Pensions Bulletin 2012/09

1 March 2012

Consumers warned to steer clear of early release pension offers

The Pensions Regulator, Financial Services Authority and HM Revenue & Customs have joined forces to publicly warn consumers about the dangers of "early release pension schemes" – offers that claim to be able to provide loans or release tax-free cash from people's pension pots before they reach the age of 55.

Such schemes often refer to unlocking, liberating or releasing funds tax free, usually by transferring some of a member's pension fund into highly risky and/or opaque investment structures which are often based overseas.

The risks to members include:

- The possibility of losing their entire pension if the arrangement is not bona fide (a relatively high chance given the nature of the business being undertaken).
- Significant tax charges – Pension funds are not meant to be taken before age 55; if they are the tax charges can be up to 55% of the value of the payment for a scheme member and at least 15% of the value of the payment for the person responsible for the scheme – the Scheme Administrator. If HMRC is not told, penalties may be charged.

In addition, very high fees of 20-30% of the fund value are not uncommon.

The warning has been prompted by a recent upsurge in such schemes, with known transferred funds amounting to nearly £200m by the end of 2011. Individuals are urged not to be taken in by website promotions, cold calls or adverts encouraging them to transfer their existing pension in order to access a cash payment or loan.

The Pensions Regulator has published details of its investigations into two such cases – Ark Business Consulting and Hollywell Enterprises Pension Scheme.

Comment

These warnings are of course entirely appropriate. Instant access to a substantial cash sum will be very enticing to many, particularly those in financial distress, and these schemes prey on that temptation. As the Regulator says, "if the offer sounds too good to be true, it probably is". But we have had these warnings before. Given

that fraud will always be with us, the real question is how can these agencies keep a lid on such practices?

High Court ring fences money purchase benefits in wind-up

The High Court has given an interesting judgment in the case of Alexander Forbes Trustees v Doe.

The case concerns two hybrid pension schemes which went into wind-up in deficit in the early 2000's. An application to the court was made for it to determine how the statutory priority order (SPO) set out in section 73 of the Pensions Act 1995 should operate for members with money purchase benefits.

The SPO sets out the order of preference in which liabilities are secured when a scheme is winding up. Currently (and this has changed a lot over the years) the SPO specifies that benefits bought out with an insurance company before 6 April 1997 come first, the benefits corresponding to the compensation which would be due from the Pension Protection Fund, if the scheme was to enter it, come second, benefits derived from voluntary contributions come third and everything else comes last.

However, section 73 goes on to state that "money purchase" assets and liabilities are not taken into account for the purposes of these calculations. Moreover, there is a specific regulation applicable to hybrid schemes such as the ones involved in this litigation which also specifies that most money purchase assets and liabilities are not included in the calculation.

This is important because the legislation makes it possible for money purchase benefits to be effectively ring-fenced from the general trust fund where a scheme is winding up with insufficient assets to cover the liabilities. It has been generally thought that the scheme documentation would need to be drafted so as to facilitate this ring-fencing and prevent members with money purchase benefits from losing them into the black hole of the defined benefit (DB) deficit.

What appears to have happened in this case though, is that the scheme documentation did not effectively ring-fence the money purchase benefits. So the judge took the step of appealing to what he thought the Parliamentary draftsman must have intended when ruling that the statutory law "formed a complete code" and hence overrides whatever it was that the private law in the scheme documentation stated about the disposition of money purchase benefits in an underfunded scheme wind-up. The members with money purchase benefits thus get to keep them, irrespective of what the documentation says.

Comment

This ruling, from the Birmingham District Registry of the High Court, seems to overturn some conventional wisdom. We had all thought before that the legislation facilitated the ring-fencing of money purchase benefits but that the documentation needed to reflect this for it to work. Apparently the legislation now overrides the documentation.

This case is timely as there is already legal uncertainty as to what actually constitutes "money purchase" in the context, among others, of deficit wind-ups (see our reporting of this for example in Pensions Bulletin 2011/44). The judiciary seem to be strongly of the view that, to quote here, money purchase members would be "outraged" if their benefits were swallowed up by a DB deficit and that it would be an "injustice" if this were to happen.

