ISSUE NO. 3, 2006
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SPC has added a new member:

- **Eversheds**, London EC2

New President for SPC

Mark Ashworth succeeded Robert Birmingham as President on June 1st 2006. On June 14th he met key figures from other pension bodies, journalists and SPC Council Members at a reception in SPC's office to welcome him into his new role.

He told the gathering that he was conscious of being the first professional Trustee to serve as the SPC's President.

He said: "I'm pleased and proud that a Trustee should have this opportunity of contributing from the particular perspective of one of the more than one hundred thousand trustees of occupational schemes."

Regarding the need for a Government-led overhaul of the pensions system in the UK he added: "While championing work-based schemes, the SPC is not doctrinally opposed to the idea of a National Pensions Savings Scheme.

"We recognise that something has to be done in respect of the estimated 46% of those in work who are not contributing to a private pension - an alarming and growing statistic. But, we will continue to examine carefully the interaction of any new scheme with existing schemes to alert policy makers to any danger of unintended consequences.

"Perhaps I should be more of a conspiracy theorist, but I believe that most public and private policy misfortune is the result of the unintended and unanticipated. Together we stand more chance of spotting at least some of these outcomes than if we retreat to our own trenches and bunkers, and start to do what, tragically, comes naturally to those who are forced to inhabit trenches or bunkers."

SPC Dinner 2006

This year's SPC Dinner takes place on October 31st at the Savoy, London WC2.

The principal speaker will be Mark Wood, Chief Executive of Paternoster. The response to the toast to the guests will be given by Chris Holmes – a pension lawyer with Ashurst, Board Member of UK Sport and Great Britain's most successful paralympic swimmer, with 9 Golds. SPC President Mark Ashworth will also give his views on the issues facing SPC and trends within the industry.

In order to increase the usefulness of the Dinner as a networking event, we are again encouraging 'new blood' this year. If your company has never previously been represented at the Dinner, the person making the booking will benefit from a special price of just £115.00, as will one other special guest.

Feedback from previous years' Dinners indicates that, for many, the modest cost can be re-paid many times over in terms of useful contacts and strengthening of business relationships.

Full-priced tickets are £135.00 per head. This holds the ticket price for 2005 and represents exceptional value, as it covers pre-dinner cocktails, a five-course meal (in the best Savoy style), half a bottle of wine with dinner, and a liqueur with the coffee. For second and subsequent tables, the price is again just £125.00 per head.

Because of this year's special promotion for newcomers and because bookings are running ahead of last year's we suggest early booking to avoid disappointment. A form is at http://www.spc.uk.com/2006/Dinner-Booking-Form.doc.

The closing date for applications is October 4, and tickets will be available from the third week in October.

New Honorary Treasurer for SPC

Council has elected Lindsay Davies (Hymans Robertson) to succeed Eric Shepley as SPC Honorary Treasurer, Eric having retired.

We are very grateful to Lindsay for agreeing to take on the role and to Eric for the valuable work which he did during his term of office.

SPC Annual Report 2005

SPC has published its annual report for 2005. For a comprehensive and concise summary of SPC's many activities during the year just past, please visit http://www.spc.uk.com/htm/ar2005.pdf.

SPC London Evening Meetings

The handout is available from the following meeting:-

Date	Subject	Speaker
May 24 2006	Safeguarding Members' Interest in Contract-Based Schemes	Julian Webb (Fidelity)

You can obtain a copy by clicking on the subject.

HMRC rule changes which might affect some benefit calculations

On 3rd April HMRC issued Updates 159,160 and 161, which made last minute changes to the benefit regime in force immediately before A-Day, three days later. The "Practice Notes" (IR12/IR76) were re-published to reflect the changes. The significance of this is that some benefits after A-Day are determined by reference to the benefits which were permitted on 5th April 2006, and the definitions of these are subtly changed. Only a minority of members in a limited number of schemes are likely to be affected but the effect could be significant and increase some scheme liabilities. ■

HMRC responds to technical issues raised by SPC

At the request of HMRC, SPC submitted a note of pressing technical issues connected with the new pension taxation regime. The note was submitted in December 2005. You can view it by clicking here.

HMRC's response, received in May, is available at http://www.spc.uk.com/2006/ADC55.pdf and http://www.spc.uk.com/2006/ADC60.pdf. ■

New Pension Taxation Regime: Administration Of Trivial Pensions

As A-Day for the new pension taxation regime approached, SPC members were continuing to report difficulties in planning for the requirements on commutation of trivial pensions. There is considerable concern that schemes will be left with small fund values in respect of members, which they will not be able to discharge.

The most pressing problems arise where a fund comprises small amounts of residual protected rights, and/or is too small to meet insurers' annuity purchase limits, but where a member has other funds which are of such size as to rule out commutation on grounds of triviality.

Another problem, which will emerge, will be that of how to deal with accruing interest on protected amounts while the lifetime allowance remains at whatever its current level might be. As an example, take someone with a money purchase fund of £20,000 at A-Day, which can be taken entirely as tax free cash. On retirement later in 2006, with no further contributions having been paid, the fund may have grown to £20,500. The protected tax-free cash would still be £20,000, as the lifetime allowance has not increased, leaving £500 which needs to be used to provide an income.

In theory, a trivial benefit need not be commuted, but the alternatives to commuting are in practice extremely unattractive. If a benefit is paid from the scheme, the administrative cost of paying it might be out of proportion to the size of the benefit. Another possibility is to transfer the fund to a stakeholder scheme, but what can be very small amounts would soon be significantly eroded by charges.

