

C/M/S/ Cameron McKenna

# Pensions Act 2004

Your plain English guide

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## 1. Introduction

The Pensions Act 2004 received Royal Assent on 18 November 2004 and was published on 29 November 2004. This Guide summarises the provisions of the Act and looks at how they work in practice.

Each section of the Guide deals with a particular area of the Act and incorporates references to relevant Regulations and Codes of Practice.

Each section also contains a timetable of when the relevant changes came into force and by when pension schemes will need to comply with them.

If you have any queries about the content of this Guide or would like any further assistance on any of the matters raised, please contact Mark Grant ([mark.grant@cms-cmck.com](mailto:mark.grant@cms-cmck.com)) or your usual contact in the pensions team at CMS Cameron McKenna LLP.

This Guide is not intended to be a comprehensive review of this area of law. Specific advice should always be sought on any particular subject.

## 2. The Pensions Regulator (including “moral hazard” provisions)

### Sections 1-106 Pensions Act and Schedules 1-4

#### 2.1 Background

In the December 2002 Green Paper, *Simplicity, Security and Choice: Working and Saving for Retirement*, the Government observed that the existing pensions regulator, Opra (operating from April 1997 following creation by the Pensions Act 1995) was mainly a reactive regulator, taking action in response to reports of problems with pension schemes and as a result could not anticipate problems and intervene proactively. Therefore it was proposed that a new, more proactive regulator be introduced, focused on *“tackling fraud, bad governance and poor administration”* and which would have an increased education and guidance role. *The new regulator is called the Pensions Regulator and according to the Government is intended to “operate a targeted and proportional regulatory regime, applying greater regulatory scrutiny where it deems members’ benefits are most at risk. This approach will be supported by increased powers to gather, retain and share information”.*

In many ways the Pensions Regulator looks quite like Opra and has inherited all of its powers and functions. However, it has a much more complex structure and a range of additional powers and functions and we have focused on these in this Guide.

#### 2.2 Composition of Pensions Regulator

##### 2.2.1 Act

There are several components to the Pensions Regulator. The Regulator itself is made up of a Government appointed chairman, at least 5 other Government appointed members and a chief executive. (Section 2)

There is also a committee made up of the non-executive members of the Regulator. The main function of this committee is to monitor the activities of the Regulator. (Section 8)

Finally, there is a Determinations Panel. The panel must have at least 7 members, a chairman who is appointed by a selection committee and the others are appointed by the Panel chairman. The Regulator delegates many of its day to day functions to the Panel. (Sections 9 and 10, Sch. 1 paras 11-16. Sch. 2 contains a list of the Regulator’s functions which the Panel can exercise).

##### 2.2.2 Regulations

None currently.

##### 2.2.3 Codes of Practice

None currently.

## 2.3 Functions of Pensions Regulator

### 2.3.1 Act

All of Opra's functions (which were largely to apply a variety of sanctions for breach of the key provisions of the Pensions Act 1995) have been transferred to the Regulator, including the maintenance of the Register of Occupational and Personal Pension Schemes. (Sections 4 and 59-65)

The Regulator has a number of statutory objectives, including protecting the interests of scheme members, reducing the risk of situations arising which might require compensation from the Pension Protection Fund and promoting and improving the understanding of good administration of pension schemes. (Section 5)

### 2.3.2 Regulations

The Pensions Act 2004 (Commencement No.3, Transitional Provisions and Amendment) Order 2005 dealt with the dissolution of Opra and the transfer of its assets and liabilities to the Regulator.

### 2.3.3 Codes of Practice

None currently.

## 2.4 Powers of Pensions Regulator

### 2.4.1 Act

The Regulator has inherited all of Opra's powers. It has also been given a range of additional powers. Among these new powers are the following:

- providing "*information, education and assistance*" to schemes and their advisers
- serving "improvement notices" on those in breach of legislative requirements, stating certain actions they are required to take (or refrain from taking)
- issuing "third party notices" to any person who has caused a breach of legislative requirements, directing them to take (or refrain from taking) specified steps
- requiring a scheme to be wound up during an assessment period for the Pension Protection Fund (usually where the employer is insolvent) in order to keep any funding shortfalls to a minimum
- issuing restraining orders or repatriation orders, or applying to court for restitution orders where "pension liberation" has occurred (i.e. where a member's transfer value is paid out of the scheme to a third party on the basis that the third party agrees to use the money in an authorised way but fails to do this)
- issuing "freezing orders" to prevent a winding up beginning or further benefits accruing in a scheme while the Regulator is considering whether it will wind up the scheme, provided the order is necessary to protect members (the Regulator may also make additional directions

about a scheme which is subject to a freezing order, such as no contributions or benefits to be paid).

(Sections 12-37)

#### 2.4.2 Regulations

The Pensions Regulator (Freezing Orders and Consequential Amendments) Regulations 2005 have been issued. They extend time limits for transfers where a freezing order has been made. Pension liberation is dealt with in the Occupational and Personal Pension Schemes (Pension Liberation) Regulations 2005.

#### 2.4.3 Codes of Practice

None currently.

### 2.5 Requirement for independent trustee

#### 2.5.1 Act

Sections 22-26 Pensions Act 1995 required appointment of an independent trustee where an insolvency practitioner had been appointed in relation to an employer with a defined benefit scheme. These provisions have been extended to schemes being assessed for protection under the Pension Protection Fund. Insolvency practitioners are now required to give notice to the Regulator, scheme trustees and the Board of the Pension Protection Fund when they start to act in relation to an employer with a defined benefit scheme.

An appointment of an independent trustee may be made by the Regulator (previously, the insolvency practitioner had to make such an appointment where necessary). The Regulator has established a register of independent trustees who can be appointed as and when necessary.

(Section 36)

#### 2.5.2 Regulations

The Occupational Pension Schemes (Independent Trustee) Regulations 2005 set out minimum criteria for inclusion on the register of independent trustees and detail on their appointment.

#### 2.5.3 Codes of Practice

None currently.

### 2.6 "Moral Hazard" provisions – contribution notices, financial support directions and restoration orders

The Regulator has been given significant powers aimed at preventing employers avoiding pension debts by use of group structures. The Regulator can, in certain circumstances, transfer liability from employers to those "associated" or "connected" with them. These terms are defined very widely in Sections 249 and 435 Insolvency Act 1986 and include directors and other group companies. The Regulator's powers enable it to issue "contribution notices" and "financial support directions".

### **Contribution notices**

Under the current legislation, a contribution notice can be issued where:

- an employer or someone associated or connected with it
- is a party to “*an act or deliberate failure to act*” which occurs on or after 27 April 2004
- one of whose main purposes was to prevent the recovery of all or part of a debt due under Section 75 Pensions Act 1995 or, otherwise than in good faith, to prevent such a debt becoming due or, to compromise or otherwise settle such a debt or to reduce the amount of such a debt, and
- the act or failure to act occurred within a six year period prior to date of issue of the contribution notice.

In practice, contribution notices have proved difficult to issue because of the requirement to show what the purpose of an action was. Therefore, the Government has announced proposals to extend the Regulator’s powers to issue contribution notices and these changes are effective from 14 April 2008. The key changes in relation to contribution notices are:

- the introduction of an alternative basis for a contribution notice which focuses on the effect of a transaction rather than its purpose. The Government have suggested framing this test as whether an “*act, failure to act or course of conduct was materially detrimental to the likelihood of a member receiving current and future benefits from the scheme of which he is a member after the conduct in question*”
- allowing the Regulator to look at a course of conduct (going back to April 2004) in determining whether a contribution notice should be issued
- removing the “otherwise than in good faith” limb of the test referred to above. This would be replaced with a statutory defence if the person could demonstrate that based on what they knew or ought to have known, they could not reasonably have foreseen that their actions could have a materially detrimental effect on the security of members’ benefits.

Contribution notices cannot be issued against insolvency practitioners acting in accordance with their functions.

The notice can require the employer, its associate or connected person to pay all or part of the debt.

The Regulator will assess whether it is reasonable to impose a contribution notice on a particular person having regard to their relationship with the employer and the scheme, their degree of involvement in the act complained of, their financial resources, whether there was any failure to report to the Regulator, all the purposes of the act or failure to act including whether a purpose was to prevent loss of employment.

A clearance procedure allows parties to request the Regulator to confirm in advance whether any proposed action will give rise to a contribution notice. If the Regulator gives

clearance to a particular transaction, it is binding on it unless the facts are materially different to those presented to it.

(Sections 38-42)

### **Financial support directions**

Under current legislation, a financial support direction can be issued where the Regulator thinks it is reasonable and the employer is:

- a service company, or
- "*insufficiently resourced*", which means its resources are less than 50% of the estimated Section 75 deficit in the scheme and the resources of a connected or associated person would, when added to the employer's resources, be 50% or more of that deficit.

The Government has announced changes which are effective from 14 April 2008 which will, in addition, allow a financial support direction to be made where a group of associated or connected persons is between them well-enough resourced to meet the insufficiently resourced test.

A financial support direction involves the Regulator directing the employer or person connected or associated with it to put financial support in place for the scheme within a specified time. The person issued with the direction may put in place a variety of arrangements including:

- making all group companies jointly and severally liable for the employer's pension liabilities
- making a holding company (which satisfies certain requirements) liable for the employer's pension liabilities, or
- making additional financial resources (which satisfy certain requirements) available to the scheme.

Note, however, that apart from people in partnerships (see below in relation to Section 57) the only individuals who can be made liable are those associated with an *individual* employer (e.g. a sole trader) and are so associated for a reason other than being an employee of that individual employer e.g. as a spouse.

A financial support direction will apparently last for the lifetime of the scheme.

If a financial support direction is not complied with, the Regulator may issue a contribution notice to any of the persons to whom the direction was issued (which would effectively remove any flexibility in how the deficit is covered).

As with the contribution notice provisions, a clearance procedure exists so the Regulator can be asked to confirm in advance whether a person would be potentially liable to provide financial support and, if so, whether the Regulator considers it reasonable to impose such a liability. The clearance statement is binding on the Regulator unless the facts are materially different to those presented to it. Clearance only relates to the applicants, scheme and events described in the application and while scheme trustees will

usually be involved in an application for clearance, they are unlikely to be a party to the applications in most cases.

In January 2008, the Pension Regulator issued its first financial support directions against Sea Containers Limited requiring it *provide financial support for two pension schemes belonging to its London-based UK subsidiary Sea Containers Services Limited. Support had to be provided within 30 days.*

(Sections 43-51)

For tables summarising contribution notices and financial support directions, see the end of this Chapter.

### **Restoration orders**

The Regulator can issue restoration orders where there has been a transaction at an undervalue (that is significantly less than money for money's worth) involving the assets of the scheme (other than a money purchase scheme). For these powers to apply, the transaction must be entered into:

- ▶ on or after 27 April 2004, and
- ▶ no more than 2 years prior to a "relevant event".

A "relevant event" is either the employer becoming insolvent or the trustees making an application to the Board of the Pension Protection Fund or being notified that the Regulator has given notice to the Board that (for certain types of employer only) the employer is unlikely to continue as a going concern. The relevant event must occur on or after 6 April 2005.

A restoration order is such order as the Regulator thinks fit to restore the position to what it would have been if the transaction had not been entered into. However, no order may be made which prejudices any interest in property acquired in good faith and for value. Where a party fails to comply with a restoration order, the Regulator may issue a contribution notice.

(Sections 52-56)

Regulations may be issued to set out how the contribution notice, financial support and restoration order provisions apply to partnerships and limited liability partnerships. (Section 57)

#### **2.6.1 Regulations**

The Pensions Regulator (Contribution Notices and Restoration Orders) Regulations 2005 list the schemes which are exempt from the contribution notice and restoration orders provisions.

The Pensions Regulator (Financial Support Directions) etc Regulations 2005 provide that the same schemes are exempt from financial support directions as contribution notices. They define "insufficiently resourced" and set out how the employer's assets are to be valued for this purpose. They also provide that the Regulator can only look back 12 months to determine whether an employer was insufficiently resourced or a service company.

### 2.6.2 Codes of Practice (and Guidance)

There is no Code of Practice, but the Regulator issued Guidance on obtaining clearance statements in April 2005. As a result of experience and “*changes in the pensions landscape*”, the Regulator published revised clearance guidance in March 2008 which contains significant differences from the original version.

In the original clearance guidance, The Regulator had specified three different classes of event (types A, B and C) to help parties decide whether they should seek clearance. The revised guidance no longer refers to Type B and C events.

When determining whether there has been a Type A event and if clearance should be sought, the following should be considered:

- Whether there is anything which might amount to a Type A event. The revised guidance is intended to be less prescriptive as to what might constitute a type A event, it can include anything which reduces the strength of the employer covenant and a number of scheme related events such as entering into compromise agreements or apportioning a scheme deficit
- Whether the event is “materially detrimental to the ability of the scheme to meet its liabilities”? An event may be “detrimental” if it affects the strength of the employer covenant or the recovery of a section 75 debt (or prevents one from becoming due) and if it affects the ability of the scheme to meet its liabilities. The parties will also need to consider any mitigating action taken to reduce the impact of a detrimental event, this could include parent company guarantees, additional contributions or changes in the scheme’s balance of power.
- Does the scheme has a relevant deficit as a type A event will only be materially detrimental if this is the case? This is determined using the highest deficit figure calculated on the various ongoing bases (FRS 17, section 179 and technical provisions). A higher basis (such as buy-out) may be used in some circumstance where for example the scheme is in wind-up or there has been a significant weakening of the employer covenant

When clearance is sought for a type A event, the Regulator clearly envisages its normal role as referee rather than as an active negotiator on the pension scheme’s behalf.

Each party who wishes to benefit from clearance must apply to the Regulator. There is no need to have consulted the scheme trustees in advance, but the Regulator envisages that, where possible, this will have been done.

In the financial year 2006/2007, the Regulator granted 149 applications for clearance and refused only 1.

In relation to when it will exercise its extended moral hazard powers (granted from April 2008), the Regulator has issued a statement saying that prior to new legislation being enacted, it only intends to exercise them where a business activity has certain characteristics, in particular:

- Moving the employer or scheme to another jurisdiction;

- Splitting the operating company from the scheme or the assets from the operating company without appropriate mitigation for the scheme;
- Transferring assets and liabilities to another scheme which did not have adequate support from an employer;
- Running a scheme for profit without adequate account being taken of member interests;
- Business models in which risk is predominantly borne by scheme members, but high investment returns would benefit investors.

The Regulator's statement can be found at:

<http://www.pensionsregulator.gov.uk/pdf/StatementOnPowers.pdf> .

## 2.7 Information Gathering

### 2.7.1 Act

The Regulator took over Opra's role in maintaining an up to date register of all occupational and personal pension schemes. (Sections 59-62)

Trustees must complete a scheme return notice (a request for information issued by the Regulator) containing the information required for the register and any other scheme information relevant to the Regulator. This information can include information for calculating the Pension Protection Fund levy and assist the Pension Protection Fund, including the assessment of risk for each scheme. The returns will need to be completed following receipt of notice from the Regulator, which will be given every 1-3 years (the Regulator has said that all but the smallest schemes are likely to have to complete a return every year – the first batch of scheme returns was issued to 8000 schemes at the end of June 2005, with trustees having approximately 8 weeks to return it to the Regulator). A number of schemes have failed to return scheme return notices within the required time periods and the Regulator has issued a press release reminding such schemes that it has power to issue an improvement notice if they do not comply. (Sections 63-65)

The Regulator can also collect information relevant to the functions of the Board of the Pension Protection Fund.

Both employers and trustees have duties to report certain "notifiable events" to the Regulator (see 2.7.2 below for details) where the scheme is potentially eligible for the Pension Protection Fund should the employer become insolvent. Individuals who report such events to the Regulator have statutory protection if making the report would breach any other duty (such as a duty of confidentiality). Failure to comply with this obligation may result in fines. (Sections 68-69)

The Regulator may issue a notice requiring trustees, employers or administrators to provide it with a report prepared by a skilled person nominated or approved by the Regulator. The costs of the report must be met by whoever the Regulator issues the notice to, although the notice may provide for them to be reimbursed by a third party. (Section 71)

The Regulator can request information from trustees, employers, administrators and anyone else it thinks might hold relevant information. It has powers to inspect premises connected with a scheme to investigate whether key statutory provisions are being complied with and to take possession of and copy any document or require its production. Criminal penalties apply for non-compliance with the information and inspection provisions. (Section 72-77)

The Regulator may also obtain a warrant from a justice of the peace to enter premises and seize documents where it has reason to believe documents requested were not provided or if they were requested would be withheld, damaged or destroyed or that an offence has been committed and there will be misuse/misappropriation of scheme assets. It is a criminal offence knowingly or recklessly to provide the Regulator with false or misleading information. (Sections 78-80)

The information obtained by the Regulator can be disclosed to other statutory authorities and individuals holding public office (with a limited right of onward disclosure) including the Revenue, the Pensions Ombudsman and the Director of Public Prosecutions. Disclosure can also be made by the Regulator, or third parties who have received information from the Regulator, in connection with certain legal proceedings and investigations. (Sections 82-88 and Sch. 3)

The majority of communications between lawyer and client are excluded from the disclosure duties listed above. (Section 311)

## 2.7.2 Regulations

Details about the register of schemes are contained in the Register of Occupational and Personal Pension Schemes Regulations 2005 (as amended by the Register of Occupational and Personal Pension Schemes (Amendment) Regulations 2007).

