1. IORP II

In September, amendments to the proposed reforms to IORP II were published in the First Presidency compromise text as the proposal moves through the EU's co-decision legislative process.

The European Commission had published its proposal to revise the IORP Directive[i] in March this year. The revised directive, the so-called IORP II Directive, is expected to focus on governance, transparency and reporting requirements.

In particular, the proposals are likely to require EU member states to implement minimum governance standards for pension schemes in their countries, including a "fit and proper" test for those running an IORP. Schemes may also be obliged to disclose information to members about their pension entitlements in the form of a new EU-wide standard-form annual pension benefit statement.

While existing UK legislation appears to be largely compliant with the new provisions in many respects, the modified "fit and proper" requirements may be a cause of concern as this is some doubt as to whether non-professional trustees (such as lay "member-nominated" trustees) can still be appointed to run pension schemes in the UK. Guidance is likely to be required from the DWP/Pensions Regulator on this (for example, there is some suggestion that the Regulator's "Trustee Toolkit" could form a suitable professional qualification).

Key issues

Slightly more positive, is the removal of the requirement for cross-border schemes to be fully funded at **all times**, although it should be noted that full funding would still be required at the **start** of cross-border activities. This may make it somewhat easier for a multinational to merge its schemes from different EU countries, although there are still significant hurdles.

The implementation date of 31 December 2016 for the recast directive to be transposed into national law has also been removed, with the date left blank.

2. European Court Holiday Pay Ruling – Impact on Pensionable Pay?

A recent ruling by the Court of Justice of the European Union ("**CJEU**") may result in employers facing potentially substantial bills for miscalculated holiday pay. Pension schemes with rules that include bonus, overtime or commission payments within the calculation of pensionable pay could potentially, as a result, be subject to back dated claims for loss of pension benefits.

The case of **Lock v British Gas Trading Ltd**[2] was referred to the CJEU by the Leicester employment tribunal for clarification on whether contractual commission should be included within holiday pay calculations. The right to paid annual leave is derived from the Working Time Directive[3], however the Directive does not specify how holiday pay should be calculated. The Working Time Regulations[4] which implement the Directive in the UK set out various formulae for calculating holiday pay. There has been doubt in recent years about whether the UK's approach to calculating holiday pay is in accordance with the Directive.

The CJEU has clarified that commission should be taken into account when calculating holiday pay – this may well also have implications for employers who pay overtime and/or bonuses, for example, if those elements form part of pensionable pay in any particular scheme, there may be a knock on effect for pension liabilities (employers and trustees may wish to consider how this affects their particular rules).

Employers may want to consider whether, if they face such claims, it may impact on pension liabilities. Trustees may want to, at least ask employers, about the potential for such claims in case they need to factor it into funding decisions.

3. DC flexibility changes

George Osborne announced on 29 September 2014 the government's intention to abolish the 55% tax charge (deemed too high) on pension savings in a drawdown account at death from April 2015. Under the new system, those with a drawdown arrangement or with uncrystallised pension funds will be able to nominate a beneficiary to pass their pension to if they die. In the event that the individual dies before the age of 75, their remaining DC pension will pass to the nominated beneficiary as a tax free lump sum. If the individual is aged 75 or over when they die, the nominated beneficiary will pay tax at their marginal rate of income tax.

This follows on from the publication by HM Treasury on 21 July of the government's response to "Freedom and choice in pensions", the consultation document that had been issued on 19 March alongside the 2014 Budget.

The principal thrust of the government's consultation was to give individuals greater flexibility and choice in how they could access their defined contribution ("**DC**") pension savings at retirement after April 2015. In particular, the government sought views over a range of issues which included the design of the new tax system, the guidance guarantee and whether to continue to allow transfers from defined benefit ("**DB**") to DC schemes.

