Transfer values – Government lays regulations for new trustee-driven regime

Regulations have been laid before Parliament that bring into force the new individual transfer regime. As a result, all individual transfer values quoted on or after 1st October 2008 must be determined on no less than a “best estimate” basis, set by the trustees having taken actuarial advice. By this time, all defined benefit schemes should have replaced the old actuary-certificated arrangement with one that is trustee-driven.

The Occupational Pension Schemes (Transfer Values)(Amendment) Regulations 2008 (SI 2008/1050 – see also the explanatory memorandum) have the same intention as those issued in draft last year (see Pensions Bulletin 2007/29). They incorporate much of actuarial guidance note 11 (GN11) into regulations and as a result GN11 is expected to be withdrawn. Furthermore, the Board for Actuarial Standards is not expected to issue a technical standard, so it appears that actuaries will not be constrained when advising trustees as to what “best estimate” means.

There are some important changes from the draft regulations when one examines the detail. These are explained in the Government’s response to the consultation, which has also been published. The changes include the following:

- Discretionary benefits – consent of the employer is now generally required before trustees can take these into account;
- Discount rates – these must now have regard to the scheme’s investment strategy as a whole – the draft regulations referred to the strategy for the individual class of member;
- “Best estimate” – the individual assumptions need not be set on a “best estimate” basis, provided that a “best estimate” is the overall result;
- Reduction for under-funding – amendments have been made with the intention of retaining the flexibility currently found in GN11.

Trustees can adopt a basis that delivers more generous transfer values than under “best estimate”, but subject to any consent requirement that governs the operation of their scheme. Such a transfer value is still a “cash equivalent” and so there should be no concerns about the validity of the statutory discharge should they be paid.

As at present, trustees have broadly three months from the member’s application to supply the transfer quote, but the conditions under which it is possible to defer by a further three months have been broadened from “reasons beyond their control” to obtain the necessary information to any reasons beyond their control. Both may prove to be useful as trustees implement the new regime.

To help trustees understand the different considerations and new requirements in relation to transfers the Pensions Regulator will be publishing guidance before the new regulations come into force in October. It also plans to publish guidance for scheme members to help them compare the key risks with any potential advantages associated with taking a transfer to another pension vehicle.
**Comment**  
The timing of the Regulator’s guidance will be crucial if there is to be a smooth transition to the new regime. The Government may believe that it has kept broadly to its promise of allowing six months for trustees to implement, but the regulations read in isolation do not appear to be a sufficient description of the Government’s policy intention (as referred to in the consultation response and the explanatory memorandum). For example, the regulations do not make clear that it is the long-term investment policy to which the trustees need to have regard when setting the discount rate. They are also completely silent on the Government’s desire that the basis should respond to changes in financial conditions.

Despite not having everything in place, many trustees will now need to get the topic onto their agenda as they may have delayed carrying out a thorough review of their existing transfer basis as they waited for details of the new regime to become available. They will need to have detailed discussions on the new basis and following their decisions, reach agreement to implement any system changes. The Regulator’s guidance is sorely needed.

**Regulator “moral hazard” powers to increase**

In what is being promoted as a response to the launch of business models that look to sever the link between employer and scheme, and operate well-funded occupational pension schemes for profit but to the possible detriment of scheme members, the Government will shortly be issuing a consultation document on proposed changes to the “moral hazard” powers of the Pensions Regulator. This development follows the debate in the House of Commons in February (see Pensions Bulletin 2008/09).

In order to be able to apply these changes ahead of the necessary legislation, the Department for Work and Pensions (DWP) has issued a statement regarding its plans – in particular, employers may be subject to a Contribution Notice if their actions could threaten the security of members’ pensions.

At present a Contribution Notice can be issued if there is an act, or a deliberate failure to act which has as its main purpose, or one of its main purposes, the prevention of recovery of a debt from an employer to a pension scheme, or to preventing a debt becoming due.

However this formulation would not necessarily cover a disposal of significant company assets, for example, where the impact on the employer debt simply had not been considered (as opposed to deliberately planned). Therefore the DWP is proposing that Contribution Notices may be issued where “the effect of an act is materially detrimental to a scheme’s ability to pay members’ current and future benefits”.

Significantly, this would also mean that the Regulator would no longer need to prove intent on the part of a party to avoid funding the scheme, but rather that the effect of an act or course of conduct posed a materially detrimental risk to members’ benefits. Conscious of the furore that greeted the original moral hazard powers nearly four years ago, careful drafting is promised which may amongst other things limit the use of the power to situations where the prospective recipient of the Contribution Notice is unable to demonstrate that the likely consequences of their actions could not reasonably have been foreseen.