The events trustees and employers (of schemes potentially eligible for the Pension Protection Fund should the employer become insolvent) need to notify the Regulator about are set out in the Pensions Regulator (Notifiable Events) Regulations 2005 (as amended by the Occupational Pension Schemes (Miscellaneous Amendments) Regulations 2005), although note certain exemptions under the Regulator's Directions (see 2.7.3 below). Events notifiable by the trustees include:

- any decision to take action which will, or is intended to, result in any debt which is, or may become, due to the scheme not being paid in full
- 2 or more changes in the scheme auditor and actuary within 12 months
- a decision by the trustees to make a transfer payment to, or accept a transfer payment from, another scheme, or where the trustees are required to make or accept a transfer payment without such a decision having been taken, the making or acceptance of that payment, the value of which is more than the lesser of (i) 5% of the scheme assets and (ii) £1,500,000
- a trustee decision to grant benefits on more favourable terms than those normally provided for by the scheme rules, without either seeking

advice from the scheme actuary or securing additional funding where such funding was advised by the actuary

- a trustee decision to grant extra benefits, or where the trustees are required to grant extra benefits without such a decision having been taken, and those benefits cost more than the lesser of (i) 5% of the scheme assets and (ii) £1,500,000.

The events notifiable by the employer include:

- any decision to take action which will, or is intended to, result in a debt which is or may become due to the scheme not being paid in full
- ceasing to carry on business in the UK
- certain offences under insolvency legislation relating to trading when insolvency is imminent
- any breach by the employer of a banking covenant
- any change in the employer's credit rating
- a controlling company relinquishing control of the employer company
- two or more changes in the chief executive and any director or partner responsible for finance matters within the last 12 months
- convictions of directors or partners for offences involving dishonesty.

### 2.7.3 Codes of Practice (and Directions)

Code of Practice No.2 has been issued which sets out a framework to assist trustees and employers in determining which events they are required to report to the Regulator under sections 68-69. The Regulator also issued Directions on 6 April 2005 (under its power in Section 69(1) of the Act) which set out some important exemptions to the requirement to report notifiable events. Therefore, the Regulations summarised above must also be read in the light of these Directions.

## 2.8 Whistleblowing

### 2.8.1 Act

The Act contains more extensive whistleblowing requirements than were previously contained in the Pensions Act 1995. Section 48 Pensions Act 1995 placed obligations on auditors and actuaries to make reports to Opra. Other advisers and the trustees could do so if they wished but were not obliged to. The Act extends these whistleblowing obligations to require reports from trustees, anyone involved in the administration of the scheme (e.g. a pensions manager or third party administrator), employers and anyone providing advice to the trustees (there are however exclusions for lawyers relating to information they get from their clients - Section 311).

Reports should be made where a person has reasonable cause to believe that there has been a breach of a duty imposed by law relating to the administration of the scheme which is likely to be of material significance to the exercise of the

Regulator's functions and they should be made as soon as reasonably practicable. (Section 70)

### 2.8.2 Regulations

None currently.

### 2.8.3 Codes of Practice

Code of Practice No.1 on whistleblowing has been issued explaining how this duty should be discharged and how to decide whether a breach is of material significance. The Regulator expects those under a whistleblowing obligation to be aware of it, train relevant members of staff and have a procedure in place to deal with any relevant breaches.

The Regulator has also published additional Guidance which sets out a traffic light framework dealing with events that it is interested in (red), events it might be interested in (amber) and events it is not interested in (green). The Guidance contains a decision tree which is reproduced at 2.14 below.

## 2.9 Codes of Practice

### 2.9.1 Act

The Codes of Practice are intended to give practical guidance on compliance with pensions legislation. The Act sets out a variety of areas which must be covered by Codes of Practice. These include:

- whistleblowing
- what constitutes a "reasonable" period where it appears in certain parts of the legislation (for example in relation to early leavers and disclosure)
- knowledge and understanding duties of trustees
- Section 67 of the Pensions Act 1995 as amended
- member-nominated trustees,
- internal dispute resolution;
- internal controls, and
- scheme funding requirements.

A breach of a Code of Practice will not in itself result in legal proceedings. However, the Regulator may issue directions in an "improvement notice" by reference to a Code of Practice. Codes of Practice are admissible as evidence in legal proceedings, including investigations of the Pensions Ombudsman and proceedings of the Board of the Pension Protection Fund. If a court or tribunal finds that they are relevant, it must take them into account in making its judgment. (Sections 13 and 90)

Once a Code of Practice has been drafted, it must be sent out for consultation, approved by the Secretary of State and laid before Parliament, which can pass it or reject it. (Section 91)

There are 11 Codes of Practice to date.

## 2.9.2 Regulations

None currently, but Regulations may set out additional areas to be covered by Codes of Practice.

## 2.10 Procedure

### 2.10.1 Act

The Regulator and the Determinations Panel are required to have standard and special procedures for exercising their functions. These procedures must be published by the Regulator.

The standard procedure must

- involve a “warning notice” to those who would be directly affected
- allow representations from those who receive a “warning notice”
- provide for consideration of such representations, and
- give details about the content of “determination notices” and “warning notices” and the right of appeal.

The Regulator cannot enforce its determination while any right of appeal exists or appeal proceedings continue. This does not apply to some functions of overriding importance such as the prohibition and disqualification of a trustee. (Section 96)

The special procedure applies to key powers such as freezing orders where the Regulator believes there would be an immediate risk to members’ interests or scheme assets if it gave a “warning notice” or allowed time for representations to be made. It allows the Regulator to exercise its powers immediately. This is subject to a review and affected parties can make representations prior to the review decision (except where the interests of scheme members or the scheme assets are at risk). (Sections 97-99)

The Regulator must have regard to the interests of members as a whole and anyone else who might be directly affected. (Section 100)

The Regulator has a general power to vary or revoke any determination, notice, direction or order issued. (Section 101)

### 2.10.2 Regulations

None currently.

### 2.10.3 Codes of Practice

None currently. However further information about the process the Regulator follows for making determinations can be found at:

<http://www.pensionsregulator.gov.uk/regulatoryActivity/determinations/index.aspx>

An example of a situation where the Regulator used its special powers to appoint additional trustees to a scheme was the Telent case (the review of the

determination panel's initial decision can be found at <http://www.thepensionsregulator.gov.uk/pdf/TelentReasonsofDeterminationsPanel.pdf>)

## 2.11 Appeals

### 2.11.1 Act

The Regulator's determinations may be appealed to the Pensions Regulator Tribunal by anyone who receives notice of the determination or who the Tribunal feels has been directly affected. Appeals must be made within 28 days. (Section 103)

The Tribunal is made up of legally qualified people and people with appropriate experience appointed by the Lord Chancellor. (Sch. 4)

The Tribunal can summon anyone to give evidence or to produce any document in their custody or control. There are fines for failure to attend the Tribunal or to give evidence without reasonable excuse. Persons who alter, suppress, conceal, destroy or refuse to disclose a document required for the Tribunal's proceedings can be fined or imprisoned. A party who has acted vexatiously, frivolously or unreasonably may be ordered to pay the costs of another party. Similarly, where the Tribunal considers that the Regulator has made an unreasonable decision, the Regulator can be ordered to pay another party's costs. (Sch. 4)

The Tribunal may remit matters to the Regulator specifying appropriate actions or directions. The Regulator is obliged to act in accordance with any directions given by the Tribunal. (Section 103)

Appeals can be made from the Tribunal to the Court of Appeal (or the Court of Session in Scotland) on points of law if the Tribunal or appeal court gives leave. (Section 104)

### 2.11.2 Regulations

The following Regulations have been issued:

- The Pensions Regulator Tribunal Rules 2005
- The Pensions Regulator Tribunal (Legal Assistance Scheme) Regulations 2005, and
- The Pensions Regulator Tribunal (Legal Assistance Scheme – Costs) Regulations 2005.

### 2.11.3 Codes of Practice

None currently.

## 2.12 Timetable

The provisions in the Act establishing the new Regulator and the Pensions Regulator Tribunal and on issuing Codes of Practice came into force on 17 December 2004.

The majority of the other provisions relating to the Regulator (including those on moral hazard) came into force on 6 April 2005.

**2.13 Comment**

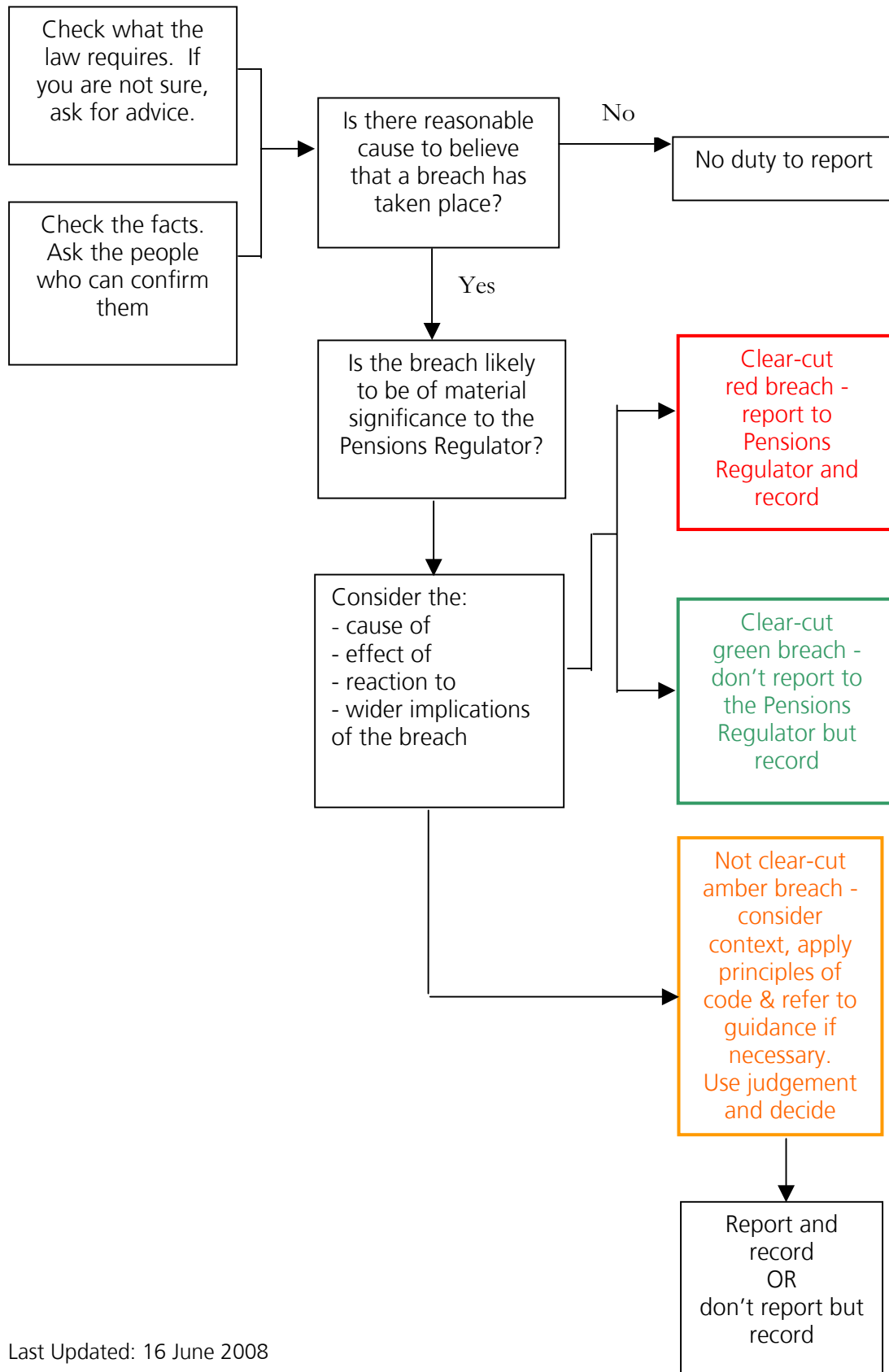
Due to the way in which it was set up, Opra often focused on high volume trivial breaches at the expense of more important ones which might threaten the security of members' benefits. The Pensions Regulator has been given powers to tackle the areas of greatest risk, with the aim of providing better protection to pension scheme members. Greater flexibility and proportionality should in theory benefit those the new Regulator seeks to protect and those who provide and administer pension schemes. Whether this happens in practice will depend very much on how the Regulator chooses to go about its job and what resources are made available to it.

Some of the Regulator's powers have already been criticised as being too far-reaching. The provisions on contribution notices and financial support directions could in effect allow the Regulator to "pierce the corporate veil" and pursue group companies and others connected or associated with an employer for that employer's pension deficit. It was feared that this could have a significant impact on loan transactions (as lenders might find it difficult to determine where potential liability might lie) and corporate transactions. However, so far the exercise of these powers has been limited and so initial fears may prove to be unfounded.

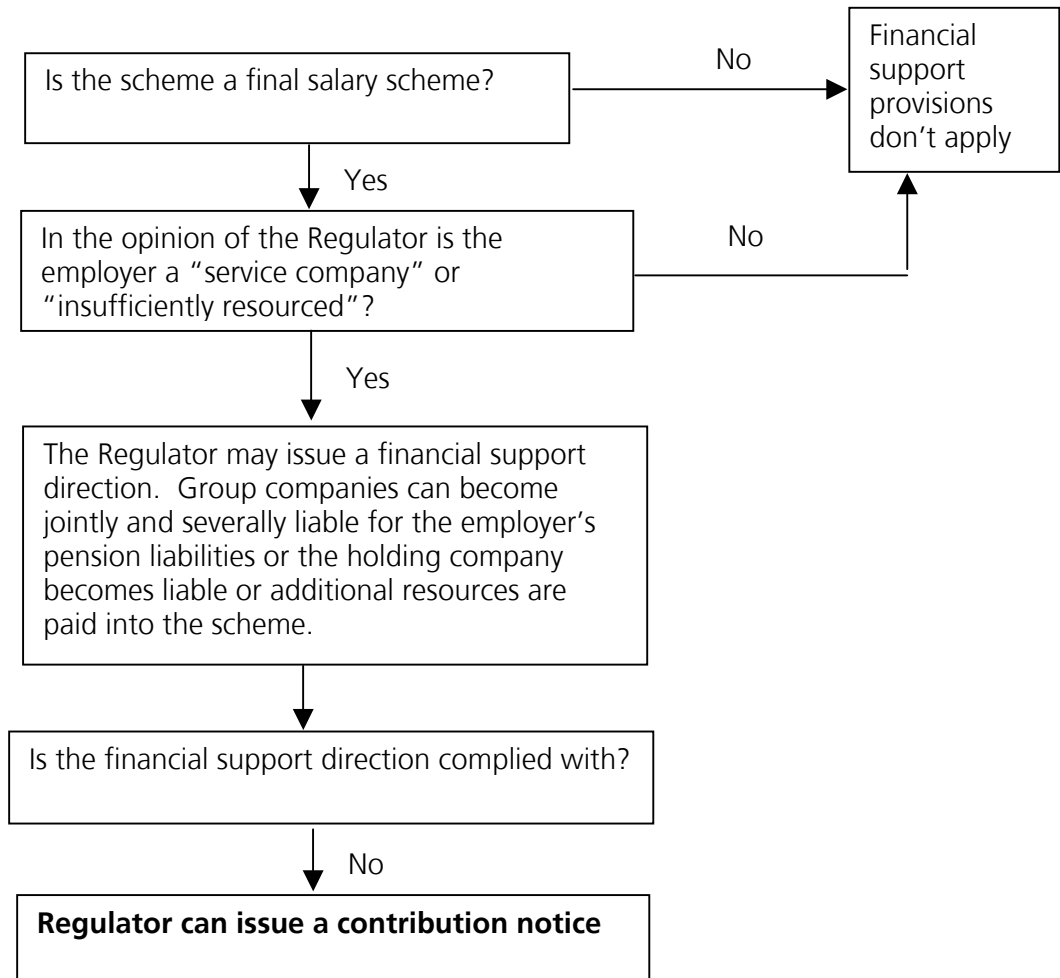
Further information about the Regulator is available at:  
<http://www.pensionsregulator.gov.uk/>

