

Trustee Knowledge Update

Welcome to the Spring 2009 edition of our Trustee Knowledge Update. The purpose behind this Update is to inform trustees about changes in the law to help them to comply with provisions of the Pensions Act 2004 which impose a duty on each trustee (or trustee director) to have knowledge and understanding of the law relating to pensions and trusts.

Tax (<http://www.hmrc.gov.uk/pensionschemes/index.htm>)

Budget 2009: The main change, which will affect pension provision, is the restriction of tax relief for the highest earners. From April 2011, for those with an income of £150,000 or more, tax relief on pension contributions will be reduced on a tapered basis so that it falls to 20% for those with incomes over £180,000. Full details of how this tapering will work are yet to be published.

In the meantime, provisions were introduced with immediate effect to prevent individuals likely to be affected by the 2011 changes from making "substantial additional pension contributions" in the interim. If an individual above the threshold changes their normal pattern of contributions and their pension savings exceed £20,000 per tax year, the additional savings will be eligible for tax relief at the 20% basic rate only. There are complex rules for determining whether an individual is over the threshold and whether there has been an increase in the normal patterns of savings.

Schemes considering "creative" solutions aimed at mitigating the impact of these provisions need to be careful as draft legislation includes a broad anti-avoidance provision which threatens to catch any arrangement "*the main purpose, or one of the main purposes, of which is to avoid or reduce liability*" to the new tax charge. In particular it will not be possible to circumvent the £150,000 figure by entering into new pension salary sacrifice arrangements (i.e. made following the Budget announcement) that would otherwise have the effect of reducing the individual's income to less than £150,000.

The budget makes other small changes relevant to pension schemes. In particular, the annual allowance for pension contributions is confirmed at £245,000, and the lifetime allowance at £1,750,000, for 2009/10.

It should be noted that the legislation is still only in draft form and these provisions may therefore be subject to change.

The full Budget report is available at <http://budget.treasury.gov.uk/>.

Notional Earnings Cap 2009/10: the notional earnings cap for 2009/10 will be £123,600. HMRC has agreed to continue publishing details of the notional cap until 2011.

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Legislation

(<http://www.opsi.gov.uk/acts/acts2008a>)

Pensions Act 2007: The Pensions Act 2007 contains provisions, which will change the calculation of the second tier of the state pension, the State Second Pension ("S2P"). The intention is that S2P should eventually become a simpler, flat-rate benefit that is not earnings-related. Some of the relevant provisions came into effect on 6 April 2009 (brought forward from their anticipated 2012 start date).

Prior to April 2009, S2P accrued on earnings between the lower and upper earnings limits. These limits increased each year, typically in line with price inflation. However, from 6 April 2009 a new concept called the upper accrual point ("UAP") was introduced which replaced the upper earnings limit for S2P accrual purposes. The UAP will remain fixed (at £40,040) rather than being increased each year. The lower earnings limit will continue to be increased each year (and will eventually reach the level of the UAP in about 2030). The UAP also replaces the upper earnings limit for the purposes of calculating future contracted-out benefits.

There will still be an upper earnings limit which will be used for other purposes and which has been significantly increased.

Scheme rules, which contain references to the "upper earnings limit", should be reviewed to determine whether such references should be changed to the "upper accrual point".

Occupational, Personal and Stakeholder Pensions (Miscellaneous Amendments) Regulations 2009 contain a variety of changes to existing legislation. In particular:

- There is a power for the Pensions Regulator to issue fines for breach of the requirements for employers to consult members where certain "listed" changes are made to schemes and where there is no "reasonable excuse" for having failed to do so (DWP has published guidance on the application of these requirements);
- UK legislation prohibits more than 5% of scheme assets being invested in the sponsoring employer. There are

however a number of exemptions to this requirement, including investments derived from members' AVCs and certain insurance policies. These exemptions will be removed with effect from September 2010 and trustees will need to consider whether they currently have any investments which fall within them;

- Contracted-out final salary schemes can make transfers without members' consent to other contracted-out final salary schemes where either both schemes are within the same corporate group or the transfer is as a result of a commercial transaction. These Regulations allow a scheme that used to be contracted-out to make transfers under the same circumstances; and
- The Regulations confirm that where any of the rates of contributions payable by the employer are determined by the actuary without the employer's agreement, the comparable rates in the schedule of contributions must be no lower than the rates the actuary would have provided for.

These changes are effective from 6 April 2009 except the change in relation to self-investment, which is effective from 23 September 2010.

The Pensions Regulator (Miscellaneous Amendment) Regulations 2009 remove the requirement to notify the Pensions Regulator of:

- in the case of trustees, two or more changes in either the auditor or the actuary within the previous 12 months; and
- in the case of employers, any change in the employer's credit rating, or the employer ceasing to have a credit rating; or
- two or more changes in the Chief Executive and any director or partner responsible in whole or in part for the financial affairs of the employer within the previous 12 months.

