

# Pensions and Employment: Pensions Bulletin

Legal and regulatory developments in pensions

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## I. The Watch List

The Watch List is a summary of some potentially important issues for pension schemes which we have identified and where time is running out, with links to more detailed information. New or changed items are in **bold**.

No.	Topic	Deadline	Further information/ action
1	Information to retiring DC members about the guidance guarantee	6 <sup>th</sup> April, 2015	Template information available on request
2	Information to transferring DB members about the requirement for independent financial advice	6 <sup>th</sup> April, 2015	<a href="#">Pensions Bulletin 15/09</a>
3	Requirement to check that independent financial advice received before effecting DB transfers	6 <sup>th</sup> April, 2015	<a href="#">Pensions Bulletin 15/11</a>  <b>Action point:</b> Check transfer-out provisions in scheme rules. They will require amendment if they give members the right to transfer without taking independent financial advice
4	New governance requirements for occupational schemes which have money purchase benefits in them (unless limited to AVCs)	6 <sup>th</sup> April, 2015	Client note dated 24 <sup>th</sup> February, 2015 (updated 2 <sup>nd</sup> April, 2015) available from <a href="#">Lynsey Richards</a>  Note additional requirements for "relevant multi-employer schemes" – see <a href="#">Pensions Bulletin 15/08</a>

5	Cap on charges in default fund for auto-enrolment qualifying schemes	6 <sup>th</sup> April, 2015	Client note dated 24 <sup>th</sup> February, 2015 (updated 2 <sup>nd</sup> April, 2015 to reflect exemption from charge cap for AVCs) – <a href="#">Pensions Bulletin 15/06</a> available from <a href="#">Lynsey Richards</a>
6	Abolition of refund of contributions for members of occupational schemes with at least 30 days' pensionable service who are just provided with money purchase benefits	1 <sup>st</sup> October, 2015	<a href="#">Pensions Bulletin 15/09</a>  <b>Action point:</b> Check scheme rules and amend where necessary (by 1 <sup>st</sup> October, 2015) to remove right to refund of contributions where member has at least 30 days' qualifying service but less than 2 years' qualifying service <a href="#">Pensions Bulletin 15/06</a>
7	VAT recovery changes	31 <sup>st</sup> December, 2015	Consider putting in place tripartite agreements with investment managers to improve VAT recovery <a href="#">Summer Budget 2015 Supplement</a>
<b>8</b>	<b>Reduction in annual allowance for high income individuals</b>	<b>6<sup>th</sup> April, 2016</b>	
9	Reduction in Lifetime Allowance from £1.25 million to £1 million	6 <sup>th</sup> April, 2016	<a href="#">Pensions Bulletin 15/05</a>
10	Abolition of DB contracting-out: managing additional costs	6 <sup>th</sup> April, 2016	<a href="#">Pensions Bulletin 15/05</a>  Checklist available to clients on request. Planning for this should be well developed by now.

11	Abolition of DB contracting-out: practicalities	6 <sup>th</sup> April, 2016	<a href="#">Pensions Bulletin 14/08</a>  Checklist available to clients on request. Planning for this should be well developed by now.
12	Prohibition on Active Member Discounts in auto-enrolment qualifying schemes	6 <sup>th</sup> April, 2016	<a href="#">Pensions Bulletin 14/16</a>
13	Proposed ban on corporate directors	Delayed to 2016	<a href="#">Pensions Bulletin 15/07</a>  Government announced on 23 <sup>rd</sup> June, 2015 that implementation, previously expected to be on 1 <sup>st</sup> October, 2015, will be delayed to 2016, with revised timings to be announced "shortly"
14	Automatic transfers of DC pots of £10,000 or less	Phase 1 1 <sup>st</sup> October, 2016	<a href="#">Pensions Bulletin 15/03</a>
15	Registration for Individual Protection 2014	Before 6 <sup>th</sup> April, 2017	<a href="#">Pensions Bulletin 14/12</a>