2.14 Tables summarising financial support directions and contribution notices and whistleblowing obligations

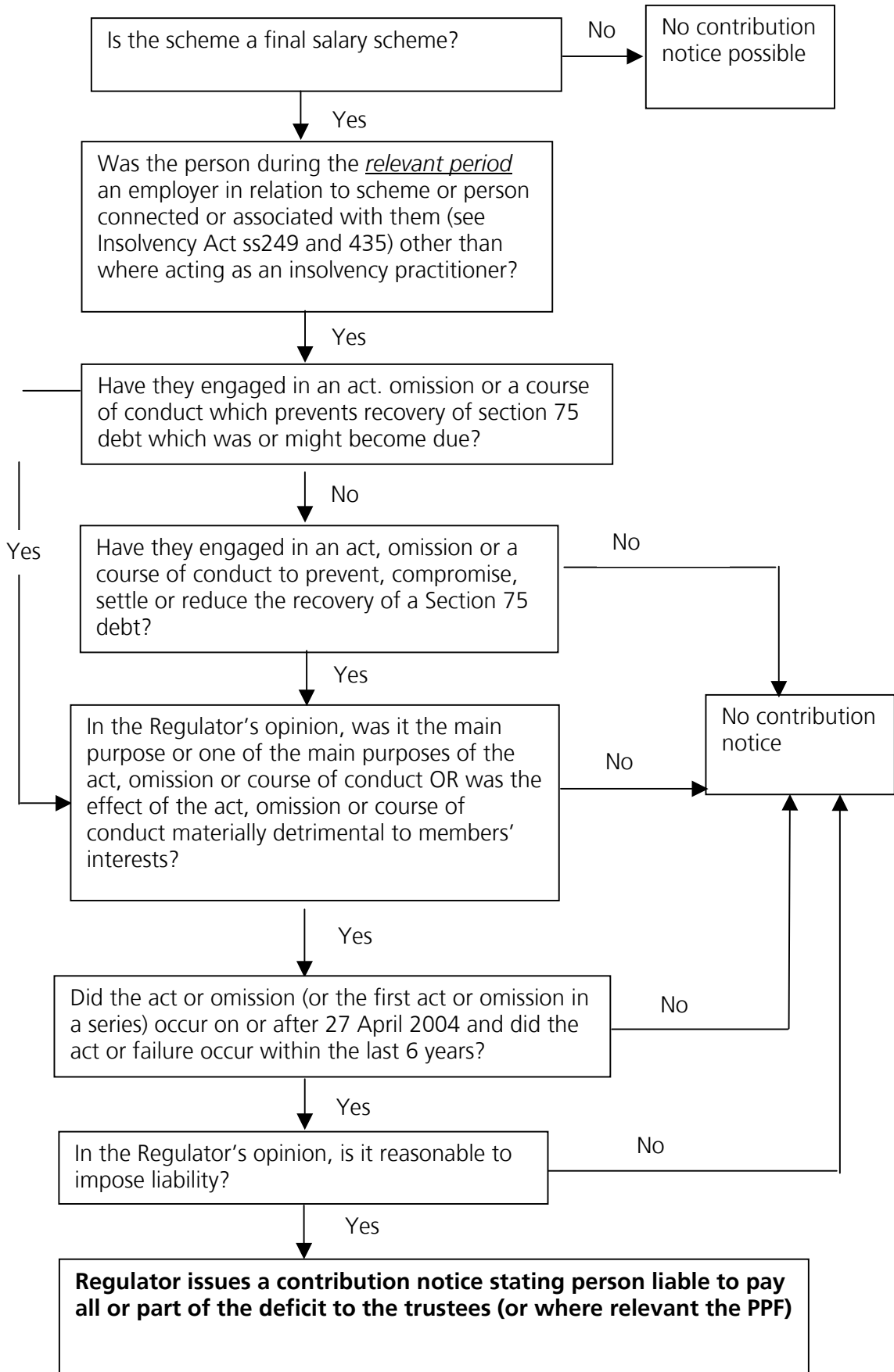
2.14.1 Whistleblowing Decision Tree



2.14.2 Summary of financial support directions



2.14.3 Summary of contribution notices



## 3. Pension Protection Fund

### Sections 107-181 and 190-218 Pensions Act and Schedules 5-9

#### 3.1 Background

In the December 2002 Green Paper, *Simplicity, Security and Choice: Working and Saving for Retirement*, the Government said that it wanted to *"take action to increase members' confidence that they will receive the pension they were promised by the employer"*. One of the proposals for achieving this which appeared in the June 2003 Paper, *"Action on Occupational Pensions"* was the introduction of a Pension Protection Fund ("PPF").

The Government has said that the aim of the PPF is to *"provide increased protection for members of defined benefit and hybrid schemes by paying compensation should their employer become insolvent and the pension scheme is underfunded. It will also assume the functions of the existing Pensions Compensation Board that pays compensation to both defined benefit and money purchase schemes in cases of fraud and misappropriation of scheme assets"*.

PPF benefits are available on the employer's insolvency (or in the case of certain employers that cannot technically become 'insolvent' where that employer is unlikely to continue as a going concern).

The PPF basically functions by requiring the relevant scheme to be wound up and to transfer its assets and liabilities to the PPF. The PPF then pays benefits out to the members broadly equal to 100% of their accrued pension in the case of those over normal pension age and 90% in the case of those under normal pension age (subject to compensation caps and reduced pension increases).

#### 3.2 The Board of the Pension Protection Fund

##### 3.2.1 Act

The PPF is operated by a Board, which like the Regulator consists of a chairman, chief executive and at least 5 other members. According to the Government, the constitution of the Board has been designed to *"ensure an appropriate balance of independence and accountability"*. (Sections 107-109, with additional details of the structure and operation of the Board set out in Sch. 5)

The role of the Board is to manage the PPF and the Fraud Compensation Fund. (Sections 110-111)

As with the Regulator, there is also a committee whose main role is to monitor the activities of the Board. (Section 112)

If the Board invests the funds held by it, at least two fund managers must be appointed and the Board must have a statement of investment principles. Any income or capital arising from investment of PPF assets must be retained in the PPF. The Board is also given powers to borrow. (Sections 113-115 and 173)

The Board must maintain accounts and obtain actuarial valuations of the PPF.

An administration levy can be required from schemes to fund the establishment of the Board and its ongoing expenses and Regulations may allow the Board to

charge fees to meet certain costs (see 3.8 below for further information on levies). (Section 116-118)

### 3.2.2 Regulations

The procedure for appointing ordinary members to the Board is set out in the Pension Protection Fund (Appointment of Ordinary Members) Regulations 2005.

The Pension Protection Fund (Limit on Borrowing) Order 2005 sets the Board's borrowing limit at £25 million.

Details of the form and content of the Board's statement of investment principles are in the Pension Protection Fund (Statement of Investment Principles) Regulations 2005. A copy of the Board's 2006 statement of investment principles is available at [www.pensionprotectionfund.gov.uk/sip2006.pdf](http://www.pensionprotectionfund.gov.uk/sip2006.pdf)

The Pension Protection Fund (Payments to Meet Investment Costs) Regulations 2005 enable the Board to pay fund managers and custodians. The Occupational Pension Schemes (Levies) Regulations 2005 and the Occupational Pension Schemes (Levies) (Amendment) Regulations 2008 set the administration levy between £1.39 and £4.33 per member, depending on scheme size for the year ending March 2009.

The Pension Protection Fund (Prescribed Payments) Regulations 2008 enable the Board to make payments to cover any expenditure incurred in respect of risk-based administration costs.

The Pension Protection Fund (Valuation of the Pension Protection Fund) Regulations set out how the assets and liabilities of the PPF are to be valued.

The Pension Protection Fund (Tax) Regulations 2006 state that various tax legislation applies to the PPF in the same way that it applies to a registered pension scheme.

### 3.2.3 Codes of Practice

None currently.

## 3.3 Employer's insolvency

### 3.3.1 Act

Where an employing company goes into administration, has an administrative receiver appointed, enters into a creditors voluntary arrangement or is wound up (other than a voluntary, solvent wind up), the insolvency practitioner must notify the Board, Regulator and the trustees (different events trigger the notice in the case of individuals and partnerships).

Regulations set out the detailed requirements of such notifications (see 3.3.2 below). The insolvency practitioner must also notify the Board, Regulator and trustees whether a scheme rescue has occurred or whether it is not possible to rescue the scheme. (Sections 120-122). The Board must formally approve any notice given by an insolvency practitioner for it to be binding. (Section 123). If the insolvency practitioner fails to issue this notice, the Board must do so itself. (Sections 124-125)

### 3.3.2 Regulations

The Pension Protection Fund (Entry Rules) Regulations 2005 define a “scheme rescue” as occurring either where:

- there has been a rescue of the employer’s business as a going concern and the employer retains responsibility for the scheme and has not entered into an agreement with the PPF Board to compromise a Section 75 debt, or
- someone else has assumed responsibility for the employer’s liabilities under the scheme.

Further details about the information the insolvency practitioner needs to provide the Board are in the Pension Protection Fund (Provision of Information) Regulations 2005. The Pension Protection Fund (Provision of Information) (Amendment) Regulations make some amendments to these Regulations.

Further provisions on when an insolvency practitioner must notify the Board in relation to an insolvent partnership are set out in the Pension Protection Fund (Insolvent Partnerships) (Amendment of Insolvency Events) Order 2005.

### 3.3.3 Codes of Practice

None currently.

## 3.4 Schemes eligible to benefit from the PPF

### 3.4.1 Act

The PPF is available to occupational pension schemes (other than money purchase schemes) which were not in wind-up before 6 April 2005. Certain schemes are excluded from the scope of the PPF by Regulations (see 3.4.2 below). (Section 126)

To benefit from the PPF, the employer must generally be insolvent and the insolvency practitioner must have issued a scheme failure notice stating that a scheme rescue is not possible (see 3.3 above). The assets of the scheme must also be insufficient to secure the liabilities which are covered by the PPF. (Section 127)

Where the structure of the employer is such that a normal insolvency is not possible (such as an unincorporated charity), the trustees will have to apply to the Board for it to assume responsibility for the scheme if it appears that the employer is unlikely to continue as a going concern. (Section 129)

For the PPF to apply, the Board must not have issued a “withdrawal notice” where it has determined that the employer is not insolvent or likely to become insolvent or that a scheme rescue is possible. (Section 149)

Where a scheme was outside the scope of the PPF for three years (or for the life of the scheme if that is less than three years), the Board may refuse to accept responsibility for it (presumably to stop schemes which have not paid the levy from benefiting from the PPF). (Section 146)

If a scheme makes a transfer to a new scheme with the same employer that was set up within 3 years of an assessment period for the new scheme with the

intention of enabling the members to benefit from the PPF where they could not have done so under the old scheme, the Board will not accept responsibility. (Section 147 and the Pension Protection Fund (Entry Rules) Regulations 2005)

### 3.4.2 Regulations

The Pension Protection Fund (Entry Rules) Regulations 2005 list the schemes ineligible for the PPF. This includes schemes which have compromised Section 75 debts (although arrangements permitted under the Employer Debt Regulations are excluded from this category), certain public sector schemes, unapproved schemes and death benefit only schemes. They also set out the consequences of the Board ceasing to be involved with a scheme following the issue of a withdrawal notice. More provisions on PPF entry requirements are in the Pension Protection Fund (Entry Rules) Amendment Regulations 2005, including changes to the qualifying insolvency events for companies and partnerships. Further amendments were made to these Regulations by the Pension Protection Fund (General and Miscellaneous Amendments) Regulations 2006 and the Pension Protection Fund (Miscellaneous Amendments) Regulations 2007.

The Pension Protection Fund (Eligible Schemes) Appointed Day Order 2005 sets 6 April 2005 as the date on or after which schemes must commence winding up to be eligible for the PPF.

The Pension Protection Fund (Multi-employer Schemes) (Modification) Regulations 2005 explain how the PPF applies to multi-employer schemes, depending on whether the scheme has segregated sections for each participating employer and whether the scheme has a partial wind-up rule. Similarly, the Pension Protection Fund (Hybrid Schemes) (Modification) Regulations 2005 make special provision for hybrid schemes.

The Pension Protection Fund (Partially Guaranteed Schemes) (Modification) Regulations 2005 set out how the PPF applies where a public authority has given a guarantee in relation to part of a scheme.

### 3.4.3 Codes of Practice

None currently.

## 3.5 Assessment periods

### 3.5.1 Act

If the employer is insolvent, an assessment period begins, during which the Board sees whether the PPF will cover the scheme. (Section 132)

In the assessment period, no contributions can be paid, no new members admitted and no further benefits accrue. The scheme may not begin winding up unless the Board decides it is consistent with the aim of ensuring the scheme can meet the PPF liabilities. Transfer payments are also restricted. (Sections 132-135)

If an ill-health pension was granted in the 3 years before the assessment period, and the member would be entitled to 100% of the compensation provided under the PPF (see 3.7 below), the pension may be reviewed. Trustees who fail to decide whether to grant an ill-health pension for an existing application within 6 months of the assessment period beginning may be fined. (Sections 140-142)

The Board may give directions on scheme investment, conduct of legal proceedings and incurring expenses. The trustees' rights over any employer debt owed to the scheme vest in the Board. (Sections 134 and 137)

In an assessment period:

- scheme benefits payable must be reduced to the PPF level. If the scheme cannot afford this, the Board can give a loan.
- where pensionable service ends at the start of the assessment period, no scheme benefits are payable in this period. (Sections 138-139)

### 3.5.2 Regulations

The Pension Protection Fund (Reviewable Ill Health Pensions) Regulations 2005 deal with Board review of ill health pensions.

The Pension Protection Fund (Entry Rules) Regulations 2005 deal with payment of benefits in an assessment period.

The Pension Protection Fund (Contributions Equivalent Premium) Regulations 2007 deal with the payment of contributions equivalent premiums (to buy back SERPS/state second pension where a member has less than 2 years pensionable service) where a scheme has entered an assessment period.

### 3.5.3 Codes of Practice

None currently.

## 3.6 What happens to the scheme

### 3.6.1 Act

The Board must arrange an actuarial valuation of the scheme to see whether there are enough assets to cover the liabilities protected by the PPF. It must approve the valuation and give copies to the Regulator and the trustees. (Sections 143-145)

If a scheme would have been eligible for the PPF but does not have a PPF deficit and a scheme rescue is not possible, the trustees must wind up the scheme. The wind up will be taken as beginning immediately before the assessment period. (Section 154)

Where a scheme is required to be wound up, the trustees may apply to the Board to reconsider its refusal to accept the scheme. They must provide scheme accounts and an annuity quote which shows the scheme has a PPF deficit. (Sections 151-152)

Where there are enough scheme assets to secure PPF benefits, but the trustees cannot obtain a buy-out quotation from an insurer (for example, due to the size of the scheme) they must apply to the Board for the scheme to continue as a closed scheme. Periodic valuations may be required of such closed schemes and if at any time the trustees become aware that the scheme assets are less than the PPF liabilities they must apply to the Board to assume responsibility for the scheme. (Sections 153 and 155-159)

Where a scheme has a PPF deficit and any other relevant requirements are met, the Board must assume responsibility for the scheme. The Board must give the trustees a transfer notice (which cannot be done in the first 12 months of the assessment period, which means all assessment periods will last at least 12 months). The scheme's assets are then transferred to the Board, trustees are discharged from their scheme obligations, the scheme is treated as being wound up and the members will receive the PPF benefits described below. No such transfer can be made while an application for a fraud compensation payment is pending. (Sections 160-161 and 172 and Sch. 6)

### 3.6.2 Regulations

Details of how actuarial valuations of schemes are to be done for the PPF are in the Pension Protection Fund (Valuation) Regulations 2005 (as amended). Usually, assets are based on its audited accounts and liabilities are on a buy-out basis.

The Occupational Pension Schemes (Modification of Pension Protection Provisions) Regulations 2005 deal with what happens when part of the scheme's liability is reduced by a transfer payment or otherwise.

The Pension Protection Fund (General and Miscellaneous Amendments) Regulations 2006 include provisions allowing the Board to change contractual liabilities which transfer to it.

The Pension Protection Fund (Closed Schemes) Regulations 2007 set out further requirements in relation to schemes which are required to operate as closed schemes under section 153 because they cannot obtain a buy-out quote.

### 3.6.3 Codes of Practice

None currently.

