



Pensions Update

October 2012

Legislation focus

Cash not king in new Code of Practice on incentive exercises

In June 2012 a new voluntary Code of Practice was issued by an Industry Working Group set up with the aim of ensuring that incentive exercises are undertaken in line with good practice [more>](#)

HMRC relaxes salary sacrifice requirements for auto-enrolment

Many employers offer their employees the opportunity to make pension contributions by way of salary sacrifice arrangements [more>](#)

CPI and council tax – the latest position

At its July meeting, the Consumer Prices Advisory Committee (CPAC) discussed including council tax in the measurement of the Consumer Prices Index (CPI) and whether this should be recommended to the Office for National Statistics [more>](#)

Case notes

Capping pensionable pay and interpreting extent of a power

Bradbury v BBC [more>](#)

Public Sector Outsourcing: Pension protections survive but is change in the air?

Urenco UK Limited v Urenco UK Pension Trustee Company Limited [more>](#)

Scheme Rules take precedence over employer's written promise on redundancy

Wallace v Unisys Insurance Service Ltd, Unisys Ltd [more>](#)

Round up

Consultation on automatic enrolment earnings thresholds [more>](#)

Consultation on the Miscellaneous Amendment (No.2) Regulations 2013 [more>](#)

The formula effect gap between RPI and CPI: consultation on calculating RPI [more>](#)

Any comments or queries

Philippa Connaughton
Partner

philippa.connaughton@rpc.co.uk
D +44 (0)20 3060 6818

Charles Suchett-Kaye
Partner

charles.suchettkaye@rpc.co.uk
D +44 (0)20 3060 6619

Legislation focus

Cash not king in new Code of Practice on incentive exercises

In June 2012 a new voluntary Code of Practice was issued by an Industry Working Group set up with the aim of ensuring that incentive exercises are undertaken in line with good practice. The new Code is much more detailed than the Pensions Regulator's December 2010 guidance on this subject.

In response, over the summer the Regulator withdrew its guidance and replaced it with a short principles based statement aimed at trustees and insurers, as well as employers and their advisers.

What are incentive exercises?

Incentive exercises are targeted at members with defined benefits in trust-based occupational pension schemes. They commonly involve approaching members and asking them to transfer out their accrued benefits to a personal pension arrangement or other investment product offered by an insurance company, such as an annuity or income drawdown product. In the Code these are referred to as 'transfer exercises'. Alternatively, members may be encouraged, for example, to give up their future rights to pension increases. These are referred to in the Code as 'modification exercises'.

In all cases incentives are offered to encourage members to take part in the exercise, the aim being to de-risk the defined benefit scheme by reducing its liabilities.

Code of Practice: 7 Principles

The Code has 7 principles which should be followed:

1. No cash incentives.
2. Individual financial advice required for all transfer exercises. For modification exercises, whether advice should be provided depends on whether a 'value requirement' (the detail is in the Code) has been met. The cost of providing advice should be met by the person making the offer.
3. Communications with members should be fair, clear, unbiased and straightforward.
4. Records should be kept providing an audit trail.
5. Members should be allowed sufficient time to make up their minds, with no undue pressure applied.
6. Incentive exercises should only be offered to members who are over age 80 on an "opt in" basis. Those providing advice or guidance to members should adhere to a vulnerable client policy.
7. All parties involved in an incentive exercise should be aware of their respective roles and responsibilities and act in good faith in the areas over which they have direct control.

Voluntary code

The Code is voluntary. However, the fact that the Code was, or was not, followed will be taken into account by the Pensions Ombudsman and the Financial Services Ombudsman when considering an incentive exercise complaint.

Pensions Regulator's July 2012 statement

The Pensions Regulator reiterated its long-held views of incentive exercises namely that "trustees should start from the presumption that incentive exercises are not in members' interests".

Where an incentive exercise is brought to the Pensions Regulator's attention, it will take into consideration the trustees' involvement and, if appropriate, require an investigation to be made into the general administration and governance of the scheme concerned.

