Trustee Knowledge Update

CMS Cameron McKenna

CMS Law . Tax

Welcome to the February 2013 edition of our Trustee Knowledge Update. It aims to inform trustees about changes in the law to help them to comply with the legal requirement for each trustee (or trustee director) to have knowledge and understanding of the law relating to pensions and trusts. This edition focuses on the key legal developments over the last three months that trustees may need to be aware of.

Legislation (http://www.legislation.gov.uk)

Draft Pensions Bill 2013 and White Paper
The draft Bill will introduce the proposed single tier state pension which will replace the basic state pension and state second pension and, in today's terms, will be around £144 per week. Individuals will need to have a national insurance contributions record of 35 years to qualify for the full benefit. There are provisions for converting existing national insurance records to the new basis when it is introduced, which will be some time in 2017 or later.

Contracting-out will be abolished. However, formerly contracted-out schemes will need to continue to comply with the existing requirements in relation to GMPs. In order to allow employers to mitigate their increased national insurance costs following abolition, they will be able to unilaterally amend future accrual or contribution rates. Actuarial certification will be required. This power will last for 5 years and further detail will be provided in regulations.

The increase in state pension age to 67 will be accelerated and will now take place between 6 April 2026 and 5 March 2028. In addition, the government will carry out a periodic review of the state pension age and we may see further increases if life expectancy continues to rise.

Several changes are proposed in relation to occupational pension schemes, most notably the introduction of a regulation making power to prohibit incentive exercises designed to induce a member from transferring pension rights out of a salary-related scheme.

Government

Call for evidence on introducing smoothing and a new statutory objective for the pensions regulator
The Government is asking for evidence on:

- whether the smoothing of assets and liabilities would be appropriate in schemes undertaking the valuations required under the Pensions Act 2004 and how smoothing might be applied; and
- whether a new statutory objective for the Pensions Regulator is necessary to consider the long-term affordability of deficit recovery plans to sponsoring employers.

Transfers and micro-pots
Last July, DWP announced that, alongside the abolition of short service refunds from DC schemes, it would bring forward legislation providing for the automatic transfer of dormant DC pots to a member's new employer's workplace scheme. It promised to consider further whether the very smallest, "micro pots" should still be commutable. It has now decided they should not be. An announcement confirms that: "*The Government's policy is that automatic transfer should be the norm, for pots of any size. The assumption should be that pension savings will follow a person throughout working life.*"

Outcome from the National Statistician's consultation on the Retail Prices Index
The Retail Prices Index will continue to be calculated on its current basis. However, there will be a new RPI-based index (called RPIJ) which will be calculated more in line with international standards. For schemes whose rules refer to RPI, this change should have no effect. Where rules allow trustees to choose an appropriate index, they may wish to consider this new measure.

Tax (www.hmrc.gov.uk/pensionschemes/index.htm)

Autumn Statement and Finance Bill 2013
The biggest changes announced by the Chancellor are to the lifetime allowance which will fall in the 2014-15 tax year from £1.5 million to £1.25 million and the annual allowance which will fall at the same time from £50,000 to £40,000. As with previous reductions to the lifetime allowance, there will be a fixed protection regime available to individuals with benefits in excess of the reduced limit and possibly a new "personalised protection" (see below for more details).

There are also provisions in the Finance Bill which allow for more flexibility in bridging pensions to reflect changes in the state pension age and which clamp down on parties using "family pension plans" to get round annual allowance limits by an employer paying pension contributions to an employee's family member rather than the employee.

Draft annual allowance charge amendment order
Various technical changes are proposed to the annual allowance legislation, including the following:

- Currently, deferred members of final salary and cash balance schemes are exempt from the annual allowance charge in most circumstances. However where there is a transfer, the exemption will be lost. An amendment will extend the exemption to cover a deferred member in respect of whom there is a "recognised transfer" of all the assets relating to them, providing no further benefits are accrued in the receiving scheme.
- Contributions which have been refunded through a refund of excess contributions lump sum will not be included when calculating the pension input amount in a money purchase scheme.