## New Law

### II. Abolition of DB contracting-out: Regulations for formerly contracted-out schemes made and laid

#### A. Overview

1. Regulations<sup>1</sup> have been made that will replace the existing Contracting out Regulations 1996 with effect from 6th April, 2016. They set out the ongoing requirements for schemes formerly contracted out on a salary-related basis (“**former COSRs**”) after 6th April, 2016, when defined benefit contracting-out is abolished.
2. The as-laid Regulations are substantively changed from the version published in draft on 8th May, 2014 ([Pensions Bulletin 14/08](#)).
3. The Regulations apply to all schemes that have been COSRs at any time since 1978, and include requirements relating to GMPs, contributions equivalent premiums (“**CEPs**”), and “**section 9(2B) rights**” (i.e. post-6th April, 1997 contracted out rights).

<sup>1</sup> The Occupational Pension Schemes (Schemes that were contracted out) Regulations 2015 (S.I. 2015/1452) (the “**Regulations**”)

4. Respondents to the consultation asked the DWP to address issues relating to GMP conversion. The DWP says that conversion and equalisation issues are being explored separately.
5. Consequential changes to other legislation need to be made to take account of the abolition of contracting-out (for example to the **Contracting Out (Transfers and Transfer Payments) Regulations 1996** (the “**Transfer Regulations**”). The DWP will be undertaking a further consultation on these provisions “later this year”.

#### B. Savings Order

1. Alongside the Regulations, the DWP has laid an Order<sup>2</sup> preserving for 3 years from 6th April, 2016 key contracting-out provisions currently in the Pension Schemes Act 1993 (the “**PSA 1993**”).
2. This is to allow HMRC and trustees of COSRs to carry out any necessary activity in relation to periods of contracted-out employment which occurred before 6th April, 2016.

<sup>2</sup> The Pensions Act 2014 (Savings) Order 2015 (S.I. 2015/1502) (the “**Savings Order**”).

#### C. The Consultation Response

1. This was published on 16th July, 2015.
2. Points to note include:

2.1 **Reference Scheme underpin:** respondents were concerned that the Regulations would not preserve the Reference Scheme Test (“**RST**”) in any form for **DC schemes** that operate an RST underpin that is defined by reference to the legislation rather than being written into the scheme rules. The DWP says it initially thought that saving the relevant sections of the PSA 1993 would be sufficient but the issue has turned out to be more complex and it needs more time to develop a solution to satisfy all parties. For now, it has preserved the relevant sections until April, 2019 in the Savings Order.

2.2 **Guidance:** the DWP and HMRC are currently working on providing guidance for pension scheme administrators of COSRs. They intend to update the contracting out guidance manuals for “early 2016”.

2.3 **Transfers between former COSRs:** The Transfer Regulations will be amended so that all references to a “salary-related contracted out scheme” will be extended to include a scheme which was formerly a salary-related

contracted out scheme. This will ensure it is possible for individual transfers that include GMPs or Section 9(2B) rights to be made between former COSRs.

**2.4 Revaluation of GMPs and anti-franking:** the DWP confirms that, by virtue of amendments to (i) the revaluation requirements for GMPs for early leavers and (ii) the anti-franking rules, the abolition of contracting-out will not trigger the early leaver rules for those who cease contracted-out employment on 6th April, 2016 but who remain in pensionable service. It is the policy intention that such members will be entitled to fixed rate revaluation of their GMPs from 6th April, 2016.

**2.5 Power to modify scheme rules for “integrated schemes”:** respondents asked for a power to modify scheme rules that make reference to “basic state pension” or are otherwise affected by the 6th April, 2016 changes. The DWP believes that most schemes will be able to make changes under existing scheme rules. It will not provide a specific power to enable trustees to make changes with agreement of the employer where the scheme rules do not allow this. As the value of Basic State Pension will remain for people reaching State Pension Age before 6th April, 2016 and will be provided for in the annual uprating

order published by the DWP, schemes should be able to take into account the amount of Basic State Pension which will continue to be published each year after abolition. As a consequence, the DWP says it will not be necessary to include a power to modify scheme rules to reflect state pension reforms.