This is of interest to anyone managing a scheme wind-up. It appears that the court will go out of its way to protect money purchase benefits, irrespective of what either the documentation or the applicable SPO at the date of wind-up says. This may be a marker for schemes with money purchase benefits whose continued status as such may be problematic because of the changes to the definition introduced by the Pensions Act 2011. The Government may yet find that it will be allowed limited room for manoeuvre when trying to recategorise otherwise money purchase benefits if the consequence is that they do, in fact, get swallowed up.

Ombudsman fails to bark in PPF levy dispute

The Deputy PPF Ombudsman has found against an animal charity which disputed the calculation of its PPF levy when it increased enormously but the risk presented to the PPF by it had not altered.

The PDSA was used to a perfect D&B failure score and consequently enjoyed low PPF levies. But in January 2008 its score dropped from 100 to 87 and as it remained at this point at the 31 March 2008 cut off, its 2008/09 levy rocketed. A levy of £174,000 was demanded compared to £9,000 in 2007/08.

The cause of the drop in the failure score was D&B not having the PDSA's latest accounts (although PDSA mistakenly assumed it was due to an outstanding County Court judgment).

This case has brought into focus that until 2011/12 the charity sector was effectively discriminated against because of the way in which D&B collected financial information. D&B sought accounting information only from Companies House, but charities were obliged only to file their accounts with the Charity Commission.

D&B operated an unpublished obsolescence policy in relation to accounting information. So they downgraded PDSA's creditworthiness in January 2008 because the latest accounts in their possession at that time (supplied directly by the PDSA) were for the year ending 31 December 2004. Once D&B received the 31 December 2007 accounts (again directly from the PDSA) PDSA's failure score went back to 100. But this was too late for the 2008/09 levy.

The PDSA appealed on a multitude of grounds, but not only did the Ombudsman find against them but, given that the PDSA claimed to be monitoring its failure score and on other grounds, she concluded that *"the root of the problem and indeed unfairness is the PDSA's failure"*.

Comment

Whilst one can have sympathy with the PDSA the Ombudsman is right to rule in the way that she has.

The good news in this story is that not only has the PPF changed its procedure so that D&B now collects accounting information from the Charity Commission, but under the new levy regime schemes are no longer hostage to sudden drops in failure scores. We should see less of these cases in future.

What happened to the PDSA is a salutary tale, as this year's levy deadlines draw near, for trustees to ensure that everything is done so that their schemes get the best possible 2012/13 levy calculation. As pointed out by the Ombudsman, it is also important for trustees to check with D&B the cause of any large decrease in failure scores rather than make their own assumptions.

FSA overhauls transfer analysis assumptions

The Financial Services Authority (FSA) has launched a consultation proposing changes to the way independent financial advisers (IFAs) compare the value of defined benefit (DB) scheme pensions with the benefits that might be bought by a defined contribution (DC) fund when advising on the suitability of transferring. The net effect is likely to make it more difficult for IFAs to give the green light to such transfers going ahead.

The proposed changes include:

- updating the mortality assumptions used (in line with those used by the Board for Actuarial Standards for statutory money purchase illustrations) – for males aged 45 this could increase the calculated annuity by around 7%;
- calculating annuities on a gender-equal mortality rate, in line with the European Court of Justice's decision in March 2011 – this is said to increase the calculated annuity for males by 4% and reduce it for females by 4%;

- introducing a Consumer Prices Index (CPI) assumption for re-valuing pensions in deferment, reflecting legislative changes made by the Government in 2011 – however, the consultation itself does not set out what the CPI assumption should be;
- requiring CPI-linked and Limited Price Indexation (LPI)-linked benefits to be valued using the Retail Prices Index (RPI)-linked annuity interest rate – there is currently no guidance on CPI-linked benefits and confusion over how LPI-linked annuities should be calculated may have led to a 15% difference in values being calculated by different firms; and
- using growth rates that take into account the likely returns on the DC fund assets reduced if necessary to reflect the transfer of risk from the DB scheme to the member.

The consultation period closes on 27 March 2012.

Comment

Although this may seem to be a straightforward technical update, the consultation paper reveals that the FSA is concerned with the manner in which a number of market participants advise individuals, especially given the increased interest by scheme sponsors in undertaking liability management exercises. But the FSA has limited proposals in this area. It is one thing to update the assumptions; entirely another to address concerns that the mechanical approach many firms are using in these exercises is leading to individuals not being properly advised.