## 3.7 Benefits provided by the PPF

### 3.7.1 Act

PPF benefits (referred to in the Act as "compensation") are calculated by reference to age, length of pensionable service, the accrual rate and pensionable earnings under the scheme. Recent rule amendments, discretionary increases and rule changes that apply as a result of winding up may be ignored if they increase the PPF benefits. (Sch. 7, paras 8-14 and 35)

Members who are below normal pension age when the assessment period begins get 90% of their pension benefit (subject to a cap). Members who have reached normal pension age when the assessment period begins get 100% of their pension (uncapped). Spouses entitled to benefits get 50% of the member's pension. Pensions in payment get an annual increase of RPI up to 2.5% in respect of post-6 April 1997 pensionable service only. There are no annual increases for pensions related to pre-6 April 1997 pensionable service. The Secretary of State may vary these percentages. (See table below for a summary of the compensation provided by the PPF). No five year guarantee lump sum is payable under the PPF (often payable where a pensioner dies within five years of retiring). (Sch. 7)

	Is member over Normal Pension Age?	Coverage of scale pension (%)	Does the cap apply?
<b>Active Members</b>	Yes	100	No
	No	90	Yes
<b>Deferred Members</b>	Yes	100	No
	No	90	Yes
<b>Pensioners (not incapacity)</b>	Yes	100	No
	No	90	Yes
<b>Pensioners (incapacity)</b>	Not Relevant	100	No

Pensions for members under normal pension age at the date of assessment are capped. Regulations set the cap at £27,777.78 pa for 2005 which rose to £30,856.33 on 1 April 2008 (and as compensation is limited to 90% where the cap applies, the maximum payout currently permitted is £27,770.70) based on pension at normal pension age. It will be reduced for those who draw PPF benefits earlier and increased for those who draw them later. The cap is subject to annual review. (Sch. 7, para 26)

Where the scheme provides for a lump sum, the PPF may pay a lump sum of 25% of the PPF entitlement. (Sch. 7, para 24)

If the scheme provided Guaranteed Minimum Pensions (GMPs), the Board will notify the Revenue that the trustees' obligations to provide GMPs have been discharged. Although the PPF contains no provisions for replicating GMPs, the members will continue to be treated as entitled to a GMP when calculating their social security benefits. (Section 165)

Instead of providing benefits directly from the PPF, the Board can purchase buy-out policies or, in certain circumstances, discharge benefits by a cash payment. (Section 169)

Regulations provide how any money purchase benefits are to be dealt with (see 3.7.2 below). (Section 170)

PPF benefits must not reflect any sex discriminatory provisions in the scheme. This will not apply where the Board believes the difference is due to a genuine material factor not based on sex and Regulations may make additional exceptions. (Section 171)

### 3.7.2 Regulations

The compensation cap is currently in the Pension Protection Fund (Pension Compensation Cap) Order 2007.

The Pension Protection Fund (Compensation) Regulations 2005 deal with matters such as when PPF benefits can be taken before normal pension age, when spouse's pensions will not be payable and when dependants' and partner's

pensions will be payable and how much will be paid, what happens where there is a change in a person's circumstances, the treatment of ill-health pensions, revaluation of deferred benefits, commuted lump sums and further limitations on PPF benefits.

The Pension Protection Fund (General and Miscellaneous Amendments) Regulations 2006 include provisions

- dealing with the treatment of lump sum death in service benefits where the member dies before the assessment period
- dealing with the treatment of overpayments and underpayments
- setting out how money purchase liabilities can be discharged by the Board
- amending the PPF provisions on trivial commutation to bring them in line with the provisions of the Finance Act 2004.

These Regulations also contain provisions about the mechanics of payments by the PPF including a requirement to make compensation payments as soon as reasonably practicable.

Where the member is divorced or has had a civil partnership which has been dissolved, additional provisions are set out in The Dissolution etc (Pension Protection Fund) Regulations 2006, The Divorce etc (Pension Protection Fund) Regulations 2006 and the Pension Protection Fund (Pension Sharing) Regulations 2006.

### 3.7.3 Codes of Practice and PPF Publications

The PPF has published a consultation document setting out its approach to paying equal compensation to men and women where there is a problem with unequal GMPs. Broadly speaking, trustees whose scheme is in an assessment period will need to consider whether they need to seek comparators amongst the other scheme members and/or equalise benefits affected by the potentially discriminatory effect of GMPs, to calculate PPF compensation.

## 3.8 The levy

### 3.8.1 Act

In addition to the levy to fund the administrative expenses of the Board (discussed at 3.2 above), there was an "initial levy". This applied for the first year after the PPF was introduced. The rate of the initial levy and when it should have been paid was set out in Regulations (see 3.8.2 below). (Section 174)

After the first year when the initial levy applied, a pension protection levy became payable. (Sections 175-181)

The pension protection levy has two elements:

- a "risk-based levy", which takes into account the difference between scheme assets and the level of benefits which would be paid to its members under the PPF. The Board is also able to include other factors, such as the risk of the employer's insolvency.

- a “scheme-based levy”, which will take into account factors such as the number of scheme members, their pensionable earnings and the amount of scheme liabilities.

At least 80% of the total levy must be risk-based (Section 177). Before determining the levy rates or the factors the Board takes into account when setting the rates, it must consult with whoever it considers appropriate. Regulations require trustees to arrange actuarial valuations and to provide other information about assets and liabilities to allow the Board to calculate the risk-based levy. (Sections 175-176 and 179)

There is a levy ceiling set each year by the Secretary of State. In the first year, the ceiling had to be approved by the Treasury and in subsequent years can increase only by earnings inflation. (Section 178)

The levies are payable by the trustees (Regulations may make others liable) and are treated as debts due to the Board. (Section 181)

### 3.8.2 Regulations

The Occupational Pension Schemes (Levies) Regulations 2005 set the initial levy at £15 per active and pensioner member and £5 per deferred member.

The Pension Protection Fund (Pension Protection Levies Consultation) Regulations 2005 set out how the Board must consult about the pension protection levy.

Actuarial valuations for calculating the risk based levy are dealt with in the Pension Protection Fund (Valuation) Regulations 2005. Valuations must be provided at least every 3 years and within 12 months of the effective date of the valuation. Assets are based on the scheme accounts figure and liabilities on a buy-out basis. These Regulations are amended by the Pension Protection Fund (General and Miscellaneous Amendments) Regulations 2006 which provide that external liabilities should be taken into account in determining the value of the assets.

The Pension Protection Fund (Risk-based Pension Protection Levy) Regulations 2006 state that when the Board calculates the risk based levy, it may take into account any arrangements which may reduce the risk of compensation being payable from the PPF in the event of the employer’s insolvency.

The Occupational Pension Schemes (Pension Protection Levies) (Transitional Period and Modification for Multi-employer Schemes) Regulations 2006 make provisions for the calculation of the levy in multi employer schemes depending on whether the scheme contains a partial winding up rule (see 3.8.3 below for further information on calculation of the levy in such cases).

The Occupational Pension Schemes (Levy Ceiling) Order 2008 sets the total amount of levies raised for the financial year beginning April 2007 as a maximum of £833,410,200. The legislation requires the levy ceiling to be increased each year by the percentage increase in earnings over a 12 month review period. The Occupational Pension Schemes (Levy Ceiling - Earnings Percentage Increase) Order 2008 say that over the last review period, the increase in earnings was 3.6%.

The Pension Protection Fund (Waiver of Pension Protection Levy and Consequential Amendments) Regulations 2007 allow for setting aside either or both of the risk based and scheme based levy on application by the trustees, in particular where either (i) the scheme will receive no further contributions and all of the benefits are to be secured with insurance policies or (ii) the scheme has no active members, the employer is in voluntary liquidation and its dissolution is imminent.

### 3.8.3 Codes of Practice and PPF publications

The PPF has published guidance in relation to calculation of the risk based levy which is available (along with other publications on the levy) at: [www.pensionprotectionfund.gov.uk/index/risk\\_based\\_levy/rbl\\_publications.htm](http://www.pensionprotectionfund.gov.uk/index/risk_based_levy/rbl_publications.htm).

There is also guidance here on the valuation of contingent assets in the levy calculation process (which has been updated for the 2008/9 levy year). Contingent assets which were taken into account in 2007/8 risk based levy calculations will need to be recertified if they are to be taken into account in the 2008/9 calculations.

In March 2008, the PPF announced that it was changing its valuation assumptions for the purposes of section 143 and 179 valuations. Further details of the revised assumptions can be found at <http://www.pensionprotectionfund.gov.uk/index/press-office/news-details.htm?id=6490>.

Multi-employer schemes could submit a declaration of scheme structure form which set out whether the scheme had a partial wind-up rule. The PPF will then calculate the weighted average probability of insolvency for all participating employers. In a last-man standing scheme there will be a reduction to recognise that some degree of cross-subsidy exists within the scheme. In addition, for one year only, the PPF said that it would also calculate the insolvency risk of the largest participating employer and use that figure where it is lower or the scheme did not submit a declaration of scheme structure form.

The PPF measures schemes' insolvency risk (part of the calculation of the risk based levy) using "failure scores" produced by Dun and Bradstreet as at 31 March. To obtain the failure scores for participating employers, schemes can contact Dun and Bradstreet's PPF helpline.

The PPF's determination setting out the way in which the 2008/9 levy is calculated is at: [http://www.pensionprotectionfund.gov.uk/0809\\_levy\\_determination\\_-\\_feb\\_19\\_2008.pdf](http://www.pensionprotectionfund.gov.uk/0809_levy_determination_-_feb_19_2008.pdf)

A general guide to the PPF levies is available at [www.pensionprotectionfund.gov.uk/guide\\_to\\_levies.pdf](http://www.pensionprotectionfund.gov.uk/guide_to_levies.pdf)

## 3.9 Gathering information

### 3.9.1 Act

The Board can demand information relevant to its functions and can inspect premises. It is a criminal offence to fail to provide requested information or knowingly to provide false information. (Sections 190-195)

Information obtained may be passed to the Pensions Regulator and other bodies such as the Revenue and the Pensions Ombudsman. (Sections 196-202 and Sch. 8)

Regulations require the Board to disclose information to scheme members in certain circumstances. (Section 203)

The Board may publish a report on any matter arising out of a particular case. (Section 205)

### 3.9.2 Regulations

The Pension Protection Fund (Provision of Information) Regulations 2005 (as amended by the Pension Protection Fund (Provision of Information) (Amendment) Regulations 2006) set out information which the Board needs to provide to various people on various occasions.

### 3.9.3 Codes of Practice

None currently.

## 3.10 Reviews, appeals and the PPF Ombudsman

### 3.10.1 Act

On a written application the Board must review its own determinations under a two stage review procedure. Regulations may suspend the force of a determination pending review. The Board may vary or revoke its determination or make a new one. It must also investigate complaints of maladministration in relation to its activities. Compensation can be paid where the Board considers it appropriate. (Sections 206-208. What can amount to a "reviewable matter" is set out in Sch. 9).

There is a PPF Ombudsman (Tony King, who is also the Pensions Ombudsman) and a Deputy PPF Ombudsman (Charles Gordon, who is also the Deputy Pensions Ombudsman), who can consider any matter reviewed by the Board, including complaints of maladministration. The PPF Ombudsman is funded by a Pension Protection Fund Ombudsman levy collected by the Regulator from April 2006 onwards.

The PPF Ombudsman may decide the dispute or refer it back to the Board with directions on how it should proceed. Appeals may be made from the PPF Ombudsman to the High Court (or Court of Session in Scotland) on points of law. The PPF Ombudsman's jurisdiction, procedures and powers are set out in Regulations and Orders (see 3.10.2 below). The PPF Ombudsman may publish reports on any case he considers appropriate. It is an offence to obstruct the PPF Ombudsman in the performance of his functions. (Sections 209-218)

### 3.10.2 Regulations

How determinations are reviewed is dealt with in the Pension Protection Fund (Reviewable Matters) Regulations 2005 and the Pension Protection Fund (Review and Reconsideration of Reviewable Matters) Regulations 2005 and the Pension Protection Fund (Reference of Reviewable Matters to the PPF Ombudsman) Regulations 2005. Amendments have been made to these Regulations in the Pension Protection Fund (Reviewable Matters) and (Review and Reconsideration of Reviewable Matters) (Amendment) Regulations 2006.

The Pension Protection Fund (Maladministration) Regulations 2005 and the Pension Protection Fund (Investigation by the PPF Ombudsman of Complaints of Maladministration) Regulations 2005 deal with complaints about the Board's maladministration.

The Pension Protection Fund (PPF Ombudsman) Order 2005 and the Pension Protection Fund (PPF Ombudsman) Amendment Order 2005 deal with PPF Ombudsman operational issues.

### 3.10.3 Codes of Practice and PPF Publications

Details of the PPF Ombudsman's determinations to date can be found at <http://www.faso.org.uk/determinations.asp>

## 3.11 Timetable

The provisions relating to the creation of the Board and the PPF Ombudsman came into force on 17 December 2004.

The majority of the other PPF provisions came into force on 6 April 2005. However, certain provisions about calculating the levy in the PPF's second year came into force between 1 October 2006 and 1 March 2007 and various provisions in relation to closed schemes discussed at paragraph 3.6.1 above did not come into force until 6 April 2007.

## 3.12 Comment

In principle, the PPF represents a welcome safeguard for members of occupational pension schemes whose employers become insolvent and leave behind underfunded schemes which are unable to pay promised benefits.

However, the Government has made it clear that it does not intend to underwrite the costs of the PPF. As a result, if a significant number of schemes end up claiming on it, with significant aggregate deficits, the levy on other schemes could increase. The PPF is based on a similar arrangement in the USA (the PBGC) which currently has a very large deficit. The chairman of the PPF has said the PPF does not "guarantee" that it will pay benefits.

As at April 2008, 41 schemes had transferred to the PPF and over 12,000 people were receiving benefits from it with monthly payments totalling £1.4million.

Further information about the PPF is available at [www.pensionprotectionfund.gov.uk](http://www.pensionprotectionfund.gov.uk)

## 4. Fraud compensation

### Sections 182-189 Pensions Act

#### 4.1 Background

The Fraud Compensation Fund is similar to the former Pensions Compensation Board ("PCB"). The PCB has been dissolved and its assets and liabilities transferred to the Fraud Compensation Fund. The Fund is run by the same Board which runs the PPF and the provisions on the gathering of information by the Board (Sections 190-205), reviews and appeals (Sections 206-208) and the PPF Ombudsman (Sections 209-218) apply to the Board's functions both in relation to the PPF and the Fraud Compensation Fund.

#### 4.2 Conditions for fraud compensation payments to be made

##### 4.2.1 Act

For a payment to be made:

- the employer must either be insolvent or for certain types of employer, unlikely to continue as a going concern
- a binding scheme failure notice must have been issued to the scheme
- the value of the scheme assets must have been reduced since 6 April 1997 as a result of a "prescribed offence" (Regulations currently say that this means an offence involving dishonesty)
- a transfer notice in relation to a transfer of assets to the PPF must not have been issued, and
- a "cessation event" has not occurred (defined in Section 182(9)).

Certain schemes are outside the scope of this protection. (Section 182)

##### 4.2.2 Regulations

The Occupational Pension Schemes (Fraud Compensation Payments and Miscellaneous) Amendment Regulations 2005 set out which schemes are exempt from these requirements and includes death benefit only schemes, unapproved schemes and SSASs. They also define what is meant by an employer being unlikely to continue as a going concern.

##### 4.2.3 Codes of Practice

None currently.

#### 4.3 Making payments

##### 4.3.1 Act

Where an application for payment is made, the trustees must make efforts to recover any assets they can within a reasonable time period and without disproportionate cost. No payment can be made until the Board is satisfied that further money is unlikely to be recovered. (Section 184)

A payment may be made on such terms and conditions as the Board considers appropriate. The amount of the payment is to be determined in accordance with Regulations. While considering an application, the Board may make interim payments where trustees cannot otherwise meet certain liabilities (details of which are to be set out in Regulations). (Sections 185-186)

#### 4.3.2 Regulations

The amount of compensation is set out in the Occupational Pension Schemes (Fraud Compensation Payments and Miscellaneous Amendment) Regulations 2005 and will generally be the difference between (i) the adjusted amount of the assets in the last audited accounts or the scheme's PPF valuation and (ii) the actual value of the scheme assets determined by an accountant immediately before the application date. Interim payments may be made in respect of a variety of liabilities including pensions, ill health pensions and GMPs. The Regulations also vary the application of the fraud compensation scheme for different types of scheme.

#### 4.3.3 Codes of Practice

None currently.

