Sackers

Corporate briefing

March 2017

Highlighting the latest developments in pensions for employers and corporate investors

Welcome

Welcome to the first edition of our Corporate briefing.

The last 12 months have seen household names such as BHS and British Steel reveal financial problems and large pension deficits. As the Government pushes ahead with Britain's exit from Europe, embarking on a journey into unchartered waters, should more be done to help corporate sponsors who are already struggling to finance their defined benefit (DB) schemes? In "Facing the DB strain", we look at the possibilities, as well as the Government's recently published Green Paper.

Never has it been more important for employees and employers to work together to ensure that we all save enough for retirement. In this edition, we highlight the forthcoming mandatory increases to contributions in defined contribution (DC) arrangements being used for automatic enrolment, and touch upon the issue of re-enrolment. We also look at upcoming changes to salary sacrifice and a recent case on the scope for changing increases under a pension scheme.

Mandatory increases to DC contribution rates from April 2018

For DC schemes being used to meet an employer's automatic enrolment requirements, the minimum employer and overall contribution rates are set to rise from 6 April 2018 (not 1 October 2017 as originally planned). A further increase will be required from 6 April 2019.

The actual percentage increase which will apply to a particular DC scheme will be dictated by the elements of income which are pensionable in that scheme. The table to the right sets out the figures when band earnings (£5,876 – £45,000 for 2017/18) are used to calculate contributions. Please get in touch if you would like to discuss how the increased DC rates will impact on your DC scheme design (as different elements of pay are pensionable in different schemes).

Every three years employers have a legal duty to put certain staff into their designated scheme for automatic enrolment purposes, known as "re-enrolment". For more information about this process, and the key issues to consider, please see our DC Briefing dated October 2016.

Phasing period	Employer minimum contribution	Total minimum contribution*
Before 6 April 2018	1%	2%
6 April 2018 to 5 April 2019	2%	5%
6 April 2019 onwards	3%	8%

* including any employee contribution

Facing the DB strain

Options for change

DB schemes have been under pressure for quite some time, with the cost of running such schemes having increased considerably over the last decade.

2016 witnessed a string of papers all looking at what could be done to help alleviate the DB burden. Firstly, the Government issued a consultation on various options for potentially helping the British Steel Pension Scheme, as part of a wider package of support for the UK steel industry and affected communities. Subject to certain safeguards, possibilities include changing relevant legislation either to allow the trustees to amend the scheme without member consent to reduce increases on deferred and pension benefits, or to permit a transfer without consent to a new scheme providing the same.

The Government has not, to date, offered an official response to consultation, perhaps unsurprisingly given the rash of other DB related reports over the last six months or so. These include the Work and Pensions Select Committee's report into the collapse of BHS, as well as the PLSA's DB Taskforce's recent report focusing squarely on "The Case for Consolidation".

On 21 December 2016, the Work and Pensions Select Committee published its latest Report on DB schemes, offering specific recommendations for tackling the perceived "flaws in DB schemes and their regulation" (see box).

The Government's Green Paper focusing on keeping DB schemes sustainable was published on 20 February 2017. It wrestles with a vast array of feedback from commentators, concluding that there are a lot of issues and options to contend with. As a result, there are no firm proposals put forward, but rather a number of questions are posed instead. The consultation is open until 14 May 2017, so we will have to wait a while longer to see whether any concrete recommendations emerge.

Work and Pensions Select Committee's key recommendations include:

- **A nimbler regulator** – TPR "intervening earlier to nip potential problems in the bud"
- **A nuclear deterrent to avoidance** – empowering TPR to impose punitive fines that could treble the amount currently payable
- **Empowered trustees and scheme members** – arming trustees with new powers (some possibly with TPR approval) to:
  - demand timely information from scheme sponsors
  - consolidate small schemes in an aggregator fund managed by the PPF
  - agree changes to increases on benefits, where needed, to make a scheme sustainable, including putting in place conditional arrangements that will revert to original increase levels when good times return.
- **Mandatory TPR clearance in certain circumstances** – with the current voluntary practice perceived as having "fallen out of fashion", imposing mandatory clearance in circumstances where "there is the greatest risk of material detriment" to the scheme (eg the deficit size heavily outweighs the sponsor's value).

Halcrow Pension Scheme case study – solvent restructucturing of a DB scheme

Not all DB schemes can afford to wait for the various ongoing DB reviews to conclude before requesting help. That's why in 2016 we led a project advising the trustees of the Halcrow Pension Scheme on an innovative way of restructuring their DB pension liabilities in order to safeguard member benefits, whilst preventing the scheme from falling wholesale into the PPF.

