation to prevent any unintended consequences of that sort.

Jonathan Moody

Abolition of protected rights

From 6 April 2012:

- individuals will no longer be able to contract out of the State Second Pension ("**S2P**") through a money purchase (i.e. defined contribution) pension scheme; and
- protected rights funds will cease to be subject to special treatment under legislation and may be used to provide benefits in the same way that non-protected rights funds are used.

Protected rights:

Currently, money purchase schemes can "contract out" of S2P. This means that members and employers pay a reduced rate of NI contributions. Employers pay the NI savings into the scheme and HMRC also pays in an "age-related rebate". The scheme uses these payments to build up a "protected rights fund" within the scheme which is used to provide income for members in place of the S2P benefit which the NI contributions would otherwise have provided.

(Protected rights can also be acquired when a transfer is paid into a contracted out money purchase scheme from another contracted out scheme.)

Abolition of contracting out for money purchase schemes:

The Pensions Act 2007 abolishes contracting out on a protected rights basis from 6 April 2012.

Currently, protected rights funds are subject to statutory restrictions, which are designed to ensure that the benefits provided are similar in nature to those the State would have provided. One key effect of the abolition of protected rights will be the removal of these statutory restrictions. Schemes will no longer need to make special provision for protected rights in their rules.

Therefore, subject to their rules, schemes will be able treat protected rights funds in the same way as non-protected rights funds.

Communication requirements:

Subject to certain exceptions, trustees must tell members with protected rights that the scheme will no longer be contracted out within one month of 6 April 2012.

Trustees must also explain the effect on members' existing protected rights and their entitlement to S2P within four months of 6 April 2012.

A scheme can provide this information ahead of 6 April 2012 as part of other member communications.

Trustees should make members aware that they will have more choice over how to take their benefits if they defer their retirement until after 6 April 2012. However, trustees should avoid giving financial advice in all circumstances.

Key effects for members:

Members may now see protected and non-protected funds amalgamated in annual benefit statements.

Members who are contracted out on 5 April 2012 will be automatically contracted back in to S2P with effect from 6 April 2012 and will start to build up S2P benefits. They will not receive confirmation from the DWP.

Rozet Shah

Steve Webb at NAPF Conference

After his speech at the NAPF Conference last month, no-one was left in any doubt about where Pensions Minister, Steve Webb, stands on incentive exercises such as an enhanced transfer value ("**ETV**") offer and a pension increase exchange ("**PIE**"). The Minister had issued a warning about such exercises in May 2011 and confirmed his views in his speech on 20 October 2011.

He said he would like to stop cash being offered to members as an incentive to transfer out as it was impossible for people to make a sensible decision where a cash lump sum is involved. He also said that he has concerns about the way PIE offers are explained to members.

It is intended that next summer there will be a new Code of Practice released to cover ETVs and PIEs. The Code will aim to ensure that all offers are communicated to members in a balanced way, in terms that members can understand, with independent financial advice being available and paid for by the employer.

The Pensions Regulator issued detailed guidance on incentive exercises in December 2010 which seemed to cover a lot of the same issues which Steve Webb is addressing. Employers and trustees should be aware that a further Code of Practice may be coming, but it seems unlikely that properly-run exercises will need to be changed substantially.

Beverly Cox

Scheme documents - looking beyond the words on the page

Where questions arise regarding whether a scheme's Trust Deed and Rules properly reflect what the parties intended, there are two main legal tools for dealing with this:

- construction – ascertaining the true meaning of the document; and
- rectification – correcting the wording to bring it into line with what was intended.

There are recent cases on both.

In *Pioneer GB Limited v Webb* the Court was asked to rectify a deed executed in 1995 which incorrectly defined the normal retirement age as 60 for female members and 65 for male members.

The Court had the benefit of contemporaneous documentation (including detailed minutes and announcements to members) and witness evidence from the individuals involved at the time, from which it was clear that it had been intended that the deed would equalise the normal retirement age at 65. The Court was prepared to rectify the deed, ordering that it should be corrected with effect from 1995 to reflect what had been clearly intended at the time.

A significant feature of this case is that the Court gave summary judgment, dealing with the matter without the need for a full trial. It was suitable for summary judgment because of the overwhelming evidence of what the deed should have said – highlighting the importance of records showing the intended effect of a document, so a clear and compelling account can be presented to the Court.

Turning to construction, on 2 November 2011 the Supreme Court handed down an important ruling on the role to be played by considerations of business common sense when interpreting documents (*Rainy Sky SA v Kookmin Bank*).

It confirmed the established principle that the court has to determine what the reasonable person, having regard to the surrounding circumstances, would understand the parties to have meant. However, if there are two possible interpretations, the court is entitled to prefer the one which is consistent with business common sense.

This is good news if it helps to avoid documents being interpreted in a way that does not make commercial sense – but it also highlights that working out what a document means is much more than just reading the words on the page.

Stuart Pickford

Dates and deadlines

November 2011	DB trustees required to identify their scheme's statutory employers in TPR scheme return
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
October 2012	Auto enrolment into NEST or better alternative arrangement starts for large employers - 1% employer contributes 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 likely to apply affecting how employers account for pension liabilities
July 2013	New tax regime - deadline for employers to provide members with information about their pensionable pay and benefits and length of service
5 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	Proposed revised deadline for making resolution under s251 to retain scheme rules allowing surplus payments to employer
October 2016	NEST or better alternative arrangement - 2% employer contributions required
October 2017	NEST or better alternative arrangement - 3% employer contributions required

Key:
Important dates to note
For information

Joanna Myerson

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