Review

Pensions

INTRODUCTION

Do you ever feel as though you are in a dreamlike world when dealing with pensions? No sooner do you get a good grasp of what is going on, then things start to change around you, and you are left feeling, as Alice in Wonderland did, that "it would be so nice if something made sense for a change."

In our Alice inspired Summer Review, we consider recent pensions developments and, as much as is possible in an evolving world, we attempt to pin down the reality into suggested action points for employers and pension scheme trustees.

Our articles cover recent political developments, the effect of changes to the compulsory retirement age, pension increase exchange exercises and public sector pensions. We finish with a round up of some recent developments that we would suggest feature on forthcoming trustee agendas.

The quotations in the margin are provided by Lewis Carroll and may not always offer the soundest legal advice!

THE BEST OF BRITISH?

After a "nul points" in the Eurovision Song Contest, a "four games and you're out" in the World Cup and "oooooh, so near but oh so far" at Wimbledon, can the new Coalition Government re-invigorate the British Nation as it takes us forward with its pensions vision for the future?

Following the announcement of the coalition between the Conservatives and the Liberal Democrats there has been much speculation as to which of their pension policies would take precedence in the new alliance.

In May 2010 the Government confirmed that it had reached internal agreement on certain policies and set out several clear aims reflecting the areas of common ground between the two parties on pensions, including:

- increasing State Pension Age to 66 (not sooner than 2016 for men and 2020 for women). The fine-tuning has yet to be divulged but the Department for Work and Pensions has now issued "A Call for Evidence" requesting testimony that will inform its decision regarding the timing of the increase.
- abolishing compulsory annuitisation at age 75 from 2011. Interim measures apply for members reaching age 75 on or after 22 June 2010.
- phasing out the Default Retirement Age for employment purposes.
- using an independent payment scheme to pay "fair and transparent" compensation to Equitable Life policy holders.
- establishing an independent commission to review the long-term affordability of public sector pensions. John Hutton, a former Secretary of State for Work and Pensions, has now been appointed to head this commission.
- restoring the earnings link for the basic state pension from April 2011. This is to be achieved via a "triple guarantee" which provides that pensions will be raised by the higher of earnings, prices (based on the Consumer Prices Index) or 2.5%. (However, in April 2011 the basic state pension will be increased by at least the equivalent of the Retail Prices Index).

> "When you've once said a thing, that fixes it, and you must take the consequences."
> **THE RED QUEEN**

- exploring the possibility of allowing people greater flexibility in accessing part of their personal pension fund early. This could include early access to lump sum payments.
- working with business and the industry to support automatic enrolment. In June the Government announced details of an independent review of how automatic enrolment should be implemented and whether the current plans should be reformed.

It is clear that the new Government – with Iain Duncan Smith as Secretary of State for Work and Pensions and Steve Webb as Pensions Minister – has not rested on its laurels. It has already begun tackling the aims listed above, as well as announcing further measures which will impact upon pension schemes. These further measures include:

- going back to the drawing board on plans for restricting pensions tax relief for high earners, which were due to take effect from April 2011. The Emergency Budget published on 22 June revealed that the Government will investigate alternative, simpler systems for restricting pensions tax relief. The measures previously proposed by the Labour Government centred around the "high income excess relief charge" and were widely criticised for being too complex and difficult to administer in practice. However, the Emergency Budget emphasised that any new system adopted must raise the same amount of revenue as the previous plans. The Government has indicated a preference for reducing the annual allowance from £255,000 to between £30,000 and £45,000 in April 2011 – a measure which appears far simpler to administer, but is predicted to impact upon many more pension savers than the previous proposals. In the meantime, the existing "anti-forestalling" arrangements continue.
- the CPI is expected to replace the RPI as the index on which increases in pension rights should be based – for public sector and private sector pensions, as well as increases to payments made by the Pension Protection Fund and Financial Assistance Scheme. The Government justifies this proposal by stating that the CPI provides a more "appropriate measure of pension recipients' inflation experiences and is also consistent with the measure of inflation used by the Bank of England". Unsurprisingly, this change has proved controversial, as the CPI has traditionally risen at a slower rate than the RPI and therefore it is predicted that pension entitlements will be lower than expected.

Both the Conservatives and the Liberal Democrats support the notion that the rules and regulations relating to pensions must be simplified to help reinvigorate occupational pensions and encourage employers to offer high quality pensions to all employees. This is a commendable aim but past experience indicates that simplification is no easy task in the pensions arena and it is inevitable that many of the reforms to be implemented by the new Government will instead lead to further complexity. The scale of the reforms and the timescale within which they are due to take effect inevitably mean that the pensions industry is going to be very busy keeping pace with the changes over the months and years ahead.

We'll keep you posted!

Jessica Cheek
Professional Support Lawyer
T: +44 (0)121 222 3725
E: jessica.cheek@hammonds.com

Denise Van Gellecum
Lawyer, Legal Assistant
T: +44 (0)121 222 3493
E: denise.vangellecum@hammonds.com

This calls for consideration of "the different branches of Arithmetic - Ambition, Distraction, Uglification, and Derision."

THE MOCK TURTLE

DEFAULT RETIREMENT AGE – THROUGH THE LOOKING GLASS

What's it all about?

Regulation 30 of the Employment Equality (Age) Regulations 2006 allows an employer to retire an employee compulsorily at age 65 without that employee having any of the usual age discrimination or unfair dismissal protections. Heyday, an arm of Age Concern, challenged that provision, arguing that it was of itself discriminatory and that this cut-off in the protection afforded by the Regulations had no basis in the European Directive on which they were based.