### 4.4 Relationship with PPF

#### 4.4.1 Act

While an application for fraud compensation is pending, no notice can be served for a transfer of assets to the PPF. Any fraud compensation is counted as a scheme asset when deciding if a scheme is underfunded for PPF purposes. (Section 172)

Where the Board assumes responsibility for a scheme under the PPF, it may transfer money from the Fraud Compensation Fund to the PPF if it believes a fraud compensation payment could have been made due to events which took place before a transfer notice was served. (Section 187)

#### 4.4.2 Regulations

None currently.

#### 4.4.3 Codes of Practice

None currently.

### 4.5 The levy

#### 4.5.1 Act

The Act allows for regulations to provide for a levy to be set to meet the costs of the Fraud Compensation Fund. The amount of the levy will be treated as a debt due to the Board by the trustees (and Regulations may specify additional parties from whom the levy can be collected). The Board, or if it requires, the Regulator, must determine which schemes should pay the levy, calculate the levy and notify those liable to pay it. (Section 189)

#### 4.5.2 Regulations

The Occupational Pension Schemes (Fraud Compensation) Levy Regulations 2006 provide for the calculation and payment of the levy. The levy is calculated by

reference to the number of members in the scheme at the end of the previous scheme year and be capped at 23 pence per member.

4.5.3 Codes of Practice

None currently.

**4.6 Timetable**

The Fraud Compensation Fund went live on 1 September 2005.

**4.7 Comment**

The extended compensation for fraudulent losses is a welcome change.

## 5. Scheme funding

### Sections 221-233 Pensions Act

#### 5.1 Background

In its December 2002 Green Paper, the Government acknowledged that the “MFR has not worked as intended, and from the outset has given rise to a number of concerns. It has proved to be inflexible and unable fully to reflect the specific circumstances of individual schemes. The need to satisfy the MFR test has also led some schemes to focus too much attention on the impact of short-term market conditions instead of an appropriate strategy for meeting their specific pension commitments”. As a result of these problems, the Government suggested replacing the MFR with a scheme-specific funding approach.

In addition, the European Pensions Directive contains provisions in relation to scheme funding which needed to be reflected in the new legislation.

#### 5.2 Statutory funding objective

##### 5.2.1 Act

Every scheme (other than money purchase schemes and certain exempt schemes) will need to meet a statutory funding objective which is to “have sufficient and appropriate assets to cover its technical provisions”. “Technical provisions” is a term used in the European Pensions Directive and is defined opaquely in the Act as meaning “the amount required, on an actuarial calculation, to make provision for the scheme’s liabilities”. (Section 222)

Regulations set out the detail of how assets and liabilities are to be valued. The Act provides that the trustees must obtain the employer’s agreement when deciding how to calculate the technical provisions and if they cannot do so within specified time limits, they must report the matter to the Regulator (but see 5.2.2). They must also obtain actuarial advice. (Sections 222 and 229-230)

##### 5.2.2 Regulations

The Occupational Pension Schemes (Scheme Funding) Regulations 2005 provide that it is for the trustees to determine how the scheme’s technical provisions are calculated, having taken into account certain principles including the need for economic and actuarial assumptions to be chosen prudently. The trustees must choose an “accrued benefits funding method” to calculate the scheme’s technical provisions (undefined in the Regulations). Any change from the method or assumptions used when technical provisions were last calculated must be justified by a change of legal, demographic or economic circumstances.

In relation to obtaining employer agreement on how the scheme’s technical provisions should be calculated, the Regulations provide that employer consent is not needed and consultation will suffice where “the rates of contributions payable by the employer are determined by the trustees or managers without the agreement of the employer, and no person other than the trustees or managers is permitted to reduce those rates or to suspend payment of contributions”.

These provisions are modified by the Occupational Pension Schemes (Regulatory Own Funds) Regulations 2005 for some schemes (i.e. where the scheme underwrites any liability to cover against biometric risk, guarantees an investment

performance, or guarantees a level of benefits). Such schemes must hold additional assets over the technical provisions *"to absorb discrepancies between the anticipated and actual expenses and profits of the scheme"*. The Regulations set out how this additional amount should be calculated and amend parts of the Funding Regulations and the Act.

### 5.2.3 Codes of Practice

Code of Practice No. 3 which came into force on 15 February 2006 (see The Pensions Act 2004 (Funding Defined Benefits) Appointed Day Order 2006) deals with funding.

The Code of Practice stresses the need for trustees to have a full understanding of the funding decisions they are making and the implications for their scheme. On the need for prudence, the Code says that trustees:

*"should choose individual assumptions with a level of prudence consistent with the overall confidence they want to have that the resulting technical provisions will prove adequate to pay benefits as they fall due... The trustees must consider whether, and if so to what extent, account should be taken of a margin for adverse deviation when choosing prudent economic and actuarial assumptions... Whilst technical provisions should represent a prudent reserve to hold against a scheme's future liabilities, trustees are not obliged to attempt to eliminate all risk that they will fail to be sufficient. In particular, legislation does not require technical provisions to be set at the level needed to buy out accrued liabilities with an insurance company"*.

In relation to the employer, the Code says:

*"Where the rules of the scheme give the trustees the power to set the contribution rate without the agreement of the employer, the trustees are required only to consult the employer before making funding decisions. However, they should seek to obtain the employer's agreement... It is essential for the trustees to form an objective assessment of the employer's financial position and prospects as well as his willingness to continue to fund the scheme's benefits (the employer's covenant). This will inform decisions on both the technical provisions and any recovery plan needed"*.

The Code lists matters that trustees should consider when setting assumptions and Regulator Guidance issued in March 2005 provides further assistance.

## 5.3 Statement of funding principles

### 5.3.1 Act

The trustees must have a statement of funding principles setting out their policy for ensuring that the statutory funding objective is met, the methods and assumptions used and the period over which any shortfall will be made up. Similar obligations apply for obtaining the agreement of the employer, making a report to the Regulator if that cannot be obtained (but see 5.3.2 below) and taking actuarial advice when preparing or revising the statement as discussed at 5.2 above. (Sections 223 and 229-230)

### 5.3.2 Regulations

The Occupational Pension Schemes (Scheme Funding) Regulations 2005 set out the information which needs to be included in the statement. This includes:

- any funding objectives provided in the scheme rules, or which the trustees have adopted, in addition to the statutory funding objective,
- whether there are arrangements for a person other than the employer or a member to contribute and when such contributions would be made,
- whether there is a power to make payments to the employer out of the scheme and when such power may be exercised,
- whether there is a discretionary power to provide benefits for any members, and if there is, the extent it is taken into account in funding,
- trustee policy on reduction of cash equivalents on account of scheme funding, and
- how often the trustees will usually obtain actuarial valuations and when they will obtain additional actuarial valuations.

In relation to obtaining employer agreement, the Regulations provide that consultation will suffice where *"the rates of contributions payable by the employer are determined by the trustees or managers without the agreement of the employer, and no person other than the trustees or managers is permitted to reduce those rates or to suspend payment of contributions"*.

These provisions are modified for certain schemes by the Occupational Pension Schemes (Regulatory Own Funds) Regulations 2005 (see 5.2.2 above).

### 5.3.3 Codes of Practice (and Guidance)

The Code of Practice says that if the trustees have made any decisions about eliminating a shortfall, the statement must record this together with any assumptions used. The trustees may combine the statement of funding principles with the statement of investment principles.

The Regulator has also issued Guidance which contains a sample statement of funding principles.

## 5.4 Actuarial valuations

### 5.4.1 Act

Actuarial valuations will be required every year, or every 3 years if the trustees obtain actuarial reports in the intervening years setting out developments affecting the scheme's technical provisions since the last actuarial valuation. Any valuation, not simply those prepared to meet these provisions, must be made available to the employer within 7 days of the trustees receiving it. (Section 224)

When a valuation is carried out, the actuary must certify that in his opinion the calculation of the technical provisions has been made in accordance with any prescribed requirements. (Section 225)

#### 5.4.2 Regulations

The Occupational Pension Schemes (Scheme Funding) Regulations 2005 set out information on the content and timing of the actuary's report and contain a draft actuary's certificate.

#### 5.4.3 Codes of Practice

The Code of Practice stresses that the trustees are responsible for managing the valuation process and advocates an action plan to ensure that valuations are completed on time (generally 15 months from the effective date of the valuation). It sets out the key features that such an action plan should have.

The Code says that trustees should *"ask their actuary to advise them on any matter which the actuary considers relevant in the circumstances even though it was not covered in the initial discussions and they did not specifically request advice on it"* and should be *"alert to circumstances in which they may need further actuarial advice"*. It also stresses the need for trustees to understand actuarial advice and advocates the use of *"face to face"* meetings to achieve this.

Actuarial Guidance Note GN49 has been published on *"Matters on which the advice of an actuary must be obtained"*, but this simply refers back to the Code of Practice and does not give any assistance on how actuarial assumptions should be determined.

The Regulator has also published draft guidance for trustees on choosing assumptions with a particular focus on those related to mortality. This is available at:

<http://www.pensionsregulator.gov.uk/pdf/LongevityConsultationDocument.pdf>

### 5.5 Recovery plan

#### 5.5.1 Act

If a valuation shows that a scheme does not meet the statutory funding objective, a recovery plan must be put in place by the trustees setting out how the objective is to be met and over what period. In preparing the recovery plan, the trustees must obtain agreement from the employer (and if they cannot do so, report this to the Regulator, but see 5.5.2 below) and take actuarial advice. A copy of the recovery plan must be sent to the Regulator. (Sections 226 and 229-230)

The Occupational Pension Schemes (Winding up Procedure Requirement) Regulations 2006 insert a new section 231A into the Act which requires the trustees of a scheme which begins to wind up during a recovery period to prepare a winding up procedure as soon as reasonably practicable. This procedure must include information on any action taken to establish liabilities, whether there will be a reduction in accrued rights and how liabilities will be discharged. The trustees must send a copy of the winding up procedure to the Regulator as soon as reasonably practicable. Trustees will also need to disclose an outline of the winding up procedure to scheme members and register the start date of the winding up.

#### 5.5.2 Regulations

The Occupational Pension Schemes (Scheme Funding) Regulations 2005 require trustees to consider the following when preparing or revising a recovery plan:

- the asset and liability structure of the scheme,
- its risk profile,
- its liquidity requirements,
- the age profile of the members, and
- where employer contributions are determined by or in accordance with the advice of a person other than the trustees or managers (e.g. the scheme actuary), and without the agreement of the employer, the recommendations of that person.

In relation to obtaining employer agreement, the Regulations provide that consultation will suffice where *"the rates of contributions payable by the employer are determined by the trustees or managers without the agreement of the employer, and no person other than the trustees or managers is permitted to reduce those rates or to suspend payment of contributions"*.

These provisions are modified by the Occupational Pension Schemes (Regulatory Own Funds) Regulations 2005 for certain schemes (see 5.2.2 above).

### 5.5.3 Codes of Practice and Guidance

The Code of Practice provides that trustees should *"aim for any shortfall to be eliminated as quickly as the employer can reasonably afford. What is possible and reasonable, however, will depend on the trustees' assessment of the employer's covenant"*.

The Code gives a list of factors which trustees should take into account when considering the structure of a recovery plan. The plan must include the date by when the shortfall is expected to be eliminated and *"the date by when the amount of those additional contributions to be made is half the amount of all the contributions due under the plan. This will provide the trustees with an understanding of the plan's structure"*. The Code also gives guidance on revising an existing recovery plan.

The Regulator has also issued Guidance which contains a sample recovery plan.

In September 2007, the Regulator published an analysis of the recovery plan data it had received so far. This showed that:

- average technical provisions were close to FRS17 accounting levels and above section 179 (PPF valuation) levels
- one third of recovery plans did not trigger any action by the Regulator and of the two-thirds that did, the majority required only minimal action;
- more than 80% of schemes had recovery plans of less than 10 years with the average being 7.5 years.

## 5.6 Schedule of contributions

### 5.6.1 Act

As with the MFR, schemes will also need a schedule of contributions showing the rates and due dates of employer and employee contributions. The actuary must certify that the schedule is consistent with the statement of funding principles and that it is expected that the statutory funding objective will be met throughout the schedule period (or if a recovery plan is in force, at the end of the recovery plan). Where the statutory funding objective was not met, a copy of the schedule must be sent to the Regulator. (Section 227)

Where employer or employee contributions are not made on time in accordance with the schedule, reports to the Regulator are only required where there is reasonable cause to believe that the failure is likely to be of material significance in the exercise by the Regulator of any of its functions. (Section 228)

Employer agreement is required to the schedule of contributions if such agreement is normally needed for employer contributions in the scheme rules (see 5.6.2 below). If the trustees cannot reach any required agreement with the employer within certain time limits, they must report the matter to the Regulator. Unlike the MFR legislation, there is no default provision allowing the trustees to determine the schedule on their own up to a certain level where employer agreement is required but is not obtained; instead, the Regulator steps in (see 5.7 below). (Section 229)

The trustees must also obtain actuarial advice when preparing or revising the schedule of contributions. (Section 230)

### 5.6.2 Regulations

The Occupational Pension Schemes (Scheme Funding) Regulations 2005 deal with the timing and content of schedules of contributions.

In relation to obtaining employer agreement, the Regulations provide that consultation will suffice where *"the rates of contributions payable by the employer are determined by the trustees or managers without the agreement of the employer, and no person other than the trustees or managers is permitted to reduce those rates or to suspend payment of contributions"*.

Where scheme rules provide that the actuary sets the employer contribution rate, the actuary's certificate must state that the rates shown in the schedule of contributions are not lower than the rates he would have provided for if he, rather than the trustees, had the responsibility of preparing or revising the schedule, the statement of funding principles and any recovery plan.

These provisions are modified by the Occupational Pension Schemes (Regulatory Own Funds) Regulations 2005 in relation to certain schemes (see 5.2.2 above).

### 5.6.3 Codes of Practice and Guidance

The Code of Practice gives guidance on the content of the schedule. In relation to the PPF levy, the Code says that the trustees should treat it *"as an annual expense item. Even where this expense item is included in the employer's overall contribution rate, the schedule of contributions should include a note to this effect indicating the assumed annual amount incorporated for this purpose"*. The Code also says that trustees should have in place a robust procedure for

monitoring the receipt of contributions and where the employer fails to pay any amounts due under the schedule, the trustees should investigate it and discuss it with the employer as soon as practicable.

The Regulator has also issued Guidance which contains a sample schedule of contributions.

## 5.7 Role of the Regulator

### 5.7.1 Act

Where:

- trustees breach their obligations relating to the new funding documents,
- the actuary is unable to provide a relevant certificate,
- the employer fails to make payments required by a schedule of contributions, or
- the trustees and employer are unable to agree (where agreement is required) any of the relevant items

the Regulator has very wide powers, including powers to:

- modify the scheme for future accrual of benefits (presumably to prevent the scheme from becoming further underfunded), but not so as to affect adversely any subsisting rights,
- direct how the technical provisions should be calculated,
- determine the period over which a shortfall is to be made up, and
- impose a schedule of contributions.

(Section 231)

### 5.7.2 Regulations

The Occupational Pension Schemes (Scheme Funding) Regulations 2005.

### 5.7.3 Codes of Practice and Guidance

A Code of Practice contains guidance on the information that needs to be sent to the Regulator and the timescales for doing so.

The Regulator has also issued a statement setting out its proposed approach on using its powers in relation to scheme funding. The Regulator recognises that it needs to focus its attention on schemes that are likely to pose the greatest risk, to this end it intends to *"use a filter mechanism based on triggers to identify schemes whose funding plans seem more likely to be based on imprudent or inappropriate assumptions. This will enable us to focus our attention on pension schemes that might merit scrutiny to determine whether the trustees have made reasonable decisions"*.

The first trigger is based on a scheme's technical provisions (see 5.2.1 above). The Regulator will look at a scheme's funding position under FRS17 and on the PPF valuation basis and compare these with the scheme's technical provisions. Whether the Regulator's further involvement is triggered by where the scheme's technical provisions fall within the range depend on its maturity and the employer's strength. The Regulator is keen to point out that defining "*the technical provision trigger as a range between section 179 and FRS17 / IAS19 liability values does not mean that either of these values is to be used as a funding target. Nor does it mean that schemes have to change their investment strategy. The use of a prudent discount rate for technical provisions does not necessarily require trustees to adopt the same assumptions for their investment strategy, so long as they are comfortable with the employer's covenant and have allowed for the risk that the employer may not be able to cope with any adverse experience*".

The second trigger relates to recovery plans (i.e. plans to bring the scheme back up to full funding). It may consider intervention if a recovery plan:

- ▶ is longer than ten years;
- ▶ appears to be significantly back-end loaded (higher contributions towards the end); or
- ▶ has assumptions underlying it, especially in relation to investment, which appear inappropriate.

