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Pensions Newsletter
February 2012

UK: Pensions Update

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1. DWP consultation on GMP equalisation

The Department for Work and Pensions (DWP) issued a consultation on the draft Occupational Pension Schemes and Pension Protection Fund (Equality) (Amendment) Regulations 2012 containing a proposed approach to the equalisation of guaranteed minimum pensions (GMP) for men and women. The draft Regulations would not actually change the law on equalisation of GMPs. It remains (and could, following the Regulations, remain) unclear as to whether such equalisation is required.

The consultation does contain a suggested method for equalising GMPs. The consequences of adopting the proposed method will be costly and administratively burdensome for schemes, and probably disproportionate in terms of the relatively small benefit adjustments that this will necessarily entail for most members.

The government has made it clear that this method is not mandatory, and that if it survives the consultation, it would not constitute legal advice or a definitive statement on how to effect equalisation. Schemes can elect to use alternative equalisation methods.

As GMPs are linked to the state pension scheme and are payable at age 65 for men and 60 for women, and therefore accrue at different rates. there has always been an argument that they are inherently discriminatory and should be equalised. At the same time, because GMPs were always designed to broadly mirror unequal State benefits, as was expressly permitted, there was an argument that they need not be equalised.

The government has received legal advice that GMP equalisation is required, and the Regulations would make some fairly technical amendments, in particular clarifying that the requirement to remove any unfavourable treatment is not subject to the requirement to identify an opposite sex comparator.

The methodology which accompanies the draft regulations essentially requires an additional calculation to be performed, to compare what a member would get under the scheme rules and the relevant legislation if they were treated as being a person of the opposite sex. The member's entitlement is the higher of the amount the member would get under the scheme rules and the amount their '*opposite sex comparator*' would receive. The comparison is done each time the amount of pension in payment is recalculated (generally annually) and the scheme pays the higher amount.

The consultation period runs until 12 April 2012 with the proposed amendments due to take effect from a date to be determined in 2012.

Given the cost implications of the proposed method and the lack of certainty as to whether there is a legal requirement to equalise GMPs, we suspect many schemes will continue their historic approach of not equalising GMPs.

2. Employer debt

Further to the government's consultation last year on The Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2011, these regulations have been finalised and came into force on 27th January 2012.

The regulations introduce a new easement, the Flexible Apportionment Arrangement ("**FAA**") to facilitate restructurings across multiple employers without an employer debt being triggered. They also extend the period of grace (currently 12 months) for employers that cease to have active members but intend employing new ones to 36 months.

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Where a debt has been triggered, entering an FAA reduces any debt that has already been triggered to nil. There is a facility to pay part of the debt into the scheme.

For the avoidance of doubt, the leaving employer must cease to employ any active member of the scheme in order for the FAA to take effect.

In practice, the new flexibility introduced by the regulations is fairly limited – FAAs are very similar to the existing "Scheme Apportionment Arrangements", and continue to require trustee consent.

3. Test-Achats

In our March 2011 newsletter, we reported that the European Court of Justice in **Association Belge des Consommateurs Test-Achats ASBL and others (Case C-236/09)** had ruled that from 12 December 2012, it will be unlawful for some UK insurers to use differential pricing of insurance policies for men and women in comparable circumstances.

The government has since confirmed that annuities and insurance contracts calculated using gender-based risk factors before 12 December 2012 should continue in that form after that date. It is currently consulting on making amendments to the Equality Act 2010 to reflect the position post 12 December 2012, and is also be working with the European Commission and other member states to ensure a consistent approach across the EU of the implications of the judgement.

In December 2012, the European Commission published guidelines to assist in the implementation of unisex pricing of insurance from 21 December 2012. The guidelines confirm that the ruling applies only to new contracts concluded after 21 December 2012 i.e. whenever a contractual agreement requiring the expression of consent by all parties is made, including an amendment to an existing contract. Examples of what would be considered new contractual agreements include:

- contracts concluded for the first time as from 21 December 2012; and
- agreements between parties, concluded as from 21 December 2012, to extend contracts concluded before that date which would otherwise have expired.

The guidelines also note a number of scenarios which would not constitute a new contractual agreement, for example "*adjustments made to individual elements of an existing contract, such as premium changes, on the basis of predefined parameters, where the consent of the policy-holder is not required.*"

Finally, the Commission has confirmed that, in its view, EU law does not require occupational pension schemes (which are governed by the Equal Treatment Directive1 and currently permits the use of sex-based actuarial factors by occupational pension schemes, for example in the context of commutation or transfer values) to implement unisex pricing. However, there may, of course, be some tangential effect where individual annuities are purchased.

4. Re Nortel – priority for pension liabilities on insolvency

The Court of Appeal has confirmed, in accordance with the High Court's decision in December 2010, that Contribution Notice (CN) liabilities arising post insolvency as a result of the exercise of the Pensions Regulator's moral hazard powers are **expenses** that rank ahead of all creditors other than those with a fixed charge.

Although the Court recognised that this conclusion is unsatisfactory given the close relationship between s75 debts and moral hazard liabilities whereby s75 debts enjoy a lower priority **but** CNs enjoy a higher priority, he felt that he had no alternative but to award the pension liabilities a "super priority" status. A combination of inconsistent case law and the less than satisfactory interaction between pensions legislation (which is silent on the treatment of moral hazard liabilities in the context of insolvency) and the Insolvency Rules 1986 meant that the pension liabilities had to be either a "super priority" claim or no claim at all.