In March 2009 the European Court of Justice decided that the inclusion of such a cut-off was nonetheless potentially lawful and remitted the matter to the domestic UK High Court to decide whether it actually was. In September, the High Court narrowly found that the 65 cut-off was lawful, but made it clear at the time that this was primarily as a result of the Government's announcement two days before the hearing that it would review Regulation 30 in early 2010.

Even though it was unsuccessful in its High Court and ECJ litigation, there will therefore have been a certain amount of schadenfreude at Heyday HQ following the new Government's decision last month that the default retirement age is to be phased out altogether. That this was announced in the Queen's Speech by an 84 year old nearly 60 years in the job will not have escaped notice either!

"The Queen's argument was, that if something wasn't done about it in less than no time she'd have everybody executed, all round."

Phase-out

This phase-out goes further than had been anticipated, though at a time when the Government is desperate to raise PAYE Tax and NI Revenues and to reduce the burden of the State Pension, it is perhaps unsurprising from the perspective of political expediency. Charitably, one could also accept that the retirement age of 65 was chosen at a time when many life expectancies were little beyond that, and that a later date for that purpose would now better reflect the previous balance between working and post-retirement lives. In the Heyday litigation, the Equality and Human Rights Commission had pressed for a default retirement age of not less than 70. That would have caused a number of mostly short-term headaches for employers but it would otherwise have been business as usual. However, the proposal to remove that default age altogether creates a variety of wholly new questions for employers, most of them without terribly attractive answers. Employers will need to take great care to avoid falling into the myriad traps that this development will lay, many of which could well be sprung entirely innocently based on societal and cultural norms going back hundreds of years.

The precise form of the revised Regulation 30 is as yet unknown, but first among the other parts of the Regulations which will have to be amended with it is Regulation 7(4). This allows an employer not to recruit someone who is less than six months short of 65 or is past that age at the time of application. If the default retirement age goes, then it is hard to see that Regulation 7(4) can survive without itself being vulnerable to the same sort of challenge. If it also is repealed then employers will have to consider applications regardless of the candidate's age and, in particular, regardless of whether the candidate is already at or over the employer's own normal pension age.

It is hard to avoid the conclusion that this will lead to an increase in unsuccessful job applications and, in turn, in the number of legal challenges to those decisions. As a prelude to this, we could expect a surge in the number of employers served with age discrimination questionnaires seeking various statistical age breakdowns for the workforce. The best defence against such claims will therefore remain the development, maintenance and retention of proper records both at a statistical level across the company and of the reasoning for each particular individual's lack of success.

Benefit strain

The extension of employments past 65 may well place strain on employers' benefit arrangements, especially insurance-backed products provided by external suppliers. Many such schemes either increase the premium for cover beyond 65 (or any later state pension age) or simply do not offer such cover at all. The employer's options are limited:

- rely on the terms of the insurance policy as justification and defend the less favourable treatment on that basis. While this might work if the benefit is simply unavailable for the over 65s, it is not likely to do so just because it would cost more to provide it for them.
- convert the benefit into cash and pay the same amount to everyone regardless of whether it actually allows them to secure the cover or not (the "cafeteria compensation" model).
- by agreement with staff, abandon the benefit altogether.

Smoothing the path to retirement

Just as vexing for both parties in the longer term may be the consequences of removing the certainty of a "not before" date for retirement. One attraction of the "duty to consider" procedure under Regulation 47/Schedule 6 (presumably another necessary victim of the repeal of Regulation 30) is that it gives the employee at least 6 months' notice of what could be the end of his working life, allowing time to make the psychological and financial adjustments necessary to transition into retirement relatively smoothly. It also allows departure with some degree of dignity. By contrast, the abandonment of the default retirement age will force employers to identify and demonstrate legally-acceptable reasons for dismissal, a process likely to focus on the employee's relative incompetence, failing health or waning capabilities.

For the employer, problems also arise in relation to morale, retention and manpower planning. It cannot offer upward progression to its high performers if those already ensconced at the top of the organisation can no longer be obliged to make way for them. The employer will not know when to start looking for replacements for its older staff – doing so too late leaves it hamstrung, but doing so in the later stages of formal performance procedures is likely to be seen as pre-determining the outcome of those proceedings, so making the dismissal unfair.

Perhaps the biggest adjustment required to be made by employers, however, is in relation to the termination of employment. From the very start of the unfair dismissal regime in 1971 employers have always been able to rely on the longstop of the normal retirement date to procure a relatively trouble-free parting with their oldest staff. Removing that date throws the assumptions of generations of employers into disarray. There is no legal reason why this should be the case – employers have shown themselves quite able to live within the unfair dismissal regime (albeit with varying degrees of success) since its inception, and the principal effect of the repeal of Regulation 30 would simply be to extend that regime to its oldest staff. The problem is, therefore, not legal but cultural – the common phase "elders and betters" reflects an ingrained attitude to older people, one which will make most managers instinctively reluctant to take hostile action (warnings, dismissal, etc) against people old enough to be not just their parents but, without Regulation 30, possibly their grandparents too.

