

alert

DEREGULATORY REVIEW – THE SIMPLE LIFE?

1 INTRODUCTION

The Deregulatory Review stems from the realisation that many layers of pensions legislation could be removed, merged or simplified. Following the publication of the White Paper¹, an advisory group was established to help the Government carry out an ongoing examination of legislation governing private pension provision. On 13 December 2006, two external reviewers, Chris Lewin and Ed Sweeney, were appointed to work with this group.

Following a March 2007 consultation paper², the final report (“the Report”) was published on 25 July 2007. But does it really offer a glimpse at a simpler legislative life ahead?

2 SOME KEY RECOMMENDATIONS INCLUDE

- Making it easier for surplus to be repaid to employers (see section 4).
- A move towards less detailed and prescriptive legislation, starting with simpler rules on disclosure (see sections 5 and 6).
- Changing the circumstances in which an employer leaving a multi-employer defined benefit scheme has to make good its share of any deficit (see section 7).
- Concentrating the requirement for trustee “expertise” collectively at board level rather than focusing on individual trustees (see section 8).
- The Report also recommends changes so that restrictions in scheme rules are overridden where they prevent schemes from taking advantage (for future service benefits) of developments in legislation.

¹ See our Sackers Extra Alert: “The Pensions White Paper” dated 25 May 2006

² See our Sackers Extra Alert: “The Two Reviews – Double Trouble from the DWP?” dated 21 March 2007

alert

Continued

DEREGULATORY REVIEW – THE SIMPLE LIFE?

3 TERMS OF REFERENCE

The Report makes recommendations to Government on the potential areas for reform. To recap, the review's stated terms of reference were:

"To examine regulation with the aim of simplifying and reducing the burden of legislation governing private pensions:

- drawing on proposals from stakeholders;
- seeking consensus on the balance between member protection and encouraging employer provision of pensions; and
- having regard to appropriate legal and other constraints.

The review will ensure that emerging proposals are based on robust analysis and are coherent".

4 TREATMENT OF SURPLUS

There seems to be growing concern amongst employers that "resources that will never be needed for benefits will become trapped in pension funds". The Report cites the combination of international accounting standards, the risk-based levy and "the demands of trustees in the course of transactions" as reasons for schemes potentially becoming overly funded.

It proposes that the surplus provisions in section 37 of the Pensions Act 1995 be amended to allow for a return of surplus to employers provided that:

- the scheme has reached the scheme specific funding target; and
- the trustees agree that such a payment should be made.

But the current statutory requirement that trustees must be satisfied that the return of surplus is in members' interests should be removed as it

alert

Continued

DEREGULATORY REVIEW – THE SIMPLE LIFE?

“encourages overly conservative behaviour”. The Report notes that trustees already have underlying fiduciary duties.

The possibility of an automatic return of surplus at a “premium above buy-out level” is seemingly rejected because it does not allow for trustee input to ensure that the way in which surplus arose is taken into account (for instance, if this were due to increased member contributions). Likewise, the prospect of dropping the threshold for considering a return of surplus to the PPF³ level of funding is ruled out as the “diminished benefits that would be provided...should the scheme fail should not be relevant”.

5 PRINCIPLES BASED LEGISLATION

Attracted to a principles based approach, the Report advocates legislation which prescribes “required outcomes alone” where appropriate. Although acknowledging the risks inherent in this approach (such as the possibility of member safeguards being undermined and uncertainty as to how the law will ultimately be enforced) it is viewed as a better means of regulating. An emphasis on “proportionality, accountability, consistency, transparency, and targeting” sits alongside this thinking. Ultimately, the goal is to make “rules and guidance more accessible and intelligible”.

6 DISCLOSURE

The March 2007 consultation paper identified the disclosure regime as an area where a light touch regulatory framework (the principles based approach) could be pioneered. The Report therefore recommends the adoption of this approach as a “good place to start in an effort to bring unnecessary costs down”. But what might this mean in practice?