**2.6 Protected Rights:** the DWP confirms that protected rights previously transferred to a COSR which then became categorised as Section 9 (2B) rights continue to remain such after the abolition of DC contracting-out i.e. they will retain their contracting out status after 6th April, 2012.

**2.7 Permitted lump sums under RST:** the DWP has refused to allow lifetime allowance excess lump sums to be added to the list of lump sums that may be payable under the RST; it is to consult on other changes to the Transfer Regulations that will allow members to take advantage of the 6th April, 2015 flexibilities.

**2.8 Notification/consultation:** the issue on whether employers should notify and consult with members in advance of the ending of contracting out will be addressed in a further consultation on changes to the **Disclosure Regulations 2013**.

The consultation response is on the [Gov.uk website](#).

#### D. Further consultation

1. The DWP is to consult further on the following issues later in 2015:
  - 1.1 the extent to which employers should notify and consult with members in advance of abolition of DB contracting-out,
  - 1.2 DC schemes with reference scheme underpins,
  - 1.3 how to update the “Regulation 42” restriction on amendments to the rules of formerly contracted-out schemes, and
  - 1.4 change to the Transfer Regulations relating to (i) transfers between former COSRs and (ii) the new DC flexibilities.

**Comment:** Many issues remain unresolved following publication of the final form of the Regulations.

**Action point:** Notwithstanding the DWP’s comments on the need for modifications for integrated schemes, schemes that include any kind of reference to state pension will need to consider carefully the impact of the changes and whether to make rule amendments to reflect the new definitions.

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Similarly, schemes with “baked in” contracting-out provisions will need to consider whether to remove these. In particular, are they likely to be picked up automatically under an auto-correct provision? If so, is this what the scheme intends?

We are in the process of updating our checklist on the abolition of DB contracting-out to reflect the final form Regulations. Please get in touch with your usual pensions contact at Slaughter and May if you would like a copy.

**E. HMRC’s Countdown Bulletin 9**

This was published on 15th July, 2015 and responds to the remainder of queries raised during HMRC’s conferences for scheme administrators held in April/ May, 2015 on the practical impact of the abolition of DB contracting out.

The points addressed are generally detailed administration points. Points of wider interest include:

**Q:** For how long can schemes pay contribution equivalent premiums?

**A:** Where the period of employment in the scheme, including any transfers, starts before 6th April, 2016 and ends before 6th April, 2019 a CEP

can still be paid so long as the total period of employment is less than 2 years,

**Q:** Can HMRC provide administrators with a list of schemes that they are currently responsible for according to HMRC records?

**A:** HMRC’s customer relationship manager will be contacting those administrators using the scheme reconciliation service to provide details of any additional schemes that have yet to register,

**Q:** Can a tolerance be applied to the GMP figures?

**A:** HMRC does not apply tolerances to any GMPs. But in the winding-up guidance on the Pensions Regulator’s website, a tolerance of £2 is suggested.

An on-line self-service facility will be introduced from April, 2016 which will provide administrators with GMP and contribution/earnings information for scheme members.

Countdown Bulletin 9 is on HMRC’s [website](#)

**Tax**

**III. Finance (No. 2) Bill 2015: Pensions measures**

The Finance (No. 2) Bill 2015 and explanatory notes were published on 15th July, 2015.

The pensions-related provisions are:

- **Clauses 21 and 22: taxation of lump sum death benefits:** From 6th April, 2016, lump sum death benefits payable on the death of a member over age 75 will be taxed at the recipient’s marginal tax rate, rather than under the special lump sum death benefits charge of 45%, and
- **Clause 23 and schedule 4: reduced annual allowance/aligning pension input periods with tax years:** From 6th April, 2016, the annual allowance is tapered for those with an “adjusted income” (which includes the value of their total pension input for a particular tax year) of more than £150,000. Individuals with a “threshold income” of less than £110,000 (i.e. excluding pension inputs) will not be caught by the taper. As a consequence, amendments to the Finance Act 2004 align an individual’s pension input period (“PIP”) with the tax year from 2016/17. All PIPs open on 8<sup>th</sup> July, 2015 are deemed to have closed with immediate effect. The Bill contains complex transitional provisions for the 2015/16 tax year.