Comment

There is a great deal of detail in the voluntary Code of Practice, with a useful glossary for those who are not familiar with some of the terminology. Whether a voluntary Code will work will depend on whether employers and their advisers are willing to follow both the letter, and spirit, of the Code.

Action Needed

If you are an employer, pension adviser, trustee, insurer or financial adviser in relation to an incentive exercise, you will be expected to have read, understood and followed the Code's principles. If you choose not to do so either generally or in relation to a particular aspect of your incentive exercise, you would be well advised to document your reasons.

Useful Information

To read the Code and the Practitioner Notes go to: www.incentiveexercises.org.uk

[Back to contents>](#)

HMRC relaxes salary sacrifice requirements for auto-enrolment

Many employers offer their employees the opportunity to make pension contributions by way of salary sacrifice arrangements. This saves both the employer and the employee National Insurance Contributions. An unresolved question was whether salary sacrifice arrangements were compatible with the auto-enrolment of employees into a pension scheme by their employer.

HMRC requires a variation of the individual's employment contract. To be effective, the salary sacrifice arrangement had to be in place for a minimum 12 month period. However to comply with auto-enrolment regulations, an employer has to allow employees to opt out and opt back in to its pension scheme at will (with no minimum 12 month requirement). The concern was that this could jeopardise the salary sacrifice arrangements for all concerned (not just those who opted in/out).

In June 2012 HMRC revised the Q&As which accompany its guidance on salary sacrifice. These now confirm that opting in and out of a pension scheme under the auto-enrolment regime does not affect the validity of pension salary sacrifice arrangements.

Technical information

For a copy of HMRC's revised Q&As on salary sacrifice go to: <http://www.hmrc.gov.uk/specialist/sal-sac-question-and-answers.htm>

[Back to contents>](#)

CPI and council tax – the latest position

At its July meeting, the Consumer Prices Advisory Committee (CPAC) discussed including council tax in the measurement of the Consumer Prices Index (CPI) and whether this should be recommended to the Office for National Statistics (ONS). Earlier this year TV licencing fees, trade union subscriptions and vehicle excise duty were included in CPI for the first time, so there were arguments for including council tax. The decision was not to recommend its inclusion, on the grounds that it would not be compatible with the European harmonised standard for CPI.

However, the CPAC did agree to recommend to the ONS that owner occupiers' housing costs (OOH) be included in a new index to be known as CPIH, being developed for first publication in March 2013. A consultation on the methodology for calculating OOH was run which closed on 31 August 2012.

At its latest meeting on 13 September the CPAC considered the consultation responses it had received to its recommended method for reflecting owner occupiers' housing costs in CPIH. The recommendation had been to use the rental equivalence approach, although opinion from those who took part in the consultation was divided on whether a net acquisitions approach should be used instead. On balance, the Committee decided to go ahead with its recommendation that the rental equivalence approach should be used to calculate OOH for the purpose of the CPIH.

Comment

Until the advent of CPI being used to calculate pension increases, changes to the methodology for calculating inflation went by largely unnoticed. It will be interesting to see how CPIH develops. The key question being asked at present is whether CPIH, once published from March 2013, will be used by Government in the future as an alternative measure of inflation to RPI and CPI.

Technical information

To read the CPAC papers and minutes from its September meeting go to: www.ons.gov.uk/ons/guide-method/development-programmes/other-development-work/consumer-prices-advisory-committee/cpac-papers/index.html

[Back to contents>](#)

Case notes

Capping pensionable pay and interpreting scheme provisions

*Bradbury v BBC*¹

The High Court reaffirms the use of binding agreements between an employer and employee outside the pension scheme as a legitimate way of capping pensionable pay without the need for a rule amendment. The Court also interpreted the extent of an employer power in the BBC Rules in the light of legislative restrictions on amendments.