We know that HMRC is confident that it is possible to find a life office which will provide an annuity for a purchase amount as low as £3,000, but our information is that, if purchase prices at this level are available, they might not be available in the market generally, but are the result of special arrangements struck between schemes or their advisers and life offices, where a certain minimum volume of trivial purchase prices has to be available, to be acceptable to the provider.

Schemes are already considering how they can resolve these issues. The unauthorised payment approach seems unsatisfactory. Returning the money as an unauthorised payment seems to be extremely penal in the circumstance, as our understanding is that, because an authorised pension is not being provided, the condition for payment of a Pension Commencement Lump Sum might not be met and therefore the whole payment could be subject to a 55% charge on the member, with between 15% and 40% also due as a scheme sanction charge in addition. Similarly, even if the member waived their rights to the excess above the PCLS, it would appear that this would render the PCLS an unauthorised payment.

One means of addressing the practical problems would be to allow very small trivial benefits to be dealt with as scheme administration member payments.

Alternatively, the provisions of the Registered Pension Schemes (Authorised Payments) Regulations 2006, which are helpful in dealing with small amounts of equivalent pension benefits, could be extended.

We do recognise that in the short term there is no prospect of change in the current provisions on trivial commutation, but with the passage of time there is no doubt that this is an area of the new pension taxation regime, the design of which will need to be reviewed and we therefore consider it important to maintain HMRC's awareness that the practical problems persist, but can be overcome by quite simple changes to the tax regime.

One other aspect of trivial commutation which might also be simplified is the taxation of commuted lump sum arising from uncrystallised funds paid by the pension schemes which do not operate a payroll. For example, it would be appropriate to tax these payments in a similar way to that which will apply to the lump sum payment of a deferred State pension, as has been provided for under the Income Tax (Pay As You Earn)(Amendment) Regulations 2006. Allowing a simpler approach to taxing, documenting and reporting these commuted payments would allow schemes to benefit fully from reduced administration in the new regime.

We have written to HMRC, setting out the position. HMRC's response confirms our expectation that in the short term its position will not change. ■

HMRC gives SPC clarification on quarterly tax returns

HMRC has responded in detail to our questions relating to the quarterly tax returns under the new pension taxation regime.

You can view the correspondence at http://www.spc.uk.com/2006/ADC64.pdf ■

SPC contacts HMRC on stand-alone lump sums

We have been considering SI 2006/572 (the Taxation of Pension Schemes (Transitional Provisions) Order 2006), and in particular articles 25 and 26.

Background

These articles cover, inter alia, the situation where, as at 5/4/06, a member's accrued uncrystallised cash rights equal the value of the accrued uncrystallised pension rights. Provided there is no "relevant benefit accrual" under the scheme after 5/4/06, in such cases the member would be allowed to take all his or her rights as a single lump sum payment on or after 6/4/06. Such a payment (a "stand-alone lump sum") deals with the fact that a "pension commencement lump sum" cannot be taken without a pension also starting.

Problem

It is clear that such a "stand-alone lump sum" does comprise a benefit crystallisation event, and so is relevant for the Lifetime Allowance assessment. If, however, the lump sum to be paid was less than the member's Lifetime Allowance, one would then expect the payment to be completely tax free.

However, there does not appear to have been a corresponding change to section 636A of the Income Tax (Earnings and Pensions) Act 2003 to specifically refer to "stand-alone lump sums". We assume that this is an oversight, rather than deliberate. Strictly, therefore, such payments would not be tax-free but would be taxed as pension income, which is clearly a nonsense. There does not appear to be anything in the RSPM on this, per se. (In the case where the cash payment exceeds the lifetime allowance, RPSM03105640 refers to RPSM03105620, which does refer to cash up to the Lifetime Allowance limit being tax-free.

However, that page concerns "pension commencement lump sums", not "stand-alone lump sums". It does seem, nevertheless, that HMRC believes that "stand-alone lump sums" below the member's Lifetime Allowance are tax-free, and that the failure to amend ITEPA 2003 is indeed an oversight.)

We have requested that the appropriate amendment be introduced through the current Finance Bill. ■

SPC obtains clarification on scheme modification regulations

SPC has sought clarification from HMRC on the effect of sub-paragraph (3)(b) of regulation 5 of the Registered Pensions Schemes (Modification for the Rules of Existing Schemes) Regulations 2006.

For a copy of our correspondence with HMRC please click here. ■

SPC raises questions on "relevant benefit accrual" under the Finance Act 2004

SPC has raised some concerns on the calculation of "relevant benefit accrual" under the Finance Act 2004.

For a copy of the correspondence, please click here.

HMRC recognises SPC concerns on pension commencement lump sums

We have corresponded with HMRC on the need for the provision of information regulations to clearly require the scheme administrator to provide the member concerned with details of the amount used up by the payment of a pension commencement lump sum, so that this information can be passed to the administrator of any separate scheme from which a lump sum is due to be paid.

HMRC has now placed an announcement on its website, addressing SPC's concern.

For a copy of our correspondence, please click here. ■

SPC obtains confirmation on enhanced protection and lump sum death benefits

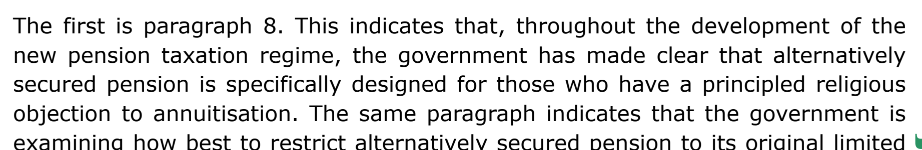
SPC has obtained confirmation from HMRC on a few aspects of the changes in its position on enhanced protection and lump sum death benefits which it announced in March.

