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news
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DB schemes - increasing member contributions

Over the last few months, many household names struggling to counter scheme deficits have taken the significant step of increasing member contributions. This measure can offer employers, trustees and employees alike a more palatable alternative to winding-up a defined benefit scheme and/or shifting to defined contribution. This newsletter looks at some key legal points that employers and trustees need to address before implementing such a change.

Background

Why increase member contributions?

- Alleviating scheme deficits is a major factor behind the growing trend.
- For other employers, the motivation to change merely recognises factors such as increasing pension costs and the economic climate in the world at large.

Pension promises

What to review?

- The pension promises made to a member under his/her "contractual" terms need to be checked.
- "Contractual" pension promises may be found in documents such as the contract of employment, booklets and announcements.
- Any oral pension promises (say, in an interview) will also need to be verified.

Contractual terms

Some questions to ask

- What do the contractual terms say about employee contributions?
- Can the employer increase them without employee consent?
- What do the contractual terms say about scheme amendments?

Employee consent required?

Possible problems if not sought

- If employee consent is required, the employer will be in breach of contract if it proceeds unilaterally.
- Regardless of whether the employee leaves or stays in service following the increase, claims could then ensue.
- The employer may also be in breach of the Employment Rights Act 1996 if it has no authority to deduct a higher level of contributions from employees' wages.

Employers' duties

Arising under case law

- Whether or not an employer can act alone, should it use its power in this way?
- Under case law, an employer has a duty to act in "good faith" towards its employees (i.e. it should not introduce change for capricious reasons).
- To help comply with this duty, it may be advisable for an employer to consult with employees before making the proposed change.

Scheme rules

Amendment required?

Role of trustee

- If a rule amendment is needed to increase employee contributions, the scheme's rules may require trustee consent.
- If so, trustees must safeguard members' interests especially for past service (although this does not necessarily amount to a duty to negotiate).
- They should only take account of relevant factors (e.g. is the change legal? have members been informed? why the change? what will happen if the trustees do not agree? what are the employer's long-term intentions for the scheme?).

NB: trustees may seek further assurances from the employer given the danger that, in the event of winding-up, the increased contributions paid by active members may be perceived as having funded benefits for those in a higher priority class (pensioners).

Conclusion

Tread with care

Before increasing member contributions, a number of issues need to be tackled by both employers and trustees. Trustees may also seek indemnities if they are concerned that their role may be open to challenge by members. One way to minimise risks to employers and trustees is effective communication with the members.

SACKER & PARTNERS

Solicitors specialising in pensions law

29 Ludgate Hill
London EC4M 7NX
Tel 020 7329 6699
Fax 020 7248 0552

enquiries@sacker-partners.co.uk
www.sacker-partners.co.uk