sackers extra

THE PENSIONS BILL HAS LANDED

1 INTRODUCTION

More than 18 months after the publication of the Pickering report[1] on the simplification of pensions, on 12 February 2004 the Pensions Bill was published. Much of the Bill is dedicated to the new Regulator and the Pension Protection Fund.

However, some long overdue reforms such as easing the restrictions on amending schemes under section 67 and the simplification of Guaranteed Minimum Pensions do not seem to feature at all. In addition, there is currently no more news on the Regulations published on 11 June 2003 requiring solvent employers to buy benefits out in full on a wind-up and the separate Regulations issued in Autumn 2003 proposing to change the winding-up priority order.

In total, the Bill runs to some 248 clauses and 12 schedules. We highlight some of the key elements below. As some of the clauses will be fleshed out by subsequent regulations and Codes of Practice, we will issue more in-depth analysis on core areas over the coming months.

The bulk of the measures are likely to take effect from Spring 2005.

2 THE REGULATOR

2.1 Background

Eighty clauses are devoted to the new Regulator and its functions. Essentially, it will comprise a Chairman, a Chief Executive and at least five others. There will also be a Non-Executive Committee and a Determinations Panel. The new Regulator will have power to charge fees for granting modification orders.

[1] The Pickering Report "A Simpler Way to Better Pensions" (published 11 July 2002)

SACKER & PARTNERS

Continued

THE PENSIONS BILL HAS LANDED

One of the criticisms of the existing regulator, the Occupational Pensions Regulatory Authority ("Opra"), has been that it does not have a clear objective. The Bill proposes to cure this problem by listing three main objectives:

- protecting members' benefits;
- reducing the risk of "situations arising" which may result in calls upon the Pension Protection Fund ("PPF") (see paragraph 3 below); and
- promoting and improving "understanding of…the good administration of work-based pension schemes" (which includes occupational, stakeholder and some personal pension schemes).

2.2 Functions

Some of the Regulator's functions will be split between the Non-Executive Committee and the Determinations Panel. The Non-Executive Committee will have strategic responsibility to monitor areas such as the Regulator's financial controls and the extent to which it is attaining its targets and objectives. The Determination Panel's role is to exercise the "reserved regulatory functions" which range from prohibiting someone from acting as a trustee to making an order to wind up a scheme.

Applications for review of certain of the Regulator's decisions may be made to the Pensions Regulator Tribunal, another new body.

2.3 Enhanced powers

The new Regulator will generally be equipped with all of Opra's existing powers.

Continued

THE PENSIONS BILL HAS LANDED

But if another of the criticisms of Opra is that it lacks teeth, the new Regulator will be kitted out with a whole set of fangs. It will be able to:

- request information;
- appoint an "inspector" to enter premises, make inquiries and remove documents;
- exercise increased powers to intervene in the winding-up of a scheme;
- recover unpaid contributions from an employer;
- issue "improvement notices" directing someone who is breaching pensions legislation to take corrective steps;
- exercise similar powers over third parties if they are at fault. This will take care of frustrations expressed by Opra in the past that it is often powerless to act against third parties whose inaction may be responsible for the trustees' breach.

Like now, failure to comply with the requirements of the Regulator (and certain requirements under the Bill in general) may result in a civil penalty and even criminal liability (for example, if a person "intentionally delays or obstructs" an inspector).

2.4 Codes of Practice

Recommended by the Pickering Report, Codes of Practice are set to become a reality from 2005. Whilst the new Regulator has flexibility to issue Codes of Practice generally, it **must** do so for the following matters:

Continued

THE PENSIONS BILL HAS LANDED

- determining what constitutes a "reasonable period" where pensions legislation requires action to be taken within such a time-frame;
- the duty to report breaches;
- duties relating to preparing and reviewing statements of funding principles and schedules of contributions (see paragraph 4 below);
- the appointment of member-nominated trustees;
- the requirement that trustees have knowledge and understanding of certain areas to carry out their role (see paragraph 6 below).