- Changes will be made in relation to the treatment of bulk transfer payments involving final salary arrangements in the calculation of the annual allowance. HMRC have concerns that the current provisions do not work as intended.
- Amendments will provide that where an individual becomes entitled to all of their benefits from a scheme and wishes to make use of "scheme pays", they will need to give the scheme notice of their intention to do so before taking the benefits.

Newsletter 56 – Personalised protection

Personalised protection**:** This looks in more detail at the form the new annual allowance protection referred to in the Autumn Statement might take. It would be available to members who do not have one of the existing forms of protection and they would have a lifetime allowance of the greater of the value of their rights on 5 April 2014 (up to £1.5 million) and the standard lifetime allowance (£1.25 million from 6 April 2014). There would be no restrictions on future accrual.

Carry-forward rules: HMRC confirms that no changes are being made to the existing carry forward rules which allow individuals to carry forward unused annual allowance from the three previous years. This will mean the amount of unused allowance available for an individual to carry forward in relation to the 2011/12 to 2013/14 years will continue to be based on £50,000.

Regulator (www.pensionsregulator.gov.uk)

Regulating work based DC schemes: consultation paper

The consultation relates to a new code of practice, accompanying regulatory guidance and a regulatory approach document which will establish a new framework to enable the Regulator to regulate the governance and administration of occupational DC schemes.

Code of Practice: The draft Code covers the following:

- Know your scheme – Trustees must understand basic pension and trust law requirements, investment duties and scheme documentation. They should "*ensure that sufficient time and resources are identified and made available for maintaining the ongoing governance of the scheme*". It suggests a number of things which should be standing agenda items at meetings including costs, investment monitoring and a legal update. Hybrid scheme trustees should have separate meetings to deal with DC issues.
- Risk management – Trustees must have adequate internal controls in place and key areas of concern are highlighted.
- Investment – Where "*members are offered a choice of funds, the number of investment options should enable members to make meaningful choices. Trustees need to ensure that the investment options made available are appropriate to the profile of the membership and take into account members' needs throughout the lifetime of their membership. The potential benefits and risks for every fund offered should be clearly communicated*". The Code looks at considerations for trustees when selecting funds and reviewing investment performance.
- Conflicts and managing advisers – It looks at issues which can arise when providers are represented on trustee boards and when advisers offer associated services or products. It sets out specific considerations for trustees when negotiating agreements with advisers.
- Administration – There is an emphasis on accuracy of data. Trustees should ensure that there are processes in place with employers to ensure that data is accurate from the outset and have a service level agreement in place with administrators.

Guidance: The draft guidance looks in more detail at a variety of issues including communications, governance and administration.

PPF (www.ppf.gov.uk)

PPF Levy Policy Statement and Determination for 2013/14

The 2013/14 pension protection levy estimate is £630 million. In order to raise this amount the PPF has reduced the levy scaling factor from 0.89 to 0.73, and the scheme based levy multiplier from 0.000085 to 0.000056. Other rules used to set the levy remain substantially the same, except for relaxing the requirements for a guarantee from a bank or custodian so that guarantees from institutions with A- credit ratings or better will now be sufficient.

Key dates in relation to the levy are as follows:

- Information from scheme returns submitted (on Exchange) by **5pm on 28 March 2013** will be used to calculate levies.
- Insolvency risk will be measured using the average annual failure score of each sponsoring employer measured on the last working day of each month from 30 April 2012 to 28 March 2013.
- The deadline for certification and re-certification of contingent assets is **5pm on 28 March 2013**.
- Deficit reduction contributions that have been made up to and including 31 March 2013 must be certified by **5pm on 30 April 2013**.
- Full block transfers up to and including 31 March 2013 must be certified by **5pm on 28 June 2013**.
- Market data over five years will be used to smooth funding levels, so for 2013/14 this will be market data for each weekday in the five years to 31 March 2013.

