1. The Chancellor's Autumn Statement

George Osborne delivered his third Autumn statement on 5 December and set out below are the headline policy decisions as they relate to pensions:-

Pensions tax relief

As hotly anticipated, and in a bid to raise more cash from the rich, the Chancellor has reduced the Annual Allowance ("**AA**") from £50,000 to £40,000 for the tax years 2014/15, giving the Treasury a saving of £1bn a year.

The Lifetime Allowance ("**LTA**") will also be reduced from £1.5m to £1.25m for the aforementioned tax years.

A transitional 'fixed protection' regime ("**fixed protection 2014**") will be introduced for those who believe they may be affected by the reduction in the LTA.

The government also wishes to offer a personalised protection regime for individuals, in addition to fixed protection 2014 and will discuss the feasibility of this with interested parties in the coming months.

Legislation will be introduced in the Finance Bill 2012 to make these changes.

Key issues

Discount rate consultation

Following intense lobbying by the CBI and NAPF, the Chancellor has bowed to pressure and announced that the DWP will launch a consultation into smoothing the discount rates used to calculate scheme liabilities which could result in billions being wiped off scheme deficits. Scheme deficits have increased exponentially in recent years as record-low gilt yields, which are used to calculate the discount rate, drove up the value of liabilities.

The DWP will consult on whether companies undergoing valuations in 2013 or later should be able to take a longer-term view of projected returns and also whether to allow companies undergoing valuations in 2013 or later to smooth asset and liability values.

The Pensions Regulator's new statutory objective

The DWP will be consulting on providing the Pensions Regulator ("**tPR**") with a new statutory objective to consider the long-term affordability of deficit recovery plans to sponsoring employers with a view to ensuring, in keeping with the government's determination, that *"defined benefit pensions regulation does not act as a brake on investment and growth".*

State pension reform

The Chancellor has confirmed the government's commitment to a single tier pension. A paper from the DWP is due soon outlining the move from a means-tested state pension to a flat-rate of £140 per week.

The Chancellor also announced a commitment to the triple lock guarantee meaning the basic state pension will increase by 2.5% in April 2013, higher than both average earnings and inflation, resulting in a cash increase of £2.70 with the basic state pension increasing to £110.15.

2. tPR's statement on financial support directions ("FSD") and insolvency

tPR has issued a statement on its approach to the use of FSDs in insolvency cases following the controversial decisions in the **Nortel** and **Lehman** cases where FSD liabilities were effectively "super-prioritised" in certain circumstances.

An FSD requires a target company to put in place financial support for a pension scheme in the form of cash, guarantee or other security arrangements. Such an arrangement requires the approval of tPR before it is put in place.

The High Court and the Court of Appeal ruled that where a CN or FSD is issued to a company that has already gone into administration, the liabilities rank as an expense in administration with special priority as a result (behind fixed charges but ahead of, say floating charges). The decisions prompted concerns that banks would be reluctant to lend if it meant that their debt would be subordinated to the FSD liability, and that equally, insolvency practitioners would be reluctant to act if their fees were not paid until the FSD liability had been satisfied.

tPR seeks to allay these concerns in its statement, reassuring stakeholders that its powers will not frustrate legitimate insolvency and restructuring practice, nor impact negatively on the lending market. In particular:

- tPR will not deliberately delay issuing an FSD until after an insolvency event for it to take advantage of a higher post-insolvency priority ranking
- In assessing the extent of financial support under an FSD issued after an insolvency event, but based on facts and matters before the insolvency, a key consideration will be what could have been assessed before the insolvency
- tPR will take the claims of other creditors into account with a level of financial support which achieves broad equity between trustees and unsecured creditors
- In most circumstances, tPR will not seek to subordinate the administrator's expenses to the FSD

3. FATCA

The UK and US recently signed a bilateral agreement on 12th September 2012 to improve international tax compliance and implement The Foreign Account Tax Compliance Act of 2009 (FATCA).

The agreement provides for the US and UK to exchange specified information on reportable US and UK financial accounts maintained by FATCA reporting financial institutions. The reporting requirements are costly and administratively burdensome. There were concerns that UK pension schemes would be included within the ambit of the reporting institutions.

However, following intensive lobbying, certain pension schemes have been effectively excluded from complying with the FATCA requirements, and these include:

- Pension schemes established in the UK covered by the UK-US double taxation convention

- Pension schemes registered with HMRC under Part 4 of the Finance Act 2004
- Pension schemes where annual contributions are limited to £50,000 and funds cannot be accessed before age 55 (except on serious ill-health grounds)
- Annuities

The Government will implement the bilateral agreement by introducing legislation in the Finance Bill 2013. A consultation document published by HMRC last month in relation to this matter does not, however, specifically address the pension exemption.

