

## Pensions monthly update – keeping you on track

May 2013

Pension briefing

### HIGHLIGHTS

Hogan Lovells pension group is delighted to send you our news Alerter for May, setting out developments over the last month.

Our Pension Planner gives a comprehensive overview of legal developments in the previous 12 months and expected future changes. For the latest issue, please click on the link in the email alerter.

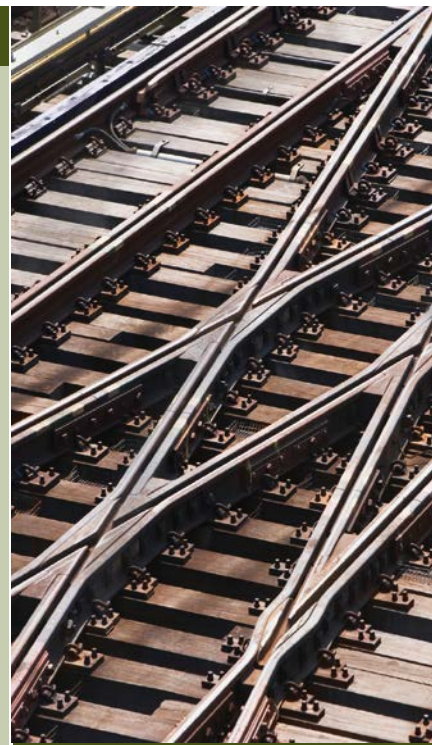
### DATES FOR YOUR DIARY

#### 3 July 2013 – recent developments in pensions

Our regular informal breakfast seminar aimed at trustees and sponsors of occupational pension schemes and their advisers. Speakers from the Hogan Lovells pension team will review legal developments over the past few months and will explain the practical implications for pension schemes. For an invitation and to book a place, please click on the links in the email alerter.

#### 13 September 2013 – trustee training day

A full day seminar aimed at new or inexperienced trustees, or those who would like a refresher, covering all legal aspects of the Pension Regulator's trustee knowledge and understanding syllabus. To pre-book a place, please click on the link in the email alerter.



### PENSIONS BILL

The Pensions Bill has been introduced in the House of Commons. Areas covered include:

- establishment of the single-tier State pension;
- abolition of defined benefit contracting-out;
- increases to State pension age;
- automatic transfer of small pension pots;
- power to prohibit incentive offers;
- abolition of short service refunds from money purchase occupational schemes;
- power to require pension levies to be paid in respect of past periods;
- prohibition of a corporate trustee where one or more of its directors has been prohibited from being a trustee;
- a new statutory objective for the Pensions Regulator (please see below).

In relation to auto-enrolment, changes include:

- power to make exceptions from employer duties (for example, in relation to members with fixed or enhanced protection) and to convert an employer duty into a power;

- power to prescribe limits on administration charges or types of administration charges, use of which would prevent a scheme from being a qualifying scheme.

### FROM THE PENSIONS REGULATOR

#### Annual funding statement 2013

The Regulator's annual funding statement for 2013 considers that trustees may need to make greater use of the flexibilities available than was the case with previous valuations.

#### When setting discount rates for technical provisions and expected investment returns for recovery plans:

- schemes may use either the expected yield on assets held by the scheme or a gilts-based approach;
- trustees should adopt an approach that best suits the individual characteristics of their scheme and employer;
- assumptions used may differ from previous valuations, to reflect changes in market conditions. The reasons for any change should be well documented.

#### When deciding contribution rates and recovery plans:

- as a starting point, trustees should consider whether the current level of contributions can be maintained;
- where there are significant affordability issues, trustees may consider agreeing to lower contributions;
- any investment in the employer's business given priority over paying otherwise affordable pension contributions should be used to improve the employer's covenant.

## Approach to risk

- Trustees are encouraged to take an integrated approach to addressing covenant, investment and funding risks. The Regulator is moving away from its previous use of triggers focussed on individual factors to an integrated approach to risk management.

## Pensions Regulator: statutory objective

The Pensions Bill includes the following new objective for the Regulator:

*"in relation to the exercise of its functions under Part 3 [scheme funding] only, to minimise any adverse impact on the sustainable growth of an employer".*

## FROM THE TAXMAN

### Finance Bill 2013

The Finance Bill 2013 has been issued, with clauses largely in the form previously issued in draft. However, some minor amendments have been made, including:

- fixed protection 2014:** technical changes will clarify that revaluation of GMPs and increases to GMPs that have been postponed will not count as benefit accrual for the purposes of the new fixed protection;
- primary protection and lump sum protection:** new provisions have been added to deal with changes resulting from the reduction of the lifetime allowance in 2014/15.