The key points worth noting in the response are:

The new tax system

- a permissive statutory override will be introduced to enable (but not oblige) all DC schemes offer their members increased flexibility
- individuals will also be able to transfer between DC schemes, up to the point of retirement, if their scheme does not offer flexible access
- the tax rules will be changed to facilitate the creation of new and innovative products by providers which more closely meet consumers' needs, including allowing annuities to decrease and allowing lump sums to be taken from annuities
- new tax rules will be put in place to ensure that individuals do not use the new flexibilities to avoid tax on their current earnings by diverting their salary into their pension with tax relief, and then immediately withdrawing 25% tax-free. Those who choose to draw down more than their tax-free lump sum from a DC pension will be able to benefit from further tax-relieved pension

saving, and make further tax-free contributions to a DC pension of up to £10,000 per year

- the government will increase the minimum age at which people can access their private pension under the new tax rules from 55 to 57 in 2028

The guidance guarantee

- everyone with DC pension savings will be entitled to free and impartial guidance at retirement. This guidance will be tailored to individuals' personal circumstances but will not recommend specific products or providers
- to guarantee impartiality, the guidance will be provided by independent organisations that have no actual, or potential, conflict of interest. The Financial Conduct Authority (**FCA**) will be given responsibility for setting standards for guidance and monitoring compliance with those standards
- pension providers and schemes will be required to make people aware of their right to impartial guidance and signpost them to the guidance service as they approach retirement
- the government will legislate to establish a levy on regulated financial services firms to fund the cost of the guidance service

DB schemes

- the government will continue to allow transfers from private sector DB to DC schemes (excluding pensions that are already in payment)
- the government will introduce two new safeguards to protect individuals and pension schemes: a new requirement for an individual to take advice from a professional financial adviser, who is independent from the DB scheme and authorised by the FCA, before a transfer can be accepted; and new guidance for trustees on the use of their existing powers to delay transfer payments and take account of scheme funding levels when deciding on transfer values
- the government intends to consult on removing the requirement to transfer first to DC schemes for those DB members who wish to access their savings flexibly
- the government continues to believe that transfers from unfunded public service DB schemes should be banned. Transfers from funded public service DB to DC schemes will be permitted and safeguards similar to those in the private sector will be introduced where appropriate
- the trivial commutation and small pot rules will continue to apply to DB schemes. These rules allow individuals to take up to £30,000 of total pension savings as a lump sum, or a £10,000 small pot as a lump sum regardless of total pension wealth. The age at which an individual can make use of these rules will also be lowered from 60 to 55

The government will legislate this autumn to implement these reforms.

4. HMRC issues updated guidance on the "fit and proper" person criteria in relation to pensions liberation

On 1 September 2014, HMRC published guidance relating to the legal requirement (effective from the same date) that all scheme administrators of registered pension schemes must be a "fit and proper" person. A scheme administrator is now required to complete a declaration that they are a fit and proper person when they apply to register a pension scheme.

The intention of the fit and proper person legislation is to prevent the misuse of tax relieved funds, the abuse of pensions tax relief as well as to assist HMRC in its efforts to combat pension liberation.

There is no definition in the legislation of a "fit and proper person" but the guidance issued sets out the approach that will be taken by HMRC in determining whether a scheme administrator is a fit and proper person.

In essence, HMRC will take the view that all persons appointed as scheme administrators are fit and proper persons unless it holds information, or obtains information, which causes it to question that assumption. Where HMRC considers that the scheme administrator is not a fit and proper person, it has powers to seek information from the scheme administrator or others and/or to issue an inspection visit notice. Penalties apply where there is a failure to comply with such an information notice or an inspection notice approved by tribunal.

HMRC can :

- Refuse to register a new pension scheme
- De-register an existing registered pension scheme

The scheme administrator can appeal against a decision of HMRC not to register a scheme or to de-register a scheme within 30 days of being notified of the decision or to assess tax charges or penalties on the scheme administrator. The scheme administrator is liable for the de-registration charge of 40% on the aggregate value of the sums and assets within the pension scheme immediately before the scheme is de-registered.

Factors that may lead to HMRC deciding that the scheme administrator is not a fit and proper person include, but are not limited to, where it appears to HMRC that the scheme administrator:

- does not have sufficient working knowledge of the pensions and pensions tax legislation to be fully aware and capable of assuming the significant duties and liabilities of the scheme administrator, or does not employ an adviser with this knowledge;
- has previously been the scheme administrator of, or otherwise involved with, a pension scheme which has been de-registered by HMRC;
- has been disqualified from acting as a company director or are bankrupt.

