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PENSIONS ACT 2008 - THE ROAD TO 2012

1 INTRODUCTION

With the summer's success at the Beijing Olympics still ringing in its ears, the Government is knuckling down to preparations for the London Games in 2012. And faced with a similar timetable for Personal Accounts, its other big project for 2012, the next Olympiad will be a busy one.

The Pensions Act 2008 (the Act), which paves the way for Personal Accounts, received Royal Assent on 26 November 2008. In this Alert we look at some of the key features of the new regime, as well as the more immediate changes which pension schemes can expect under the Act.

2 KEY POINTS

- Personal Accounts are the primary focus of the new Act (section 3).
- The Pensions Regulator will be able to make use of new anti-avoidance powers (section 4).
- The Act also includes measures aimed at simplifying occupational and state pension provision. These include a reduction in the statutory cap on revaluing deferred pensions from 5% to 2.5% (section 5).

3 A MARATHON NOT A SPRINT - PERSONAL ACCOUNTS

Designed to encourage greater pension savings, Personal Accounts are due to be introduced from 2012. One of the main purposes of the Act is therefore to establish a framework for Personal Accounts.[1]

[1] For more details, please see our Alert - "Another Year, Another Pensions Bill" dated 7 December 2007

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A framework for Personal Accounts

Personal Accounts will be set up as a trust based, money purchase (or defined contribution (DC)) occupational pension arrangement. Eligible employees (referred to in the Act as "jobholders") between the ages of 22 and State Pension Age will need to be automatically enrolled into either a Personal Account or an employer sponsored arrangement (trust or contract based) which meets the relevant "quality requirement".[2]

The Quality Requirement

For contracted-out defined benefit (DB) schemes, the quality requirement means the reference scheme test, while contracted-in DB schemes will be pitched against a "test scheme" (using a 1/120th accrual rate over a maximum of 40 years). Subject to lower transitional rates which will apply for at least the first two years, overall contributions to a DC scheme (including personal pension arrangements) must be no less than 8% of "qualifying earnings"[3]. Employees will contribute at least 4% of qualifying earnings, matched by a minimum 3% employer contribution and 1% in tax relief.

There will also be additional hurdles for schemes wishing to qualify as "automatic enrolment schemes" to overcome. For example, an agreement between the insurance company and the employer will be required where a personal pension is being used as the auto-enrolment vehicle.

In all cases, employees will have a right to opt-out of an automatic enrolment scheme. But as an additional measure of encouragement towards pension savings, automatic "re-enrolment" will apply on a rolling three year basis. From 2012, there will also be a ban on "encouraging or forcing workers to opt-out of pension saving" by, for example, offering higher salaries or one-off bonuses. The Pensions Regulator will be responsible for enforcing this prohibition.

[2] Employers will be able to "self certify" that their scheme meets this requirement
[3] Between £5,035 and £33,540 based on 2008/09 tax year figures

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4 STEPPING UP SECURITY - NEW ANTI-AVOIDANCE POWERS

Just as security will be a key feature of the Government's preparations for the 2012 Games, the security of occupational pension scheme members is once again at the heart of pension reform. As such, the Act also introduces new anti-avoidance powers for the Regulator.

Anti-avoidance powers were first introduced by the Pensions Act 2004, to enable the Regulator to act where corporate transactions were aimed at avoiding debts to pension schemes, in the form of contribution notices (CNs) and financial support directions (FSDs).

Owing to the Government's concern over the emergence of "business models that look to sever the link between employer and scheme", the Act extends the powers of the Regulator. Following consultation by the Department for Work and Pensions (DWP) in the spring[4], these extensions (which will be retrospective to 14 April 2008[5]) include:

- the power to issue CNs where an act or failure to act has detrimentally affected, in a material way, the likelihood of members' benefits being received (the "material detriment test"). This test will allow the Regulator to look at the effect of an act, rather than the intention of the parties, but its exercise will be subject to a statutory defence. A code of practice setting out the circumstances in which the Regulator expects to use its new power will also be published;[6]
- the removal of the "good faith escape clause" (this prevented the Regulator from issuing a CN where, even though the actions of a party had the effect of preventing a debt from becoming due to the scheme, that party acted in good faith); and

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[4] For more information, please see our Alerts: "Proposed extension of anti-avoidance powers" (16 April 2008) and "Anti-avoidance powers - update" (22 October 2008)

[5] This was the date on which the DWP first announced its intention to enhance the Regulator's powers

[6] A formal consultation on the code is expected imminently, now that the Act has received Royal Assent

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- clarification of the DWP's policy intention that a whole group of companies can be considered when the Regulator is judging whether to issue an FSD where there is an insufficiently resourced employer.