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The Bill received its first reading in the House of Commons on 14th July, 2015 and its second reading on 21st July, 2015.

The Bill moves to Committee stage on 8<sup>th</sup> September, 2015, after the summer recess. Committee stage must be completed by 20<sup>th</sup> October, 2015.

#### IV. July, 2015 Budget: HMRC Pension Schemes Newsletter 70

1. This, published on 21st July, 2015, summarises the main measures announced in the July, 2015 Budget, many of which are being enacted in the Finance (No. 2) Bill 2015 (see III above).
2. Points to note include:
  - **Tapered Annual Allowance/Pension Input Periods:** HMRC has made minor amendments to its Budget Day technical guidance on the transitional pension input period (“PIP”) for 2015/16. In particular, a new practical example has been added illustrating how the carry-forward rules work for the pre and post-alignment mini tax years in the case of an individual with unused annual allowance to carry forward from 2014/15.
  - **Reduction in Lifetime Allowance (“LTA”) from £1.25 million to £1 million:** The protection regimes for those affected by the reduction in

the LTA that takes effect on 6th April, 2016 will be in the Finance Bill 2016. According to HMRC, they will largely replicate Fixed Protection 2014 and Individual Protection 2014. But HMRC is considering not requiring members to make a claim for either form of protection by a specific deadline (i.e. for protection to be automatic). It says it will publish further details about its plans later in the summer.

- **Flexibility:** Printable forms are now available for individuals who want to reclaim tax after flexibly accessing DC pension rights since 6th April, 2015. Guidance for scheme administrators on how to operate PAYE coding and reporting in relation to flexible access was contained in HMRC’s [Pension Schemes Newsletter 68](#), published in April, 2015

Pension Schemes Newsletter 70 is on [HMRC’s website](#)

**Comment:** The reductions in the LTA and annual allowance take place on 6th April, 2016. Schemes and employers should start thinking now about how to communicate the changes to affected individuals.

## Cases

### VII. Discrimination arising from disability: Linking ill-health pension to part-time salary: Trustees of Swansea University Pension Scheme v Williams

#### A. Overview

1. On 21st July, 2015, the Employment Appeal Tribunal held that basing an employee’s ill-health pension on his part-time salary after his employer had reduced his hours as an adjustment to accommodate his disability did not amount to treating the employee “unfavourably”.
2. The Equality Act 2010 provides that “*discrimination arising from disability*” occurs where both:
  - A treats B unfavourably because of something arising in consequence of B’s disability, and
  - A cannot show that the treatment is a proportionate means of achieving a legitimate aim.
3. Mr Williams (“W”) suffered from Tourette’s Syndrome, obsessive compulsive disorder, depression and other psychological problems. He had worked full-time as a lab technician for Swansea University for 10 years before gradually, at his request, reducing his working hours by half.

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4. W took ill-health early retirement on 30th June, 2013 at the age of 38. The Trust Deed and Rules of the Swansea University Pension Scheme (the “Scheme”) provided him with an enhanced pension, based on final salary at retirement without actuarial deduction.
5. W claimed that this amounted to discrimination arising from disability on the basis that the failure to base his enhanced pension on his previous full-time salary amounted to unfavourable treatment because of something arising in consequence of his disability.
6. The Employment Tribunal agreed and held that the Scheme itself was discriminatory.
7. The Tribunal accepted that the University had a legitimate aim to protect but held that W’s treatment was not a proportionate means of achieving that aim, since the Trustees had not considered whether there were other ways of achieving it.