It is not entirely clear whether international pensions or s615 schemes will come within the exemption, and it remains to be seen therefore whether this will be clarified in the legislation.

4. PPF confirms 'underpin' method to equalising GMPs

Following a six month pilot study to trial the proposed statutory 'underpin' method of equalising GMPs for schemes in an assessment period, the PPF has confirmed that the methodology can be implemented.

On the basis of legal advice, the PPF has concluded that it is the most suitable method available as it best reflects the interaction between the relevant preservation and contracting-out legislation and the legislation which applies for the purposes of calculating PPF and FAS compensation. The 'underpin' method acknowledges that women are entitled to their GMP at 60 and equalises the GMP entitlement accordingly. However, an assessment will be made to ascertain whether the total pension payable at 60 covers the whole of the GMP.

Separately, it should be noted that there remains much debate as to whether there is a legal obligation to equalise GMPs. 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.

In our February 2012 Pensions Newsletter we reported on the government's consultation to equalise GMPs for men and women. We understand the government remains firm on its stance that GMPs should be equalised, and that regulations are expected to be issued in this respect before the end of this year. However, until such time as these regulations are published, and indeed come into force, it is likely that many ongoing schemes will continue not to equalise GMPs.

With regard to schemes in an assessment period, the PPF will be writing to schemes to inform them of how they expect the GMP 'underpin' method to be taken into account but does not expect schemes to alter their current approach until they have heard from the PPF.

5. IBM case – rectification of documents and variation of schemes by contract

A claim for a rectification order made by the trustee of the IBM Pension Plan (the "**Plan**") against IBM's UK subsidiaries (IBM United Kingdom Limited and IBM United Kingdom Holdings Limited, collectively "**IBM**") has succeeded.

Rectification

Rectification is an equitable remedy that is available at the court's discretion to change a document that mistakenly fails to reflect the parties' intentions, and that mistake cannot be corrected by another means. The assessment of the parties' intentions must be analysed objectively, by looking at the parties' communications and acts and not subjectively, according to their private understanding. It can often be a difficult remedy to obtain.

On the basis of "compelling" evidence before him (witness testimonies), the Judge ruled that the trust deed and rules of the Plan as it relates to the defined benefit section from 1983 permitted active members to retire between 60 and 63 without the employer's consent or a reduction to their pension (referred to in the judgment as 'flexible retirement'), and should therefore be rectified from 1983 through to the current deed.

He did not make the same modification for deferred members, stating instead that there would be an opportunity for further legal argument. Although up until April 2005 "preservation" legislation meant that they should have been able to require an unreduced pension at age 60, that legislation has been amended and cannot be relied on retrospectively.

The cost to IBM for complying with the judgment would be in the region of £100 million.

IBM's counterclaim and the inalienability of pensions

Under a counterclaim advanced by IBM in respect of new joiners, the court also considered the extent to which contractual terms are capable of restricting benefits otherwise arising under a pension scheme. Case law to date has established that it may be possible for employees to agree contractual terms which have the effect of varying the rights which they would otherwise have under a pension scheme. IBM argued that new employees joining after 1983 contractually agreed that they could only retire from age 60 with consent. The pensions booklet issued to new employees from 1983 indicated that consent would be required for retirement before age 63.

The Judge disregarded this, saying that the booklet did not form part of an employee's contract; it merely provided a summary of the benefits under the Plan and was subject to IBM's right to alter or terminate the Plan. The booklets also referred to the overriding effect of formal scheme documentation.

We understand that IBM is considering its rights of appeal. The trustee is also taking legal advice as to whether to pursue some further questions over the rights of deferred members.

6. TUPE – Procter & Gamble v SCA

In our July 2012 Pensions Newsletter we reported on the High Court's decision in the Procter & Gamble case which ruled on the types of pension benefits that will transfer under The Transfer of Undertakings (Protection of Employment) Regulations 2006 ("**TUPE**"). Leave to appeal the decision has been granted by the Court.

To reiterate, the Court held that:

- The right to be considered in good faith in respect of an application for early retirement transfers under TUPE
- The liability to provide full early retirement benefits does not transfer where the transferring employees are entitled to deferred pensions in the transferor's scheme thereby squashing any prospect of double recovery by the transferring employee from both the transferor and transferee
- Pension instalments paid to a member after normal retirement age (NRA), intended to support the member after retirement, having attained a particular age and without any trigger, constitute an 'old age benefit', and so will not transfer under TUPE even if the pension came into payment before NRA

7. Fair Deal

Changes to 'A Fair Deal for Staff Pensions' ("**Fair Deal**") are underway following the Treasury's response this month to the government's initial consultation issued in March 2011.