## Annual allowance – scheme pays

Final regulations provide that a pension in payment may be reduced in accordance with a "scheme pays" arrangement (under which the member's annual allowance charge is paid from the scheme) without the remaining pension ceasing to be a scheme pension.

## Pension liberation

HMRC has amended its website to include a new page explaining pension liberation and to add further text clarifying the tax consequences of pension liberation activities. Scheme administrators are asked to include information on pension liberation in member newsletters and to consider links to information on HMRC and the Pensions Regulator websites.

## Provision of information

Draft regulations will amend the information that scheme administrators and individuals are required to report, in particular in connection with transfers to qualifying recognised overseas pension schemes (QROPS) and fixed protection 2014. In addition, scheme administrators who issue a pension savings statement to a member (because the member's pension saving for the tax year has exceeded the annual allowance) will have to report the supply of the statement to HMRC.

## FROM THE PPF

### Pension Protection Fund: GMPs

The PPF has issued guidance on reconciling guaranteed minimum pensions (GMPs) for schemes in a PPF assessment period. Schemes in assessment periods may

accept a discrepancy between a scheme's records and NISPI's records of up to £2 per week. Where there is a greater difference, the scheme should make one reasonable attempt to resolve the issue.

## Successful challenge to calculation of PPF risk-based levy

The Deputy Pension Protection Fund Ombudsman has upheld a complaint about the calculation of a scheme's risk-based levy that failed to take account of up-to-date financial statements filed by the Luxembourg-registered employer at the Luxembourg companies registry. In Luxembourg, D&B did not obtain information on companies from the national registry but relied only on information sent to it, in contrast to its practice in the UK.

The DPPFO commented that it would have been helpful for the PPF to publicise the fact that D&B did not collect data from national registries in all countries. A public body, properly directing itself, should not decide that a statutory levy could be imposed based partly on a procedure that the levy payer was unaware of.

*(Trustees of the West of England Ship Owners Insurance Services Limited Retirement Benefits Scheme)*

## DEFINED CONTRIBUTION ISSUES

### Pensions Regulator: DC scheme returns

The Pensions Regulator has issued guidance notes for trustees or managers on completing scheme returns for defined contribution schemes (whether trust or contract-based). Two sets of notes have been issued: one aimed at schemes with 2-11 members and the other for schemes with 12 members or more.

## Europe: consumer protection in personal pension schemes

The European Commission has issued a consultation paper intended to identify specific problems encountered by consumers in relation to personal pensions "third-pillar retirement products" (TPRPs) and to investigate whether consumer protection could be improved by voluntary codes coordinated at EU level or by certification schemes.

## Single European market for personal pension products

The European Insurance and Occupational Pensions Authority (EIOPA) has issued a discussion paper on a possible EU-single market for personal pension products.

The paper focuses on two possible approaches: passporting and the "second regime". (The second regime is a body of law enacted in a particular field to create an alternative uniform European system to different national regimes. Private parties can choose which of the two bodies of law will govern their legal position.)

EIOPA intends to advise the Commission on legislative changes needed to create a single market for personal pension products.

## PENSION REFORM

### Red tape challenge

Steve Webb, the Pensions Minister, has announced the results of the review of the regulatory framework for private pensions, undertaken as part of the Government's Red Tape Challenge. Broadly, the DWP has concluded that the current regulatory framework strikes the right balance between

reducing burdens and protecting consumers and accrued rights. However a number of changes are proposed:

- simplification and consolidation of the disclosure requirements (draft regulations have been consulted on);
- a new statutory objective for the Pensions Regulator to support scheme funding arrangements compatible with sustainable growth (included in the Pensions Bill);
- examining whether indexation for future accrual should be discretionary;
- consideration of how difficulties caused by the employer debt regime for charities and others participating in multi-employer schemes could be improved;
- amendments to regulations on the treatment of pension rights on bankruptcy, to ensure compliance with EU treaty obligations.

