

Consultation on new winding-up priority order published

1 BACKGROUND

The Government's Green Paper of 17 December 2002 set out numerous possible changes to the statutory winding-up priority order for defined benefit schemes so as to try to ensure a fairer sharing of assets where a scheme which is winding-up has insufficient assets to meet all of its liabilities. The Action Plan of 11 June 2003 suggested that the draft Regulations would be published over the Summer and laid by the Autumn.

Despite rumours of further delay, the Government published its long anticipated consultation on 22 October 2003. The consultation period ends on 3 December 2003.

2 WHAT DO THE DRAFT REGULATIONS SAY?

Additional voluntary contributions (AVCs) and pensions in payment are still given the highest billing (categories "a" and "b") on winding-up. However, increases applicable to a pensioner's benefits will rank lower down the list than a non-pensioner's main benefits.

To achieve the Government's stated goal of affording the greatest protection to members who have contributed to a scheme for the longest, the draft Regulations divide the next priority - non-pensioner benefits - into two categories ("c" and "d").

Essentially, the entire main benefits of a non-pensioner with 40 years' pensionable service will rank in the higher of these two categories, category "c". The main pension benefits of non-pensioners who have less than 40 years' pensionable service (probably the overwhelming majority of any scheme's members), will then be split between category "c" and the lower category "d" according to a sliding scale. The sliding scale works by reallocating 2.5% of a non-pensioner's main benefits into category "d" for each year of pensionable service by which they fall short of the 40 year threshold.

Pension increases (indexation) then bring up the rear, being sub-divided into three separate categories "e", "f", and "g", which correspond with categories "b" to "d" so that pensioner increases rank first and non-pensioner category "d" increases last.

NB: It appears that the existing priority afforded to contracted-out benefits will disappear and they will merely form part of the relevant category into which the member's main benefits fall.

3 CONFUSED? – SOME USEFUL EXAMPLES

The differences between categories "c" and "d" can best be illustrated by the following examples:

Continued

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- A non-pensioner who has 40 years' pensionable service will have 100% of their main benefits covered by category "c";
- A non-pensioner who has 30 years' pensionable service, will have 75% of their benefits covered by category "c" and 25% will fall into category "d";
- A non-pensioner who has 20 years' pensionable service, will have an even 50/50 split between categories "c" and "d";
- A non-pensioner who has 10 years' pensionable service will have 25% of their benefits covered by category "c" and 75% will fall into category "d".

4 CONCLUSION

It is not clear when the new priority order will take effect other than at some point in 2004. However, it seems likely that the Regulations will apply to schemes which begin to wind up on or after a certain date and will not have retrospective effect.

At first glance, the draft regulations look somewhat confusing and will no doubt require a certain amount of fine tuning before they eventually come into force. Their precise effect on schemes will largely depend upon the composition of the current membership. But there may be concern amongst pensioners that increases to their benefits are essentially being "downgraded". Given this, the timing of any windings-up which commence in the near future could be critical for them.