In severe financial difficulty, Halcrow sought to restructure its pension liabilities to preserve its business and to avoid its pension scheme entering the PPF. Following a Court case in which the judge reluctantly concluded that she could not bless a proposal under which members would be transferred without their consent, because of the restrictive drafting of the relevant legislation, a new solution was required.

This involved establishing a new scheme providing identical core benefits to that of the transferring scheme, but with revaluation and pension increases reduced to statutory levels. Members' consent was sought to the transfer, with anyone electing this option being provided with a one-off benefit uplift in the new scheme. Anyone who chose not to transfer would then ultimately be provided with benefits via PPF compensation.

Whilst this solution may sound simple on paper, there were any number of moving parts and legislative hurdles to contend with. Given the financial pressure on the company, getting the project over the line as quickly and efficiently as possible was an imperative. On 5 October 2016, consenting Halcrow members (93% of the membership) transferred to their new scheme.

"We've demonstrated that it is possible, though not straightforward, to act now to make DB schemes more sustainable within the constraints of the current legislative and regulatory framework." Faith Dickson, Sackers' partner

Salary sacrifice changes from April 2017

On 5 December 2016, HMRC announced new rules for limiting salary sacrifice arrangements which will take effect from 6 April 2017. The new rules will apply to salary sacrifice arrangements for benefits in kind entered into on or after 6 April 2017, but with some notable exceptions and transitional arrangements.

Exceptions to the new rules – the good news

For once there was good news for pension savers. The April 2017 changes will not affect salary sacrifice arrangements that enable employees to give up basic salary in return for non-contributory membership of their employer's occupational pension scheme. Neither will the changes affect employers who offer professional pensions advice through salary sacrifice arrangements.

Salary sacrifice arrangements that will be impacted

Those employers who offered group life insurance schemes or group health schemes via salary sacrifice will no longer be able to do so when their existing arrangements are next due for renewal. However, it is anticipated that those who have company cars via a salary sacrifice arrangement will become the biggest losers as a result of the new rules.

Transitional arrangements

Existing salary sacrifice arrangements that are not protected arrangements may continue to run after 6 April 2017, until the earlier of 6 April 2018 and the next renewal date/end date.

Special transitional arrangements apply to salary sacrifice arrangements relating to cars, accommodation and school fees. Those salary sacrifice arrangements may run until the earlier of 6 April 2021 and the next renewal date or their end date.

What is salary sacrifice?

It's an arrangement offered by the employer, typically on a rolling 12 monthly basis or for a longer fixed period.

At the start of the arrangement, and on each salary sacrifice renewal date after then, employees agree to give up their contractual right to receive some of their annual basic salary during the forthcoming salary sacrifice period (usually the coming year) in return for a benefit in kind. The value of the benefit in kind is equal to the amount of salary given up.

The reduction in basic salary reduces both national insurance contributions payable by both the employer and employee and income tax (where this is payable).

Protected arrangements

The new rules will not affect salary sacrifice arrangements involving:

- pension contributions
- employer-provided pensions advice
- cycle to work schemes
- childcare vouchers
- workplace nurseries
- directly contracted child care
- ultra-low emission cars (75g CO_2/km or less).

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Switching from RPI to CPI

In the recent Barnardo's v Buckinghamshire case, the Court of Appeal upheld an earlier High Court decision that the Barnardo's trustees did not have the power to select CPI (the consumer prices index), as an alternative measure of inflation to RPI (the retail prices index). The question was whether the trustees could use CPI as the index for calculating increases to DB pensions in payment and to calculate increases on an early leaver's pension between the date of leaving and taking the pension.

Broadly speaking, the case hinged on a reference in the Barnardo's scheme rules to such benefits being increased by RPI **"or any replacement adopted by the Trustees"**. The Court of Appeal concluded that the trustees' ability to use another index, such as CPI, could only be achieved via a two-stage process, namely, RPI being replaced by another index by the authority responsible for publishing it and the trustees then adopting that replacement.

Whilst permission to appeal to the Supreme Court has been sought, as things stand, this decision leaves employers and trustees in an unsatisfactory place. For many sponsoring employers of DB schemes, moving from using RPI as the index for measuring inflation to CPI will produce significant cost savings, which in turn could be used to reduce pension deficits over the long-term.

Contact

Sackers is the leading UK law firm for corporate sponsors of UK based pension schemes, pension scheme trustees and pension providers. Founded in 1966, Sackers has over 50 lawyers, including specialist investment and banking and finance lawyers, who advise clients on their corporate pensions strategy, M&A and restructuring transactions, death benefit trusts, asset-backed contribution structures and investment restructuring projects. We are consistently ranked in the top tier in the Legal 500 and Chambers UK directories. Sackers is a member of Ius Laboris, the international network of law firms.

If you would like to discuss any of the issues raised in this briefing, or would like to speak to us about any aspect of corporate pensions advice, please contact:

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