

## Pension Monthly Update - Keeping you on track October 2011

### HIGHLIGHTS

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

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

#### Date for your diary

#### 8 November 2011 - Recent developments in pensions

Our regular breakfast update 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. To pre book a place please click on the link in the email alerter.



### STOP THE PRESS!

#### Court of Appeal confirms that pensions financial support directions and contribution notices are expenses

In related *Nortel* and *Lehman Brothers* cases, the Court of Appeal has ruled that financial support directions ("FSDs") and contribution notices ("CNs") issued under the Pensions Act 2004 rank as expenses if they are issued against insolvent targets.

This decision has been eagerly awaited by both the pensions and finance/insolvency communities, as it bears directly on the competing interests of pension scheme members and other creditors in an insolvency context. The Court of Appeal's conclusion offers welcome protection for scheme members, but at the same time means that FSD and CN liabilities will rank in an insolvency ahead of unsecured creditors.

### FROM THE GOVERNMENT

#### Employer debt regulations

The DWP has issued a statement on its record in meeting the Government's policy of "one-in, one-out" in relation to new regulation. The statement indicates that the draft employer debt regulations changing the period of grace provisions and introducing flexible apportionment arrangements are delayed until December 2011.

#### Executive remuneration

The Department for Business, Innovation and Skills has issued a discussion paper with proposals to curb "excessive" executive remuneration, including pension benefits. The proposals include giving shareholders a binding vote on companies' executive remunerations policies. The new rules are expected to be implemented in October 2012.

#### Finance Bill 2012

The Treasury has confirmed that draft legislation to enact measures announced in the Budget 2011 for inclusion in the Finance Bill 2012 will be issued on 6 December 2011. The draft clauses will be open to consultation until 10 February 2012.

### Future pension reforms

The Pensions Minister has made various statements on the Government's intentions for pension reform. Key points include:

- consultation on short service refunds is expected in November 2011;
- measures will be considered to enable members' small pension pots to be consolidated in fewer larger pots;
- risk-sharing models of pension saving will be reconsidered;
- the need for additional consumer protection, for example a cap on charges in default funds, will be looked at.

### FROM THE TAXMAN

#### Registered Pension Schemes Manual

HMRC has issued a list of recent changes to the RPSM made in relation to the changes enacted in the Finance Act 2011. Points covered by the guidance include confirmation that:

#### Income Drawdown

- An individual using drawdown may only take a pension commencement lump sum within the standard timeframe, that is within six months before and one year after the individual became entitled to the drawdown pension.
- An individual using capped drawdown (with the maximum that may be drawn down linked to the annuity that could be bought with the member's pension pot) may continue to make pensions contributions.
- An individual using flexible drawdown (having demonstrated that he or she has guaranteed income of at least £20,000 pa) may not make contributions in the tax year in which flexible drawdown starts. Contributions made in subsequent years will be subject to the annual allowance charge in full.
- An individual with a final salary link will be considered an active member for the purposes of the flexible drawdown

provisions and so would not be eligible to enter a flexible drawdown arrangement.

### Annual Allowance

- A member who has left pensionable service may be treated as an active member for the purposes of the annual allowance if:
  - the member's benefits are subject to a final salary link;
  - the deferred member receives a more favourable revaluation rate while still employed by a participating employer compared to the rate given to a deferred member who has left service;
  - the member retains life cover in the same scheme as the deferred benefits;
  - the member is eligible for ill health benefits from deferment if the ill health cover increases by more than revaluation linked to CPI (or the rate in the scheme rules on 14 October 2010).
- Giving up non-statutory pension increases in return for a higher starting pension will result in the increase in pension being tested against the annual allowance. Offering the exchange one year after retirement could amount to an "avoidance-inspired post-entitlement enhancement" under the Finance Act 2011.
- Where a member's benefits are reduced under a "scheme pays" facility, HMRC would expect a scheme to be able to demonstrate that the reduction applied meets the "just and reasonable" test. Dependents' benefits may not be reduced, although there may be an indirect reduction where benefits are based on a percentage of the member's pension.

### Fixed protection

- Certain contributions to provide life cover under a policy in existence before 6 April 2006 will not jeopardise a member's fixed protection.
- A member who is auto-enrolled in his employer's automatic enrolment scheme will not lose his fixed protection if he submits a valid opt-out notice within one month of his auto-enrolment date.

### Newsletter 49

HMRC issued its Newsletter 49.

The Newsletter includes some explanation of a scheme administrator's responsibilities in relation to flexible drawdown. Administrators must take reasonable steps to satisfy themselves that the individual satisfies the minimum income requirement, including routinely asking for more specific detail of the income source.