For a copy of the correspondence, please click here. ■

HMRC response to SPC on Inheritance Tax

We generally welcomed Budget Note 26 on inheritance tax, but there were two paragraphs about which we had concerns. We raised these with HMRC.

The first is paragraph 8. This indicates that, throughout the development of the new pension taxation regime, the government has made clear that alternatively secured pension is specifically designed for those who have a principled religious objection to annuitisation. The same paragraph indicates that the government is examining how best to restrict alternatively secured pension to its original limited



purpose. We assume that this relates to consideration of any further measures in connection with charging inheritance tax on left over ASP funds. We assume that the intention is not to consider measures specifically designed to exclude access to alternatively secured pension. It would be helpful to have certainty on what the government has in mind.

The second paragraph of concern to us is paragraph 10. This indicates a further addition to the duties of the scheme administrator. We trust that HMRC's current discussions with practitioners on future procedures for administering inheritance tax will minimise the associated burden.

In response to our query on paragraph 8 of the Budget Note, HMRC has stated that the government is considering all options for ensuring that ASP funds are used only for intended purposes; this is not restricted only to matters in connection with IHT charges on leftover funds.

HMRC indicates that it has noted our comments regarding paragraph 10. ■

SPC maintains concern at HMRC position on recycling of tax-free cash

While the Budget announcement contained welcome changes to the monetary threshold and cumulative period proposed in the earlier consultation on the proposed anti-avoidance rule in respect of recycling tax-free cash, we are extremely disappointed that HMRC continues with its intention that any scheme sanction charge will be levied against the scheme administrator.

As we indicated in our response to consultation, this will be a cause of significant complexity. We feel that scheme administrators will be left with little choice but to design systems and procedures, mirroring the guidance, so as to demonstrate that they are taking steps to thwart manipulation of tax-free cash.

Additionally, some scheme rules may have been amended from 6 April 2006 with general regard to the Finance Act 2004, to explicitly prohibit the trustees making unauthorised payments - accordingly, the retrospective treatment by HMRC as an "unauthorised payment" of what to the trustees is a bona fide "pension commencement lump sum" would mean that the trustees were in breach of trust through no fault of their own.

We continue to be of the view that, if HMRC considers that this is an area, in which significant problems are likely to arise, it should monitor and address manipulation directly with individual tax payers through self-assessment, rather than complicate the running of schemes generally.

We also had some comments on the detail of the guidance note associated with the Budget announcement.

We have summed up our position in a letter to HMRC. ■

Pensions regulator issues final statement on how it will monitor compliance with statutory funding objective

The Pensions Regulator has published a definitive statement on how it will regulate compliance with the statutory funding objective provisions.

The general approach of using "triggers" to determine which schemes will be subject to investigation remains unchanged, but there are some changes of emphasis following consultation.

- The funding target trigger will lie in the range between 100% of PPF liabilities (on the "s179" basis) and 100% of FRS17 or IAS19 liabilities. Strong sponsors with immature schemes will have a trigger towards the lower end of this range; weak sponsors with mature schemes towards the higher end. This range will often be lower than the previously trailed 70-80% of buy-out. The influence of buy-out has been reduced, but the Regulator will take it into account when filtering out those schemes which trigger further investigation.
- The 10 year reference point for triggering attention to the recovery plan remains, but the suggestion that shorter periods may be appropriate is restricted to the narrow class of weaker employers who could afford them.
- "Inappropriate" use of an investment return in a recovery plan above the discount rate used for technical provisions will be a trigger, but appropriate use is acceptable. The distinction is not defined.
- The Regulator is at pains to stress that funding at a level designed to avoid the triggers is neither a necessary nor sufficient condition for compliance. Some valuations which would not trigger may still not be prudent, and some triggered cases will be acceptable if due process can be demonstrated. If a trigger is activated, the Regulator will apply other "filters" before taking any action. If it decides to act, it will request further information on the circumstances of the scheme, the process followed by the trustees and the advice they have obtained.
- In weak covenant cases a longer recovery plan (but not a weaker ultimate funding target) may be justifiable and acceptable, but the onus may be on the trustees to prove they have been through due process and got the best deal possible.
- The separate check on schemes, funded below 110% on MFR pending the first statutory funding objective valuation, has been dropped. However, the Regulator will continue to encourage trustees to aim at higher funding levels than the MFR.
- There are special considerations for employers in regulated industries and the not-for-profit sector.

It appears from the announcement on the Regulator's medium term strategy that the focus is expected to be on the weakest schemes in terms of funding and employer covenant, especially those with over 1,000 members. 10-20% of these large schemes (150-300) are in their "active/tailored engagement" category.

The statement is at http://www.thepensionsregulator.gov.uk/schemeFunding/statement/index.aspx ■

White paper "security in retirement – towards a new pensions system"

The Government has broadly accepted the Pensions Commission's proposals for changes in the pension system. Its plans are contained in a White Paper issued on May 25th, 2006 for consultation until 11 September. SPC has set up a working party to co-ordinate SPC's response.

The main proposals are as follows:

State Pensions

- Increase in state pension age – to 66 by 2026, 67 by 2036 and 68 by 2046
- Basic state pension to be earnings linked, probably from 2012
- State second pension accrual to be increasingly flat-rate, reaching this point by about 2030
- Contracting-out from occupational money purchase schemes and personal/stakeholder pensions to be abolished from 2012
- Changes to Pensions Credit starting in 2008, to gradually reduce the proportion of people eligible for means-tested help
- Reduction to 30 years in the contributions required to qualify for full basic state pension, from 39-44 years currently.