Treasury applies further restrictions on employer asset-backed contributions tax relief

The Treasury has published further draft Finance Bill 2012 clauses that are intended to restrict employers to only obtaining upfront tax relief on asset-backed pension scheme contributions where the total of such payments are fixed. These latest clauses are effective from 22 February 2012.

The Treasury originally published draft Finance Bill 2012 clauses back in November (see Pensions Bulletin 2011/50) to prevent employer asset-backed pension contributions receiving unintended and excessive upfront tax relief. But it now seems that this draft legislation (effective from 29 November 2011) is not sufficiently rigorous to achieve the Government's policy aim.

LCP INSIGHT CLARITY ADVICE

New inquiry into governance and best practice in workplace pension provision

The Work and Pensions Select Committee has launched a new inquiry to explore some of the wider issues raised in the Committee's auto-enrolment inquiry (the Committee report from which is expected shortly) and to consider other issues affecting workplace pensions. The focus is particularly on:

- how to ensure defined contribution (DC) schemes deliver good outcomes for their members; and
- the implications of the changing balance between defined benefit (DB) and DC schemes.

Submissions are requested by 13 April 2012.

Corporate reporting – simplification deferred

The Department for Business Innovation & Skills (DBIS) has announced that it intends to defer the proposed introduction of simplified company reporting requirements (see Pensions Bulletin 2011/40) until April 2013, following feedback suggesting companies would not be able to adjust in time to meet the original October 2012 start date.

DBIS plans to publish its formal response to the consultation in March.

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.

www.lcp.uk.com

LCP is a firm of financial, actuarial and business consultants, specialising in the areas of pensions, investment, insurance and business analytics.

Lane Clark & Peacock LLP
London, UK
Tel: +44 (0)20 7439 2266
enquiries@lcp.uk.com

Lane Clark & Peacock LLP
Winchester, UK
Tel: +44 (0)1962 870060
enquiries@lcp.uk.com

Lane Clark & Peacock Belgium CVBA
Brussels, Belgium
Tel: +32 (0)2 761 45 45
info@lcpbe.com

Lane Clark & Peacock Ireland Limited
Dublin, Ireland
Tel: +353 (0)1 614 43 93
enquiries@lcpireland.com

Lane Clark & Peacock Netherlands B.V.
Utrecht, Netherlands
Tel: +31 (0)30 256 76 30
info@lcpnl.com

LCP Libera AG
Zürich, Switzerland
Tel: +41 (0)43 817 73 00
info@libera.ch

LCP Libera AG
Basel, Switzerland
Tel: +41 (0)61 205 74 00
info@libera.ch

LCP Asalis AG
Zürich, Switzerland
Tel: +41 (0)43 344 42 10
info@asalis.ch

Lane Clark & Peacock UAE
Abu Dhabi, UAE
Tel: +971 (0)2 658 7671
info@lcpgcc.com

All rights to this document are reserved to Lane Clark & Peacock LLP ("LCP"). This document may be reproduced in whole or in part, provided prominent acknowledgement of the source is given. LCP is part of the Alexander Forbes Group, a leading independent provider of financial and risk services. Lane Clark & Peacock LLP is a limited liability partnership registered in England and Wales with registered number OC301436. LCP is a registered trademark in the UK (Regd. TM No 2315442) and in the EU (Regd. TM No 002935583). All partners are members of Lane Clark & Peacock LLP. A list of members' names is available for inspection at 30 Old Burlington Street W1S 3NN, the firm's principal place of business and registered office. The firm is regulated by the Institute and Faculty of Actuaries in respect of a range of investment business activities. The firm is not authorised under the Financial Services and Markets Act 2000 but we are able in certain circumstances to offer a limited range of investment services to clients because we are members (as defined under the Act) of the Institute and Faculty of Actuaries, a Designated Professional Body. We can provide these investment services if they are an incidental part of the professional services we have been engaged to provide. Lane Clark & Peacock UAE operates under legal name "Lane Clark & Peacock Belgium – Abu Dhabi, Foreign Branch of Belgium". © Lane Clark & Peacock LLP.