Performance management

However uncomfortable the prospect, the repeal of Regulation 30 coupled with potentially unlimited compensation for a finding of unlawful discrimination will leave employers with no choice but to apply their performance management regimes to their older staff with just the same rigour as to their younger population. Indeed, an older employee's more limited re-employment (and hence mitigation) prospects and consequently greater potential compensation actually points to that regime being applied to him with even greater rigour to ensure that age claims not realistically open to younger staff can be defeated. This does have merit from another perspective; heading off the risk of proceedings for less favourable treatment if conduct or performance which is "let go" for the older employee, on the basis that he is likely to be retiring soon anyway, is nonetheless made the subject of formal disciplinary action against someone younger. It goes without saying that any visible discrepancy in the application of performance management processes, whichever age group is favoured, can expose the employer to litigation.

For these purposes, the performance management regime means not just formal warnings but crucially also appraisals and notes of informal performance counselling. It would be naïve of the new Government to think that removing Regulation 30 would lead to an end of the "tap on the shoulder" conversation when an employee is viewed as about to outlive his usefulness to the employer. Especially at senior level, a severance package covering the resulting wrongful and

"I don't think they play at all fairly…and they all quarrel so dreadfully one can't hear oneself speak–and they don't seem to have any rules in particular; at least, if there are, nobody attends to them." **ALICE** unfair dismissal entitlements would often be seen as a price worth paying. However, if through lack of decent records of the performance shortcomings relied upon, the employer is unable to displace the employee's inevitable suggestion that his exit is a product of his age, the employer risks falling victim to an age claim also. The burden of proof in such cases (paraphrased, but for practical purposes not by very much) makes the employer guilty until proven innocent. Without that documented evidence, the dismissal of staff who reach 65 (or any later state pension age) will carry much more significant financial risks as a result of this proposed change in the law.

David Whincup
Partner, Employment
T: +44 (0)20 7655 1132
E: david.whincup@hammonds.com

There are many dimensions to the complex topic of whether and how to retain the Default Retirement Age. The Confederation of British Industry gave Hammonds the following view: "*As life expectancy increases, our approach to working life will change – more people want to keep working and employers welcome that. But people and businesses need a framework for retirement, whenever it happens. That means a conversation between employer and employee, and a time to have that discussion. Our members are convinced that the DRA – rising with the state pension age – is essential to this and we will continue to campaign for it to stay. In its absence performance management, succession planning, staff development and business innovation all become harder. It is not good enough to dismiss the DRA as a block on progress. Without it, employers would face the threat of discrimination claims when raising the subject of retirement with staff, and many employed who are currently retiring would face drawn out performance review processes.*"

STOP PRESS!

A consultation document published on 29 July 2010 proposes to abolish the Default Retirement Age from April 2011, with transitional arrangements applying until October 2011.

PENSION INCREASE EXCHANGES – RISK REDUCTION

Many employers are currently assessing ways to manage their pension scheme liabilities in order to manage risk and reduce volatility.

One option is to offer a pension increase exchange incentive, whereby pensioners are typically offered a cash lump sum or a one-off uplift to their pension in return for giving up future non-statutory pension increases provided for under the pension scheme. The exchange incentive can not apply to Guaranteed Minimum Pensions earned between 6 April 1988 and 5 April 1997 or to any pension earned after 5 April 1997 (except to the extent that the pension scheme provides increases in excess of the minimum statutory amount in respect of this period of pensionable service).

Employer considerations

For employers there is a clear financial advantage in making an offer of a pension increase exchange, although the extent of that financial advantage will depend on the decision the Government makes in relation to the change from RPI to CPI as the basis for setting pension increases in future. Increases in payment constitute a significant part of the overall cost of a pension, and (even once the base pension is increased), an increase swap reduces this cost element.

Apart from reducing pension scheme deficits, replacing pension benefits that increase with benefits that remain level will reduce risk and could have a positive effect on pricing for any potential buy-out/buy-in of liabilities. In addition, this can be a cashless exercise if the pension increase is exchanged for a one-off uplift to the pension.

There have been a number of high profile cases of pension increase exchange exercises where the uptake from pensioners has reportedly been high. This is not surprising: there are many reasons why pensioners may welcome an option of this kind, such as deteriorating health, the need for immediate cash and a desire for a higher pension early in retirement.

"Would you tell me, please, which way I ought to go from here?" "That depends a good deal on where you want to get to," said the Cat.

In designing any pension increase exchange the employer will need to decide on the extent to which it will share the value of the savings with members. In general, for the exercise to make sense for the employer, the value of the uplift to the member's base pension must be less valuable than the value of future increases given up (using appropriate longevity assumptions). Experience to date has been that the pensioner receives the majority of the value of the saving (60/40 or 75/25 splits are not uncommon), but a 50/50 split can also be acceptable.

The employer will need to consider who will receive the offer – will this just be an exercise in respect of existing pensioners, or will it include active and deferred members as part of standard retirement options? Will the offer only be made to members over a certain age or above a specific pension amount to avoid the cost of the exercise outweighing the savings? Will the uplift be calculated on an age related basis to reflect the proportionate value of the increases given up?

Trustee considerations

Pension increase exchange exercises are likely to be employer driven, but trustee involvement will still be required. It is likely that, in designing any pension increase exchange programme, the employer will need to obtain details of members' benefits from the trustees, and so their co-operation will be required from an early stage. The trustees will only be able to release the relevant data to the employer in accordance with their obligations under the Data Protection Act 1998.