It should be noted that even if the Pensions Regulator considers a person to be suitable to act as trustee of scheme, that person will not necessarily be considered to be a fit and proper person to be a scheme administrator. This is because the Regulator and HMRC have different responsibilities and priorities and therefore carry out different checks. In particular, HMRC is privy to information that is not available to the Regulator.

Finally, HMRC does not offer a clearance service to confirm whether a scheme administrator is a fit and proper person.

5. An update on the Government's review of survivor benefits in occupational pension schemes

In the April 2014 edition of our client newsletter, we reported on the decision of the Employment Appeal Tribunal (**EAT**) in **Walker v Innospec**[5] which ruled that the entitlement of a surviving civil partner to non-contracted out pension benefits could be restricted to service on or after 5 December 2005. This decision is in keeping with an exemption in the Equality Act 2010 ("**2010 Act**") which permits inequality in respect of pension benefits built up prior to that date. Leave to appeal the EAT decision has been granted and it is understood that the case will go before the Court of Appeal after 1 September 2014.

The same restriction applies to surviving same-sex spouses contracted (i.e. to post-2005 service) after 13 March 2014, the date the Marriage (Same Sex Couples) Act 2013 (the "**Marriage Act**") came into force. Benefits in excess of the statutory minimum may still be provided by schemes but trustees will need to obtain the consent of the sponsoring employer to make the modification.

However, under the Marriage Act, the Secretary of State was required to undertake a review of the differences in present survivor benefit provision in both public and private sector schemes and the cost to those schemes of eliminating the differences. If he considers it necessary to change the law he has the power to do so under regulations. The outcome of the review was published on 26 June 2014.

The review explores various options for equalisation and the related costs (and also looked at the differences between widows and widowers in opposite sex marriages). Key findings include:

- the cost of elimination of all differences (that is, equalising widows' and widowers' benefits, and also providing same-sex spouses and civil partners with identical benefits). The cost for this is estimated at £0.4 billion for private sector schemes and a capitalised cost of £2.9 billion for public sector schemes.
- providing same-sex benefits on the same basis as widows. The cost for this is estimated at £0.1 billion for private sector schemes and £0.8 billion for public sector schemes. This would disadvantage male survivors in opposite sex marriages as compared with same-sex survivors of either gender and women in opposite sex marriage
- providing same-sex survivor benefits on the same basis as widowers. The cost for this is estimated at £0.1 billion for private sector schemes. The cost for public sector schemes would be negligible as the current

position would be maintained. Differences between women due to sexual orientation would remain, as would differences between men and women.

The Government is clearly hesitant about taking this step given the significant cost implications for schemes and has stated that it will consider "very carefully" the findings of the review before making a decision on whether the law should be changed.

The Court of Appeal decision on **Walker v Innospec** is also likely to have some influence on the Government's decision.

6. The Taxation of Pensions Bill

The Taxation of Pensions Bill (the "**Bill**") was published by HMRC in draft on 5 August, together with draft guidance ("**Guidance**") for the Bill. The Bill will be introduced into Parliament in the autumn and the changes will apply to pensions which individuals become entitled to on or after 6 April 2015. The consultation for this draft legislation closed on 3 September.

The draft clauses are intended to implement the proposed flexibility changes to pension tax rules with effect from 6 April 2015 in order for individuals to be able to access their entire pension fund flexibly if they wish, from age 55, subject to their marginal rate of tax.

To access their funds, the individual will have two main choices:

- to put their funds into a drawdown fund, known as a flexi-access drawdown fund from which to drawdown any amount over whatever period they want;

  or

- to take a single or series of lump sums from their crystallised funds (known as an uncrystallised funds pension lump sum).

The Guidance also confirms that scheme trustees or managers will not be compelled to provide benefits using the new flexible access provisions.

7. PPF levy consultation

On 29 May 2014, the PPF published *Consultation on the second PPF Levy Triennium - 2015/16 to 2017/18*, setting out the PPF's plans for the levy over the next three levy years, starting from *2015/16*. The consultation document proposes the introduction of a new measure for assessing the risk that a scheme employer will experience an insolvency event during the levy year, which is an integral part of the calculation of the risk-based levy. The consultation closed in July but the final determination has not yet been published.