The proposals will also:

- remove the existing provision that states that a Contribution Notice may not be issued where a party has acted in ‘good faith’, but their actions have had the effect of preventing a debt becoming due
(this is to avoid situations where a company has simply not considered the impact on the pension scheme, but again lowers the bar for Contribution Notices to apply); and

- allow the Regulator to require an employer or associate to make additional contributions to a scheme where a bulk transfer has been carried out and was detrimental to the interests of members.

At the same time the legislation is to be “clarified” so that:

- a Contribution Notice can be triggered by a series of acts, and not just a single act aimed at avoiding a debt to a pension scheme; and

- the resources of the whole group of companies may be considered when judging whether to issue a Financial Support Direction when there is an under-resourced employer – rather than requiring the Regulator to identify one single ‘person’ which is sufficiently resourced to enable the issue of a direction.

Amendments to legislation introducing these changes will be effective from 14th April 2008, other than the “series of acts” amendment which will be effective from 27th April 2004 (on the grounds that this is merely a clarification of an existing power).

The formal proposals will be available shortly on the DWP website on which there will be an eight-week consultation period.

LCP has produced a News Alert that analyses and comments on this development from the corporate and trustee perspective.

Comment  These are significant extensions to the current Contribution Notice and Financial Support Directions framework. The most contentious would appear to be the main proposal for Contribution Notices.

Despite Government claims that the proposed changes are targeted at “non-insured” buyouts, they would seem to have far wider implications. It is not obvious whether this is intentional. We expect significant push-back from various industry sectors during the consultation process, and would hope that the actual changes in law will properly reflect the Government’s stated objectives of providing clarity to pension schemes and their sponsors and targeting actions that pose risks to pension benefits.

The main immediate outcome is far higher levels of uncertainty regarding how pension liabilities might impact upon many forms of corporate activity, such as transactions, re-structuring and refinancing exercises. Such uncertainties will drive up the cost and the complexity of corporate activity and could even confound the plans of corporates looking to carry out much-needed changes in how they operate.

Trustees also now face a period of uncertainty during which the extent of the Regulator’s powers to support them is unclear. For the period before the proposals are finalised trustees negotiating with sponsors will not have clarity as to the mitigation they should seek and the powers that the Regulator will ultimately have to step in if required.
It will also be interesting to see the detail of the proposed extension of the Financial Support Direction provisions as it could signal a broadening of the range of companies which could be in the firing line where, let’s not forget, no mischief at all, apart from the simple fact of under-funding is alleged.

Non–insured buyouts – Undertaking from Pension Corporation

The Pensions Regulator has received an undertaking from Pension Corporation that it will not permit anyone from Pension Corporation, or a wide-range of associated entities, to be appointed as a trustee of any scheme in which Pension Corporation has a specified financial interest or liability without the prior permission of the Regulator. This permission will not be sought on a regular basis and in any event not within eighteen months of the undertaking. This addresses one of the Regulator’s concerns about conflicts of interests which led to the appointment last October of three independent trustees with exclusive powers to the telent pension scheme (see Pensions Bulletin 2007/44).

And specifically in relation to the telent scheme a number of additional measures have been agreed whose purpose is to protect members’ interests and safeguard the future governance of the scheme – such as restrictions on the composition and responsibilities of the board of the trustee and the adoption of a conflicts of interest protocol.

The Pensions Regulator says that these measures, which will govern the scheme after the expiry of the independent trustee appointments on 18th April, address the concerns that were before the Determinations Panel.

The Pensions Regulator has also published a report outlining the background to its involvement in this case, the issues that have arisen and how, in relation to the scheme it will deal with these issues in the future.

Comment

One imagines that there has been some choreography between this announcement and the proposals to increase the Regulator’s moral hazard powers (see article above). But to the casual observer, it is not obvious why the need is so pressing to deal with similar vehicles that a statement has to be issued ahead of a formal consultation on extending the Regulator’s powers. The fact that a solution has been found under the existing regime also calls into question the need for any new powers. But in a fast-moving buyout market and with a Pensions Bill going through Parliament, perhaps the Government feels compelled to legislate for Rumsfeldian ‘unknown unknowns’.

Separately, although the circumstances surrounding telent are unusual, the agreement reached with the Regulator is instructive as to how “potentially acute and pervasive” conflicts can be addressed.