Fair Deal is a non-statutory policy applying to pension provision for public sector staff. It requires that where staff are compulsorily transferred out of the public sector to an external provider, the new employer must provide a broadly comparable pension scheme for transferred staff. Pensions accrued to the date of transfer are also protected.

On 4th July 2012, the Chief Secretary to the Treasury, Danny Alexander confirmed in a ministerial statement to Parliament that the government intends offering all transferring staff (including those whose employment is subject to a subsequent TUPE transfer) on an outsourcing from the public sector the opportunity to remain within their public sector pension scheme. This will enable the transferee employer to participate in the public sector scheme and will no longer be required to provide a "broadly comparable" scheme, as is currently the case.

Currently, only employees in the Local Government Pension Scheme (LGPS) can routinely remain members of that scheme following an outsourcing to the private sector subject to certain limited exceptions applying to the NHS Pension Scheme and the Teacher's Pension Scheme to enable some private employers to participate.

Key points to note arising out of the Treasury's response are:

- **New contracts**: the response confirms Fair Deal will be revised for new contracts such that transferring employees will remain in their current pension arrangements The draft guidance issued by the Treasury is lean on detail relating to how the arrangements will interact with unfunded public sector schemes
- **Retendering of existing contracts covered by Fair Deal**: the Government proposes that contractors in a retendering scenario (including the incumbent contractor) will be given a choice of whether to (i) transfer the employees back into a public sector pension scheme or (ii) provide broadly comparable pension provision for future service, but based on the schemes currently available in the public sector (i.e. career average schemes from 2015). This proposal is subject to further consultation
- **LGPS/Best value authorities**: LGPS admission and transferring employees who are covered by "best value" authorities (which operate outside of the Fair Deal policy) will be considered separately by the Department for Communities and Local Government and other departments

The existing Fair Deal policy will continue to apply until the start date for the new policy is announced. Responses to the consultation are requested by 11 February 2013.

8. Public Service Bill

The Public Service Pensions Bill was published in September and is currently at the committee stage in the House of Commons. The aim of the Bill is to reduce public service pension costs by nearly half whilst still delivering high quality sustainable public service pensions.

Implementing most of the recommendations made by the Independent Public Service Pensions Commission in March 2011, the Bill sets out new arrangements for the creation of schemes for the payment of pensions and other benefits, provides powers to Ministers to create such schemes in accordance with a common legislative framework and gives powers to tPR to oversee independently the operation of these schemes.

In addition, the following have been proposed:

- Moving to career average pension schemes from the hugely advantageous final salary schemes
- Expecting public servants to work longer to receive a full pension, linking their Normal Pension Age to their State Pension Age, except for the Armed Forces, Police Officers and Fire fighters
- Ensuring that those closest to retirement are protected: those ten years from their Normal Pension Age on 1 April 2012 will not see any change in when they can retire, nor any decrease in the amount of pension they receive on retirement
- Setting an employer cost cap to ensure that public service pensions remain affordable and sustainable
- Creating a high barrier to changes to specific elements of these pension designs for 25 years – a settlement for a generation

It is anticipated that that the reforms will save £65 billion over the next 50 years.

9. The abolition of stakeholder pensions and the advent of auto-enrolment

On 1st October 2012, the government's auto-enrolment regime came into effect and the requirement for a UK employer employing five or more employees to designate and facilitate access to a stakeholder pension was abolished.

Auto-enrolment imposes a statutory duty on 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.

As far as stakeholder pensions are concerned, transitional provisions continue to protect employees who are already members of their employer's nominated stakeholder pension scheme on that date. However, new employees and other employees not covered by the transitional measures will no longer need to be given access to a stakeholder pension.

Supplementary provisions also apply from 1st October 2012, requiring an employer to notify an employee of the consequence of having made a request to cease making deductions.

The staging timetable for auto-enrolment runs from 1st October 2012 until 1st February 2018, and an important point to note is that for many employers, there will not be a statutory duty to provide access to a pension scheme for their employees for some years.

Contacts

Imogen Clark
Partner

Hywel Robinson
Partner

Clare Hoxey
Partner

To email one of the above please use:
firstname.lastname@cliffordchance.com
T: +44 20 7006 1000