Of particular concern however, is the PPF's plan to change the rules on asset-backed pension contributions (**ABCs**), so that they can only be included for levy purposes in limited circumstances. Essentially, only ABCs built around real estate will be counted, and there is a limit on the value that can be given to them which is based on their likely value in insolvency. It is not clear how this can be achieved as it is doubtful that the PPF actually has the power to do this as part of the prescribed process under the section 179 regulations. It remains to be seen whether this proposal will be realised.

There are also numerous statements which cast doubt on the extent to which parent company guarantees will continue to be recognised for levy purposes. No resolution has been recorded on this, but parent companies considering giving such a guarantee may want to delay any decision for the time being.

8. Olympic Airlines – PPF entry rules amended

In the April 2014 edition of our Client Newsletter, we provided an update on the Court of Appeal case of **Olympic Airlines**[6] which ruled that members of the underfunded Olympic Airlines pension scheme (the "**Olympic Scheme**") which had a deficit of over £15 million, will not be entitled to receive compensation from the PPF, the UK pensions 'lifeboat' for underfunded DB schemes where the employer becomes insolvent.

The appeal focused on whether Olympic Airlines SA had an "establishment" in England which would have given the English court jurisdiction to commence a winding-up process, thereby allowing for entry into the PPF. The Appeal Court took the view that, on the facts, the test for establishment to permit the insolvency proceedings in the UK, had not been met.

Following the case, the government had indicated in February of this year that it would look into whether PPF legislation on employer insolvency could be amended to enable members of the Olympic Scheme to benefit from PPF compensation.

Amendments to the PPF entry rules came into force on 21 July 2014 that should allow the Olympic Scheme to qualify for the PPF.

The changes are very limited in scope and will only apply until 21 July 2017. They create a new type of insolvency event which will be triggered if:

- A scheme's sponsoring employer was on 20 July 2014 subject to insolvency proceedings in an EEA state other than the UK
- The employer has its main centre of interests in that state.
- A winding-up order in relation to the employer was granted by the UK court, but set aside because the court did not have jurisdiction to wind up the company on the basis that the employer did not have an establishment in the UK.
- A PPF assessment period would ordinarily have been triggered by the winding-up order, were it not for the order being set aside as above.

The European insolvency event is deemed to take place on the fifth anniversary of the start of the insolvency proceedings.

The trustees of the Olympic Scheme had previously received permission to appeal to the Supreme Court and at the time of writing this update, the status of that appeal is not known.

9. The end of the road for the Lehmans litigation

The Pensions Regulator has secured a settlement with the Lehman Brothers group companies on the financial support directions (**FSDs**) issued in September 2010 in respect of the Lehman Brothers pension scheme (the "**Scheme**"), nearly six years after the insolvency of the group. The settlement worth around £184 million has been reached to buy out the full pension rights of Lehman Brothers employees with an insurer. This means that the Scheme will not have to be bailed out by the Pension Protection Fund (**PPF**).

The settlement comes after years of litigation which saw the trustees and the Regulator securing the following victories:-

- FSDs can be effective against companies in administration – the Supreme Court ruled on 24 July 2013 that an FSD is effective against insolvent targets and that liabilities under it rank as a provable debt.
- Trustees are "Directly Affected Parties" for the purposes of Upper Tribunal proceedings which were held in March 2012. This enabled the trustees to apply for another 38 group companies to be issued with an FSD even though the Regulator's Determinations Panel had decided against it and the original time limit of two years for the Regulator to issue a determination had expired.
- The Regulator can issue contribution notices for more than the value of the initial section 75 debt on the employer in cases where multiple contribution notices are to be issued and it is reasonable to do so.

[i] Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision.
[2] C-539/12.
[3] (2003/88/EC).
[4] SI 1998/1833.
[5] 2014.
[6] The Trustees of the Olympic Airlines SA Pension & Life Insurance Scheme v Olympic Airlines SA [2013] EWCA Civ 643.

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