National Pensions Savings Scheme

- To be launched in 2012 broadly as the Pensions Commission proposed
- Contributions of 8%, made up of 3% employer/4% employee on earnings between £5,000pa and £33,000pa, with an additional 1% tax relief
- Employer contribution to be phased in over three years, with further help on costs for smallest businesses
- Automatic enrolment but employees can opt-out
- Government preference for a single state-sponsored delivery system for NPSS, rather than insurance or super trust alternatives.
- Little new detail on precise operation - consultation to follow, which will include ways of using private sector expertise in delivery.
- Occupational schemes can be used as opt-out vehicles if they meet NPSS standards.

Occupational schemes

- There will be a fresh review of potential simplifications to the legislative/regulatory system, which may include revisiting matters like mandatory indexation, member-nominated trustees and other administrative requirements.
- Legislation will be brought in to convert GMPs into other forms of pension to reduce complexity.

Financial Assistance Scheme

- Extended to cover those within 15 years of retirement, previously three years
- Cost increased from £400m to over £2bn in cash terms.

The White Paper is at http://www.dwp.gov.uk/pensionsreform/.

DWP deregulatory review

In the pensions White Paper DWP announced a rolling deregulatory review of occupational pensions and a pilot pensions law rewrite project (along similar lines to the HMRC tax law rewrite). It also committed DWP to changes in the field of contracting out and guaranteed minimum pensions.

DWP has set up an advisory group to assist it in this work, providing it in particular with guidance on the key issues to be addressed at working level. SPC has accepted an invitation to participate in the advisory group. Its representative will be the new SPC president, Mark Ashworth. ■

DWP to regulate the calculation of transfer values

Following its announcement that it is to regulate the calculation of transfer values, DWP has published a consultation document on approaches to the calculation of transfer values. As we went to print, we had the document under consideration. A copy is at http://www.spc.uk.com/2006/AC42.pdf. ■

Pensions reglator consults on the form and content of pension scheme reports and accounts

The Pensions Regulator has issued a discussion paper, seeking views on the form and content of pension scheme reports and accounts from the perspective of improving accountability to their users, including the Pensions Regulator.

At the time of preparing this issue of SPC News, SPC had the discussion paper under consideration.

You can obtain a copy of the paper at http://www.spc.uk.com/2006/ADC61.pdf ■

SPC discusses draft portability directive with DWP

Following its submission of written comments on the draft EU Portability Directive, SPC has taken part in a meeting with DWP to be briefed on discussions so far on the Directive and to explore the prime concerns in SPC's response. ■

Member-nominated trustees

Previously, employers were able to opt-out of the requirement to have member-nominated trustees. This is no longer possible after 6 April 2006. Where schemes have already opted-out, this opt-out will have to end by 31 October 2007. This means that all schemes (unless specifically exempted) will have to ensure that at least one-third of the scheme trustees have been nominated and selected by the members.

In addition, the Government has announced that, in two or three years' time, the one-third proportion will be increased to one-half.

Summary

- Trustees must, within six months, have arrangements to ensure that at least one third of the trustees, or at least one third of the directors of a trustee company, are member-nominated.
- Once these arrangements have been decided upon, the trustees have up to six months to implement them.
- Arrangements include a nomination process and a selection process.
- Nominations should involve at least all the active and pensioner members, and selections should involve at least some of the members.
- Both the nomination and selection process should be fair, transparent and proportionate, and should include effective communication to the members involved. The nomination process should give sufficient time for the members (or their representatives) to consider the proposals. The selection process should include a method of selection (such as a ballot).
- If there are less nominations than vacancies, the nomination process should normally be re-run within three years.
- Arrangements should be reviewed every three to five years.

Exemptions

The requirement to have arrangements which provide for at least one-third of the trustees (or the directors, in the case of corporate trustees) to be member-nominated does not apply to the following occupational pension schemes:

- Schemes with less than two members.
- 'Small insured schemes' – schemes with less than 12 members where all the benefits are secured with an insurer under a contract of insurance or annuity contract.
- 'Relevant small occupational pension schemes' – schemes with fewer than 12 members where:
  - All the members are trustees and either the rules require that the member trustees make decisions unanimously, or the scheme has a registered independent trustee.
  - All the members are directors of a company which is the sole trustee of the scheme and either the rules require that the members make decisions unanimously, or one of the directors of the company is a registered independent trustee.
- 'Direct payment, paid-up insurance schemes' – insured paid-up schemes where the insurer pays benefits direct to members.
- 'Relevant centralised schemes' – industry-wide schemes where the power to appoint trustees is not exercisable only by one employer and at least one-third of the trustees are independently selected.
- Schemes where the sole trustee (or director), or all the trustees (or directors), are independent.
- Schemes in respect of which an independent trustee must be appointed under the Pensions Act 1995 (e.g. because the employer has become insolvent, or a scheme enters the PPF assessment period).
- Schemes independent of the employer because the employer was dissolved or liquidated before 6 April 2005.
- Schemes which are not registered pension schemes.
- Stakeholder pension schemes.
- Schemes for overseas employees, former old code schemes, parliamentary schemes, some coal industry schemes and schemes subject to church law.

In the case of sole corporate trustees, there are two additional exemptions:

- 'Relevant executive pension schemes' – schemes where there is one sponsoring employer which acts as sole trustee, and the members include at least one-third of the current directors and are either current or former directors of the employer.
- 'Relevant wholly insured schemes' – schemes fully invested in insurance policies, some or all of which are with an insurer which is (or is connected with) the scheme's sole trustee but is not (and is not connected with) the employer.