## 5.8 Timetable

The legislation came into force on 30 December 2005 and applies to valuations from 22 September 2005. Schemes which started a valuation between 22 September 2005 and 30 December 2005 were allowed 18 months to complete their first valuation under the new regime (as opposed to the usual 15).

## 5.9 Comment

Proposals for reform of the MFR have been around for a number of years and it is unfortunate that the Government had to change them at the last minute to fit in with the requirements of the European Pensions Directive. Many of the requirements in the legislation are imported directly from European law and are fairly difficult to interpret in a UK context. In particular, the Regulations contain several references to the need for "prudence" and it remains to be seen how this will actually be interpreted (however, the draft Regulator guidance on choosing funding assumptions may be of some assistance).

In some respects, the Regulator's powers to intervene in relation to scheme funding issues have proved more limited than the Regulator might have wished. Therefore, the Pensions Bill 2008 contains proposals which will allow the Regulator to intervene where it determines that technical provisions in relation to funding have not been determined prudently.

## 6. Financial planning

### Sections 234-238 Pensions Act and Schedule 10

#### 6.1 Background

In its June 2003 paper, Action on Occupational Pensions, the Government said that: *"We will be working across Government and beyond to ensure that we emphasise the importance of planning for retirement, and provide sufficient information, so that individuals are aware of the choices they can make, and where they can get information and advice to help them make those choices"*.

According to the Government, the provisions in this Part of the Act *"provide the Secretary of State with the power to promote and facilitate planning for retirement and allow him to receive the information to do so. They also provide powers to require schemes to provide combined benefit forecasts and employers to provide their employees with access to information and advice about pensions and saving for retirement"*.

#### 6.2 Promoting and facilitating financial planning for retirement

##### 6.2.1 Act

The Secretary of State is given powers to *"take action for the purpose of promoting or facilitating financial planning for retirement"*. This could include providing individuals with an estimate of what they will need in retirement, what benefits they will receive in retirement and what action an individual might take. (Section 234)

Those holding the information relevant to providing such advice to individuals are given a statutory power to give it to the Secretary of State. There are detailed provisions on how the Secretary of State can use the information supplied to him in accordance with these provisions. (Sections 235-236 and Sch. 10)

##### 6.2.2 Regulations

None currently.

##### 6.2.3 Codes of Practice

None currently.

#### 6.3 Combined pension forecasts

##### 6.3.1 Act

Proposals for combined pension forecasts, a single statement summarising total projected benefits from state and private pension provision on retirement, have been around for some time and some schemes have been piloting them but they have generally been thought to be logistically difficult.

The Act provides that trustees may be required to provide members with information about:

- ▀ their basic state pension, SERPS and State Second Pension entitlements (providing the information has been given to them), and

- ▶ the pensions and other benefits likely to accrue to them under the occupational pension scheme.

(Section 237)

#### 6.3.2 Regulations

None currently.

#### 6.3.3 Codes of Practice

None currently.

### 6.4 Information and advice to employees

#### 6.4.1 Act

Employers may be required to take action to enable their employees to obtain information and advice about pensions. The type of information which employers must provide is to be set out in Regulations. Employers will be required to notify the Regulator about the steps which they have taken to comply with this obligation. (Section 238)

#### 6.4.2 Regulations

None currently.

#### 6.4.3 Codes of Practice

None currently.

### 6.5 Timetable

The provisions of the Act in relation to financial planning and the supply of information came into force on 18 November 2004 (Sections 234-236). No commencement orders have yet been issued in relation to the other provisions discussed.

In the meantime amendments have been made to the disclosure regime in the Personal and Occupational Pension Schemes (Indexation and Disclosure of Information) Amendment Regulations 2005 to require members to be given basic information about annuities where relevant and to increase the level of fines payable for non-compliance with the disclosure regime.

### 6.6 Comment

Although the promotion of sensible financial planning is a laudable aim, these measures will increase the burden of red-tape for employers and possibly trustees as well.

## 7. Definitions of pension schemes and employer

### Sections 239-240 Pensions Act

#### 7.1 Background

The definitions of “occupational pension scheme” and “personal pension scheme” were previously contained in Section 1 Pension Schemes Act 1993. These definitions have been amended. It was said that the changes were necessary to reflect the pensions tax simplification provisions (contained in the Finance Act 2004) and the European Pensions Directive. In particular, the Government said that the current “*definition of ‘occupational pension scheme’ is very similar to that for ‘personal pension scheme’*. *If we had had to rely on those definitions alone, it could have proved difficult to decide how some schemes should be classified. However, in practice that has not proved to be a problem until now, because the Inland Revenue system has always made it clear within its eight categories for determining tax approval whether a scheme is given tax approval as an occupational pension scheme or as a personal pension scheme. However, that will change under the simplified tax regime introduced in the Finance Bill. In future, schemes will register for tax purposes, rather than having to obtain approval*”.

The definition of “employer” in Section 125 of the Pensions Act 1995 has also been amended so that the existing definition can be changed by Regulations when the need arises.

#### 7.2 Definition of occupational pension scheme

##### 7.2.1 Act

For a scheme to be an occupational pension scheme:

- it must provide benefits for people with service in employment (or self-employment) of a kind described in the scheme rules and which may also provide benefits to members who are not in that kind of employment (or self-employment)
- it must provide benefits to or in respect of people on retirement or on having reached a particular age, or on termination of service
- it must have its main administration in the UK or outside the European Union
- at least one of the people establishing it must be an employer, employee or self-employed person or their representatives
- it can be established for paid office-holders by the person who pays them, and
- it may cater for more than one kind of employment (or self-employment).

(Section 239)

##### 7.2.2 Regulations

The Pension Schemes (Categories) Regulations 2005 provide for certain additional schemes to be included within the definition of occupational pension

scheme, including schemes established by someone other than an employer where an employer of active members is contributing to the scheme.

7.2.3 **Codes of Practice**  
None expected.

### 7.3 **Definition of personal pension scheme**

#### 7.3.1 **Act**

The definition of personal pension scheme has been amended to tie in with the Finance Act 2004 and covers schemes which are established by:

- an insurance company
- a unit trust scheme manager
- an operator, trustee or depositary of a recognised EEA collective investment scheme
- an authorised open-ended investment company
- a building society
- a bank, or
- an EEA investment portfolio manager.

(Section 239)

#### 7.3.2 **Regulations**

The Pension Schemes (Categories) Regulations 2005 provide for stakeholder schemes established under trust which do not require employer contributions to be treated as personal pension schemes.

7.3.3 **Codes of Practice**  
None currently.

### 7.4 **Definition of employer**

#### 7.4.1 **Act**

The definition of employer in Section 125 Pensions Act 1995 has been amended so that its scope can be altered by Regulations. (Section 240)

#### 7.4.2 **Regulations**

None currently.

7.4.3 **Codes of Practice**  
None currently.

**7.5 Timetable**

On the definitions of occupational and personal pension schemes, the provisions for occupational pension schemes that have their main administration in the UK came into force on 22 September 2005 and for other schemes from 6 April 2006.

**7.6 Comment**

These are not generally changes of substance. However, some schemes which were formerly classified as occupational pension schemes may no longer fall within the new definition, so if in doubt, advice should be sought.

## 8. Member-nominated trustees

### Sections 241-243 Pensions Act

#### 8.1 Background

In its December 2002 Technical Paper, *Simplicity, Security and Choice*, the Government said: *"We want more members to be involved in the running of their pension schemes, and we plan to remove the employers' right to propose an opt-out. We believe that having member trustees on the boards of occupational pension schemes helps give members a sense of involvement, and increases member confidence. It can also help to raise the standards of governance. Removing the employer opt-out would also help to make MNT arrangements simpler for schemes to operate"*.

The removal of the employer's opt-out had already been legislated for in Sections 43-46 Child Support, Pensions and Social Security Act 2000. However, these provisions were never brought into force (and have now been repealed) as they were dependent on Regulations which were delayed pending the outcome of the Government's simplification review.

#### 8.2 Requirement for member-nominated trustees ("MNTs")

##### 8.2.1 Act

The MNT requirements in Sections 16-21 Pensions Act 1995 have been repealed. (Sch. 13)

Under the new requirements, trustees must ensure that within a "reasonable period" of the new legislation coming into force (see 8.2.3 below), at least one-third of the total number of trustees are:

- nominated in a process in which at least all the active and pensioner members or organisations which adequately represent them could participate, and
- selected as a result of a process which involves some or all of the scheme members.

Under the Pensions Act 1995 requirements, arrangements could be put in place where although the nomination was by members, the selection was not. This no longer appears to be possible. (Section 241)

There is no longer any requirement for a minimum of 2 member-nominated trustees in the case of a scheme with at least 100 members.

Similar requirements apply in relation to directors of corporate trustees. (Section 242)

An important change introduced by the Government at a late stage of the Act's passage through Parliament was a Regulation-making power to increase the minimum number of MNTs from one-third to one-half. (Section 243)

##### 8.2.2 Regulations

The Occupational Pension Schemes (Member-nominated Trustees and Directors) Regulations 2006 set out exemptions from the MNT requirements. The list is

fairly similar to the existing exemptions, with the addition of schemes where all the trustees are independent. Where scheme rules currently require more than one third of the trustees to be member-nominated, the statutory minimum will not override the requirements in the scheme rules.

Existing opt-out arrangements will be allowed to continue until the earlier of the date they would otherwise cease to have effect (normally 10 years from the date they were put in place) or 31 October 2007.

The consultation paper which accompanied the draft of these Regulations indicated that the Government intends to work towards implementing the 50% MNT requirements sometime in 2009. It also says independent trustees would be disregarded in the calculation of the 50% minimum.

### 8.2.3 Codes of Practice

Code of Practice No.8 which came into force on 22 November 2006 deals with member-nominated trustees. It does not set out rigid requirements to ensure that one-third of trustees are member-nominated but says that trustees should determine what the arrangements for their scheme should be, taking account of the principles of proportionality, fairness and transparency.

The Code defines a reasonable period for complying with the new requirements and putting new MNT arrangements in place as being 6 months from the requirement applying to the scheme. However the Regulator expects most schemes to take less than 6 months but acknowledges that in certain circumstances schemes may take longer than 6 months. The Regulator also expects a review of arrangements at 3-5 year intervals or on certain changes to the scheme.

## 8.3 Nomination and selection process

### 8.3.1 Act

The nomination and selection of MNTs must take place within a reasonable time. If a vacancy is not filled due to insufficient nominations, the selection process must be repeated at reasonable intervals. A person who is not a scheme member must have the employer's approval to be an MNT. (Sections 241-242)

### 8.3.2 Regulations

The Occupational Pension Schemes (Member-nominated Trustees and Directors) Regulations 2006 have been issued but do not deal with the mechanisms of nomination and selection.

### 8.3.3 Codes of Practice

The Code of Practice (see 8.2.3 above) gives a considerable amount of detail on how the Regulator envisages the nomination and selection procedure operating. It says who should be involved in the nomination and selection process and who can be nominated. It does not specify the processes for nomination and selection, as in the Regulator's view these are scheme specific issues, but it does set out some minimum criteria.

Where there are insufficient nominations to fill the vacancies, the Code provides that a reasonable interval for repetition of the process is no more than 3 years.

The nomination and selection process should normally take place within 6 months of the MNT arrangements being put into place.

## 8.4 Conditions of office for MNTs

### 8.4.1 Act

As under the Pensions Act 1995, an MNT can only be removed with the agreement of all of the other trustees. Their functions must not be different from those of other trustees merely because they are MNTs. (Sections 241-242)

### 8.4.2 Regulations

The Occupational Pension Schemes (Member-nominated Trustees and Directors) Regulations 2006 have been issued.

### 8.4.3 Codes of Practice

The Code of Practice does not deal with the conditions of office of MNTs.

## 8.5 Additional provisions for trustee companies

### 8.5.1 Act

The majority of provisions are the same for individual trustees and directors of corporate trustees.

Where a company is a trustee of more than one scheme, the MNT provisions apply as if the schemes were a single scheme. However, the trust company may elect for this provision not to apply to it. Professional trustees in particular will wish to make such elections. (Section 242)

### 8.5.2 Regulations

The Occupational Pension Schemes (Member-nominated Trustees and Directors) Regulations 2006 have been issued.

### 8.5.3 Codes of Practice

The Code of Practice says that the same provisions apply to the nomination and selection of directors of a trustee company as apply to individual trustees.

## 8.6 Timetable

The new MNT requirements came into force on 6 April 2006, although existing arrangements will be allowed to continue until the earlier of the date they would otherwise cease to have effect or 31 October 2007. The 50% minimum MNTs requirement is not expected to be implemented until 2009 or later (there is currently no draft legislation in place), however, the regulation making power in the Act enabling the Government to do this came into force on 1 November 2005.

## 8.7 Comment

There is no doubt that these provisions are administratively simpler than the existing MNT requirements. There are no prescriptive time limits (although guidance as to timing is contained in the Code of Practice) and because there are no longer any employer opt-outs, there are no detailed statutory member consultation procedures and hence no provisions for what happens when an attempted opt-out fails. However, the legislation is largely silent on the question of what happens where trustees have been appointed under

the terms of existing opt-out arrangements and have terms of office which have not yet expired. The transition to the new regime may therefore need careful thought.

The prospect, via future Regulations, of 50% MNTs as a minimum could be a highly significant shift in the balance of power from employers to members. It raises the question of what will happen where there is a deadlock between MNTs and other trustees. DWP have indicated that it is not their intention to interfere in the decision making processes of individual schemes, and in their view there is nothing in the legislation that prevents a chairman from exercising a casting vote (provided there is nothing in the trust deed and rules that prevents an MNT from becoming a chairman).

## 9. Trustee obligations - investment, borrowing, knowledge, understanding and internal controls

### Sections 244-249A Pensions Act

#### 9.1 Background

Changes to trustee duties and obligations stem in part from the recommendations made in the 2001 Myners Review of Institutional Investment in the UK. Myners concluded that the lack of investment understanding among trustees was a problem and there should be a legal requirement that trustees making investment decisions should be familiar with the issues concerned.

The Government supported these recommendations, but in its June 2003 paper, Action on Occupational Pensions, said: *"We are persuaded by the argument that investment is not the only, nor always the most important, area of trustees' responsibilities. The legislation will therefore provide that trustees be required to be familiar with the issues or have relevant knowledge across the full range of their responsibilities"*.

Further changes have been made to tie in with the European Pensions Directive, including in relation to internal controls.

#### 9.2 Investment

##### 9.2.1 Act

Section 35 Pensions Act 1995 (dealing with statements of investment principles) is replaced with a new provision. The new Section contains no detail on what the statement of investment principles must contain; instead details of the required content is set out in Regulations. The statement of investment principles will need to be reviewed at prescribed intervals. (Section 244)

Section 36 Pensions Act 1995 which previously required trustees/fund managers to have regard to the diversification and suitability of investments has been amended to allow Regulations to specify the criteria to which trustees must have regard when exercising their investment powers (see 9.2.2 below). This amendment is also designed to ensure compliance with the European Pensions Directive. (Section 245)

##### 9.2.2 Regulations

The Occupational Pension Schemes (Investment) Regulations 2005 provide that the statement of investment principles must be reviewed at least every 3 years and after a significant change in investment policy (rather than from time to time as previously required). The content of the statement is much the same as previously except that trustees are required to set out the *"ways in which risks are to be measured and managed"* rather than just their policy on risk. On the issues which trustees and their delegates need to consider when investing, the Regulations say:

- ▀ the assets must be invested in the best interests of the scheme beneficiaries (reflecting the current trust law requirement)

- investment powers must be exercised in a manner calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole
- assets held to cover the scheme's technical provisions must also be invested in a manner appropriate to the nature and duration of the expected future benefits payable under the scheme.
- assets must be invested predominantly on regulated markets and investment in assets not admitted to trading on a regulated market must in any event be kept to a prudent level
- assets must be properly diversified to avoid excessive reliance on any particular asset, insurer or group of undertakings and to avoid accumulations of risk in the portfolio as a whole
- investment in derivative instruments may be made only if they reduce investment risk or help efficient portfolio management.

The Regulations set out certain exemptions from these requirements. In particular, schemes with less than 100 members are exempt from the requirement to have a statement of investment principles.

### 9.2.3 Codes of Practice

None currently.

## 9.3 Borrowing by trustees

### 9.3.1 Act

A new Section 36A has been inserted into the Pensions Act 1995 allowing Regulations to limit trustees' borrowing powers (see 9.3.2 below). This is to ensure compliance with the European Pensions Directive, which requires Member States to prohibit pension schemes from acting as a guarantor on behalf of third parties or borrowing (unless it is for liquidity purposes and is temporary).