3. THE PENSION PROTECTION FUND (PPF)

3.1 New scheme levies

As heralded by the Action Plan[2], there will be a PPF and it will be overseen by an independent body, the Board of the Pension Protection Fund. The PPF will provide some degree of protection to members of underfunded defined benefit ("DB") schemes whose employers become insolvent.

The PPF will primarily be funded by a scheme-based and a risk-based levy (the "Pension Protection Levy"). Factors which will play a part in determining the risk-based element include funding, investment strategy and credit rating. The risk-based levy will comprise at least 50% of the overall Pension Protection Levy and will commence in the second year of the PPF. To help the PPF Board determine the risk-based levy, trustees may be required to supply the

[2] Simplicity, security and choice: Working and saving for retirement, Action on occupational pensions (published 11 June 2003)

Continued
THE PENSIONS BILL HAS LANDED

PPF Board with copies of actuarial valuations.

The scheme-based levy will be calculated by reference to the number of members, "the total annual amount of pensionable earnings" and the scheme's liabilities. Whilst there appears to be a ceiling on the overall amount of the Pension Protection Levy, the PPF Board could lift the ceiling. (A scheme-based levy can only be imposed if the PPF Board estimates that it will amount to less than 10% of the levy ceiling for that year).

There will also be:

- an "initial" levy which will operate in the first year only;
- an "administration" levy which may also be charged on schemes to meet the set-up and on-going cost of running the PPF Board; and
- a fraud compensation levy, which will be put in a separate fund aimed at compensating members of occupational pension schemes generally for fraud.

3.2 The PPF Board's functions

The PPF Board's main functions will involve managing and investing both the PPF and the Fraud Compensation Fund. The PPF Board must assume responsibility for a scheme whose employer is insolvent if specific requirements (relating to notification and the like) are met.

The PPF Board will have certain powers to protect the assets of the scheme from further erosion and to wind up the scheme and secure benefits where a "rescue" is not possible. Like the Regulator, the performance of certain decisions by the PPF Board will be capable of review by another new entity, the PPF Ombudsman.

Continued

THE PENSIONS BILL HAS LANDED

3.3 PPF benefit for members

For the PPF to kick in, a DB scheme must have insufficient assets to secure the PPF level of benefits with an insurer.

The protections which DB scheme members will receive from the PPF are broadly: 100% of benefits for pensioners and members over "normal pension age"; and 90% for non-pensioners and early retirees below normal pension age (other than ill-health pensioners, who come within the 100% bracket). Those entitled to 90% benefits will also be subject to an overall "compensation cap" (to be determined by the Secretary of State) which will increase in line with earnings.

4. SCHEME FUNDING

The minimum funding requirement will be abolished for DB schemes. It will be replaced by a "statutory funding objective", which is designed to reflect the funding standard under the EU Pensions Directive (scheduled to come into force in September 2005). The statutory funding objective requires a DB scheme to have "sufficient and appropriate assets to cover its technical provisions" (namely, "the amount required, on an actuarial calculation, to make provision for the scheme's liabilities"). The details of what this means will be set out in regulations.

Trustees must prepare a statement of funding principles for ensuring, amongst other things, that the statutory funding objective is met. They must also prepare a schedule of contributions. Technically, trustees need to obtain annual actuarial valuations. However, this period can be extended to every three years provided that the trustees obtain actuarial reports for the intervening years. If the statutory funding objective is not met the trustees, with actuarial advice, will have to devise a "recovery plan" setting out proposals to make up the shortfall. The recovery plan must be sent to the Regulator.

Generally speaking, the trustees will be obliged to obtain the consent of the

Continued
THE PENSIONS BILL HAS LANDED

employer on matters relating to scheme funding. But if the trustees are unable to do so, the trustees can (with the employer's agreement) amend the scheme's future benefit accrual. Members will need to be notified within one month of any decision to modify the scheme.