Facts

Mr Bradbury was a member of the BBCs defined benefit pension scheme. Faced with an increased funding deficit, the BBC and the trustees agreed changes to the scheme's benefit structure. To the extent necessary, rule amendments were made by deed to accommodate the changes. Members of the final salary section were then given three choices: (1) remain in the final salary section but with future pay awards capped at 1% for scheme purposes (known as 'capping pensionable pay'); (2) opt out of the final salary section and join the new career average section (in which case future pay awards remained uncapped for scheme purposes); or (3) opt out of the scheme altogether and join the BBC's defined contribution plan.

The deed did not deal with the capping of pensionable pay. Instead, quite separate from the scheme and the trustees, the BBC made pay awards for members of the final salary section subject to the condition that they were capped at 1% for pensionable pay purposes. If that condition was not accepted by an individual member, no pay award would be given (or no award would be given in excess of 1%).

When Mr Bradbury was offered a pay award on that basis he complained to the Pensions Ombudsman. He argued that the capping of pensionable pay in this way was effectively a scheme amendment, requiring member consultation, trustee agreement and a formal rule amendment. When the Pensions Ombudsman did not uphold Mr Bradbury's complaint he appealed to the High Court.

Capping pensionable pay outside the scheme rules – it can still be done

Following established case law, the BBC argued that it could structure pay awards so as to cap the pensionable pay used for calculating pension benefits under the scheme, without needing to amend the scheme rules.

The Court agreed, confirming that an agreement by an active member of the final salary section to accept a pay rise from the BBC on the basis that only part of it was to be pensionable, would be binding on the member concerned and therefore on the trustees when calculating pension benefits under the scheme. However the Court went on to say that this agreement was subject to the question of breach of the implied duties of trust and confidence in the employment relationship.

¹. [2012] EWHC 1369

Breach of implied duties of good faith and/or trust and confidence?

Mr Bradbury claimed before the Court that the BBC was in breach of its implied duties of good faith and/or trust and confidence as an employer in seeking to cap pay awards for scheme purposes.

Although the Court did not rule on this issue (it was not part of the original claim), Mr Justice Warren made the point that employers can take their own interests into account in dealing with pension arrangements, provided that they balance this against scheme amendments damaging the relationship of trust and confidence between the employer and its employees. A decision in a pensions context which was irrational or perverse might offend the obligation of good faith and in that situation, members' interests and expectations might be of relevance. The Court acknowledged that there were arguments for both sides on the issue of implied duties.

Don't forget Section 91

Section 91 provides that agreements with members which seek to assign, commute or surrender a member's entitlement under an occupational pension scheme are unenforceable. Consequently, Mr Bradbury claimed that it would be illegal to agree to the cap on pensionable pay, but the Court disagreed.

In reaching its conclusion, the Court provided some useful insights into the operation of section 91 and in particular what was meant by "the right to future pension". Essentially, a member has a present right to a pension but the actual amount of that pension depends on a number of factors including pay increases and periods of future service. Here, the member's right to a future pension continued. All that happened was the pension that a member would ultimately receive would be based on capped rather than uncapped pensionable pay. As employees have no right to a pay rise, awarding a capped pay rise for pension purposes does not result in a surrender of a right that would cause a breach of section 91.

Interpreting the extent of a power under existing Rules

Whilst much of the commentary in the press on this case has been about capping pensionable pay, the case also raised an interesting question about how far the interpretation of the extent of a power under the Rules could be pushed.

BBC's position was that it had a wide discretion to determine what was meant by a Member's basic salary under the scheme rules. This was crucial, as basic salary was used to calculate pensionable pay.

Until 2000 there was no definition of basic salary in the rules. It was simply used in the calculation of pensionable pay, undefined. In June 2000 a rule amendment was introduced so that "basic salary" became "Basic Salary" in the definition of pensionable pay. "Basic Salary" was newly defined as "the amount determined by the BBC as being an Employee's basic salary and wages".