In addition, an amendment will more than likely be required to the pension scheme's governing documentation to allow the pension increases to be surrendered for either a cash lump sum or an uplifted pension. This will necessitate the trustees considering whether any such amendment is overall in the best interests of the membership of the pension scheme, taken as a whole. Trustees will frequently be able to conclude that this requirement is met, as offering members a choice in respect of their benefits is a positive action and the member does have the option to decline the offer.

Before agreeing to the amendment, however, the trustees will want to be happy with the terms of the incentive offer and member communications, ensuring that:

- any information provided to members is clear, fair and not misleading,
- excessive pressure is not being put upon members to accept the offer,
- a reasonable time period is provided for the member to make his or her decision in respect of the offer,
- members are made aware of the importance of taking independent financial advice,
- the offer is good value for the benefits the member is giving up, and
- sufficient information is provided to allow members to make an informed choice – in particular that it is clear that in accepting the offer inflation proofing of part of the pension will be lost.

Regulatory guidance

The above messages are reinforced in the Pensions Regulator's guidance on inducement offers, which was updated and issued for consultation on 13 July 2010 (under the new name of "transfer incentives"). The new draft guidance not only covers pension increase exchanges but other "scheme modifications or benefit forfeitures where members are being asked to make a choice".[1] The Regulator takes a very strong stance in this draft guidance, and potentially oversteps the mark in a number of areas: whether this stance is toned down following consultation remains to be seen, but trustees and employers who are considering undertaking any such exercise should be aware of the Regulator's position.

1 The guidance does not apply to proposals for schemes being closed for future accrual – although the scope of, and rationale for, this carve out is not at all clear.

"When I use a word", Humpty Dumpty said in a rather scornful tone, "it means just what I choose it to mean – neither more nor less".

Further considerations

There are a number of tricky legal issues which need to be navigated around in relation to pension increase exchanges. The trustees will need to ensure compliance with Sections 67 and 91 of the Pensions Act 1995 (as in accepting the pension increase exchange offer a member is being asked to surrender an entitlement to certain accrued benefits through a modification to the pension scheme documentation). This may cause particular issues where the proposal is for the pension increases to be exchanged for a cash lump sum. Consideration will also need to be given to the extent to which contingent beneficiaries should consent to the offer made to the member, in particular if the exchange exercise results in contingent beneficiaries' entitlements to future non-statutory pension increases being affected.

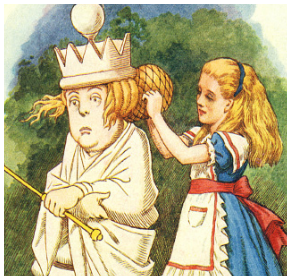
There may be tax implications for those high earners who are close to their lifetime allowance – accepting a pension increase exchange offer may not be a favourable decision for such members.

Advice may also need to be taken on whether the structure of the pension increase exchange is age discriminatory and on the implications for members should the pension scheme enter the Pension Protection Fund. Furthermore, a successful pension increase exchange exercise may lead to a potentially material increase in the scheme's PPF levy and necessitate a change to its investment strategy.

Running a pension increase exchange programme is a complex process for an employer and requires close co-operation with trustees, but it can have significant financial advantages for all parties without the requirement to provide cash upfront.

Georgina Rankin
Senior Associate
T: +44 (0) 121 222 3658
E: georgina.rankin@hammonds.com

PUBLIC SECTOR PENSIONS – IT JUST GETS "CURIOUSER AND CURIOUSER"



A coalition Government and a country facing its worst financial crisis for over a century: with a significant sea change in the political climate, it will come as no surprise that calls for public sector reform are now falling on more receptive ears.

Set against a wider programme of cost-cutting, spurred on by a public appetite for austerity and visible "belt tightening", pensions and pay in the public sector make obvious targets for spending cuts. With daily newspaper headlines highlighting the relative cost to the taxpayer, post-election changes were, perhaps, inevitable. To this end, two Huttons (John and Will) have been appointed by the Government to respectively review the pensions and pay arrangements in the public sector. The reality, however, may be that real-cost savings and changes will be far harder to achieve in practice.

"Nobody can do two things at once you know."
THE WHITE QUEEN

Hutton pensions review

The former Secretary of State for Work and Pensions, John Hutton, will chair the independent Public Service Pensions Commission's review of public service pensions, which is tasked with assessing the fundamental structure of public service pension provision. An interim report of Mr Hutton's findings is expected in September of this year, ahead of the Spending Review, with the final report issued before the next Budget in 2011.

In terms of scope, the pensions review will cover all of the key public sector schemes, as well as those relating to less familiar governmental organisations, such as the Atomic Energy Authority. Although some schemes will not be directly targeted by the review, we anticipate they will be required to act on its recommendations.

In broad terms, the review will consider:

- the gap between public service and private sector pension provision,
- future pension provision and fairness across the public sector workforce,

- how risk should be shared between the taxpayer and employee, and
- wider government policy intended to encourage people to save for retirement in the context of their longer working lives.

The commission is charged with making recommendations on how public sector pensions can be made sustainable and affordable over the longer-term, so that they are fair to both the public sector workforce and the taxpayer, and appropriate in the context of the fiscal challenges ahead, and it will also review whether any short-term savings can be made.

Public sector workers may take a modicum of comfort in the Government's confirmation that accrued pension rights will be protected. Statute generally protects pension benefits which have already built up – although parties are still free to agree changes to the employment contract amongst themselves – and so Parliamentary involvement will be required for any changes to these benefits. The Government has emphasised its policy aims of protecting lower paid workers, and the review is set to be conducted in this context. The focus is largely on ensuring that future pensions arrangements over the long-term are fair to both the public service workforce and the taxpayer, and it is anticipated that tighter controls will apply to the upper echelons of the public sector workforce.