There are some changes in relation to the certification of contingent assets. In particular, as part of the process of considering whether a guarantor would be able to meet its obligations under a Type A guarantee, the trustees will need to consider the reasonably foreseeable impact the insolvency of the employer(s) would have on the guarantor. The PPF also encourages trustees to consider adopting its own (more rigorous) approach in determining whether a guarantor can meet its obligations.

Member communication guidance for trustees
This is a draft announcement and FAQs for trustees to send to members when a scheme goes into PPF assessment to satisfy the requirement to tell members about the assessment process within 28 days of receiving notice from the PPF of the date on which assessment began. Trustees should still run the draft announcement past their PPF caseworker for comment before it goes out to members

Treatment of GMPs
All schemes transferring into the PPF from June 2013 will need to use the PPF's agreed methodology in relation to GMPs. For schemes scheduled to transfer before 31 May 2013, the PPF will do the calculations and adjust compensation payments accordingly. In broad terms the PPF's methodology results in members receiving the higher of the (overall) pensions payable in respect of post-17 May 1990 service for a male and female member whose pay, service etc are otherwise equal in every respect.

Auto-enrolment and NEST

Response to consultation on earnings triggers
As anticipated, the earnings trigger for 2013/14 will increase from £8,105 to £9,440 in line with the increase in the PAYE threshold. The qualifying earnings band will still be aligned with National Insurance lower and upper earnings limits, which will be £5,668 and £41,450.

Joint industry code of conduct on charges
The Code is intended to apply to all parties providing services to employers in setting up and administering pension schemes for auto-enrolment. It requires all charges to be clearly and accurately stated in writing, and that employers receive a standard template summarising the charges levied and the corresponding services. The Code says that employers must be able to see examples of how different levels of charges and charging structures could affect the pension pots of their employees. The Code came into effect as "a guide for best practice" on 1 January 2013 and will apply fully from 1 May 2013.

Cases

Walker v Innospec Ltd (Employment Tribunal)
The member worked for Innospec between 1980 and 2003 and entered into a civil partnership in 2006. Innospec's pension scheme provided a pension to spouses of deceased members, but the employer and trustees chose not to provide the same pension to civil partners, except in respect of benefits accrued after the Civil Partnership Act came into force in December 2005. In doing so, they relied on a provision in the Equality Act 2010 which contains a pre-December 2005 carve-out for civil partner rights from the general prohibition of discrimination in the operation of occupational schemes.

The Employment Tribunal held that the parties had directly discriminated against the member and as this was clearly prohibited under the EU law, the Tribunal would read the Equality Act in a manner compatible with the EU law (effectively, by ignoring the exemption). The parties were therefore in breach of section 61 of the Equality Act under which an occupational pension scheme must be taken to include a "non-discrimination rule" by virtue of which a responsible person (which includes trustees and employers) may not discriminate against any person in carrying out any functions in relation to the scheme. This case may be appealed.

Note: The Marriage (Same Sex Couples) Bill 2013 currently envisages that the December 2005 cut-off will continue to apply for both civil partnerships and same sex marriages.

IBM UK Pensions Trust v IBM UK Ltd (High Court)
This is a supplementary judgment to the judgment considered in the last edition of TKU. It considers the scope of the employer's duties to not "*without reasonable and proper cause, conduct themselves in a manner calculated or likely to destroy or seriously damage the relationship of confidence between employer and employee*" (their "Imperial duties"). The essential question was whether the Imperial duties meant the employer was bound to consent to a particular amendment to the scheme rules to reflect the preservation legislation.

The judge said that in relation to the Imperial duties:

- these would be breached if the employer's refusal to consent was irrational or perverse;
- the correct test was not one of fairness and assessing whether a decision was irrational or perverse was not to be equated with the application of an objective standard of reasonableness;
- the test was a "severe" one; and
- the test was an objective one.

The judge accepted that, in deciding whether to consent to an amendment requested by the trustees, the employer was subject to Imperial duties. Refusing to properly consider whether to accept or reject a proposal would be a breach of those duties. However, in this case, the employer's refusal to consent to an amendment was not, on any view, irrational or perverse and, indeed, enabled effect to be given to the intention of IBM and the trustees when the scheme was established.