The Court said that it could understand the value of including this new power in the Rules if it was restricted to allowing the BBC to decide, in cases of doubt, whether a particular element of an employee's remuneration is basic salary or some other element of pay. However, the BBC believed the power went further than that, giving it the power to determine the level of 'Basic Salary' each year. The Court used, as an example of the extent of this argument, a basic salary of £40,000, in one year being determined by the BBC in the next year to be £35,000.

If it was correct that the 2000 amendment gave the BBC such a wide power, the Court's view was that the original amendment fell foul of the restrictions in section 67 of the Pensions Act 1995. As a reminder, section 67 prevents (in the absence of members' consents) amendments which affect or could potentially affect a member's accrued rights. The Court therefore held that the BBC did not have a wide discretion under the scheme rules to determine what was or was not "Basic Salary".

Comment

This is a useful case in confirming that pensionable pay can be capped outside the scheme through an agreement between the employer and the employee. It also highlights that employers and trustees need to be mindful of the restrictions imposed by section 67 when interpreting and giving effect to Rule amendments.

[Back to contents>](#)

Public Sector Outsourcing: pension protections survive but is change in the air?

Urenco UK Limited v Urenco UK Pension Trustee Company Limited²

This High Court decision confirms the long standing principle that employees transferring out of public sector employment into pension schemes offering 'broadly comparable benefits' may, depending on the circumstances, enjoy long lasting pension protection, both at the time of the original first generation transfer and on subsequent transfers.

Facts

Members of the Urenco Scheme were historically members of the Combined Pension Scheme (CPS), a pension scheme provided by the United Kingdom Atomic Energy Authority. By a sale and purchase agreement (SPA) made between the Nuclear Decommissioning Authority (NDA), Sellafield Ltd and Urenco (Capenhurst) Limited (Urenco), certain Sellafield's employees had their employment transferred to Urenco by operation of TUPE.

As a reminder, a TUPE transfer occurs when the business and assets of one entity are transferred to another entity; with the new employer stepping into the shoes of the old employer.

As nuclear industry employees, Sellafield transferred employees were entitled to specific, enhanced pension protections (contained in the Energy Act 2004). As part of the SPA, NDA needed to be satisfied that immediately following the TUPE transfer, the pension

² [2012] EWHC 1495

benefits available under the Urenco Scheme were no less favourable than the pension benefits (taken as a whole) offered by the CPS. Urenco Scheme benefits for transferred employees had to be enhanced to enable the scheme to be considered 'broadly comparable' and for a certificate of broad comparability to be issued by the Government Actuary's Department.

A number of years later, faced with a worsening scheme funding position, Urenco proposed certain changes to the benefit structure which would affect all scheme members including the transferred employees. The proposal was to increase member contributions from 7.5% to 9.5% and reduce the maximum rate of increase applying to pensions in payment, from the lower of RPI and 5% to the lower of RPI and 2.5%. The proposed changes would result in transferred employees enjoying less favourable benefits when compared to those that they had enjoyed whilst in the public sector.

The Court had to decide whether the scheme's power of amendment could be used to implement the proposed changes bearing in mind the protections that transferred employees enjoyed under the Energy Act 2004?

To answer this question, the Court considered the statutory position under Schedule 8 of the Energy Act 2004. Although specific to the facts, the requirement under the Act that the incoming scheme was "no less favourable" can be applied generally to transfers from the public to private sectors.

'No less favourable' test

The Court acknowledged that the "no less favourable" test was difficult to apply. For a first generation transfer, the comparison is between the pension benefits available to relevant employees under their new employer's pension scheme post transfer, compared to the pension benefits enjoyed under the old public sector scheme immediately prior to the transfer.

Where there is a second generation transfer, the comparison is between the pension benefits available under the second generation receiving scheme when compared to those in the original public sector scheme at the time of the first generation transfer.

A similar approach is to be adopted where the governing documentation of the receiving scheme - which received employees from the public sector - is to be amended (as was the case here). When making the comparison to the benefit structure of the relevant public sector scheme, any actual changes that have taken place in that public sector scheme since the first generation transfer are to be ignored.