Hutton pay review

The Government has also tasked the economist Will Hutton with making recommendations to the Chancellor and Prime Minister by March 2011 on promoting "pay fairness" in the public sector by tackling disparities between the lowest and the highest paid in public sector bodies. An interim report is expected by late Autumn 2010.

The review, which aims to help shape broader social norms in relation to pay fairness, will carry out a "robust, evidence based analysis" of the scale of the problem and will make recommendations on:

- how to introduce a public sector pay multiple ("cap") that would mean that no public sector manager can earn over 20 times more than the lowest paid person in their organization,
- over what timescale a cap could be applied, and
- how a cap would operate in areas outside direct ministerial control.

Of course, this will need to be considered in the context of the Government's wider fiscal and public sector pay policies, the need for senior staff to show leadership in pay restraint, and the desire to deliver value for money from the public sector pay-bill. The review board has already been told that its recommendations must not increase the total pay bill.

"If everybody minded their own business," the Duchess said in a hoarse growl, "the world would go round a deal faster than it does."

All aspects of the public sector pay package, including levels of pay (base and variable), bonuses and other benefits, will be assessed in the context of "fairness" across the pay range. The pay review will take into account any recommendations or findings from the public sector pensions review and will not make independent recommendations on areas already covered by the scope of the pensions review.

The pay review will mainly focus on senior staff and managers covered by the Senior Salaries Review Body: senior civil servants, senior NHS commissioning body managers, senior military, managers in local government and the NHS, publicly-funded regulators, and senior staff in further and higher education. The review terms are broad, covering areas such as the relationship between remuneration, recruitment and retention, market pay rates and "opportunity cost" (what staff members give up in order to work in the public sector), "transparency" and ministerial approval of senior pay decisions. It also covers existing benchmarking measures, the effect of market failures in private sector pay and implications for public sector pay, and rewarding entrepreneurship.

Summary

It would appear that change is on the horizon, but short of large-scale revision of historic benefits, it is difficult to see how the existing public sector deficit can be effectively reduced in the short-term. The hoped-for cost-savings are more likely to be achieved over the longer-term, through changes to future benefit arrangements, in a way which does not compromise accrued benefits.

Of course, the devil will be in the detail: the specifics of any changes proposed will be keenly anticipated (and, no doubt, heavily debated) on release later this year. The expected cost-cutting and uncertainties surrounding the outcome of the Hutton reviews may well increase scope for outsourcing from the public sector, perceived to be one of the ways in which 'value' and savings are achieved. Whatever happens, it is likely that the relevant pensions requirements that apply on a transfer of staff from the public sector will change: in particular, Fair Deal may be overhauled or even revoked, alongside the two-tier workforce code. September is likely to prove an interesting month for public sector pensions and procurement specialists. Watch this space for details of our seminar session on the implications of the Hutton reviews later this year.

Jaimie Blueman
Associate
T: +44 (0)113 284 7240
E: jaimie.blueman@hammonds.com

TRUSTEE ROUND-UP

Under this miscellaneous heading, we draw your attention to a number of diverse matters that we suggest should feature on forthcoming pensions agendas.

Surplus to requirements

A quirk of legislation[2] requires trustees of occupational pension schemes to pass a resolution before 6 April 2011, if they wish to retain existing powers in their scheme rules to make a future repayment of surplus to an employer either whilst the scheme is ongoing or potentially even upon a future wind-up. This legislation applies to schemes that were established before 6 April 2006 and whose rules contained a power to make payments to the employer out of scheme funds[3]. Many schemes will have such a power.

In our view, the legislation was not intended to have such wide application. Concerns have been raised with the Department for Work and Pensions but we have no evidence to suggest that the legislation will be amended in time. We recommend that pension schemes therefore consider taking action now – otherwise there is a real danger that time will run out and a valuable power will be lost.

Trustees have to be satisfied that passing a resolution to retain powers to make payments to the employer is in the best interests of members. Any actual return of surplus would be subject to payment of tax and overriding restrictions: these include ongoing schemes being fully funded on a buy-out basis and schemes in wind-up having fully discharged their liabilities.

Sponsoring companies have a vested interest in this issue. They may reasonably expect to preserve the possibility of a refund if the scheme becomes overfunded. There are also accounting implications – for example, under IFRIC 14, a company may currently be able to recognise a right to a return of a pension scheme surplus on its balance sheet – this could now be jeopardised.

Before a resolution can be passed, trustees have to give three months' notice to employers and to scheme members. Communication with members will need careful consideration, especially if the scheme has taken recent cost-cutting measures.

Whilst the context of the legislation indicates that it is concerned purely with the repayment of surplus, it is arguable that it could also apply to any other payment to an employer. We recommended that trustee resolutions are drafted to cover all circumstances.

Agenda item 1 – Trustees to check scheme rules on employer payments and agree further action.

Disclosure of information

The disclosure regulations[4] specify the information that trustees must provide to scheme members and other interested parties, and whether this information has to be provided automatically or

"The time has come," the Walrus said, "To talk of many things: Of shoes – and ships – and sealing-wax – Of cabbages – and kings…".

2 Section 251 of the Pensions Act 2004.

3 The legislation does not apply if the scheme was already in wind-up on that date.

4 The Occupational Pension Schemes (Disclosure of Information) Regulations 1996 (as amended).

upon request. The DWP has wanted to simplify and update these regulations for a long time but struggled to decide what level of change is needed. New regulations exist in draft form and are due to come into force on 1 October 2010.