Ombudsman (www.pensions-ombudsman.org.uk)

Goudie (member should have identified that he was receiving overpayment of pension)
The member had pensions from two periods of scheme service, which following a complaint by him were aggregated into a single pension of £11,900. Unfortunately, as well as the aggregated pension, he continued to be paid the pension based on his earlier period of service. The mistake was identified in 2011, and the administrator discovered several other errors. The administrator said that it would write off 40% of the amount outstanding. The member complained, saying that he should not be required to repay the remaining 60%. In March 2012, the member became bankrupt.

The Ombudsman said that an overpayment as a result of a mistake was in principle recoverable, subject to defences. One condition of any defence was that the money must have been spent irrecoverably. In this case the member had spent it and, being bankrupt, had no assets to show for it. A second condition was that the overpayment must have been spent in the reasonable belief that the money was the member's to spend. The member could have identified that the monthly payments were higher than they should have been, and should reasonably have known that his benefits were being overpaid. It was not reasonable for him to rely on the money as being his. In the light of events, the administrator was unlikely to be able to recover any of the balance of the overpayment in lump sum form. It would have to take into account his bankruptcy in deciding whether it could or should recover by deduction from future instalments of pension.

Houghton (booklet references to RPI did not prevent trustees interpreting "cost of living" as CPI for the future)
The scheme rules provided that pension would "*increase by five per cent compound in each year… except that no pension will be increased in any year by more than the increase in the cost of living over a preceding relevant period chosen by the Trustees.*" The booklet summarised the rule saying that pension increases were "guaranteed" in line with the RPI up to 5%, although contained a disclaimer that the provisions of the rules prevailed. In 2011 the trustees announced that they would be using CPI to determine annual increases going forward. The member complained that they should honour the wording of the booklet providing for increases based on RPI.

The Deputy Pensions Ombudsman rejected his complaint, saying that the trustees were entitled to decide which index to use for calculating annual increases and their decision was not unreasonable, not least as it could be argued that CPI was more accurate reflection of price inflation. The booklet disclaimer meant that the booklet could not be relied on as an unambiguous statement that RPI would be used and in any case the booklets did not actually promise that RPI would always be used. Had the booklet wording explicitly said that RPI was currently used but that another measure might be used in future, the member would not have acted any differently.

Dates for diaries: Trustee training remains one of the most important ways of ensuring that trustees have the knowledge and understanding required to perform their duties. We have trustee training courses taking place on **11 June 2013 and 15 October 2013** and there will be others at regular intervals after that. If you have any enquiries about any of these courses or would like to reserve a place, please contact **Karen Mumgaard – E:** karen.mumgaard@cms-cmck.com.

General: For further information on our pension services, please contact **Mark Grant – E:** mark.grant@cms-cmck.com, **T:** +44 (0)20 7367 2325 or your usual pension partner. Please also visit our website at **www.cms-cmck.com**.

Get to grips with the requirements of the Pensions Regulator with our **Field Guide for trustees**. You will need to be a subscriber to our Law-Now website (which is free) to access this guide. Register at **http://www.law-now.com/register.** You can also get help here with understanding the Pensions Act 2004 and all related regulatory publications by viewing our online **Plain English guide to the Pensions Act**. If you are interested in the Pensions Ombudsman's activities, visit our website **www.law-now.com/po-info**.

The Pensions team is part of the CMS Cameron McKenna Human Capital group and advises employers and trustees of schemes varying in size, from a few million pounds to several billion pounds. Additionally, we act for some of the largest firms of administrators, actuaries, consultants, brokers and professional trustees. We provide a full range of services in connection with occupational pension schemes, including all aspects of employment and EU law. The team also works closely with our corporate lawyers, providing support on mergers and acquisitions, insolvency lawyers supporting us on employer covenant issues, and the financial services team which specialises in regulatory and fund management matters.