A snapshot approach should be applied

The Court held that the proposed changes to the scheme could not be made. This was because the receiving scheme must provide benefits in respect of all future service which are no less favourable than the benefits provided by the nuclear scheme on the transfer date, ignoring its power of amendment. The Scheme could not be said to have satisfied the 'no less favourable' test if benefits for future service were subject to reduction as a result of the operation of the 'broadly comparable' scheme's power of amendment.

In this respect, increases in contributions to the scheme were, in principle, to be treated in the same way as reductions in future service benefits are treated ie both were objectionable.

The impact of the Undertakings

The Court was also asked to decide whether the scheme's power of amendment in relation to the future service benefits of the transferred employees was constrained by the terms of the SPA and the Undertakings given by Urenco.

The Court concluded that the Undertakings given by Urenco were to be read as permanent in their effect. The Court said there was nothing in their wording or in the context in which they were given which suggested that they were time limited or subject to unilateral variation. It did not make any difference that the undertakings could have been given effect to by amendment to the scheme itself, but that this had not been done. In the Court's view, the power of amendment was constrained by the irrevocable nature of the Undertakings.

Comment

This case highlights the generous protections enjoyed by members of various public sector pension schemes; and importantly that such protections may continue to be enjoyed for many years. This should be factored in to any bid being made by a private sector employer that involves the transfer of public sector employees. Such an employer should consider asking for suitable indemnities in respect of unexpected pension liabilities.

Trustees and employers of schemes receiving members under a TUPE transfer out of public sector schemes need to ensure the condition of broad compatibility continues to be met before making detrimental changes to the scheme's benefit structure, which impact members who transferred out of the public sector.

Employers and outsourcing contractors should watch this space as Government announcements over the summer indicate that change is in the air. The intention is for private sector employers to be given the option of participating in existing public sector schemes instead of having to establish and operate their own "broadly comparable" schemes. We will keep you abreast of developments.

[Back to contents>](#)

Scheme Rules take precedence over employer's written promise on redundancy

Wallace v Unisys Insurance Service Ltd and Unisys Ltd

A deferred member fails to convince the Pensions Ombudsman that he should have been granted an early retirement pension on the special terms outlined to him in writing by his Employer at the time he was made redundant.

Facts

Mr Wallace (W) was a member of the Unisys defined benefit scheme. His Employer, Unisys Insurance Services Ltd was a subsidiary of Unisys Ltd, the Principal Employer of the Scheme. His Employer made him and 41 others redundant in 2006.

The letter from his Employer in April 2006 informing W of his redundancy confirmed that, if he elected to take his deferred pension before his normal retirement date, the maximum reduction that would be applied to his pension would not be more than 3% per annum. This accorded with an earlier e-mail in which all 42 members had been told that, following questions from union representatives, it had been agreed by the Principal Employer that a 3% reduction would be applied to pensions on early retirement from active or deferred status.

Under the Scheme rules, different actuarial factors applied for those who took early retirement from active status and those who took early retirement from deferred status. For active members, the reduction was 3%. For deferred members the reduction factor was decided by the trustees after taking actuarial advice and was less generous. In all cases, early retirement required the consent of the Principal Employer.

W then signed a compromise agreement with his Employer in full and final settlement of all claims relating to his employment. The only reference in it to pensions was to the fact that the agreement did not prejudice any claims in respect of accrued pension rights.

Three years' after being made redundant, W requested early payment of his deferred pension. For cost reasons, the Principal Employer declined to give its consent to the early retirement pension using a 3% reduction factor, but agreed to early retirement using the trustees' cost-neutral factors applicable to deferred members. W complained to the Pensions Ombudsman (PO).

Decision

When considering W's entitlement to take his pension early, the PO took the scheme rules as her starting point. The rules clearly stated that a request for early retirement of a deferred pension was subject to Principal Employer consent. If consent was given, it was the trustees who decided the reduction factor that would be applied to the early retirement pension and not the Employer or the Principal Employer.

