

# alert

## LIFE COVER ONLY MEMBERS – THE FINAL INSTALMENT

### 1 INTRODUCTION

Some topics just seem to run and run – we have already been in contact on the topic of life cover only members.<sup>1</sup> It has been unclear, following the implementation of the European Pensions Directive into UK legislation, whether it is possible for occupational pension schemes to continue to have life cover only members as a separate category of membership.

Guidance from the DWP was published back in February on this important topic, but schemes were advised to wait for the Pensions Regulator's guidance before taking precipitous action. The Regulator's guidance was finally published on 30 June 2006.

A copy of the Regulator's guidance can be found by following the link below:

<http://www.thepensionsregulator.gov.uk/codesAndGuidance/guidance/deathBenefits/index.aspx>

### 2 KEY POINTS

- Employers should *urgently* review stakeholder provision if they are relying on a life cover only scheme to provide them with an exemption.
- If an employee is offered membership of a pension scheme, lump sum death benefits can be part of the overall package of pension benefits.
- Trustees and employees need to be alert to the fact that provision of life cover for members in the EU can cause a scheme to be cross-border.
- See our quick reference table at the end for the different scenarios.

---

<sup>1</sup> See our Sackers Extra Alerts "European Pensions Directive" dated 24 October 2005 and "Life Cover Only Members" dated 23 February 2006 – both of which are available from the client area of our website

# alert

Continued

## **LIFE COVER ONLY MEMBERS – THE FINAL INSTALMENT**

### **3 BACKGROUND**

Since 22 September 2005, an occupational pension scheme can only carry out activities which are "retirement-benefit activities" and provide death benefits if they are ancillary or supplemental to those activities under section 255 of the Pensions Act 2004. (Please note that trustees can incur civil penalties imposed by the Regulator if they do not comply).

- A life cover only scheme will not be an "occupational pension scheme". This affects the stakeholder exemption – see section 4.
- More problematic is the question of whether an occupational pension scheme can only provide life cover in respect of individuals to whom a retirement benefit is intended to be paid. The Regulator's guidance expands on this question – see section 5.

### **4 STAKEHOLDER EXEMPTION**

Since 1999, all employers must offer all employees access to a stakeholder pension scheme, unless an exemption applies. One of these exemptions meant that an employee who was a member of a life assurance only scheme (or who had life assurance only membership of an occupational pension scheme) did not need to be offered access to a stakeholder scheme.

But the changes to the definition of "occupational pension scheme" (referred to in section 3 above) affect this exemption. The Regulator clearly states that employers with employees in this position should designate a stakeholder scheme.

Whilst the Regulator notes that the strict legal position is that an affected employer should have designated a scheme by 22 December 2005 (three months from the date that the amended definition came into force) it does recognise that employers may not have taken action yet. If an employer has not taken action the guidance states that an employer "must certainly take steps to do so without further delay if they were previously unaware of the position".

# alert

Continued

## LIFE COVER ONLY MEMBERS – THE FINAL INSTALMENT

### 5 REGULATOR'S GUIDANCE

Like the DWP note before it, the Regulator generally steers clear of providing definitive guidance. However, it does analyse the requirements by focusing on various different scenarios.

#### *Scenario 1 – Employees awaiting membership*

The provision of lump sum death benefits to employees who are in a waiting period is "likely to be acceptable" if the waiting period is an employment condition or a condition of the scheme itself. But this would not be the case if an employee would never in fact be eligible (for example, because the waiting period was 5 years and they were only 3 years from retirement).

#### *Scenario 2 – Employees who have opted out*

Again, provision of life cover only benefits to employees who have declined membership or who have opted out is "likely to be acceptable".

#### *Scenario 3 – Closed schemes (to new members or to future accrual)*

- Existing members – provision of death benefits is "likely to be acceptable" for existing members who have pension benefits in closed schemes.
- New members, without pension provision – providing life cover could infringe section 255 and death benefits should be provided in an alternative arrangement.
- New members, pension provided under separate arrangement – "it is possible that this may not infringe the terms of section 255 ...provided that there is a sufficient concrete and identifiable link through the employer between the provision of the lump sum death benefits under the one scheme, and the pension benefits under the other scheme. Such a link would need to be stronger than the simple fact that the two schemes were set up and run by the same employer."

# alert

Continued

## LIFE COVER ONLY MEMBERS – THE FINAL INSTALMENT

### 6 CROSS-BORDER

And finally, the Regulator's guidance makes some important comments regarding the interaction between the provision of life cover and the potential for a scheme to be designated as a cross-border scheme.

#### *Contributions for Life Cover*

To recap, under the Pensions Act 2004, a scheme needs to register as a cross-border scheme in order to accept contributions from a "European employer". Once registered, a cross-border scheme is required to be "fully funded at all times". An employer is a "European employer" in relation to a UK pension scheme if it employs a "qualifying person" and it makes contributions to the UK pension scheme in respect of him.

The Regulator's guidance makes it clear that life cover only members can be "qualifying persons", unless they are deferred and their death in service benefits are "calculated by reference to the member's salaries at the date of deferment". This means that if there is any link to current or final salaries for death in service benefits, the cross-border regulations may apply.

#### *Withdrawal of Cross-Border Applications*

Eleventh hour revisions to the Cross-Border Regulations<sup>2</sup> also allowed a cross-border application to be submitted in outline but withdrawn by 29 June 2006, provided that all affected members were deferred by that date (and that only contributions in respect of members' deferred status were paid).

Unhelpfully, the Regulator's guidance on life cover only members and cross-border was published after this deadline had passed.

---

<sup>2</sup> See our Sackers Extra Alert "Cross Border – the Road to Nowhere?" dated 28 March 2006

## alert

Continued

**LIFE COVER ONLY MEMBERS – THE FINAL INSTALMENT****QUICK REFERENCE TABLE<sup>3</sup>**

<b>Benefit Design</b>	<b>Can you continue to offer benefit?</b>
Life cover being provided under separate scheme	Yes (but the separate life cover only scheme will not be regarded as an "occupational pension scheme")
Reliance on life cover only scheme to provide exemption from requirement to designate a stakeholder scheme	You must now offer stakeholder access
Life cover being provided under occupational pension scheme (where no other benefit provided)	No
Life cover being provided under a closed occupational pension scheme (to existing members with existing pension benefits)	Yes ("likely to be acceptable")
Life cover being provided under a closed occupational pension scheme (to new members)	No
Life cover being provided under closed occupational pension scheme (where employer offers pension benefit through alternative vehicle)	Yes (provided "sufficient concrete and identifiable link through the employer")
Life cover provided to member in waiting period	Yes ("likely to be acceptable")
Life cover provided to member who has opted out of active membership	Yes ("likely to be acceptable")

<sup>3</sup> This table is based on the Regulator's views, which generally echo those of the DWP although they expand upon them in certain areas