Currently, information has to be provided to members in writing – this includes, for example, basic scheme information which is normally contained in an explanatory booklet. Under the new draft regulations, it will be possible to satisfy information requirements by sending an Email or by posting material on a website. Trustees will need to give advance written notice to members before electronic communications can be used and members can opt instead to be provided with paper versions. However, we anticipate that electronic communications will be widely used, especially for younger generations.

The proposed new timescale applying from October 2012 will require basic scheme information to be supplied to members within one month of joining a scheme (instead of two months). This change is consistent with the automatic enrolment provisions which are due to come into force at the same time. Simplifications are also proposed to statutory money purchase illustrations.

The new regulations will present trustees and employers with communication options: they are not intended to force changes upon pension schemes (with the exception of the tighter timescale for providing basic information from 2012).

Agenda item 2 – Trustees should discuss use of Email and websites with the sponsoring employers, ensuring that communication standards are not compromised by the use of less formal media.

Changes to maternity/paternity leave

New rights will apply to parents whose babies are born (or expected to be born) on or after 3 April 2011. Legislation will allow new fathers to take up to 26 weeks' Additional Paternity Leave if the mother returns to work before using her full entitlement to 12 months' statutory maternity leave.

The requirements will also apply to those who adopt a child and to same sex couples. Although this is more of an employment matter than a pensions issue, trustees will need to make sure that the family leave provisions set out in scheme literature and scheme rules are drafted widely enough to deal with the new requirements and that administration practices are altered accordingly.

Agenda item 3 – Trustees to discuss with appropriate parties whether any changes to scheme communications/scheme rules/administration procedures are needed.

Getting to grips with the employer covenant

The Pensions Regulator's *Guidance on monitoring employer support: covenant, contingent assets and other security* is open for consultation until 7 September. This draft guidance largely consolidates existing material but also contains useful comment, good practice suggestions and case studies. Trustees should find it helpful.

The Regulator believes that employer covenant assessment is as important to the security of a scheme as monitoring fund performance. The covenant underwrites the risk to which the scheme is exposed. A strong covenant allows trustees to bear greater risk (for example, in terms of investments), whereas a weak covenant makes it difficult to justify such risks.

Adopting a proportionate approach, trustees should:

- appoint a covenant adviser, through an objective selection process, if they do not have the expertise and independence to form their own assessments,
- arrange for a full covenant review before each three yearly scheme specific funding valuation and an annual review thereafter,
- consider agreeing a formal plan with the employer, specifying how the covenant will be monitored and setting out the factors that will cause the trustees to take action,

"Always speak the truth – think before you speak – and write it down afterwards".

THE RED QUEEN

- be poised to act swiftly following a detrimental change,
- adopt a standing agenda item for each trustee meeting to note the covenant and compare performance against the formal monitoring plan,
- assess the employer's business case before accepting any contingent asset, noting the suitability of any non-cash asset and ensuring that any agreement is legally enforceable, and
- encourage open communication with employers and be prepared to commit to confidentiality agreements if necessary.

In order to carry out these functions trustees need to understand:

- the covenant from a legal perspective, to appreciate the nature and enforceability of the promises to make payments to the scheme, and from a financial perspective, to comprehend the likelihood of these promises being met,
- the structure of the corporate group and the position of the pension scheme in relation to other creditors, and
- which employers have a legal obligation to the scheme due to current or former participation.

The Regulator emphasises that the draft guidance offers "clarification" – it does not impose new requirements. However, it is the first time that its expectations have been set out in such a level of detail, and trustees may need to modify their approach.

Agenda item 4 - Trustees should review the draft guidance and discuss whether their approach to employer covenant needs any fine-tuning.

"Come, I'll take no denial; We must have a trial: For really this morning I've nothing to do."

THE MOUSE

Employer cessation events

As mentioned in the employer covenant paragraphs above, it is hugely important that trustees of multi-employer defined benefit pension schemes understand which employers in the corporate group have a responsibility towards supporting the scheme, including when any debt might become due. Employer debt is a notoriously difficult area of legislation, but the recent *Pilots*[5] decision in the High Court should help to clarify when an employer was deemed to have left a pension scheme (an "employer cessation event"), thereby triggering a debt, under legislation which applied before 6 April 2008.

The *Pilots* judgment is of epic length (at 182 pages!), dealing with some 39 issues. It confirms that an employer will have ceased to participate in a scheme if it ceased to employ any active members or any employees eligible to join a pension scheme. This judgment disagrees with an earlier interpretation[6] of the legislation which suggested that no debt was triggered whilst there were deferred or pensioner members attributable to a particular employer.

We do not yet know whether any aspects of the *Pilots* judgment will be appealed, but the ruling relating to employer cessation events is the interpretation that the legal profession anticipated.

Agenda item 5 – Trustees should work with legal advisers to assess the effect of this judgment on their scheme in relation to former employers.

Trustee knowledge and understanding

The Pensions Regulator's Trustee toolkit is required study for new trustees "unless they can find an alternative learning programme which covers all the items in the scope guidance at a level relevant for them".

The Regulator has updated the toolkit to include the duties applying to employers from 2012 to automatically enrol eligible jobholders into a qualifying pension scheme. The updated tutorial "What is a pension scheme?" can be found in the "Introducing pension schemes" module at www.trusteetoolkit.com. Over recent months the Regulator has also issued a number of bite-sized modules for trustees on the employer covenant, exiting multi-employer schemes, transfer incentives, record keeping and scheme governance.