A person is only independent if he or she:

- Has no interest in the assets of the employer or of the scheme, otherwise than as its trustee.
- Is not connected with, nor an associate of, the employer, any person acting as an insolvency practitioner in relation to the employer, or the official receiver acting as a (provisional) liquidator of the employer.

Most of these exemptions are the same as under the Pensions Act 1995. However, there are two notable additions. The exemption for 'small insured schemes' is a new one.

The other new exemption is for schemes where the sole trustee (or director), or all the trustees (or directors), are independent.

Current rules

The Pensions Act 1995 and regulations made under it contain some highly complex rules on member-nominated

trustees (MNTs) or directors. The effect of these rules is that schemes must, unless the employer proposes 'alternative arrangements' (i.e. opts-out), implement appropriate rules to enable members to nominate at least one-third of the total number of trustees, or directors where the trustee is a corporate body, subject to a minimum of two (or one, for schemes with less than 100 members).

If the employer does not opt-out, the trustees must either adopt prescribed appropriate rules or propose their own appropriate rules. Any proposed appropriate rules or employer opt-out must be approved by the membership through a statutory consultation.

Changes

Employers are no longer able to opt-out of the MNT requirements. And there is no longer a requirement for there to be at least two MNTs, or one MNT where the scheme has fewer than 100 members. The requirement is simply that one-third of the trustees (or any higher proportion set out in the scheme rules) must be MNTs.

In addition, there are no longer detailed prescribed rules, and it is up to schemes to decide how they comply with the MNT requirements. An example is the term of office for MNTs. The 1995 Act specified a term of at least three years, but no more than six years, but this is no longer prescribed; schemes are free to set their own terms of office.

The basic requirement is that the trustees of occupational pension schemes must, within a reasonable period, have arrangements to ensure that at least one third of the trustees, or at least one third of the directors of a trustee company, are member-nominated. These arrangements must include a nomination process and a selection process (to be used if there are more nominations than vacancies). According to the Pensions Regulator's Code of Practice, a reasonable period is six months. However, the Pensions Regulator expects most schemes to take less than this. For schemes where an existing opt-out is coming to an end, the trustees should be considering new arrangements before the opt-out ends.

The nomination process should involve at least all the active and pensioner members (or their representatives), although the trustees can decide to include deferred members if they wish. Where the number of nominations received is equal to or less than the number of vacancies, the nominees may be deemed to be selected. Where a vacancy is not filled because there are not enough nominations, the nomination and selection process must be repeated until the vacancy is filled.

Once these arrangements have been decided upon, the nomination and selection process should be completed within six months.

Both the nomination and selection process should be fair, transparent and proportionate, and should include effective communication to the members involved.

Appropriate records should be kept so that trustees can demonstrate their compliance.

Nominations

The nomination process should give sufficient time for the members (or their representatives) to consider the proposals. To be effective, communication should include:

- The number of MNTs the scheme should have, the number of MNTs in place and the number of MNT vacancies.
- A short explanation of the role of a trustee and any available training.
- Any eligibility criteria.
- What happens if there are less nominations than vacancies (or the same number).
- The selection process if there are more nominations than vacancies,
- How to nominate someone for selection as an MNT.
- Any time limits which apply.
- A contact for queries.

If there are less nominations than vacancies, the nomination process must be re-run for the remaining vacancies. The Regulator would normally expect this to be done within three years, although it may be more appropriate to re-run in a shorter period if there has been a significant change in membership. If the number of nominations is equal to or less than the number of vacancies, the nominees may be deemed to be selected, and there is then no need to run a selection process.

Selections

A selection process is only needed if the number of nominations exceeds the number of vacancies. This process should include telling the members of the outcome of the nomination process, the method of selection (such as a ballot), what the members have to do, and the outcome of the selection process.

Election of MNTs

A person does need to be a member of the scheme to be nominated as an MNT. However, if they are not a member, the employer must approve their nomination for selection (if the employer requires its approval to be given in these circumstances).

The removal of an MNT will require the agreement of all the other trustees, unless the scheme rules vest the power to remove an MNT in the members. An MNT has an equal standing with non-MNTs, and may not be excluded from the exercise of any trustee functions by virtue only of the fact that they are an MNT.

There can be more than one third MNTs only with the employer's approval. Where a scheme's rules provide for there to be more than one-third MNTs, the MNT requirements will apply to that higher proportion (and will not act so as to result in a reduction to one-third).

Member-nominated directors

The same requirements apply to member-nominated directors. There is one difference. Where a company is a trustee of more than one occupational pension scheme, it can treat some or all of them as a single scheme so that there is a single process for nominating and selecting the one-third member-nominated directors.

Reviewing arrangements

Once arrangements have been implemented, the trustees should keep them under review. The Regulator expects arrangements to be reviewed every three to five years, or if there is a significant change to the scheme.

Penalties

The Regulator has a range of measures if trustees do not met the legal requirements, including providing education, assisting or instructing trustees to achieve compliance, appointing trustees to help run the scheme and removing trustees from office. It can also impose fines of up to £5,000 for individuals and £50,000 for others.

Timetable

The new rules came into effect on 6 April 2006.

Where employers have opted out of the requirements under the current rules, the opt-out may continue after 6 April 2006 until their current opt-out period expires, or 31 October 2007, whichever is the earlier.