The Regulator will update its guidance to reflect these changes (the Regulator's notifiable events documents are at <http://www.thepensionsregulator.gov.uk/codesOfPractice/notifiableEvents/index.aspx>).

The Regulations also extend the period for which the Regulator can look back to determine whether to issue a Financial Support Direction from 12 to 24 months (subject to some transitional provisions).

The Guaranteed Minimum Pensions Increase Order 2009 provides for GMPs attributable to earnings factors for the tax years 1988-89 to 1996-97 to be increased by 3%.

Regulator (<http://www.pensionsregulator.gov.uk>)

Statement on risks in economic downturn stresses that good scheme governance is of particular importance during the downturn and encourages individuals who are aware of behaviour that would cause the Regulator concern to "whistleblow" to the Regulator. The types of behaviour that the Regulator is concerned with include *"avoidance of employer debt, inappropriate transfers for individuals from under-funded schemes that would not subsequently have the resources or adequate employer support, as well as employer-related self-investment and poor practice associated with transfer incentive exercises."*

Cases

Age Concern England v Secretary of State for Business, Enterprise and Regulatory Reform (*age discrimination*)

This case is a judgment from the European Court of Justice and is also referred to as the "Heyday" case.

The case concerned a provision in UK legislation which allows employers to require employees to retire at age 65 without it being age discrimination and which allows employers to claim that differences in treatment on grounds of age are objectively justified.

Age Concern had claimed that these provisions were in breach of the requirements of the European Directive, which establishes the general principle that age discrimination in employment is unlawful. However, the Directive also allows differences in treatment on grounds of age if they are *"objectively and reasonably justified by a legitimate aim, including legitimate employment policy, labour market and vocational training objectives, and if the means of achieving that aim are appropriate and necessary"*.

The Court stated that the Directive does not require member states to include a specific list of the differences in treatment, which may be justified as a legitimate aim in national legislation. Therefore, the fact that the UK's Age Regulations merely lay down principles in relation to justification is not a breach of the Directive.

In addition, the age 65 provisions may be lawful if they are justified by legitimate social policy objectives. It is now for the UK courts to determine whether the relevant legislation is consistent with such a legitimate aim and whether the means chosen were appropriate and necessary to achieve that aim.

Ombudsman (<http://www.pensions-ombudsman.org.uk>)

Ralph (27877/1): *Court time limits and the Pensions Ombudsman*

A member complained about having been encouraged to transfer his occupational scheme benefits to a buy-out policy in 1986. The employer argued that the complaint, brought in July 2007, did not meet the normal 3-year time limit applicable to Ombudsman complaints.

The Ombudsman found the member was not in a position to make the complaint until 2004, when he would have received a statement making clear the gulf between the value of the policy and the pension he might have received had he remained in the scheme. Although the complaint was made marginally outside 3 years from when the member ought reasonably to have had knowledge of it, the member had been "actively pursuing" the matter from 2006 and had not been responsible for any undue delay in the process since then. Accordingly, the Ombudsman determined that the complaint was made within a further reasonable time and accepted it. The Ombudsman also said:

"generally they [the employer] will have assumed that anything that happened over 15 years ago is a closed subject. Against the potential detriment that, in one restricted area, such an assumption may not be safe, I have to balance the detriment to Mr Ralph of not being able to be heard on a matter within my jurisdiction of proportionately far greater financial significance to him than it is to [the employer]. In considering how to exercise my discretion I have decided that particular balance falls in Mr Ralph's favour."

The Ombudsman found there had been maladministration and the member should have his benefits reinstated in the scheme.

Adams (M00358): *Trustees personally liable for losses from investment in employer companies*

Several members complained that:

- investments had been made by the trustees in shares in employer companies which were now worthless;
- there was a failure to reinvest monies that the trustees had encashed;
- an improper unreduced transfer payment amounting to 1/6 of the total assets of the scheme had been made.

Although only one trustee was found to have acted dishonestly the Ombudsman found a failure by the trustees generally to carry out their fiduciary responsibilities. Section 33 of the Pensions Act 1995 precluded them (in respect of breaches committed on or after 6 April 1997) from relying on the indemnity and exoneration clauses in the rules.

The trustees were not entitled to discretionary relief under the Trustee Act 1925 as this required them to have acted "honestly and reasonably" and their decisions could not be said to be reasonable.