(Section 246)

### 9.3.2 Regulations

The Occupational Pension Schemes (Investment) Regulations 2005 provide that trustees "*must not borrow money or act as a guarantor in respect of the obligations of another person where the borrowing is liable to be repaid, or liability under a guarantee is liable to be satisfied, out of the assets of the scheme*". However, borrowing is permitted to provide liquidity and on a temporary basis.

The Regulations set out certain exemptions from this requirement.

### 9.3.3 Codes of Practice

None currently.

## 9.4 Requirement for knowledge and understanding

### 9.4.1 Act

The Act requires trustees and directors of trustee companies to be familiar with the scheme trust deed and rules, their statement of investment principles, the statement of funding principles and any other documentation setting out the scheme's administration policy. (Sections 247-248)

Trustees and directors of trustee companies must have an understanding of the law relating to pensions and trusts and the principles relating to the funding and investment of occupational pension schemes sufficient to enable them to exercise properly their functions. (Sections 247-248)

The functions of different trustees (and hence the need to have knowledge and understanding in relation to such functions) may vary between trustees where, for example, some trustees deal with certain matters through a sub-committee e.g. investment or death benefit discretions.

### 9.4.2 Regulations

The Occupational Pension Schemes (Trustees Knowledge and Understanding) Regulations 2006 disapply these requirements for newly appointed trustees and directors of trustee companies for their first 6 months as a trustee. However, this exemption does not apply to independent trustees.

### 9.4.3 Codes of Practice

Code of Practice No.7 which came into force on 30 May 2006 provides further guidance in this area together with two scope documents which set out in more detail the areas and level of knowledge that trustees need to have. The scope documents represent a framework of matters which trustees need to know and understand. The exact level of knowledge required in each case will depend on the functions of a particular trustee.

Trustees will need to review their levels of knowledge and understanding against this new requirement and the Regulator recommends that this is done on at least an annual basis. The Code also says that it *"is good practice for trustees to keep records of what they do individually. In addition, trustee boards should keep records of the individual learning activities of members and records of learning activities carried out by the board as a whole"*.

In relation to conversance, trustees should know enough about scheme documents and have enough technical information to enable them to ask relevant questions of their advisers. Trustees should have access to the scheme documents at any time.

## 9.5 The Regulator acknowledged that trustees in office on 6 April 2006 might not have satisfied every element of the new knowledge requirements and therefore allowed *"six months from [6 April 2006] for existing trustees to complete a learning programme which meets their needs"*. Internal controls

### 9.5.1 Act

The Act has been amended by Regulations by the insertion of Section 249A which requires trustees to ensure that they have adequate internal control processes in place. This is to comply with the European Pensions Directive. Arguably it goes little further than what diligent trustees already ought to be

doing but it will no doubt highlight the need for an adequate level of formal internal monitoring. (Section 249A)

### 9.5.2 Regulations

The Occupational Pension Schemes (Internal Controls) Regulations 2005, amend the Act to provide that trustees must operate internal controls to ensure the scheme is managed in line with the scheme rules and relevant legislation. This includes the monitoring as well as performance of scheme administration and arrangements for the custody and security of scheme assets.

### 9.5.3 Codes of Practice

Code of Practice No. 9, which came into force on 22 November 2006, is intended to assist trustees in determining and reviewing what internal controls are necessary by reference to the particular risks faced in their scheme.

In addition, the Regulator has also issued guidance for trustees in relation to complying with the internal controls requirements which includes, amongst other things, an example of a "risk register" in which trustees can record risks and the steps which are being taken to mitigate such risks.

In addition, the Regulator has published draft guidance setting out the way in which it expects conflicts of interest to be approached. The guidance says that trustees should have a procedure in place for identifying and managing conflicts and should also maintain a register of conflicts. It also deals with the issue of adviser conflicts.

## 9.6 Timetable

The provisions on investment, borrowing and internal controls came into force on 30 December 2005. The trustee knowledge requirements came into force on 6 April 2006.

## 9.7 Comment

*In the Committee stage the Government said that it does not "expect trustees to be experts on everything or to have the detailed technical knowledge of a professional. We are not seeking to professionalise the role of trustee. We want them to have a rounded knowledge of the schemes....They need to know what the trust deed and scheme rules say ...that is what we mean by conversant. Trustees also need a good understanding of the theory and practice of occupational pensions, notably legal, funding and investment issues, insofar as they are relevant to the functions being carried out" .*

However, the knowledge and understanding obligations on trustees are potentially very onerous. Trustees need to assess their level of knowledge , making arrangements to fill any gaps as soon as possible and should keep records of any training activities which they have undertaken. They should also be considering how they wish to deal with conflicts of interest as this is clearly a hot topic with the Regulator.

## 10. Payment of surplus to employer

### Sections 250-251 Pensions Act

#### 10.1 Background

To retain tax-approved status, occupational pension schemes were previously required to take appropriate steps to reduce excessive surpluses. To determine whether there was an excessive surplus, the valuation of a scheme's assets and liabilities had to be carried out on a statutory basis in accordance with Schedule 22 Income and Corporation Taxes Act 1988. One of the ways by which a scheme could reduce such an excessive surplus was by making a payment to the employer (which is taxable at 35%).

Section 37 Pensions Act 1995 set out further conditions that must be met before such a payment can be made. In addition, Section 37 only permitted surplus to be refunded to an employer from a scheme not in winding up where there was an excessive surplus on the statutory basis described above (irrespective of what the scheme rules provide).

The previous pensions legislation needed to be amended as the tax simplification provisions contained in the Finance Act 2004 removed the requirement to dispose of excessive surpluses.

#### 10.2 Payment to employer

##### 10.2.1 Act

Section 37 Pensions Act 1995 has been replaced with a new provision allowing trustees to agree to a repayment of surplus to an employer (where the scheme rules permit) providing the following conditions are satisfied:

- the trustees have obtained a valuation of the scheme's assets and liabilities from a "prescribed person" (generally the scheme actuary)
- the trustees have a certificate from a prescribed person stating that the assets and liabilities of the scheme have been calculated and verified in accordance with prescribed requirements, and setting out the maximum amount of surplus that can be refunded
- the payment to the employer does not exceed the amount on the certificate
- the trustees are satisfied that the payment is in the interests of the members
- where appropriate, the employer has requested, or consented to, the payment
- the Pensions Regulator has not issued a freezing order against the scheme, and
- scheme members have been notified in accordance with prescribed requirements.

The intention is to require final salary schemes to be funded to full buy-out level before a refund can be made, which for the majority of schemes will be a higher

threshold than the current Revenue requirements discussed above. In the case of a money purchase scheme, a refund will only be permitted where *“assets are clearly not required to meet the scheme’s commitments”*.

(Section 250)

#### 10.2.2 Regulations

The Occupational Pension Schemes (Payment to Employers) Regulations 2006 provide that a payment from a scheme to an employer cannot be made unless the scheme is in surplus on a buy-out basis (they also prescribe how assets and liabilities are to be valued). Where a money purchase scheme holds each member’s fund under a separate insurance policy, the scheme may consider making a payment to an employer where the liabilities for a member have been met in full, and the payment to the employer will be policy assets above the member’s entitlement.

#### 10.2.3 Codes of Practice

None currently.

### 10.3 Transitional power to amend scheme

#### 10.3.1 Act

Where scheme rules allow refund of surplus to the employer other than where there is an excessive statutory surplus (which would not be permitted under the existing legislation), trustees may decide to restore their original powers and what conditions, if any, to which they should be subject. Where scheme rules only allow refund of surplus if permitted by existing legislation, trustees may choose whether they wish to have a power to make payments of surplus to the employer and, if so, subject to what conditions.

The trustees:

- must be satisfied that any rule change is in the interests of scheme members
- can only make one such decision and must make it within 5 years of the commencement of these provisions, and
- must give written notice to the employer and scheme members that they plan to change the scheme rules on payments to the employer.

(Section 251)

#### 10.3.2 Regulations

The Occupational Pension Schemes (Payment to Employers) Regulations 2006 deal with the requirements for written notices to members.

#### 10.3.3 Codes of Practice

None currently.

### 10.4 Timetable

These provisions came into force on 6 April 2006.

**10.5 Comment**

Given the very small number of schemes with any significant surplus in the current climate, these amendments seem likely to be of interest or significance to very few schemes, particularly as the new conditions on refunding surplus will generally be more difficult to satisfy than the existing ones.

There is also some confusion about the interpretation of the transitional power to amend schemes and trustees may need to take advice in relation to this issue if it becomes relevant to them.

## 11. Requirements for occupational pension schemes and trustee indemnities

### Sections 252-256 Pensions Act

#### 11.1 Background

This part of the Act contains a variety of provisions which according to the Government are intended to ensure that "*occupational pension schemes established in the UK and those established outside the EU that have employees in the UK continue to be set up under trust*". Currently it is a condition of tax approval that occupational pension schemes are set up under trust, but under tax simplification introduced by the Finance Act 2004, that condition will no longer apply.

(Occupational pension schemes that are established in other EU Member States are not covered by these Sections as they are dealt with by separate provisions on cross border schemes – see Part 29 of this Guide below).

A restriction on trustees' ability to be indemnified from scheme assets for fines they may incur (on similar lines to the Pensions Act 1995) is also included.

#### 11.2 UK based schemes to be set up under trust

##### 11.2.1 Act

Occupational pension schemes principally administered in the UK must be established under irrevocable trust and can only accept contributions and transfer payments if this requirement is satisfied. In line with current Revenue requirements, schemes must have written rules setting out the benefits provided before payments can be made into them. Failure to comply renders trustees liable to civil penalties. (Section 252)

##### 11.2.2 Regulations

The Occupational Pension Schemes (Trust and Retirement Benefits Exemption) Regulations 2005 set out exceptions to this requirement.

##### 11.2.3 Codes of Practice

None currently.

#### 11.3 Non-EU schemes

##### 11.3.1 Act

Where a UK employer makes contributions to a scheme outside the European Economic Area or a contribution is being made by an employer anywhere in the world in respect of an employee in the UK, the scheme must be:

- established under irrevocable trust, and
- have a UK resident trustee (and anyone appointed by the trustees to act as a representative of the overseas scheme in the UK is to be treated as a trustee for these purposes).

Failure to comply can render an employer liable to civil sanctions.

(Sections 253-254)

11.3.2 Regulations

11.3.3 Exemptions to these requirements are being proposed in the draft Occupational Pension Schemes (Non-European Schemes Exemption) Regulations 2007. Codes of Practice

None currently.

**11.4 Activities of occupational pension schemes**

11.4.1 Act

This provision is to comply with the European Pensions Directive and requires trustees of UK based occupational pension schemes to limit the scheme's activities to "*operations related to retirement benefits*". This means that an occupational pension scheme cannot, for example, provide mortgages. There is also currently a query about the extent to which this may create problems in relation to death benefit only members. (Section 255)

11.4.2 Regulations

The Occupational Pension Schemes (Trust and Retirement Benefits Exemption) Regulations 2005 provide for certain schemes to be exempt from this requirement, notably where the scheme has fewer than 100 members.

11.4.3 Codes of Practice and Guidance

The Regulator has published guidance on the application of these provisions in light of concern about their impact on life cover only members. The guidance says, employers can provide life cover only for certain members under an occupational pension scheme plus pension benefits through another arrangement:

*"provided that there is a sufficient concrete and identifiable link through the employer between the provision of the lump sum death benefits under the one scheme, and the pension benefits under the other scheme. Such a link would need to be stronger than the simple fact that the two schemes were set up and run by the same employer"*.

**11.5 Trustee indemnities for fines**

11.5.1 Act

This provision largely replicates Section 31 Pensions Act 1995 which prevents trustees from meeting any fines they incur from scheme assets. Unlike Section 31, this new provision applies to personal pension schemes as well as occupational schemes. (Section 256)

11.5.2 Regulations

None currently.

11.5.3 Codes of Practice

None currently.

## 11.6 Timetable

Sections 252 and 255 (see 11.2.1 and 11.4.1 above) came into force on 22 September 2005. The provision on trustee indemnities in section 256 came into force on 30 June 2005. Section 253 came into force on 6 April 2006.

## 11.7 Comment

The provisions about UK schemes appear intended to replicate what was already in Revenue practice notes and which would otherwise have disappeared as a result of tax simplification. However, the provisions on the activities of occupational pension schemes mean that some employers will need to look at their existing arrangements for providing life cover only benefits for certain employees through the occupational pension scheme and consider setting up a life cover only arrangement for such employees.

The provisions about overseas schemes are designed to tie in with the European Pensions Directive and are unlikely to be of any great significance to the majority of schemes and employers.

The provisions about trustee indemnities are very similar to existing provisions in the Pensions Act 1995, except that they now also cover trustees of personal pension schemes.

## 12. Pension protection on transfer of employment under TUPE

### Sections 257-258 Pensions Act

#### 12.1 Background

There have been criticisms of the exclusion of pensions from the automatic transfer of employment rights on the transfer of a business since the requirements were first implemented. The reason for their exclusion is that the current UK requirements in the Transfer of Undertakings (Protection of Employment) Regulations 1981 ("TUPE") implement the European Acquired Rights Directive. When the Acquired Rights Directive was drafted, the member states found it impossible to come up with a coherent, community-wide way of dealing with pension rights and therefore excluded them. Whilst understandable, this treatment of pensions is anomalous given that pensions are regarded as pay for the purposes of European law and therefore ought in theory to be treated in a manner consistent with other rights to remuneration.

In its June 2003 paper, Action on Occupational Pensions, the Government said that it was proposing to amend the pension provisions in TUPE with the aim of ensuring that *"workers who already enjoy pensions contributions will not have them withdrawn by reason of a transfer, or because a company is taken over. In achieving this we want to make sure that we do not place an excessive burden on the new employer"*.

#### 12.2 Conditions for pension protection

##### 12.2.1 Act

The protection is available where there is a transfer of an undertaking (essentially, the transfer of a business or separately identifiable part of a business) and the employees become employed by the new owners of the business. In addition, to qualify:

- the employees must have been active members of the former employer's pension arrangements at the date of transfer, or
- eligible or would have become eligible to join the former employer's scheme, and
- if the former employer's scheme was a money purchase scheme, there must have been a requirement for employer contributions to have been made or, if there was no such requirement, at least one such contribution was actually made by the former employer.

(Section 257)

##### 12.2.2 Regulations

These provisions supplement the existing TUPE Regulations.

##### 12.2.3 Codes of Practice

None currently.

## 12.3 Form of protection

### 12.3.1 Act

The Act provides for several alternative forms of protection. The new employer must do one of the following for the relevant transferring employees:

- ensure they can join a final salary scheme in which the benefits are at least at the level of the reference scheme test for contracting out purposes (see Section 12A Pension Schemes Act 1993) or which complies with any requirements provided by Regulations, (see 12.3.2 below),
- ensure they can join a money purchase scheme to which the employer contributes at a minimum level (see 12.3.2 below), or
- make minimum contributions to a stakeholder scheme (see 12.3.2 below).

(Section 258)

### 12.3.2 Regulations

The Transfer of Employment (Pension Protection) Regulations 2005 provide that a final salary scheme will also be satisfactory for the transferred employees if (i) the value of benefits provided by it are at least 6% of pensionable pay for each year of employment in addition to any contributions made by the member (which must not in any event exceed 6%) or (ii) the employer matches employee contributions of up to 6% of basic pay.

Such employer matching up to 6% basic pay is also the minimum requirement for money purchase and stakeholder schemes.

### 12.3.3 Codes of Practice

None currently.

## 12.4 Timetable

These provisions came into force on 6 April 2005.

## 12.5 Comment

There had been some concern that providing protection for pension rights on business transfers could prove a major problem for acquisitive employers and lead to a proliferation of pension arrangements. However, the new legislation does not require the new employer to provide identical pension arrangements to the old employer and indeed gives the new employer considerable latitude.

## 13. Consultation by employers

### Sections 259-261 Pensions Act

#### 13.1 Background

In its December 2002 Green Paper, *Simplicity, Security and Choice*, the Government said *"It is good practice for employers to consult their employees or employee representatives, or both, before making changes to pension arrangements. It does not seem unreasonable for employees to be given the opportunity to feed in their views before employers make decisions of this importance. However, not all employers follow this good practice. We are therefore considering a requirement on employers to consult their employees or employee representatives, or both, before making changes to pension schemes."*

#### 13.2 Consultation by employers: occupational pension schemes

##### 13.2.1 Act

The Act provides that regulations may require employers who *"propose to make a prescribed decision"* about a scheme to consult specified people. (Section 259)

If the trustees are proposing to make similar decisions they may be required to notify the employer and prevented from proceeding until the employer has carried out the necessary consultation. However, the validity of any decision made about an occupational pension scheme may not be affected by any failure to comply. (Section 259)

Regulations may deal with time limits for consultation, information to be provided, employee representation and require or authorise the holding of ballots. (Section 261)

The requirements only apply where the employer has a minimum number of employees (see 13.4 below).