### Transfers: small pension pots

The DWP has issued a command paper, confirming its intentions in relation to the automatic transfer of small pension pots. Key points include:

- The legislation will permit a variety of implementation approaches. The paper considers a "pot-matching" IT solution and a "member-driven" approach under which employees would pass information regarding their dormant pension pots to their new employers on starting work, or at regular intervals.
- Initially, the automatic transfer process will apply only to "pure" money purchase benefits.
- The receiving scheme would provide solely money purchase benefits, although power would be given to extend the requirements to other schemes.
- A pension pot would be eligible for automatic transfer once all contributions had ceased, provided that it had been created after a specified date and did not exceed £10,000.
- Members may opt out of automatic transfer by giving notice within a prescribed period.
- The Pensions Regulator would be the principal enforcement body for the automatic transfer process.

## FROM THE PENSIONS OMBUDSMAN

### Ill health: suitability of alternative roles

It was accepted that the member was permanently incapable of carrying out his duties. The question at issue was whether he was also incapable of performing "any other duties which in the opinion of the trustees are suitable for him".

The Ombudsman held that, when considering suitability, factors to consider could include: mental and physical ability; previous earning capability; status; and possibly, compatibility with previous career experience. Before deciding that

particular alternative duties would be suitable, the trustees should:

- establish how the member would be suitable for the alternative roles, taking into account his health problems, experience and qualifications;
- ascertain requirements of employers in the fields suggested and assess whether the member was likely to meet those standards; and
- consider the comparative income of suggested roles. (*Brown*)

### Ill health: misapplication of rule on early retirement from deferral

It was maladministration for the employer to consider the member's eligibility for an ill health early retirement pension from active membership without informing the member that it had done so, thereby denying him his right to appeal that decision.

Subsequently, the trustees had incorrectly applied the rules on ill health retirement from deferment by holding that, as the employer had concluded the member was not eligible at the time of his dismissal, they could not consider him to meet the same incapacity test on an application made only 11 days after leaving service. The rules did not stipulate that there should be a passage of time before such an application could be considered and it should have been dealt with merely on the basis of the medical information available. (*Maddison*)

### Ill health: reason for potential improvement should have been identified

For the employer and its medical advisers to determine that the member's incapacity was not permanent, they should have identified a treatment or some other reason likely, on the balance of probabilities, to cause an improvement in the member's condition. Failing to do so meant that the only basis for asserting that the member's incapacity was not permanent was that her symptoms would spontaneously improve – which would be highly speculative. (*Wilde*)

### Armed services: no obligation to inform of deleterious effect of converting commission

The Deputy Pensions Ombudsman has rejected a complaint by an officer in the armed forces that the Ministry of Defence (MoD) should have alerted her to the fact that by converting to a different form of commission she would lose the right to an unabated pension after 16 years' service.

As an officer, the complainant had a commission not an employment contract and could not, therefore, rely on previous case law in which an obligation on the employer had been read into the employment contract. In addition, had the officer consulted the Armed Forces Pension Scheme booklet, available to members on request at the time of her decision, she could reasonably have been expected to appreciate the pension consequences of converting her commission. (*Farrimond*)

### CPI/RPI switch: member would not have acted differently had he known correct position

The Pensions Ombudsman has rejected a complaint about the use of CPI rather than RPI when calculating increases to pensions in payment. Information given to the member about RPI being used could reasonably be treated as a statement of current practice rather than a commitment for the future. In addition, given the financial inducement offered to the



member to leave employment and the circumstances of his leaving, it was highly unlikely that the member would have done anything differently had the scheme literature clearly said that there was no guarantee that RPI would be used in the future. (*Leigh*)

#### Overpayments: change of position defence upheld

The member's pension had been overpaid for several years, resulting in total overpayments of £3,100. There had been no suggestion that the member could have been aware of the error and the Ombudsman accepted that she and her husband had made decisions based on their financial situations amounting to a change of position. The trustees were directed not to pursue her for repayment and to pay £300 compensation for the disappointment of having a reduced income in future. (*Wytch*)

### FROM THE COURTS

#### Exercise of trustee discretions

The Supreme Court has upheld the Court of Appeal's decision regarding the correct application of the "principle in *Hastings Bass*" (that the exercise of a discretion by trustees may be set aside if in making the decision the trustees failed to take into account all relevant factors or have taken into account irrelevant factors).