5 The PNPF Trust Company Ltd v Taylor and others [2010] EWHC 1573 (Ch)

6 Cemex UK Marine Limited v MNOPF Trustees Limited [2010] PLR 1

Agenda item 6 – Keep trustee knowledge and understanding under review to ensure that your trustee group is up to date with new developments.

Internal controls

In June 2010, the Pensions Regulator issued detailed, updated guidance material, designed to give practical assistance to trustees on how to comply with the requirement to establish and operate adequate internal controls. The Regulator reminds trustees that the internal controls requirement covers a broad range of functions including operational, financial, funding, regulatory and compliance issues. In other words, it relates to the whole of a scheme's operations. Trustees should adopt a risk-based approach towards assessment of internal controls.

The guidance focuses on the following priority areas which are common risks in most pension schemes:

- lack of knowledge and understanding,
- conflicts of interest,
- ineffective relations with advisers,
- poor record keeping,
- deterioration in employer covenant,
- investment risk, and
- ineffective retirement processes.

The list is not exhaustive: there will be other scheme specific risks. Trustees should evaluate all risks in a sensible order of priority, starting with those that have the greatest potential impact.

Agenda item 7 – Trustees should consider the new guidance and assess whether their current processes are still fit for purpose.

Record keeping

The Pensions Regulator's research indicates that standards of pension scheme record keeping are, quite simply, not good enough. It has issued new guidance aimed at all work-based pension schemes, in an attempt to focus trustees, providers and administrators on making improvements to the quality of member data.

The guidance categorises data as two types: common data and conditional data. "Common data" is the data required to uniquely identify a member. "Conditional data" is the scheme specific information necessary to calculate benefits and administer the pension scheme – this will vary for each scheme, depending on its benefit structure and history.

The target set by the Regulator is 100% accuracy for common data created after June 2010, and 95% accuracy for data created earlier. Targets should be met by December 2012. For conditional data, targets should be set by trustees in conjunction with the administrators. In addition, trustees are expected to have enough statistical membership information to be able to put meaningful context around any data problems. Examples are set out in the guidance.

Trustees of Defined Contribution schemes are advised to consult Appendix 2 of the guidance. In this Appendix, the Regulator sets out its expectation that DC trustees should have enough understanding of administration and investment functions to be able to determine the controls that should be in place and the records that should be kept. This will require the co-operation of the administrators.

The Regulator is clear in its intention to use enforcement action where schemes have poor data standards, especially if steps are not being taken towards corrective action.

"The King said, "I shall never forget." "You will, though," the Queen said, "if you don't make a memorandum of it."

Agenda item 8 – Trustees, in conjunction with the scheme administrators, should determine the essential conditional data for the scheme. Plans should be adopted for an appropriate level of data sampling to take place and to be reported to the trustees.

Equality Act 2010

Equality legislation applying to occupational pension schemes has been consolidated into the Equality Act 2010 (the "Act"). The Government has confirmed that the pensions aspects of the Act will come into effect on 1 October 2010. The Act prohibits trustees and employers from discriminating against, or victimising or harassing, a member or prospective member of a pension scheme on a number of grounds which are referred to in the legislation as "protected characteristics". The protected characteristics covered by the Act are: sex, age, disability, religion or belief, race, sexual orientation, gender reassignment, marriage/civil partnerships, and pregnancy/maternity.

From 1 October 2010, a non-discrimination rule, covering all of the protected characteristics, will be automatically implied into pension schemes. Although much of this anti-discrimination legislation is not new (rather it is consolidated into one place), trustees and participating employers need to be aware of its application.

We are awaiting an Order to clarify the position on age discrimination. The Act will repeal an area of legislation[7] that occupational pension schemes currently rely on to a large extent. This legislation effectively allows certain distinctions to be made by pension schemes on grounds of age, without trustees or employers falling foul of the law. Such distinctions are common to many pension schemes and include: differences in treatment based on a member's length of service; restrictions on admission to a scheme based on minimum or maximum ages; and use of age related criteria in actuarial calculations (for example on early retirement). We do not yet know the extent to which the exceptions will be replicated in the new legislation.

Trustees will be able to make non-discrimination alterations to their scheme rules by resolution if they do not have the power to make such alterations, or if the amendment process is unduly complex/protracted, or involves obtaining consents which are difficult or impossible to obtain.

Agenda item 9 – Trustees to consider their scheme rules and practices in the light of the Act.

Finance Act transitional provisions

When the new simplified tax regime came into force on 6 April 2006, transitional regulations allowed features of the former regime (eg old "Inland Revenue Limits" on pension benefits and the Earnings Cap) to continue to apply where schemes did not amend their rules. Schemes that are still relying on these transitional regulations should amend their rules before 6 April 2011, otherwise they could potentially face having to provide higher benefits than intended, resulting in an increase in liabilities.

Agenda item 10 - Trustees should check what action was taken to amend scheme rules in preparation for tax simplification in 2006 and assess whether further amendments are now necessary.

Lynn Hood
Professional Support Lawyer
T: +44 (0)113 284 7115
E: lynn.hood@hammonds.com

7 Schedule 2 of the Employment Equality (Age) Regulations 2006

"I am older than you, and must know better."

