

Trustee Knowledge Update

CMS Cameron McKenna

Welcome to the May 2010 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 the legal requirement for each trustee (or trustee director) to have knowledge and understanding of the law relating to pensions and trusts. This Update focuses on the key legal developments over the last three months that trustees may need to be aware of.

Regulator (www.pensionsregulator.gov.uk)

Consultation on record keeping

Research by the Regulator has indicated that scheme record keeping is often inadequate. Therefore, the regulator proposes to set targets for the accuracy of common data which schemes must hold and to review performance of schemes. Where schemes fail to have adequate plans in place to resolve data issues, the Regulator will require them to improve. The Regulator believes that newly recorded common data should be recorded with 100% accuracy. The quality of legacy data should be tested and where necessary, plans put in place to improve its quality by the end of 2012.

Nortel applications and proceedings

In 2009, Nortel was placed into various creditor protection or administration procedures around the world, including in the UK, USA and Canada. Each insolvency process imposed a moratorium on actions against property of the Nortel Group. Claims from creditors were invited and the Nortel pension scheme trustees and the PPF submitted claims in relation to the pension scheme deficit of £2.1bn. The Regulator issued a warning notice for a Financial Support Direction (FSD) in January 2010.

Subsequently in both the US and Canada, it has been held that an FSD would breach the stay of proceedings by creditors under US and Canadian law. The Regulator is appealing these decisions on the basis that the FSD process *"has been misinterpreted as a judicial process which creates a new claim"*.

Introduction to work based pension schemes

The Regulator has published the first of its guides in relation to automatic enrolment (which will currently start to apply from October 2012). There is a basic introduction for employers which sets out the level of contributions that employers will have to pay and also how to work out whether existing pension arrangements are "qualifying arrangements".

Legislation (www.opsi.gov.uk/legislation)

Employer Debt Regulations

These Regulations amend the provisions which relate to the payment of debts under section 75 of the Pensions Act 1995 where an employer leaves an under-funded multi-employer scheme. They introduce two new "easements" and if the conditions for either easement are satisfied, a section 75 debt will not arise where an employer ceases to participate in a multi-employer scheme.

Both easements are available where there has been a restructuring within a corporate group. There are several conditions which need to be satisfied in relation to each and trustees will need to take advice on how these conditions should be interpreted.

Broadly speaking, the first easement applies where the new employer is at least as likely to meet the relevant pension liabilities as the old. The second easement is relevant where the section 75 debt would meet a "de minimis" test set out in the regulations (which looks at both the liabilities of the departing employer as a percentage of total scheme liabilities and the overall value of the liabilities).

The Equality Act 2010

The Act has two main purposes – to harmonise discrimination law, and to strengthen the law to support progress on equality. It brings together and re-states the existing legislation on discrimination (including the Equal Pay Act and Disability Discrimination Act) and will require schemes to be operated on the basis that they include a "non-discrimination rule" which prohibits anyone carrying out a function in relation to the scheme from discriminating against individuals on a ground covered by the Act.

Finance Act 2010

The Finance Act 2010 extends the special annual allowance charge (that is the charge intended to restrict the availability of higher rate tax relief on certain pension contributions) to those earning £130,000 or more.

It also contains the wording for the regime which will apply from April 2011 to restrict rate relief on pension contributions and defined benefit accrual for those earning £100,000 or more.

The Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2010

Amends existing regulations to require employers to consult with final salary members where they are proposing a change in relation to *"what elements of pay constitute pensionable earnings, or to change the proportion of or limit the amount of any element of pay that forms part of pensionable earnings, for or in respect of members or members of a particular description"*. The requirement to consult will apply to improvements to the definition of pensionable pay as well as changes to cut it back.

The regulations also provide that where an amendment power is subject to approval by the Revenue or similar wording, the trustees can remove that requirement by resolution. They also correct a drafting error which prevented members with guaranteed minimum pensions from taking small lump sums.

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

Notional Earnings cap

The notional earnings cap for 2010/11 is £123,600. This is the last year for which HMRC will publish a notional earnings cap figure. Trustees therefore need to ensure that, if required, there is a mechanism in their scheme rules for calculating this figure in future years.

The Registered Pension Schemes (Standard Lifetime and Annual Allowances) Order 2010

The standard lifetime allowance for the tax years 2011-12 to 2015-16 is £1,800,000. The annual allowance for the tax years 2011-12 to 2015-16 is £255,000.

Revenue Guidance on the Special Annual Allowance and protected input amounts

Gives guidance on a number of issues including new and re-activated arrangements and those that are made in accordance with written agreements between the individual and employer made on or before 22 April 2009.

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This deals with a number of issues including recent changes in tax rates such as the special annual allowance charge and a change to the tax payable on short service refund lump sums. From 6 April 2010, this charge is 20% on the first £20,000 and 50% on the balance.