The date for increasing the minimum proportion of MNTs from one-third to 50% has yet to be decided. The DWP has stated that it will wait to allow other provisions of the Pensions Act 2004 to bed in before it makes the change. ■

SPC response to Treasury consultation document on financial promotions in the work place

SPC has responded to the relevant parts of the Treasury's consultation document on financial promotions in the work place.

For a copy of our response please click here.

The consultation document set out the government's proposals to amend the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, in order to provide new exemptions from financial regulation for financial promotions made to employees by employers and, in some circumstances, by third party administrators.

For a copy of the consultation document, please click here. ■

SPC comments on FSA's proposals for regulatory fees and levies 2006-2007

SPC made a brief response to FSA's consultation paper 06/2 on regulatory fees and levies for 2006-2007.

For a copy of the response, please click here. ■

FRS 17 amendments and new reporting statement

On 31 May 2006, the UK Accounting Standards Board (ASB) published an exposure draft headed "Proposed Amendment to FRS 17 'Retirement Benefits' and Reporting Statement 'Retirement Benefits – Disclosures'. "This proposes to amend FRS 17 by replacing the existing disclosure requirements with those of IAS 19 'Employee Benefits'. The exposure draft also proposes a new "Reporting Statement".

This is a formulation of best practice and is intended to have persuasive rather than mandatory force. It is applicable to all entities with defined benefit schemes. The Reporting Statement will recommend disclosure of the mortality assumption, a sensitivity analysis for each of the principal assumptions, and the buy-out cost. If adopted, the proposed changes will be effective for financial years ending on or after 31 December 2006. ■

SPC submission to the Government's review of goldplating of EU legislation

Under the auspices of the Cabinet Office, the Better Regulation Executive is reviewing the UK's implementation of EU legislation. The review is planned to result in a report and recommendations to government by the end of 2006.

In our submission to the review we highlighted the implementation by DWP of article 7 of Directive 2003/41/EC (The Pensions Directive) by way of section 255 of the Pensions Act 2004.

We believe that DWP has implemented this part of the Directive too narrowly, so that there is now doubt about whether under UK law the provision of death in service benefits, as the only benefit for some members of an occupational pension scheme, is permitted.

DWP had previously told us that it was not the overriding policy intention to unsettle the current arrangements, whereby death in service benefits may be the only benefits provided to some members of occupational pension schemes and we know of no evidence which suggests that it was the intention, when the Directive was being negotiated, to call this type of arrangement into question.

DWP has issued a note which describes the basis on which one could argue that almost all aspects of current practice could continue, but it has qualified its remarks in a way which could be taken to suggest that it thinks these arguments are just as likely to be wrong as to be right.

Guidance issued by the Pensions Regulator to has not departed radically from the line taken by DWP.

We are not criticising either DWP or the Pensions Regulator for lack of serious and detailed attention to the practical consequences of the legislation as it stands.

Our criticism is that DWP's starting point for implementing the Directive could have been different and would not have led to the uncertainty we now have about when death in service benefits only may be provided, and concerns that employers will, in our view completely unnecessarily, have to consider restructuring their pension and death benefit arrangements to be sure of falling within the legislation.

In broad terms, the problems have arisen because DWP has interpreted the Directive from the point of view of the benefits provided for individual members. This leads to a situation where, if retirement benefits are not the main feature of provision for a given individual, section 255 is arguably breached. We believe that it would have been entirely reasonable, and have seen detailed legal opinion to this effect, to have implemented the Directive from a scheme-wide perspective. Following this line it would be acceptable to have a category of membership in the scheme, which is included for death in service benefits only, provided that those benefits were ancillary and supplementary to the overall retirement related benefits being provided to other categories of membership. ■

Age Discrimination

This article provides an update, following final regulations and guidance issued by the Department of Trade and Industry. The regulations are designed to bring the UK into line with the European Employment Directive, and will prohibit age discrimination in employment and vocational training by 1 October 2006.

Summary

- Regulations coming into effect on 1 October 2006 will mean that employers will no longer be able to discriminate on the basis of age. Pension benefits accrued before 1 October are not covered by the regulations.
- Unjustified retirement ages below 65 will not be permitted. Employees will be able to request working beyond retirement age, and employers will have a duty to consider such a request.
- Employers will have to give employees at least six months' notice about their intended retirement date.
- Different treatment of people of different ages may be justified if it is proven to be for legitimate reasons.
- Pension schemes will be subject to a "non-discrimination" rule, but most age and service related provisions in occupational pension schemes are specifically exempted.
- There are less extensive exemptions for contract-based pension schemes, such as group personal pensions and stakeholder pension schemes.
- It is unclear where exactly an age-related contribution structure will come within the exemptions.

Background

In July 2003, the government published a consultation paper 'Equality and Diversity: Age Matters', giving its proposals to implement the anti-age discrimination part of the European Employment Directive (2000/78/EC). Steps had already been taken to implement the other parts of the Directive to end discrimination on the grounds of religion or belief, sexual orientation, or disability. Draft age regulations were issued in July 2005, and the final regulations were issued in April 2006.

As from 1 October 2006, the regulations prohibit unjustified direct and indirect age discrimination in employment (including recruitment, promotion and training), and all harassment and victimisation on grounds of age, of people of any age, young or old.

Direct discrimination is where the trustees or an employer treat an employee less favourably than other employees on the grounds of age. There would be indirect discrimination where employees of a particular age are disadvantaged.

However, Article 6.1 of the Directive allows discrimination if it is "objectively and reasonably justified by a legitimate aim…and if the means of achieving that aim are appropriate and necessary".

Article 6.2 allows "occupational social security schemes" to have different ages for admission and entitlement to retirement or invalidity benefits, as long as this does not result in discrimination on the grounds of sex.