The trustees must report any failure to agree funding matters with the employer to the Regulator which may: give directions; impose a schedule of contributions; or, indeed, modify the scheme going forward. (The Action Plan originally put forward fairly draconian plans to allow trustees to wind up the scheme where a consensus on funding was not reached, but these do not seem to have been picked up in the Pensions Bill).

5. MEMBER-NOMINATED TRUSTEES/DIRECTORS ("MNTs"/"MNDs")

Schemes will have to have at least one-third member-nominated trustees "within a reasonable time of the commencement date" (namely, when the provisions first apply or reapply to a scheme). The number of MNTs/MNDs may only exceed one-third if the employer consents. All of the active members of a scheme must be involved in the selection process. The removal of MNTs/MNDs will, as now, require the consent of all of the other trustees. Limited exceptions to the MNT/MND requirements will apply.

6. KNOWLEDGE AND UNDERSTANDING OF TRUSTEES

All scheme trustees must be "conversant with":

- the scheme's trust deed and rules;
- any statement of investment principles (a new clause is to replace existing requirements on the preparation of such statements, which looks likely to introduce a new requirement to review SIPs at specific intervals. The new clause will also allow regulations to expand the information which must be included in SIPs);

Continued

THE PENSIONS BILL HAS LANDED

- if relevant, the statement of funding principles;
- any other document which records trustee policy on administering the scheme.

Trustees must also have "knowledge and understanding" of pensions and trusts law, the funding and investing of occupational pension schemes and any other matters which are required by regulations. The extent of this knowledge needs to be "appropriate for the purposes of enabling the individual properly to exercise his functions as trustee". Trustees' "functions" include those relating to investment delegation. (The Bill suggests that directors of a corporate trustee will generally have to satisfy the test of knowledge and understanding in relation to "any function" they individually deal with).

These fairly onerous requirements may quite possibly act as a deterrent to individuals putting themselves forward as MNTs and MNDs, unless regulations exclude them.

7. DISPUTE RESOLUTION

Whilst all occupational schemes must have a dispute resolution procedure, the arrangements for dispute resolution can become more tailored. As a minimum, the procedure must make it clear: how a dispute resolution application may be made; the particulars to be included; and the "manner in which any decisions required are to be reached and given". Decisions on disputes must be made by trustees within a reasonable time, although the procedure may specify time limits for making an application.

This may be a prime area for a Code of Practice.

8. PENSION INCREASES

As previewed by the Action Plan, the Bill will relax the requirements relating to indexation by obliging schemes to increase pensions in payment only by inflation,

sackers extra

Continued

THE PENSIONS BILL HAS LANDED

capped at 2.5% each year. This will not be retrospective but will apply to pensionable service after the relevant commencement date.

9. MISCELLANEOUS

Other changes addressed in the Bill include:

- The requirement to provide more workplace information to help educate employees and equip them to plan for retirement[3].
- The pensions exemption under the Transfer of Undertakings (Protection of Employment) Regulations 1981 ("TUPE"), will be removed. Instead, employees who have been transferred under TUPE should either be offered membership of their new employer's occupational pension scheme, or that employer should make contributions to a personal pension on their behalf.
- Amendments clarifying the level of benefits to be maintained whilst a scheme member is on paid paternity or adoption leave.
- The introduction of a specific exception to the inalienability of occupational pension benefits under section 91 of the Pensions Act 1995 to cover overpayment of benefits.
- Adjustments to the debt on the employer requirements as a consequence of introducing the PPF.
- Beefed up duties on trustees and professional advisers to report breaches to the Regulator.

[3] This is consistent with the Government's paper published on 3 February 2004, Simplicity, security and choice: Informed choices for working and saving

SACKER & PARTNERS

Nothing stated in this document should be treated as an authoritative statement of the law on any particular aspect or in any specific case. Action should not be taken on the basis of this document alone. For specific advice on any particular aspect you should consult the usual solicitor with whom you deal. **© Sacker & Partners February 2004**