### FROM THE EUROPEAN UNION

#### EU financial transaction tax

The EU Commission has issued a draft directive to introduce an EU-wide financial transaction tax from 1 January 2014. Financial institutions covered by the tax would include a pension fund or institution for occupational retirement provision or an investment manager of such fund or institution. The tax would be at 0.1% on the exchange of shares and bonds and a 0.01% tax on derivative contracts. The proposed tax would apply from 1 January 2014.

### FROM THE PPF

#### Consultation on 2012/13 levy

The PPF has issued consultation on the 2012/13 levy determination.

- The levy estimate for 2012/13 (the overall amount the PPF intends to collect) is £550m (reduced from £600m for 2011/12).
- The draft determination contains detailed rules to give effect to the new levy framework confirmed in May 2011, including changes to the measurement of insolvency risk; the addition of investment risk as a new risk factor; and fixing the levy parameters for three years rather than one.
- The maximum risk-based levy will be 0.75% of smoothed liabilities.

#### Contingent assets

The PPF's consultation on the 2012/13 levy determination includes some proposed changes to the contingent asset rules:

- The definition of "associate" will be amended, to broaden the range of eligible guarantors, chargers or purchasers to include an entity which satisfies the PPF Board of a sufficiently strong connection to an employer, independent of the existence of the contingent asset.
- Where a Type A contingent asset (parent or group guarantee) is provided for a multi-employer scheme, employers with a lower insolvency risk than the guarantor may carry their lower risk rating through to the calculation of the scheme's insolvency rate.
- With Type A contingent assets, schemes will be required to certify on Exchange that the guarantors could be expected to meet their full commitment under the contingent asset if called upon to do so at the date of the certificate. **This change will apply to newly certified contingent assets and to recertified contingent assets.**

### FROM THE OMBUDSMAN

#### Member could not undo her own decision on redundancy retirement

The Deputy Pensions Ombudsman has rejected a complaint that a member should have received a "compulsory early retirement pension". The member had been given the option of a compulsory early retirement pension or a redundancy payment plus a less generous basic early retirement pension and had chosen the latter option. The member had been free not to sign the form and, as a lawyer, must have understood that if she disagreed with the terms offered her she should not have consented to them.

The DPO also rejected the argument that, in agreeing to changes to compulsory early retirement benefits in 2008, the member had given up a right to a pension, contrary to section 91 of the Pensions Act 1995. What the member had been asked to give up in consenting to the 2008 changes had been a discretionary amount over and above what the scheme rules provided. (*Low*)

#### Distribution of death benefits – trustees failed to make proper enquiries

The Deputy Pensions Ombudsman has directed trustees to re-make their decision about the distribution of lump sum death benefits, disregarding the fact that they had already paid the lump sum to the member's partner. Upholding a

complaint by the member's son, the DPO criticised the trustees for:

- not investigating an apparent contradiction between the partner's claim that she and the member had "been together" for 12 years whereas the employer's records showed that the member had changed his address to his partner's just over a year before he died;
- not questioning why it was the member's son, not the partner, who was the informant on the member's death certificate;
- handing one of the member's sons an "information on relatives" form at the member's funeral, without an explanation as to why it was needed; failing to chase the son to return the form; and not contacting the other son at all;
- giving the son's statements that his father had had two previous relationships in the period when the partner claimed she and the member had been "together" much less weight than the recollections of his father's colleagues and failing to interview the partner or the other women involved;
- taking 11 months to provide a first stage decision under the scheme's internal dispute resolution procedure. *(Crossan)*

### Ill health early retirement – decision-maker should not abrogate its responsibility

In relation to a complaint about ill health early retirement, the Deputy Pensions Ombudsman has criticised the employer

council for not asking more questions of their medical advisers. The council was entitled to rely on the professional advice it received but should not have done so blindly. The council was directed to obtain a fresh medical opinion from a doctor not previously involved in the case and to ensure that the medical adviser had full details of Mr Parry's duties. *(Parry)*

### OTHER DEVELOPMENTS

#### Actuarial guidance notes

The Actuarial Profession has finalised a framework for use of discount rates in actuarial work. The framework sets out that, as a general rule:

- the "matching" (mark to market) method is appropriate in relation to transactions; whereas
- the "budgeting" (assuming expected returns from a pre-determined investment strategy) should be used in scheme funding calculations.

#### Kay review of UK Equity Markets and Long-Term Decision Making

The Kay Review, set up in June 2011, has issued a call for evidence. The Review is intended to assess to what extent equity market participants are excessively focussed on short term outcomes to the detriment of the markets' core purposes of enhancing the performance of UK companies and enabling investors to benefit from this corporate activity.

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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