As a general principle, members should be given “sufficient information that allows them to understand the benefits to which they will be entitled” and enables them to make decisions in their “own best interest”. Drilling down another layer from that principle, the Report favours supplementing this by guidance or general

³ The Pension Protection Fund

alert

Continued

DEREGULATORY REVIEW – THE SIMPLE LIFE?

requirements geared towards the key stages of a person's membership (joining, leaving active membership, decisions about drawing benefit and on the occurrence of other significant events). But the proposals are not intended to expand on what is currently required, so schemes that already comply with existing disclosure legislation should be deemed to comply with the principles.

If this approach proves feasible and an improvement on the current regime, the Report recommends that the Government consider simplifying other areas⁴ and establishing a "rolling programme".

7 EMPLOYER DEBT

Two reforms are put forward to section 75 of the Pensions Act 1995 which are designed to make the employer debt legislation more workable in multi-employer schemes:

- The introduction of a "period of grace" of up to a year from when the last active member employed by a participating employer leaves the scheme. If the employer takes on employees who become active members of the scheme within that time-frame no debt will be triggered. (At the moment, a debt is triggered immediately in such circumstances.)
- On a group "reconstruction" (namely, a reorganisation), no debt being triggered where the original employer covenant was strong and remains as strong afterwards. Responsibility for judging whether the covenant remains "intact" would lie with the trustees "after taking appropriate professional advice". However, Chris Lewin was clearly of the view that this should be extended so that no debt is triggered where the original covenant is potentially weak and remains unchanged after the reconstruction.

⁴ Such as the law on pensions and divorce

alert

Continued

DEREGULATORY REVIEW – THE SIMPLE LIFE?

8 TRUSTEE KNOWLEDGE AND UNDERSTANDING

The Report recommends that the legislation on trustee knowledge and understanding (TKU) should be “amended so that individual trustees...are not required to have particular standards of knowledge or understanding on a range of issues”. Instead, each trustee board should be required to ensure that the board as a whole has sufficient TKU to carry out its duties properly. Similarly, any sub-committee should be judged in the round and not on an individual basis.

If adopted, this recommendation would bring the law on TKU for individual trustees into line with the TKU requirements applied to a corporate trustee.

9 MISSING IN ACTION

There are some areas that, although consulted on and made the subject of much press speculation, have not made it through to the Report’s final cut. Examples include:

Risk-sharing

The Association of Consulting Actuaries and others were very keen to see the creation of a specific category of risk-sharing pension schemes. These would provide an alternative to traditional defined benefit schemes (where the employer generally bears the risk) or defined contribution schemes (where the employee bears the risk).

Whilst “sympathetic to the idea that efforts should be made to develop a middle ground where employers and employees can share some of [the] risks”, the Report’s authors “are not attracted to the idea...of defining this middle ground in legislation”. Instead, suggested changes to the PPF levy (and compensation) and proposed clarification of section 67 are considered to provide greater scope for risk-sharing schemes to “flourish”.

alert

Continued

DEREGULATORY REVIEW – THE SIMPLE LIFE?

Section 67 reform

Helpful commentary is included in the Report about the application of section 67 (which protects past service benefits from change) but there are no recommendations for change. The authors note that the current formulation of section 67 only came into force on 6 April 2006 and time should be given to see how it is operating in practice.

Nevertheless, section 67 should be kept under consideration as part of the rolling deregulatory review of pensions. Also, the Department for Work and Pensions (DWP) and the Pensions Regulator should consider publicly confirming whether the views expressed in the Report on how section 67 works are correct.

Indexation reform

The Report's authors "have been unable to agree" on whether the current requirement to provide limited price indexation (LPI) after retirement should be made entirely optional for future service. Therefore, the Report stops short of any recommendation.

10 WHAT NEXT?

As ever in pensions, we need to wait and see. The DWP press release states that: "Ministers will carefully consider the recommendations and will be discussing them with key stakeholders over the summer, before publishing a response in the autumn".

But bear in mind that the Report is an independent report. Whilst we understand that there has been close liaison with the DWP, its recommendations do not yet represent Government policy.