#### B. EAT decision

1. The EAT allowed the University’s appeal and remitted the case to a fresh tribunal for a complete rehearing.

2. In relation to what is meant by “unfavourably”, the EAT concluded:
  - it was “*manifestly perverse*” for the Tribunal to conclude that the Scheme was discriminatory against disabled people; in fact it treated them favourably when compared to non-disabled people,
  - the legislation referred to a person being treated “*unfavourably*”, not to a “*detriment*”. “*Unfavourably*” did not mean the same thing; it should be “*measured against an objective sense of that which is adverse as compared to that which is beneficial*”. Treatment which was advantageous, as was the case here, could not be said to be “*unfavourable*” merely because it could have been even more advantageous,
  - since the ill-health retirement scheme only applied to disabled people, the Tribunal had sought to compare W’s position to people with different disabilities, who may not have reduced working hours, resulting in a higher final salary on retirement. This amounted to a “*less favourable*” treatment test, which was also the wrong test.
3. As a consequence of finding that the Tribunal’s decision on what was treating someone “unfavourably” was wrong, the EAT did not need

to consider the issue of objective justification. But it chose to express its views on the point. The EAT criticised the Tribunal’s conclusions first, that cost alone was sufficient to amount to a “legitimate aim” and second that the ill-health provisions were not a proportionate means of achieving that legitimate aim. In relation to proportionality, following **R (Elias) v Secretary of State for Defence**, it did not matter that the trustees had failed to consider justification or come up with any alternative less discriminatory measures.

**Comment:** This is the first pensions case on the Equality Act 2010 concept of “discrimination arising from disability”. Helpfully, it suggests that courts will be slow to find such discrimination in the context of ill-health early retirement benefits. [Employment Bulletin 15/14](#) addresses the employment law implications of the decision.

#### VIII. Age discrimination: Compulsory retirement of police officers: **Harrod v Chief Constable of West Midlands Police**

On 8<sup>th</sup> July, 2015 the EAT overturned the Employment Tribunal’s decision ([Pensions Bulletin 14/04](#)) and held that the compulsory retirement by West Midlands Police (the “**Police**”) of large numbers of serving police officers under Rule A19 of the **Police Pensions Regulations 1987** following budget cuts was justifiable age discrimination.

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The ruling was a test case in relation to a decision by 7 police forces to use Rule A19 to require the compulsory retirement of a cohort of officers to meet budget cuts.

Rule A19, entitled “Compulsory retirement on grounds of efficiency of the force”, provides that “*if a police authority determines that the retention in the force of a police constable to whom the regulation applies would not be in the general interests of efficiency, he may be required to retire on such date as the Police Pension Authority determines*”. The rule applies only to police constables who, if required to retire, would be entitled to receive a pension of not less than 2/3rds of average pensionable pay (“**full pension**”) under the Police Pension Scheme.

The 7 forces had decided to retire all officers who were eligible under A19 unless, in exceptional cases, their particular skills could not immediately be replaced.

The London Central Employment Tribunal had held that the use of A19 was not justified in these circumstances and amounted to unlawful indirect age discrimination.

The EAT has allowed the Police’s appeal and substituted a finding that the use of A19 was justified. All the officers’ claims were dismissed.

The EAT held that discrimination was inherent in the statutory provisions of A19 and not in any decision by

the Police to apply it. The Police policy of retiring all officers who were eligible did not, as the Tribunal had held, add to the discriminatory impact of A19 and did not need specific justification. As the Supreme Court had held in **Seldon v Clarkson, Wright and Jakes**, if a general rule is justified, it is not necessary to go on and justify the application of the rule in individual cases.

The main issue was whether what was done was a proportionate means of achieving a legitimate aim. This involved identifying the aim that the Police had in mind. Parliament had chosen to make A19 in the terms that it did, which should have led the Tribunal to apply a less strict level of scrutiny. The Tribunal had wrongly analysed A19 in terms of the social policy aim of providing security of tenure to police officers. It had ignored the social policy aim of ensuring that compulsory retirements were restricted to those who had a financial cushion in the form of an immediate pension entitlement.