THE LORY

TEAM NEWS

The Hammonds Pensions Team (over 60 lawyers) met in Leeds in June for a mix of technical and skills training. We were joined for part of the day by a client who gave invaluable insight into her expectations of high quality client service and our team members participated in technical training and "enjoyed" some challenging role play to help their continuing development.

We are delighted to announce the appointment of Kris Weber (Partner) and Stephen Moore (Associate) to the London team, both joining from Charles Russell LLP. In Leeds, Jaimie Blueman (Associate), is a recent joiner from DLA Piper UK LLP.

Kris Weber
Partner

Stephen Moore
Associate

Jaimie Blueman
Associate

Clare Grice, Kate Lloyd and Marianne Jaekel have been promoted to Senior Associate – many congratulations go to them.

FURTHER INFORMATION

If you would like more information about any of the issues covered in this Review please contact any of the partners listed below or your usual contact in the pensions team.

Francois Barker
International Head of Pensions
Head of Birmingham Pensions
T: +44 (0)121 222 3584
E: francois.barker@hammonds.com

Catherine McKenna
Head of Leeds Pensions
T: +44 (0)113 284 7045
E: catherine.mckenna@hammonds.com

Wendy Hunter
Head of London Pensions
T: +44 (0)207 655 1119
E: wendy.hunter@hammonds.com

Steve Southern
Head of Manchester Pensions
T: +44 (0)161 830 5172
E: steve.southern@hammonds.com

Emma King
Head of Pensions Disputes
T: +44 (0)121 222 3103
E: emma.king@hammonds.com

Here is a summary of the action points flagged by this Review for trustees to complete for their own schemes.

ISSUE	SUMMARY OF ACTION NEEDED BY TRUSTEES	ACTION TAKEN BY YOUR SCHEME
Compulsory annuitisation at age 75 to be abolished.	Note the interim measures and assess potential impact on the scheme.	
Change to index from RPI to CPI for revaluation and indexation.	Keep track of developments and consider the effect on the scheme.	
Changes to Annual Allowance affecting higher earners.	Just keep an eye on this one for now.	
Risk reduction incentive exercises.	Note the new guidance if a risk reduction exercise (eg a pension increase exchange) is contemplated.	
Payments to employer – trustee resolution may be needed.	Check scheme rules on employer payments and consider passing a resolution before 6 April 2011. Note the timescales for member communications.	
Changes to disclosure of information legislation from 1 October 2010.	Consider use of electronic communications from 1 October 2010.	
Changes to maternity/paternity leave legislation – babies born from 3 April 2011.	Consider whether any changes to scheme communications, rules or administration practices are needed.	
Employer covenant draft guidance issued for consultation.	Trustees of defined benefit schemes should re-consider whether their approach to monitoring the employer covenant needs any fine-tuning.	
'Pilots' judgment on employer cessation events before 6 April 2008.	Trustees of multi-employer defined benefit schemes should discuss implications with their legal advisers.	
New e-learning modules issued.	Keep trustee knowledge and understanding under review. There is a lot to keep up with!	
Internal controls – new guidance issued.	Consider whether the scheme's existing risk management system is still fit for purpose.	
Consolidation of equality/ discrimination law.	Consider impact on scheme rules and practices.	
Transitional 'tax simplification' regulations ending in April 2011.	Check whether scheme rules were amended for tax simplification and whether further action is now necessary.	
Record keeping – new guidance contains 'targets' for member data.	Determine 'conditional' data for the scheme. Adopt plans for data sampling. DC trustees to note Appendix 2 of the guidance.	

Hammonds

Birmingham

Hammonds LLP
Rutland House
148 Edmund Street
Birmingham B3 2JR
Telephone +44 (0)121 222 3000
Fax +44 (0)121 222 3001

Leeds

Hammonds LLP
2 Park Lane
Leeds LS3 1ES
Telephone +44 (0)113 284 7000
Fax +44 (0)113 284 7001

London

Hammonds LLP
7 Devonshire Square
London EC2M 4YH
Telephone +44 (0)20 7655 1000
Fax +44 (0)20 7655 1001

Manchester

Hammonds LLP
Trinity Court
16 John Dalton Street
Manchester M60 8HS
Telephone +44 (0)161 830 5000
Fax +44 (0)161 830 5001

Berlin

Hammonds LLP
Unter den Linden 14
10117 Berlin Germany
Telephone +49 30 7261 68 000
Fax +49 30 7261 68 001

Brussels

Hammonds LLP
Avenue Louise 250
Box 65
1050 Brussels Belgium
Telephone +32 2 627 7676
Fax +32 2 627 7686

Madrid

Hammonds LLP
Plaza Marques de Salamanca 3-4
28006 Madrid Spain
Telephone +34 91 426 4840
Fax +34 91 435 9815

Paris•

Hammonds Hausmann
4 Avenue Velasquez
75008 Paris France
Telephone +33 1 53 83 74 00
Fax +33 1 53 83 74 01

Beijing+

Hammonds Beijing
Representative Office Hong Kong
Suite 1419 - 20
South Tower Beijing Kerry Centre
1 Guang Hua Road
Chao Yang District
Beijing 100020 China
Telephone +86 108529 6330
Fax +86 10 85296116

Hong Kong•

Hammonds
Suites 3201-05, 3217-20
32nd Floor Jardine House
1 Connaught Place
Central Hong Kong
Telephone +852 2523 1819
Fax +852 2868 0069

• Affiliated undertakings of Hammonds LLP + Representative Office

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