In relation to *Hastings Bass*, the Supreme Court held that:

- the rule is not concerned with situations where trustees act outside their powers ("ultra vires");
- the rule may apply where trustees act within their powers but in breach of duty. In such cases the trustees' decision may be voidable;
- inadequate deliberation by trustees when exercising a power must be sufficiently serious to amount to a breach of fiduciary duty.

In the cases concerned, the trustees had made decisions within their powers and followed apparently competent professional advice which turned out to be wrong; they had therefore not acted in breach of duty.

However, the Supreme Court allowed the appeal in *Pitt* on grounds of mistake and set aside the trust. In reaching its decision the Court held that:

- for rescission on grounds of mistake there must be a causative mistake of fact or law of sufficient gravity;
- mere ignorance, even if causative, is insufficient;
- the consequences of the mistake (including tax consequences) are relevant to its gravity;
- the facts must be examined closely and the Court must judge whether it would be unconscionable to leave the mistake uncorrected. (*Futter v HMRC; Pitt and Holt v HMRC*)

#### Protection for members on employer's insolvency: Irish Republic did not comply with European directive

The Court of Justice of the European Communities (CJEC) was asked to consider various questions relating to protection under Irish law given to members of Waterford

Crystal pension schemes whose employer became insolvent when the scheme was in deficit. The questions concerned the application of Article 8 of Directive 2008/94, which requires Member States to ensure that employees' and former employees' rights in an occupational pension scheme are protected if the employer becomes insolvent. The CJEC held that:

- State pension benefits may not be taken into account when assessing whether the Member State has complied with its obligations.
- Article 8 requires protection for at least 50% of a member's benefits. Measures adopted by the Republic of Ireland did not comply with this obligation.
- The economic situation of the Member State did not constitute an exceptional situation capable of justifying a lower level of protection.
- Failure to comply with the requirements of Article 8 was a serious breach of the Member State's obligations (which could potentially lead to members having a claim against the Member State).

The members' situation differed from that of defined benefit members in the UK: members were obliged to join one of the occupational pension schemes as a condition of employment; the loss of pension benefits did not constitute a debt on the employer recognised in the employer's insolvency; and there was no equivalent of the Pension Protection Fund. (*Hogan and others v Minister for Social and Family Affairs (Republic of Ireland)*)

### OTHER DEVELOPMENTS

#### Takeover Code

The Takeover Code has been amended with effect from 20 May 2013 to give certain rights to trustees of defined benefit schemes sponsored by a listed company subject to a takeover bid, or one of its subsidiaries. Where the new provisions apply, the bidder must state its intentions with regard to: employer contributions to the scheme (including current arrangements for funding any deficit); benefit accrual for existing members; and admission of new members. The bidder will not be required to make statements regarding the impact on the target's covenant or the likely repercussions of its strategic plans on the target's pension scheme.

In addition, documents currently provided to the target's employee representatives should also be made available to its pension scheme trustees. The trustees have the right to submit an opinion on the effects of the offer on the pension scheme, to be appended to the target's circular.

#### Auto-enrolment: consultancy charges

The Pensions Minister has announced that the use of consultancy charges in auto-enrolment schemes will be banned. The prohibition will apply to occupational and personal pensions.

#### GMP equalisation: interim response

The DWP has issued an interim response, following a consultation paper on draft regulations and a proposed equalisation method published in January 2012. The DWP has rejected the view (expressed by many respondents) that GMP equalisation may not be necessary.

Making the draft regulations law will be delayed while the DWP considers providing statutory guidance on GMP conversion, including how schemes might equalise GMPs as part of the process of converting GMPs to scheme benefits. The DWP is also considering whether any further advice is needed in relation to complex cases such as divorced members, deceased members and cases of employer liquidation.

Following representations about the equalisation method consulted on, the DWP will not make a final publication of this method. The DWP does not consider that the methodology

proposed is the only way in which equalisation can be achieved.

#### **Investment: Law Commission investigation**

As recommended by the Kay Report (July 2012), the Law Commission is reviewing the legal concept of fiduciary duties as applied to investment. Its terms of reference include: consideration of factors to be taken into account when deciding an investment strategy; whether fiduciary duties apply to all those in the investment chain; and how far fiduciaries should focus on maximising financial return, to the exclusion of ethical, social and environmental factors.

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

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