A postscript to the EAT decision notes the President’s view that the case should have been brought as a direct discrimination claim rather than an indirect discrimination claim. A19 was not an “apparently neutral” provision disproportionately affecting people of a particular age group. Rather it was a distinction directly between individuals on grounds of age, because it could not, in practice, apply to officers under the age of 48 (because they could not have accrued “full pension”), whereas those over the age 48 were at risk of inclusion.

**Comment:** This decision will come as a relief to the many police forces that have relied on Rule A19 to effect cost savings. Some of the EAT’s reasoning is of relevance to early retirement provisions in non-statutory schemes.

### **IX. Rectification: Sterling Insurance Trustees Limited v Sterling Insurance Group Limited**

On 3rd July, 2015, in an as-yet unreported decision, the High Court (Nugee J.) exercised its discretion to correct a mistake in a pension scheme trust deed to remove the word “due” from the expression “benefits accrued due” in a provision restricting any amendment affecting the value of accrued benefits.

The Court found that the phrase “accrued due” had been used to mean a sum that had fallen due for payment, and that meaning was inconsistent with the purpose of the restriction, which was to protect member benefits.

The claimant was the trustee of the Sterling Pension Scheme (the “**Scheme**”), a final salary scheme. The Scheme’s trust deed contained a restriction which prohibited any amendment which would “*substantially reduce in aggregate the value... of the benefits accrued due in respect of any member up to the date of such alteration, modification or addition*”.

In 2004 a deed of variation amended the rules in relation to the definition of “final pensionable



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salary” so that it would be calculated as at the end of September 2004 and not at the date of leaving service, thereby breaking the final salary link.

The employer argued that the restriction in the power of amendment phrase referred to payments that had already become payable so that the 2004 amendment had not breached the restriction.

Nugee J. disagreed with the employer.

As construed by the employer, the proviso would have a very limited effect and be almost entirely redundant given the protection afforded by Section 67 of the Pensions Act 1995. More significantly, it did not fit in with the remainder of the language of the clause and therefore fell within that category of case where the draftsman had failed to pay attention when using the word. The proviso was therefore to be construed as if the word “due” was not there. As a consequence the final salary link was protected.

**Regulator's information for small employers on choosing a pension scheme for auto-enrolment**

On 16th July, 2015, the Pensions Regulator announced that it has refreshed its website to include additional information to help small employers find a scheme for auto-enrolment purposes. The information includes, for the first time, a list of “master trust” schemes open to employers of all sizes. The master trusts

have been independently reviewed to prove they are administered to a high standard under the voluntary master trust assurance framework developed by the ICAEW in association with the Pensions Regulator.

In addition, a quick guide for small and micro-employers on what to look out for when choosing a scheme, and updates to website pages for IFAs and accountants, have been added.

The new guide to choosing a pension scheme is on the [Regulator's website](#).

**DWP factsheet on state pension transition and contracting-out**

On 21<sup>st</sup> July, 2015, the DWP published a factsheet explaining the effect on the new single-tier state pension of someone previously having been contracted-out.

The factsheet was published in response to criticism that people previously contracted-out were not aware of the (potentially adverse) impact of the introduction of the new single-tier state pension on them.

The note describes:

- how contracted-out amounts are treated in the transition, and how NI records up to 2015/16 are valued to create a “starting amount”,

- how contracted-out pensions are revalued from the point of leaving contracted-out employment until state pension age, and
- the effect that the ending of the current state scheme has on the uprating of additional state pension and the contracted-out deduction.

The factsheet contains a useful overview of contracting-out since 1978/79 and examples of:

- a transition calculation i.e. a calculation of state pension for an individual with contracted-out service who will reach state pension age after 6th April, 2016, and
- the effect of the ending of state second pension on the uprating of additional state pension.

The factsheet is on the [Gov.UK website](#)

**Comment:** The factsheet, which runs to 7 pages, is a useful resource for scheme administrators faced with explaining to members the complexities of the abolition of DB contracting-out.

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