As a consequence of the Court of Appeal decision, administrators may now wish to be appointed by the court, conditional upon the court granting an order, varying the order of expenses, so that they can fund the administration.

As far as issues for banks arising from the judgement are concerned, lending banks are more likely to pursue a consensual deal rather than an insolvency option, and may ask for more security, for example structuring the lending by way of fixed charges.

Borrowers will also need to be alive to the fact that banks are likely to ask more about defined benefit connections and will obviously be more concerned about priority issues.

Leave has been granted to appeal to the Supreme Court where the case is expected to be heard from October 2012 onwards.

5. Pensions Act 2011

The Pensions Act 2011 received Royal Assent on 3 November 2011. The key changes worth noting are as follows:

New definition of money purchase benefits

Following the decision in the **Bridge**[2] case, the statutory definition of "money purchase benefits" has been amended to make it clear that such benefits which are capable of creating a funding deficit will no longer be classed as "money purchase" with retrospective effect from 1 January 1997. Details of how this will work in practice will be set out in transitional regulations and once these become available, trustees and employers will need to consider making amendments to their schemes.

Payment of surplus to employers

The transitional period in section 251 of the Pensions Act 2004, enabling scheme trustees to pass a resolution to preserve the power to make a repayment of surplus to a sponsoring employer, has been extended to 6th April 2016.

CPI/RPI

Amendments to primary legislation have been made to reflect the change from RPI to CPI as the preferred measure for calculating pension increases in private and public sector schemes. As expected, there is no overriding statutory provision or modification power to help private sector occupational pension schemes switch to CPI-linked indexation or revaluation where their rules do not allow either change.

[1] The Equal Treatment Framework Directive (2006/54/EC).
[2] Houldsworth and another v Bridge Trustees Ltd and another [2011] UKSC 42.

Moral hazard time limits
The six year period for contribution notices and the 24 month period for financial support directions will end when the Pensions Regulator issues its warning notice, rather than after the Determinations Panel decision.
Also, there will a new regulation-making power to allow a period to be set (after a warning notice, has been given) beyond which the Pensions Regulator cannot exercise its powers.

Auto-enrolment

- The earnings threshold that workers will need to earn to trigger the employer duty to enrol automatically has been increased from £5,035 to £7,475. This will be reviewed annually and may be subject to change by the Secretary of State for Work and Pensions.
- An optional waiting period has been introduced to allow employers to defer a worker's automatic enrolment date for up to three months (however, a worker can opt-in at any time during this deferral period).
- A new certification regime has been introduced to allow employers to certify that their pension schemes meet or exceed certain criteria, such details have been set out in regulations that have not yet been finalised.
- Providing greater flexibility for employers dealing with automatic re-enrolment by allowing them to pick a date three months either side of their re-enrolment date.

6. Auto-enrolment – revised staging dates

From 1 October 2012, new statutory duties will come into force requiring employers to automatically enrol employees into a qualifying pension scheme and make minimum contributions. Depending on their size, employers will be required to discharge these duties on a staggered basis.
The DWP has issued a revised timetable for auto-enrolment to apply to medium and small businesses. In summary, this confirms that

- All employers with an existing staging date of on or before 1 February 2014 are unaffected.
- Medium-sized employers will be re-allocated staging dates between 1 April 2014 and 1 April 2015, a delay of up to nine months for some employers.
- Small employers will be allocated staging dates between 1 June 2015 and 1 April 2017.
- New employers setting up business from 1 April 2012 and up to and including 10 September 2017, will be allocated auto-enrolment dates between, and including, 1 May 2017 and 1 February 2018.
- New employers setting up business from 1 October 2017 onwards, will have an immediate duty to apply automatic auto-enrolment if they pay earnings which attract PAYE deductions.
- The proposed increase in the minimum rate of employer contributions from 1% to 2% of banded earnings will be delayed from 1 October 2016 to 1 October 2017.
- The employer contribution rate will then increase to 3% from 1 October 2018.

A consultation document on the detail of these changes as well as draft regulations, will be published shortly.

7. Abolition of short service refunds

The government has announced its intention to abolish short-service refunds from defined contribution (DC) schemes at the earliest opportunity. This follows a formal consultation by DWP in December 2011 on the future treatment of small pots built up by employees who move between employers in anticipation of the introduction of auto-enrolment.

Short service refund rules currently allow occupational pension schemes to offer a refund of contributions or a cash transfer if a member leaves after three months, but with less than two years of service and has not accrued any right to future benefits under the scheme.
The refund is of the member's contributions only, with the employer contributions remaining within the scheme to be used to cover, amongst other things, future employer contributions for other members. In the event that the member does not choose between a refund of contributions or a cash transfer to another pension, the scheme can nevertheless opt to make a refund.

The government is concerned that the short service refund rules are likely to influence employers to choose DC occupational pension schemes over other types of DC arrangement because of the saving costs, particularly for large employers with high staff turnover.
At the same time this is likely to lead to some individuals never building up pension savings and others building smaller pots.

Consequently, a decision has been taken to abolish short service refunds from DC occupational pension schemes by 2014 provided a solution can also be found for dealing with small pension pots. This would mean that the individual would start to accrue a right to future pension benefit under the scheme as soon as they join.
They would still have the right to transfer when they leave under existing transfer legislation and a right to opt out of automatic enrolment under the Pensions Act 2008.

Defined benefit occupational pension schemes have been excluded because of the disproportionate costs this would entail.

The consultation runs until 23 March 2012.