The PO concluded that the Principal Employer was within its rights not to give its consent to early retirement and W had no right to take his pension early or on any particular terms ie with a 3% reduction factor applied.

The PO then considered whether the statements made to W in 2006 gave him an automatic entitlement to take his pension early on the terms he said were agreed ie with a 3% reduction factor. TPAS (the Pensions Advisory Service) argued on W's behalf that the 2006 letter amounted to a contract between W and the Employer. The PO disagreed. The 2006 letter told W he was being made redundant and contained a statement about the 3% reduction factor. As there was no offer, acceptance or consideration, there was no contract.

The PO also considered whether the principle of estoppel might apply to the representations made about the 3% reduction. If it applied, it would prevent the Principal Employer from going back on its (alleged) promise.

To succeed, a clear promise must have been made to W which was intended to be acted on. W would then have to prove that he acted in reliance on it and to his detriment. The PO found that although there had been a clear promise made, W was unable to show that he had acted on the statement as he was being made redundant anyway.

The PO decided that the statement in the 2006 letter led W to believe that his pension would be greater than in fact it was. Whilst W had not acted to his detriment, his expectations had been raised which had caused distress. As the letter did not reference the need for the Principal Employer's consent this was maladministration. The PO found that the statement, although made by the Employer, was "clearly made" on behalf of the Principal Employer, so the Principal Employer was ordered to pay £250 to W.

Comment

This is a curious case. At first reading, you would be forgiven for thinking that the member had been harshly done to – particularly as others who were made redundant did get to take their pensions early with a 3% reduction. Much is made in the case about the Scheme Rules and the fact that it was the Principal Employer who needed to give consent to early retirement and not Mr Wallace's Employer. We agree with the approach that scheme rules should take precedence, however, there was clearly evidence in this case that the Principal Employer had been involved in the decision-making around the 3% reduction factor, otherwise why require that company to pay the £250? We suspect that the position might have been different had the member not signed a compromise agreement with his Employer.

[Back to contents>](#)

Round up

Consultation on automatic enrolment earnings thresholds

The DWP is consulting on the lower and upper earning thresholds to be used for auto-enrolment purposes for the tax year 2013/2014. The consultation proposes raising the lower threshold from £5,564 to £5,720 and reducing the upper threshold from £42,475 to £41,450. Separately, the DWP is proposing to raise the auto-enrolment earnings trigger from £8,105 to £9,250 to align it with changes to the PAYE threshold. The consultation closes on 17 October and a Government response is expected in November. For the consultation document go to: <http://www.dwp.gov.uk/docs/ae-thresholds-2013-2014-consultation.pdf>

[Back to contents>](#)

Consultation on the Occupational Pension Schemes (Miscellaneous Amendments No.2) Regulations 2013

A DWP consultation is underway on the Occupational Pension Schemes (Miscellaneous Amendments No.2) Regulations 2013, which as the name suggests, provide for a variety of technical changes to existing pension legislation. The draft regulations provide a limited power for trustees to amend their scheme rules to reflect changes in the state pension age. They also deal with various changes that are necessary following the use of CPI instead of RPI in the calculation of indexation of benefits. Once in force, they will amend existing regulations relating to transfer rights, indexation of pension credit benefits, indexation of pension credit benefits held within a cash balance scheme and bridging pensions. The consultation ends on 14 November. For the consultation document and the draft Regulations go to: <http://www.dwp.gov.uk/docs/occ-pen-misc-amdts-2-regs-2013consultation.pdf>

[Back to contents>](#)

The formula effect gap between RPI and CPI: consultation on calculating RPI

The National Statistician is currently consulting on proposed changes to the way in which the Retail Price Index (RPI) is calculated. The consultation ends on 14 November. The detailed consultation document can be found at: <http://www.ons.gov.uk/ons/about-ons/user-engagement/consultations-and-surveys/national-statistician-s-consultation-on-options-for-improving-the-retail-prices-index/index.html>

[Back to contents>](#)

ID Ref: 12327