Appointment of trustees

Another new power will enable the Regulator to appoint trustees to a scheme in specified circumstances[7] where it is satisfied that it is "reasonable" to do so (the current test is whether it is "necessary"). In addition, there will be a new circumstance in which the power can be exercised - when such an appointment would "protect the interests of the generality of the members". This provision looks set to come into force by the end of January 2009.[8]

Scheme funding

The Regulator can already act as tie-breaker where trustees and employers are unable to reach agreement about scheme specific funding (the scheme's "technical provisions"). In these circumstances, the Regulator can impose a schedule of contributions, modify benefits going forward, and also give directions both about calculating the scheme's technical provisions and any recovery plan.

In future, in the event that trustees fail to take into account matters prescribed in regulations for determining a scheme's technical provisions, the Regulator will likewise be able to intervene and use one or more of these powers. This new circumstance will apply even where the employer and trustees have reached agreement on the technical provisions and the scheme actuary has certified those provisions as being appropriate.

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[7] For example, "to secure that the trustees as a whole have, or exercise, the necessary knowledge and skill for the proper administration of the scheme"

[8] This is because the Act refers to it coming into force "at the end of the period of 2 months beginning with the day on which this Act is passed"

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5 THE PENSIONS SIMPLIFICATION ARENA

Long before the dawn of 2012, existing schemes will need to grapple with yet more measures designed to simplify both state and private pensions.

Reduction in the cap on revaluation

The Act reduces the statutory limit on revaluing final salary deferred pensions from 5% to 2.5%. We understand that this change, which will apply to future accrual only, will come into force from 6 April 2009.

Once in force, the extent to which the revised statutory cap will apply automatically to a scheme will depend upon how the scheme rules are drafted. For example, a rule that simply cross-refers to the relevant revaluation provisions under the Pension Schemes Act 1993 will generally result in the automatic application of the 2.5% cap. In contrast, scheme rules which identify a specific rate of revaluation (say, 5%) will probably require amendment to take advantage of the reduced statutory cap. As many revaluation provisions will be far from clear cut, trustees and employers should therefore seek advice on the effect of the revised cap on their scheme as soon as possible.

We are expecting a consultation during December 2008 on a possible "statutory override", designed to help schemes whose rules will not automatically implement the new cap. We expect regulations to set out a clear mechanism for amending scheme rules in these circumstances (for example, by trustee resolution with employer consent).

Miscellaneous

- The Act abolishes the legislative requirements relating to "safeguarded rights"[9]. In practice, this will mean that contracted-out rights which are shared as a result of a pension sharing order will be treated in the same way as shared non contracted-out rights (making it easier to transfer shared benefits outside the scheme). It also makes it possible to share pensions

[9] Pension credit benefits derived from contracted-out rights

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that have been transferred to the Pension Protection Fund.

- Legislation relating to protected rights is to be withdrawn. When implemented (expected to be in 2012), schemes which are contracted-out on a DC basis will no longer have to track protected rights separately - ultimately giving members the freedom to select the most appropriate pension or annuity for their circumstances.

- In a move aimed at helping women and carers, people retiring before April 2015 will be able to buy back up to six additional years' of state pension entitlement if they already have 20 qualifying years on their National Insurance record.

6 UNDER STARTER'S ORDERS

Given the diversity of changes in this latest pensions reform programme, as already noted the provisions of the Act will come into force at different times. In addition, in a number of cases the measures will be supplemented by regulations. This is therefore very much the beginning of the pensions reform race to 2012.

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