Some of the trustees argued that they had only been recently appointed at the time of some breaches and asked to be excused liability for the first six months of their trusteeship. The Ombudsman accepted that the Regulator's guidance on trustee knowledge and understanding suggested a six-month period for new trustees to get up to speed but continued:

"I do not accept therefore that..., the new trustees should be excused liability for the first six months of their trusteeship, on grounds of inexperience or lack of familiarisation with the Scheme administration. I do not think that the Regulator envisaged new trustees sitting doing nothing for six months while they studied all the pension scheme documents and other material. As the guidance goes on to say "even a new trustee must be equipped to make the decisions with which he or she may be faced.""

He did agree to excuse the new trustees from liability for a shorter, two-month period.

This determination illustrates the need for new trustees to ensure that they have sufficient knowledge to deal properly with the issues, which come up in trustee meetings, even in their first 6 months of appointment.

Kirby (73391/1): *overpayment not recoverable to the extent that member had already committed to spend money*

In January 2007 the member was quoted a lump sum entitlement of £9,600. A few days later, she arranged for double-glazing to be fitted, signing a contract, which compelled full payment of £3,500 on completion. In March her employer wrote to say that her correct annual pension and lump sum were half the amounts originally quoted, and that repayment of the overpaid lump sum was "now due". In April she paid the money due to the window company.

The employer claimed that it was entitled to repayment in full, as the member had paid out the money to the window company after being notified of the overpayment. However, the Ombudsman found that the member had decided to have the work done based on the mistaken original quote, and that by the time she was told of the mistake she was committed to full payment.

The employer could recover the amount of the overpaid lump sum only to the extent it exceeded the price of the double-glazing, with instalments to be agreed with the member. In addition, it was directed to pay £200 by way of compensation for its maladministration.

PPF (<http://www.pensionprotectionfund.org.uk/>)

The Pension Protection Fund (Pension Compensation Cap)

Order 2009 sets the PPF compensation cap from 1 April 2009 at £31,936.32, so where 90% compensation applies, the maximum benefit level will be £28,742.69.

The Pension Protection Fund (Miscellaneous Amendments)

Regulations 2009 include provisions that:

- the PPF can pay compensation to all those entitled to benefits as a result of death before the assessment period begins (as opposed to just active members); and
- the PPF will pay 90% of any transfer payments / contribution refunds where the member became entitled to the benefit before the assessment period began, but had not been paid by the time of PPF entry.

Financial Assistance Scheme

(<http://www.dwp.gov.uk/lifeevent/penret/penreform/fas/>)

Trustee Update: summarises recent amendments to FAS rules and progress on future changes, including the following:

- new regulations which permit entry to FAS where a scheme began wind up between 6 April 2005 and 22 December 2008, and where the scheme had an insolvency event before 6 April 2005;
- legislation has extended the embargo on eligible schemes purchasing or agreeing to purchase annuities indefinitely. FAS can void any purchase or agreement to purchase annuities, where trustees have acted outside the parameters of the legislation;
- an update has been published setting out issues for trustees to address when applying to annuitise; and

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 **17 June 2009** and **16 September 2009**. If you have any enquiries about any of these courses or would like to reserve a place, please contact Karen Mumgaard at 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 new website at www.cms-cmck.com.

Get to grips with the Pensions Act 2004 and all related regulatory publications by viewing our online **Plain English guide to the Pensions Act**. 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/law-now/zones/LN_Pensions.htm. If you are interested in the Pensions Ombudsman's activities, visit our website www.law-now.com/po-info. This site also has links to around 70 useful pensions websites.

The Pensions team is part of the CMS Cameron McKenna HR 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 law 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.

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- trustees are asked to ensure that information provided to FAS in respect of qualifying members reflects benefits calculated on an equalised basis.

Things to look out for

Revaluation: Where revaluation rates are set out in scheme rules, trustees may be asked to consider an amendment to reflect the new statutory cap on revaluation (reduced going forward from inflation capped at 5% to inflation capped at 2.5%). Trustees need to carefully consider the impact of any such proposed changes before agreeing to them.

Unauthorised payments: just as this Update was going to press, the Government published the regulations setting out various easements in relation to small and insignificant payments and making changes to the regime dealing with overpayments. The detail will be set out in our next TKU but trustees dealing with overpayments or pensions pots of less than £2000 in the interim should seek advice.

Safeguarded rights: if a pension credit is awarded following a member's divorce, any part of the credit derived from contracted-out benefits was called "safeguarded rights" and was subject to restrictions similar to those which applied to contracted-out benefits. Safeguarded rights were abolished with effect from 6 April 2009.

GMP conversion: from 6 April 2009, schemes with GMPs can convert them into ordinary final salary benefits. There are a number of requirements which schemes converting GMPs would need to satisfy, in particular the post-conversion benefits have to be "*actuarially at least equivalent to the pre-conversion benefits*". The responsibility for determining actuarial equivalence lies with the trustees.