Retirement age

Employers will no longer be able to compel an employee to retire before age 65, irrespective of the contractual retirement age or pension scheme retirement age. If the normal retirement age is below 65, it must be objectively justified. The Government will review retirement ages in 2011.

Dismissing an employee at or over the age of 65 on the grounds of retirement will not be age discrimination under the regulations. However, where an employee has a normal retirement age which exceeds the age of 65, it could be age discrimination if they are dismissed on the grounds of retirement before they have reached that normal retirement age.

An employer who wishes to retire an employee will have to:

- Give notice to the employee not more than 12 months and not less than six months beforehand of the intended date of retirement.
- Tell the employee of the right to request to work beyond the intended date of retirement.

The employee can make such a request at least three months, but not more than six months, before the intended date of retirement. Unless the employer agrees with the request, the employer must hold a meeting with the employee to discuss it, and employees can ask to be accompanied by a companion. The employer must notify the employee of the decision as soon as reasonably practicable after the meeting. Employment will continue until this has been done, even if it is after the notified date of retirement.

Transitional provisions

Where an employer gives notice to an employee before 1 October 2006 that they are to be retired after 1 October 2006 but before April 2007, the notice period must be at least four weeks (or such shorter period as is required by the contract of employment). On 1 October, or as soon as reasonably practicable, the employer will have to write to the employee telling them of the right to request working longer. The employee will be able to make this request for up to four weeks after their contract has been terminated.

If the employer gives notice after 1 October that they are to be retired before 1 April 2007, the notice period is again at least four weeks (or such shorter period as is required by the contract of employment), and the notice must tell the employee that they have the right to request working longer.

General exemptions

In most situations, it will be unlawful to treat people differently on the grounds of age. However, employers will be able to justify different treatment on the grounds of age if they can show that it fulfils a legitimate aim, and the particular circumstances make it appropriate and necessary.

A wide variety of aims may be considered as legitimate, but must reflect a real need on the part of the employer. Examples in the regulations are the fixing of a maximum age for recruitment or promotion, based in the training requirements of the particular job, or the need for a reasonable period of employment before retirement.

Objective justification will not be an easy test to satisfy. Employers, and others with obligations under the legislation, will have to be able to produce supporting evidence if challenged: assertions that an age-based approach was necessary will not be enough.

The Directive and the regulations do not cover the following (and these are therefore exempt from the age discrimination provisions):

- State pensions.
- Pension sharing arrangements on divorce or dissolution of a civil partnership.
- National Insurance rebates for contracted-out schemes.
- Pension annuities.

There is also a specific exemption if more or better benefits are provided to an employee because they have a longer period of service than another. However, where employees have more than five years' service, any award given to another employee as a result of length of service must reasonably appear to the employer to fulfil a business need e.g. through encouraging staff loyalty or motivation. In other words, service qualifications are permitted, as long as they do not exceed five years.

Exemptions for occupational pension schemes

Under the regulations, every occupational pension scheme will be treated as including a non-discrimination rule. This makes it illegal for the scheme trustees, for benefits accruing after 1 October 2006, to discriminate against or harass members or prospective scheme members on the grounds of age.

However, the Government has listed the rules and practices which will not amount to age discrimination, either because these are objectively justified under Article 6.1 or because these are exempted under Article 6.2. The Government's stated aim has been to tackle unfair age discrimination while not discouraging employers from running pension schemes. It has therefore tried to ensure that as many scheme rules as possible are not unlawful under the regulations.

The effect of the exemptions is that occupational pension schemes will not be in breach of the regulations if they have:

- Minimum or maximum ages for admission to the scheme, including different ages for admission for different groups of workers, or a minimum level of pensionable earnings for admission (as long as this minimum is not above the lower earnings limit).
- Actuarial calculations which use age criteria (such as early and late retirement factors, commutation factors etc).
- Contributions:
- Different contribution rates for member or employer contributions according to the age of the members.
- Equal rates of member and employer contributions irrespective of the age of the members.
- Different contribution rates for member or employer contributions for different members if that difference is due to the level of pensionable earnings of those members.
- A minimum age below which members may not receive age related benefits (e.g. age 50, or 55 from 2010, to comply with HMRC rules).
- An age at which benefits become payable without actuarial reduction ('early retirement pivot age') or an age at which benefits become payable without actuarial enhancement ('late retirement pivot age') and different such ages for different groups of workers. This exemption allows defined benefit schemes to, for example, pay an unreduced pension on redundancy, but only to those who were members or prospective members of the scheme as at 1 October 2006. It is unclear whether there is still an exemption if the enhancement is provided through a redundancy scheme rather than through the pension scheme.
- Benefit enhancements calculated by reference to potential pensionable service where a member retires before an 'early retirement pivot age' on ill-health grounds.
- A rule under which a bridging pension ceases once a male pensioner reaches state pension age.
- A rule under which a pension payable on death to a dependant reduces where that dependant is more than a specified number of years younger than the member.
- Any difference in the amount of benefits under a defined benefit scheme due to different periods of pensionable service, provided that, for each year of pensionable service, members in a comparable position are entitled to accrue benefits based on the same fraction of pensionable earnings.
- Any difference in benefits due to members having different pensionable earnings.
- Any restriction on the number of years which can be used to calculate benefits, and any rule providing for a minimum period of service to qualify for benefits (providing the minimum period is no longer than two years).
- Any offset from pensionable earnings when calculating benefits, as long as this is not more than the lower earnings limit, and any upper limit on pensionable earnings.
- Any rule which provides for pensions in payment to increase by different rates according to the age of the member, or according to the length of time the pension has been in payment (as long as the aim is to maintain the relative value of members' pensions).
- An age limit for transfers into or out of the scheme, as long as this is not more than one year before the scheme's normal pension age.
- Any rule which schemes must comply with in order to be registered under the Finance Act 2004.

