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CHANGING SCHEME BENEFITS – THE ALL NEW SECTION 67

1 BACKGROUND

From 6 April 2006, employers and trustees contemplating changes to occupational pension schemes will have to contend with a significantly revamped section 67 of the Pensions Act 1995 (PA 1995). The source of the new sections 67 through to 67I is the Pensions Act 2004 (PA 2004). The intention is to give schemes greater flexibility to introduce changes, with the trade off being that for some there will be even more hoops through which to jump to safeguard members' rights.

Draft regulations which will supplement the provisions under PA 2004 are currently in the pipeline. However, on 8 July 2005, TPR published a draft code of practice for consultation - "Modification of subsisting rights". Comments on the draft code of practice are invited by 30 September 2005. Here we outline the new look section 67 and TPR's current thinking.

2 THE CURRENT SECTION 67

Section 67 of PA 1995 prevents a pension scheme's power of amendment being exercised in a way which would or might affect a member's accrued rights or entitlements, unless the member consents or the scheme actuary certifies that the amendment is not adverse.

Trustees' consent to a section 67 change must also always be secured. This is the case even if scheme rules allow the employer alone to exercise the scheme's amendment power.

3 THE NEW SECTION 67 IN BRIEF

The new look section 67 will protect a member's "subsisting rights" (essentially, a member's "accrued rights" or entitlements to benefits, and those of his/her survivors). But, in a shift away from the current section 67, sections 67 through to 67I will only bite in respect of changes which would or might "adversely" affect members' subsisting rights (known as "regulated modifications").

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The key elements of the new section 67 are as follows:

- In essence, it will only be possible to make a regulated modification if a member gives “informed” consent (see section 4 below) or the “actuarial equivalence requirement” is met (see section 5).
- It will not be possible to make a change which would or might convert subsisting rights which are defined benefit into defined contribution or to reduce pensions in payment unless the member consents (these are known as “protected modifications” and may be added to by regulations).
- Before a regulated modification takes effect, the “reporting requirement” must be satisfied (see section 6 below).

4 “INFORMED” CONSENT

To elicit a member’s “informed” consent, a member will first need to be given “information in writing adequate to explain the nature of the modification and its effect on him”. The draft code of practice suggests that the information (to be provided by the trustees) should enable the member to compare the before and after effect of the modification and that, where possible, this should include individual illustrations. Members should be given a “reasonable opportunity” to make representations concerning the proposed modification and the draft code of practice puts forward a one month period for this purpose.

Member consent must be given in writing which according to the draft code can, if the parties agree, include by fax or by email. The modification must then be made within a “reasonable period” from the giving of that consent. The time-frame for modification which TPR has in mind is up to six months after “the first consent has been received from an affected member”. TPR is using the consultation to ask whether there are grounds for shorter or longer periods.

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5 ACTUARIAL EQUIVALENCE (AND THE INFORMATION REQUIREMENT)

Provided that an intended change is not a protected modification, trustees can choose to use the actuarial equivalence route as an alternative to obtaining member consent in respect of some or all of the affected members. The "actuarial equivalence requirements" will be met if the "actuarial value" of benefits immediately after a change is equal to or greater than what it was immediately before (actuarial guidance will supplement the legislation here). An actuarial equivalence statement must be obtained by trustees within a reasonable period beginning with the effective date of the modification (the draft code contemplates one month)¹. Following the correct sequence of steps is therefore crucial and the actuarial statement should not be given in advance.

Trustees should take all reasonable steps to notify affected members of the proposed change beforehand and give them a chance to make representations (the "information requirement"). (If representations received in these circumstances result in an employer placing materially different proposals on the table, trustees may well need to restart the whole section 67 process².)

6 THE REPORTING REQUIREMENT

Where trustees decide to make a regulated modification (or consent to its being made) they must notify affected members "within a reasonable period" (the code indicates one month). This must happen before the modification takes effect. If the actuarial equivalence route is used, trustees will be able to proceed with a modification even if they have been unable to get in touch with all affected members (for example, because someone has moved) provided they "have made reasonable efforts to notify them".

¹ TPR may direct trustees who fail to obtain such a statement to do so within a specified period

² The intention is that minor changes to an original proposal (especially following representations) will not warrant this

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7 TRUSTEES' ROLE – SOME ADDITIONAL POINTS

Like now, trustee consent is needed for a section 67 change to be effective. The draft code outlines a number of other key trustee responsibilities implicit in the new section 67 which include:

- before giving their consent, ensuring that the power of amendment can be used for the intended purpose and that its use in this way is proper;
- considering any member representations “properly” and making sure that any member consent “has been freely given and that no undue influence” has been brought to bear;
- building sufficient time into the modification process to seek professional advice and allowing discussions with the employer to take place if proposals need to be reconsidered.

8 AND FINALLY, TPR'S ROLE

If the requirements of the new section 67 are not met, TPR can declare any change void. TPR will also have power to impose penalties for breach and intervene to prevent a modification taking place if the section is not being complied with.

TPR expects to receive “whistle-blowing” reports under section 70 of PA 2004 where there are reasonable grounds to believe that an inappropriate modification has been or may be made. Whilst the report could be made by anyone concerned with the scheme, the draft code of practice says that trustees can expect their professional advisers “to alert them to any concerns they may have about a proposed modification”.