ECJ ruling may re-open equal treatment backdating arguments in the UK

In a case that could have implications for the UK, the European Court of Justice (ECJ) has ruled in Tadao Maruko v Vesorgungsanstalt der deutschen Bühnen regarding the rights of Mr Maruko to a widower’s pension from a German pension scheme on the death of his “life partner” (the German equivalent of a UK civil partner), a member of the scheme.
The scheme had refused to pay a widower’s pension although a pension would have been payable to a spouse. Mr Maruko sued on the grounds that he was the victim of discrimination on the grounds of sexual orientation.

The ECJ held that:

- a survivor’s benefit granted under an occupational pension scheme falls within the scope of the Equal Treatment Directive which outlaws discrimination on the grounds of, amongst other things, sexual orientation in the employment field; and

- the effect of the Directive is such that denying a life partner a pension where it was payable to a spouse constituted discrimination on the grounds of sexual orientation.

On the face of it neither of the above are a surprise. But there was a further question. Given that the restriction in the scheme was discrimination, was entitlement to the survivor’s benefit restricted to periods subsequent to 17th May 1990 on the basis of the Barber judgment as clarified by Coloroll (the deceased had been a scheme member since 1st September 1959)?

The ECJ held that as there was nothing in this case to suggest that the financial balance of the scheme was likely to be retroactively disturbed if the effects of the judgment were not restricted in time, there was no need so to do. Hence full backdating in this particular case was required.

Comment

The significance of this judgment is that the UK has chosen to restrict backdating a number of the strands when implementing the Equal Treatment Directive. For example, although the sexual orientation strand was introduced on 1st December 2003, civil partners cannot claim under the UK law implementing this strand for benefits to be backdated for periods of service before 5th December 2005. Likewise, the age strand does not enable benefits to be backdated for periods of service before 1st December 2006. As the Directive does not contain a provision authorising member states to limit backdating, it is possible that the limit will be vulnerable to legal challenge with this German case being called in evidence.

Emergency amendments made to new employer debt regime

Hurried amendments have been made to the Employer Debt regulations, only days after they came into operation (see Pensions Bulletin 2008/13). They address the concern expressed by a number of commentators that the regulations laid last month give the trustees a new unilateral power to amend their scheme rules so as to insert any apportionment rule of their liking. Although they are required to consult whatever employers they feel are appropriate, they do not need their consent. The fear was that trustees could use this unintentional power as a form of poison pill.

The emergency regulations fix this issue by only allowing the trustees to make a unilateral change to implement a scheme apportionment or regulated apportionment arrangement and then amend the definitions of both of these so that if the debt is greater than the “liability share” (ie the strict share of the scheme’s overall deficit on a buyout basis), the departing employer must consent to the arrangement, otherwise the remaining employers must consent.
The Occupational Pension Schemes (Employer Debt – Apportionment Arrangements) (Amendment) Regulations 2008 (SI 2008/1068) came into force on 15th April 2008 (see also the explanatory memorandum).

Cross-border schemes – DWP review

There is little that needs or can be done to improve the implementation in the UK of the cross-border provisions of the European Pensions Directive. This is according to a response published by the Department for Work and Pensions (DWP) on a consultation held late last year.

The review, carried out in advance of the EU Commission’s report on the implementation of the Directive which is scheduled for later this year, examined a number of issues raised by respondents. Could the full funding “at all times” requirement be addressed? Not at this time is the response. Can the information that schemes must obtain from member states be streamlined? Possibly, but subsidiarity means that member states are free to address this as they choose, is the response. And can the definition of “seconded worker” be made clearer? There is already guidance which should be sufficient is the answer.

Comment The response acknowledges that a consequence of the cross-border provisions implementation, whose purpose was to encourage pension schemes to operate cross-border, has been for a number of schemes to withdraw pre-existing cross-border arrangements. It appears that unless Brussels wishes to rethink the fully-funded at all times provision, the future will be predominantly money purchase, so far as cross-border schemes are concerned.

Actuarial profession – Falling yields on index-linked gilts

The actuarial profession has issued a briefing note that examines some of the issues that trustees of defined benefit occupational pension schemes are facing as a consequence of the recent sharp fall in the yields on long-dated gilts. It concludes by posing some questions that trustees wishing to reduce the risk of their investment strategy should consider.

Pensions Policy Institute – Personal Accounts briefing paper

The Pensions Policy Institute has published a briefing paper that looks at the different charging structures being considered by the Personal Accounts Delivery Authority for Personal Accounts and the criteria being used to evaluate them (see Pensions Bulletin 2008/10). The briefing paper concludes that there is no one charging structure that will meet all of the criteria and that some compromises will need to be made.
This Pensions Bulletin should not be relied upon for detailed advice or taken as an authoritative statement of the law. For further help, please contact David Everett at our London office or the partner who normally advises you.