It will also be possible to close a scheme to employees who have not already joined it.

The exemptions set out above are not as wide-ranging as proposed in the original draft regulations, and some exemptions have been narrowed. For example, a qualification has been added to the exemption that there can be age-related contributions to money purchase schemes. This is that the aim must be to make benefits more equal than if there were equal contributions at all ages. See later for what this might mean.

Perhaps the most important change was to remove the exemption for setting an upper age limit on accruing benefits or paying contributions into the scheme. This appears to mean, for example, that an employer contribution to a defined contribution arrangement will have to continue until the member actually retires.

One of the questions and answers in the DTI guidance 'The impact of Age Regulations on pension schemes' relates to occupational pension schemes which continue with their pre 6 April 2006 rules, not to allow members who continue to work for the employer to take a pension. According to the guidance, this may amount to indirect discrimination as it is not covered by any of the exemptions. So continuing to require members to stop working before receiving a pension would need to be objectively justified.

Exemptions for personal pension/stakeholder schemes

There are only two exemptions, of which GPPs/stakeholders may take advantage, without the employer being exposed to claims that it is in breach of the regulations:

- Different employer contribution rates according to the age of the members.
- Different employer contribution rates for different employees if that difference is due to the level of earnings of those employees.

This means that certain practices, which are exempt under occupational pension schemes, are not exempt under GPPs/stakeholders. Both may have age-related contributions, or different contributions based on earnings. However, only occupational pension schemes are exempted if they have minimum and maximum ages for entry to the scheme, a rule providing for a minimum period of service (up to two years) to qualify for benefits and/or an offset from pensionable earnings (up to the lower earnings limit). GPPs/stakeholders have not been exempted in respect of such practices.

More significantly, occupational pension schemes are exempt if contributions are equal at all ages, but this exemption is not extended to GPPs/stakeholders. We assume that this is an oversight.

Why are GPPs/stakeholders treated differently?

In the Regulatory Impact Assessment, the government conceded that it had received a number of enquiries about whether personal pension/stakeholder schemes were covered by the regulations. The draft regulations did not refer to such contract-based schemes so it was unclear whether age-related differences (such as age-related contributions) in such schemes would be discriminatory.

Since then, the government has confirmed that the European Employment Directive does not extend to personal pension/stakeholder schemes, except in relation to employer contributions (as these are 'pay'). The DTI guidance goes further and confirms that employer contributions to GPPs/stakeholders are covered by the age discrimination regulations, but that other aspects of personal pensions are not covered "because personal pensions are an arrangement between the worker and the personal pension provider and are not part of a worker's pay and conditions".

These statements do not explain why less exemptions should apply to GPPs/stakeholders; the reason is probably more do with a lack of understanding by government of the nature of contract-based schemes. By excluding member contributions from the scope of the regulations, the government is potentially sanctioning structures whereby member contributions go up according to age, but employer contributions do not, or not by the same amount. This practice would seem to be blatant age discrimination, but is not specifically banned by the regulations.

Age-related contributions

Under money purchase pension schemes, whether occupational or GPP/stakeholder, age-related contributions are only exempt under the regulations if the aim in setting the different rates is to equalise or make "more nearly equal" the benefits for members of different ages.

It is not clear how far employers must go to show that any age-related contribution structure does indeed meet that aim. Presumably the intention in setting age-related contribution bands is indeed to make benefits more equal than they would otherwise be. However, the test is not just to make benefits more equal, but to make them more nearly equal. This suggests that the trustees/employer will need to show that they have taken professional advice on the contribution structure and considered long-term investment returns.

According to the DTI guidance, a scheme with age-related contributions is more likely to come within the exemptions the more bands it has. Thus, just having two bands is unlikely to show that the contribution structure is intended to provide (more or less) comparable target pensions at retirement. But the guidance does not say how many bands are needed before it is likely that the scheme does come within the exemptions. It includes an example of a scheme with five age bands, but does not say whether or not this would leave the trustees/employer open to a claim of age discrimination by members.

The last case study in the guidance concerns an occupational pension scheme with 10 age bands, where the actuary has confirmed that the contributions should produce the same amount of benefit for all age groups. The guidance says that this ***should*** fall within the exemptions. So even having 10 age bands is no guarantee that the trustees/employer is safe from claims that there is age discrimination.

There is a worrying and, in the light of consultation, unexpectedly, large number of issues which we need to resolve before the regulations take effect.

About SPC

SPC is the representative body for the providers of advice and services needed to establish and operate occupational and personal pension schemes and related benefit provision. Our Members include accounting firms, solicitors, life offices, investment houses, investment performance measurers, consultants and actuaries, independent trustees and external pension administrators. Slightly more than half the Members are consultants and actuaries. SPC is the only body to focus on the whole range of pension related functions across the whole range of non-State provision, through such a wide spread of providers of advice and services. We have no remit to represent any particular type of provision.

The overwhelming majority of the 500 largest UK pension funds use the services of one or more of SPC's Members. Many thousands of individuals and smaller funds also do so. SPC's growing membership collectively employ some 15,000 people providing pension-related advice and services.

SPC's fundamental aims are:

(a) to draw upon the knowledge and experience of Members, so as to contribute to legislation and other general developments affecting pensions and related benefits, and

(b) to provide Members with services useful to their business.

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