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Legislation provides that where the member has to pay a tax charge because a payment from the scheme is not authorised by the Finance Act 2004, the scheme also has to pay a scheme sanction charge of up to 40%. However, this may be reduced to 15% if the member has paid the full unauthorised payment charge. In practice it has proved difficult for schemes to discover how much tax the member has paid. Therefore, from April 2010, the scheme can ask the member to complete a mandate allowing the trustees to deduct the unauthorised payment charge from the payment itself and then pay it directly to the Revenue. The member will not have to complete details of this on their self-assessment form. Details of the unauthorised payments will be included on the Event Report and the Revenue calculate the scheme sanction charge accordingly.

PPF (www.pensionprotectionfund.org.uk)

The Pension Protection Fund (Miscellaneous Amendments) Regulations 2010

Contain provisions in relation to charging interest on late levy payments, the PPF will be able to charge interest of up to 5% above the Bank of England base rate from 29 days after a levy invoice was issued. This interest can be waived in certain circumstances, including when it is reasonable to do so. They also change the age at which members can apply for PPF compensation from 50 to 55 (unless the individual has a lower protected pension age). Also amend

the rules on the calculation of compensation where the member was in a CARE scheme.

The Pension Protection Fund (Pension Compensation Cap) Order 2010

The PPF compensation cap from April 2010 is £33,054.09. This equates to £29,748.68 once the 90% cap is applied.

PPF guidance on powers to modify and disclaim onerous contracts

Liabilities transferred to the PPF include contracts that trustees have entered into. The PPF can modify or disapply a term in a contract transferred to it where its terms are "onerous" or where it is an insurance contract. To date the Board has not yet identified a term it wishes to disclaim and it says that it would not ordinarily wish to set aside terms which had been negotiated at arms length by the trustees, even where it feels that the trustees have not got a good deal. However, it cannot say in advance whether it will or will not disclaim any particular contract or term and hence it has published guidance which sets out very broad principles as to what the PPF will look at.

Because of concerns about whether the PPF might disclaim certain investment contracts relating to derivatives, the PPF has suggested wording for inclusion in such contracts providing additional termination events on assumption of responsibility for the scheme by the PPF, unless the PPF has executed a deed stating that it will not use its powers to disclaim or modify the contract.

Cases

Bridge Trustees v Yates (*meaning of "money purchase benefits"*)

The scheme started as a conventional final salary scheme before being restructured to add different tiers of defined contribution benefit. The employer went into administrative receivership in 2003, and the scheme went into winding-up in the same year. The trustees brought proceedings relating to section 73 of the Pensions Act 1995, which sets out the order of priority between different types of members (by reference to their benefits) in which assets of an occupational pension scheme should be applied on a scheme winding up in 2003. As the legislation generally excluded assets and liabilities in respect of "money purchase benefits" from section 73 (meaning that such benefits are not liable to be cut back due to a scheme deficit), the court's task was to determine whether a selection of different benefits under the scheme met the definition of money purchase benefits under legislation.

The Court held that the phrase "money purchase benefits" should not be read too restrictively, but instead construed "in a fair and reasonable way". As such, neither the application of actuarial factors at some stage of the calculation, nor of notional investment returns, were necessarily fatal to an argument that particular benefits

were money purchase. The correct test to apply was *“whether, having regard to the combination of all the features in the scheme in question, the rate or amount of the benefit in question can sensibly and reasonably be said to be calculated by reference to the payments by or in respect of the members”*.

Independent Trustee Services v Knell (Hobourn Group Pension Scheme): Construing provisions of a pension scheme

This case dealt with an error in rules drafting relating to attempts to equalise normal pension age in the wake of the judgment of the European Court in the *Barber* case (requiring equal retirement ages for men and women). The scheme sent announcements to members in April 1992 saying that it would adopt a common normal pension age of 65 for all members with effect from 1 July 1992. However, the rules were not amended until November 1993. When they were, the definition of normal pension age was: *“in relation to a female member before 1 July 1992, her 60th birthday, and in relation to any other Member his or her 65th birthday”*.

The trustees argued that this wording should be read as referring to pensionable service of a female member before July 1992, with all subsequent service (male and female) accruing by reference to a normal pension age of 65.

The judge said that in the context of a pension scheme the interpretation should be “practical and purposive”, with it being possible to prefer one of a number of competing constructions by reference to their practical consequences. In this particular case, he emphasised that the unfortunate drafting of the normal pension age provision should not be read in isolation but “as part of the document as a whole”, on the assumption that the revised trust deed and rules in 1993 were “intended to make a coherent and consistent series of amendments”. The judge therefore considered a number of other amendments which had been made at the same time as the normal pension age change.

Having done so the judge accepted that while the draftsman seemingly “lacked clarity of thought”, and it was not possible to derive “an entirely coherent scheme” from the provisions of the 1993 deed, the “natural and ordinary” wording of the normal retirement age definition made that deed “less comprehensible” when read as a whole. It was therefore legitimate to conclude that “something must have gone wrong with the language”, and on the evidence before him the judge felt able to agree with the trustees’ argument as to what the provision should have said.

The judge therefore declared the trustees’ interpretation to have been the true definition with effect from November 1993 (it having been accepted, in line with case law, that the rule amendment could not have had retrospective effect to July 1992).

Note that the judge also considered, and rejected, an argument that announcements made to members could be treated as use of the augmentation, rather than amendment power: in part because *“the announcement was not made to “a person” but to all Members”*.

Low & Bonar v Mercer: View of Scottish courts on failure to correctly execute equalisation deeds

Equalisation amendments were sent out in 1991 purporting to retrospectively equalise the scheme from May 1990. The amendment power required a deed and the consent of the trustees. No formal deed of amendment was executed until 2002. However, under Scottish law, “deed” has no technical meaning and the judge said that if *“a purported exercise of the power is clear and certain, looked at objectively, and it is put into written form, I do not think that there is any need for the court to be unduly technical or restrictive in considering the niceties of its manner of exercise”*. He was therefore able to determine that a board resolution in 1991 amounted to a “deed” as all that was required was a formal legal document that showed an intention to create legal relations. The required trustee consent was evidenced by a minute of a meeting resolving to implement the changes.

In addition, the augmentation power allowed the principal employer to change retirement dates by determination. The court held that even if the board resolution had not been effective to amend the scheme, there had been an effective exercise of the power of augmentation.

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

Kenny (28034/5): Extent of pension overpayments meant member should have spotted “something was amiss”

In October 2000, the member received a (correct) estimate of benefits for retirement, quoting an annual pension of just over £11,000. When the pension did commence, from August 2001, an annual equivalent of over £25,000 was brought into payment by mistake. The error was discovered six years later and the member was asked for proposals for repayment. The member said that he thought a previous transfer value might have contributed to the difference in pension, and provided details of money he had spent since his retirement, in reliance on receipt of the higher amount.

The Ombudsman noted the existence of the change of position defence and that if it could be shown that a member had spent such an overpayment on something which he would not otherwise have done, and the money could not now be recovered, the defence might succeed. However, an essential element of the change of position defence was that the individual must have changed his position in good faith.

The pension being received here was nearly £700 per month (around 64%) more than the member should have

been expecting. The Ombudsman said that he was happy to accept that the member “was not “a pensions expert” and that perhaps he was not the most practical of men”. Nevertheless, the discrepancy was so great that the Ombudsman found the member should have been aware that something was amiss. He was not therefore entitled to rely on change of position and was required to repay the over-payment.

Barnett (76149/1): *No redress against scheme that refused to accept member’s cash equivalent*

The member sought to transfer his benefits from his old employer’s scheme to his new employer’s scheme. The new scheme trustees asked the old scheme trustees for an indemnity in relation to equalisation but instead of answering the questions the old trustees merely inserted “N/A” into the form (it appears that the relevant section of the transferring scheme had been fully equalised from inception in 2001). The new scheme trustees refused to accept the transfer-in and the frustrated member brought a complaint against both sets of trustees.

The old scheme trustees explained that they had a policy, adopted on legal advice, of refusing to give any indemnities on transfer, even though they accepted this was “cautious”. The new scheme trustees confirmed that their policy was not to accept any transfer value unless the former scheme indemnified them against the risk of a future equality ruling.

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 **16 June 2010** and **22 September 2010**. 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 new 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/law-now/zones/LN_Pensions.htm. 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. 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.

The information in this publication is for general purposes and guidance only and does not purport to constitute legal or professional advice. It is not an exhaustive review of recent developments and must not be relied upon as giving definitive advice. The Update is intended to simplify and summarise the issues which it covers. It represents the law as at 24 May 2010.

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The Ombudsman reiterated that while the Pension Schemes Act gives members a right to a cash equivalent it does not give them a right to transfer where the potential receiving scheme does not wish to accept it. He accepted that although the risk to either scheme of adopting a different policy might be “remote”, he could not say that either scheme’s position amounted to maladministration. He could not therefore interfere.

Things to look out for

End of Finance Act 2004 Transitional Periods

Currently there are Regulations which deal with references in scheme documentation to pre-Finance Act 2004 requirements and practices. These will cease to apply from 6 April 2011 and therefore any schemes which have not already amended their rules to deal with the Finance Act 2004 need to do so before then.

Resolutions on refunding surplus

The Pensions Act 2004 contains provisions dealing with the refund of surpluses following the repeal of legislation dealing with excessive surpluses. Among other things, the Act says that where trustees wish to retain a power to refund surplus, they will need to give 3 months notice to members and pass a resolution to this effect before 6 April 2011.