##### 13.2.2 Regulations

The Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006 set out the scheme changes caught by this requirement. They are:

- increasing normal retirement age
- closing to new members
- stopping accrual of all benefits
- removing an employer's liability to make contributions
- introducing member contributions or increasing them
- changing final salary benefits to money purchase benefits
- reducing the rate of final salary *future* accrual
- reducing any other future accruals in a final salary scheme

- ▶ reducing employer contributions for money purchase benefits.

Employers must allow at least 2 months for consultation after publishing proposals. The Regulations set out the information to include in consultation and who must be consulted. The employer must consider any responses it receives before any decision is made.

#### 13.2.3 Codes of Practice

None currently.

### 13.3 Consultation by employers: personal pension schemes

#### 13.3.1 Act

Regulations may require employers who “*propose to make a prescribed decision*” about direct payment arrangements to a personal pension scheme to consult specified people. However, the validity of any decision made may not be affected by any failure to comply. (Section 260)

Regulations may deal with time limits for consultation, information to be provided, employee representation and require or authorise the holding of ballots. (Section 261)

#### 13.3.2 Regulations

The Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006 set out the scheme changes caught by this requirement. They include:

- ▶ ceasing any employer contributions towards the scheme
- ▶ reducing employer contributions
- ▶ increasing member contributions.

#### 13.3.3 Codes of Practice

None currently.

### 13.4 Timetable

These provisions come into effect in three phases. Employers with at least 150 employees were covered from 6 April 2006, then the threshold dropped to 100 employees a year later, and finally dropped to 50 employees on 6 April 2008. The manner in which the number of employees is to be calculated for these purposes is set out in the Information and Consultation of Employees Regulations 2004.

### 13.5 Comment

These are important changes and put more practical obstacles in the way of scheme changes. However, it should be borne in mind that these are consultation requirements, not consent requirements, although objections raised by members during consultation may make it harder in practice for employers and/or trustees to implement scheme changes.

## 14. Modification of pension rights

### Section 262 Pensions Act

#### 14.1 Background

The modification of rights under occupational pension schemes was made the subject of legislation in Section 67 Pensions Act 1995. However, Section 67 proved difficult to operate in practice and in its June 2003 Paper, Action on Occupational Pensions, the Government said *"We will amend the restriction in Section 67 of the Pensions Act 1995 which heavily restricts schemes' ability to change any member's accrued rights without the member's consent"*.

It was the Government's intention that changes to Section 67 will *"provide schemes with the freedom to adapt to changing circumstances, while continuing to provide security for their members. In particular, they will allow schemes to avoid escalating funding costs in the future, if the assumptions underlying the scheme change over time. They provide that the actuarial value of members' accrued rights must be maintained at the point of any change, which is an important safeguard that was widely endorsed in the responses received"*.

#### 14.2 Subsisting rights

##### 14.2.1 Act

The original Section 67 of the Pensions Act 1995 has been replaced with a new provision which provides that where a modification is being made to a scheme (other than a public service or prescribed scheme) which might result in:

- a member's (or their survivors') subsisting rights under the scheme becoming money purchase benefits, or
- a reduction in the prevailing rate of pensions in payment under the scheme rules

the trustees must give the affected member a written explanation of the proposed modification and its effect on him, tell him he is entitled to make representations and give him a reasonable opportunity to do so and get his written consent to the modification.

"Subsisting rights" are defined as accrued rights to future benefits under the scheme or any other entitlement at the relevant time to benefits under the scheme rules (and in the case of active members they are determined as if they had just left service at the relevant time).

In the case of any other modification which might detrimentally affect a member's or their survivors' subsisting rights, either the member's consent must be obtained as described above or the trustees must satisfy the following requirements:

- give the member written notification explaining the modification and its effect on him and allow him to make representations

- take steps to satisfy themselves that the actuarial value of the member's benefits after the modification will be equal to or greater than the value of their subsisting rights immediately before it
- within a reasonable period from the modification taking effect, obtain a statement from the scheme actuary that the actuarial value of the member's subsisting rights has been maintained.

After complying with the above requirements, trustee consent to the modification is also required (even where the scheme rules give the amendment power solely to the employer). The trustees must also notify all affected members that they intend to exercise their powers to make the modification.

(Section 262)

It is important to note that any restrictions on scheme changes contained in the scheme's amendment rule must still be considered.

### 14.2.2 Regulations

The Occupational Pension Schemes (Modification of Subsisting Rights) Regulations 2006 set out certain schemes and amendments which are exempt from these requirements. They also set out how the actuarial value of members' subsisting rights is to be determined (which is on a 'cash equivalent' basis).

### 14.2.3 Codes of Practice and Guidance

Code of Practice No. 10, which came into force on 24 January 2007, deals with the modification of subsisting rights.

Where member consent is required to a proposed modification, it must be informed consent. The trustees must ensure that the member has been provided with adequate information which clearly explains the nature and effect of the proposed modification. Affected members should also be told, amongst other things, if it is intended that a proposed modification will be made in respect of members who consent to it even if some do not, so those members who consent may be worse off than those who do not. Trustees should also consider whether it would be cost effective to provide affected members with named contacts that they could discuss a proposed modification with. The Code suggests that a reasonable period for implementing amendments after consent has been obtained would be 7 months.

Where members may make representations, they must be given details of how to do so and a reasonable amount of time to act. The Code suggests that 4 weeks might be a reasonable period. Trustees must consider representations properly and allow themselves sufficient time, where needed, to seek advice on issues raised or discuss them with the employer.

Where an amendment is being made on the basis that the actuarial value of members' benefits will not be reduced, it is suggested that an actuary's certificate will need to be obtained within 1 month after the effective date of the amendment.

Where trustees have decided to make an amendment covered by these provisions, they must notify affected members and the Code suggests that this should be given at least 1 month before the amendment takes effect.

Guidance for actuaries giving actuarial equivalence statements contained in Actuarial Guidance Note GN51.

### 14.3 Powers of the Regulator

#### 14.3.1 Act

Any exercise of an amendment power which does not comply with the requirements discussed above is voidable at the direction of the Regulator.

Where the Regulator believes that a modification will be made in breach of the amended requirements of Section 67, it can make a direction that the modification powers should not be exercised or require the trustees to take specified action.

(Section 262)

#### 14.3.2 Regulations

None currently.

#### 14.3.3 Codes of Practice

A Code of Practice has been issued on modification of subsisting rights (see 14.2.3 above).

### 14.4 Timetable

These requirements came into force on 6 April 2006.

### 14.5 Comment

The amendments to Section 67 were one of the changes aimed at simplification of the existing regulatory regime. It is difficult to see how these new provisions (which run to ten pages compared to one page in the former version of Section 67) achieve that aim, at least in statutory complexity terms. However, they do give more scope than under the old regime to change a member's package of accrued benefits without his consent provided that actuarial equivalence is maintained.

## 15. Early leavers

### Sections 263-264 Pensions Act

#### 15.1 Background

There are two quite separate reforms relating to early leavers, driven by two very different aims. The first reform increases the latest age at which short service benefits (a deferred member's benefit entitlement under the scheme) must be payable, from 60 to 65. This is, according to the Government *"in line with the general public policy of extending working life and raising the public service pension age in respect of future service"*.

The second reform deals with when early leavers become entitled to more than just a refund of contributions under their scheme. At present, employees who leave a scheme within 2 years only have a statutory entitlement to a refund of their own contributions. In its June 2003 Paper, Action on Occupational Pensions, the Government said that

*"It is important to enable more employees, and particularly those who change jobs frequently, to have the opportunity to start to build up a private pension when they leave an employment before their rights have vested in an occupational pension scheme. We will therefore introduce an alternative approach under which employees who have been scheme members for at least three months but who leave during a vesting period, must be offered the choice of a refund of contributions, less tax, or a Cash Equivalent Transfer Value (CETV) which they must transfer out of the scheme to another occupational scheme or personal/stakeholder pension of their choice. Opting for the latter will allow individuals to benefit from their employer's contribution and tax relief in order to build up their own pension savings"*.

The Act now deals with this proposal.

#### 15.2 Increase in latest age at which short service benefit must be payable

##### 15.2.1 Act

The legislative provisions dealing with short service benefits (i.e. deferred benefits) are in the Pension Schemes Act 1993. Section 71 Pension Schemes Act 1993 provided that where a scheme's normal pension age (the earliest age at which members have a right to take their pension unreduced) was less than 60, short service benefits were payable no later than age 60. This was aimed at a small number of schemes which anticipate retirement before age 60 because of the nature of the work (e.g. firemen and the police). The Act amended this provision on the basis that if a person was for example a fireman for only a few years early on in their career, there is no reason why the pension in respect of that service should have to be paid by 60 as opposed to 65.

The new Section amends Section 71(3) Pension Schemes Act 1993 to change the latest age from which a deferred pension is payable in schemes with an early normal pension age. The age is increased to 65. According to the Government, the change *"does not touch past rights"*. (Section 263)

##### 15.2.2 Regulations

None currently

### 15.2.3 Codes of Practice

None currently.

## 15.3 Transfers and refunds of contributions

### 15.3.1 Act

New Sections 101AA to 101AI have been inserted into the Pension Schemes Act 1993. These provisions give members who leave after 3 months' pensionable service, but before becoming entitled to vested benefits in the scheme, a right to a transfer payment or a refund of their own contributions. However, the new Sections do not provide a member with less than 2 years' service with a preserved pension entitlement under the scheme.

Once a member has left the scheme, the trustees must, within a reasonable period, give them written information setting out:

- the amount of the cash transfer sum
- how it may be used
- the amount of the contribution refund
- the date by which the member must notify the trustees of his choice, and
- other information required by Regulations (see 15.3.2 below)

If a member requests a transfer, the trustees must take whatever steps are needed to comply with the member's request within a reasonable period. If the member fails to notify the trustees of his choice, the trustees may refund his contributions.

(Section 264)

### 15.3.2 Regulations

The Occupational Pension Schemes (Early Leavers: Cash Transfer Sums and Contribution Refunds) Regulations 2006 provide that the calculation of cash transfer sums should be done on the same basis as the calculation of cash equivalent transfer values and make similar provisions about when they can be reduced or increased. They also deal with information to be given to members.

It is also worth noting that if a member is leaving a scheme which is already in wind up, they will not be entitled to a transfer payment under these provisions, only a refund of their own contributions as a result of Regulation 5 of the Occupational Pension Schemes (Winding up) Regulations 2005.

### 15.3.3 Codes of Practice

Code of Practice No. 4 "Early Leavers – Reasonable Periods" (which came into force on 30 May 2006) looks at what "reasonable periods" might be for these purposes. The Code suggests that as soon as possible and in any event within 3 months from the date of leaving would be a reasonable period for trustees to give members the required information. A reasonable date for the member to respond would be within 3 months of the trustees providing the required

information to them. Trustees are then expected to action the member's request as soon as possible which should normally be within 3 months of the member making the election.

#### **15.4 Timetable**

The provisions on the latest age when deferred benefits must be drawn in schemes with a normal pension age of less than 60 came into force on 6 April 2005.

The provisions on transfers and refunds of contributions came into force on 6 April 2006.

#### **15.5 Comment**

Given the Government's obvious aim to prolong working life, this first amendment does not come as a surprise.

The second amendment may represent an additional cost for those schemes (which are in the majority) who currently only provide a refund of member contributions to those with less than 2 years' pensionable service. However, it is a cost which the scheme will usually already be funded actuarially to meet. Happily, the Government is not requiring schemes to retain the benefits of members with less than 2 years' service as deferred pensions, as many argued that the cost of administering such small pensions would outweigh the benefits to the members.

## 16. Paternity and adoption leave

### Section 265 Pensions Act

#### 16.1 Background

These provisions are aimed at bringing paid paternity and adoption leave into line with the legislation on paid maternity leave, which requires employer contributions during periods of paid maternity leave to be made as if the woman were working normally.

#### 16.2 Paternity and adoption leave provisions

##### 16.2.1 Act

New provisions have been inserted into Schedule 5, Social Security Act 1989 which provide that for any period of paternity or adoption leave during which an employee receives contractual remuneration or statutory paternity or adoption pay, a member of an occupational pension scheme must be treated no less favourably than he would have been if he was working normally. However, the member can only be required to pay contributions based on the remuneration he actually receives. (Section 265)

##### 16.2.2 Regulations

The provisions governing paternity and adoption leave are largely set out in the Paternity and Adoption Leave Regulations 2002.

##### 16.2.3 Codes of Practice

None currently.

#### 16.3 Timetable

Section 265 came into force on 6 April 2005.

#### 16.4 Comment

It is worth noting that these provisions track the wording that currently applies for maternity leave and apply to "*employment-related benefit schemes*". This is defined in the Social Security Act 1989 as schemes which provide service related benefits. There has been some discussion about the extent to which this applies to money purchase schemes.

## 17. Inalienability of occupational pensions

### Section 266 Pensions Act

#### 17.1 Background

Section 91 Pensions Act 1995 sets out the general principle that an entitlement to benefits under an occupational pension scheme cannot be assigned, commuted, surrendered or charged and no lien or set-off can be exercised in respect of it. Any agreement to do any of these things is unenforceable.

There were already exceptions to this general rule such as an assignment in favour of spouses, commutation on grounds of serious ill-health, surrendering benefits for further entitlements under the scheme and liens or set-offs to discharge debts arising out of a member's fraudulent, negligent or criminal acts. This amendment adds a further exception to the general rule.

#### 17.2 Amendments to Section 91 Pensions Act 1995

##### 17.2.1 Act

Charges, liens or set-offs can be exercised against a member's benefits to recover overpayments made to the member from the scheme. (Section 266)

##### 17.2.2 Regulations

Additional provisions in relation to Section 91 Pensions Act 1995 are currently contained in the Occupational Pension Schemes (Assignment, Forfeiture and Bankruptcy etc.) Regulations 1997. These Regulations have been amended by the Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2006 which add to the circumstances when an occupational pension may be commuted (provided this satisfies requirements in the Finance Act 2004).

Modifications to section 91 are also contained in the Occupational Pension Schemes (Cross-border Activities) Regulations 2005.

##### 17.2.3 Codes of Practice

None currently.

#### 17.3 Timetable

Section 266 came into force on 6 April 2005.

#### 17.4 Comment

It is a logical solution for trustees to recover overpayments from further payments to the member and this change is intended to remove any concerns trustees may have had under the existing Section 91 that such recovery would be prohibited. However, trustees exercising this right should be aware that members need to be provided with a certificate showing "*the amount of the charge, lien or set-off and its effect on his benefits under the scheme*". If the member disputes the amount, the "*charge, lien or set-off must not be exercised unless the obligation in question has become enforceable under an order of a competent court*". Therefore, the new provision may not be as helpful as it at first appears.

## 18. Voluntary contributions (AVCs)

### Section 267 Pensions Act

#### 18.1 Background

In its June 2003 paper, Action on Occupational Pensions, the Government said "*The Pickering report proposed that occupational schemes should be able to choose whether to offer members a facility to make Additional Voluntary Contributions (AVCs). We propose to simplify the tax rules to enable us to implement this. Many schemes will continue to offer AVC arrangements voluntarily but, where they do not, members will have the flexibility to make their own arrangements for additional contributions through a personal or stakeholder pension*".

#### 18.2 Obligation to provide AVC facilities removed

##### 18.2.1 Act

Section 111 Pension Schemes Act 1993 which requires schemes to allow members to make AVCs has been repealed and additional consequential amendments made. (Section 267)

##### 18.2.2 Regulations

None currently.

##### 18.2.3 Codes of Practice

None currently.

#### 18.3 Timetable

This provision came into force on 6 April 2006.

#### 18.4 Comment

The Government promised that they would make this amendment in the interests of flexibility. However, as most AVC arrangements are defined contribution rather than defined benefit, they do not usually have a cost for employers, and so it is difficult to see that this change achieves anything of great importance. The change does not mean that existing AVC funds/rights go away.

## 19. Payments made to schemes by employers and members

### Sections 268-269 Pensions Act

#### 19.1 Background

In its 1999 consultation paper, Strengthening the Pensions Framework, the Government said *"It is important that people who save for their retirement have contributions paid into their scheme as soon as possible. This is especially important in money purchase arrangements where contributions need to be invested to start to build up the fund. Scheme members can suffer a loss if employers pay contributions late or, even worse, fail to pay them at all. Members of occupational pension schemes already have protection in this respect. Members of personal and stakeholder pensions also need that protection"*.

This resulted in Section 111A being inserted into the Pension Schemes Act 1993 which provides for monitoring employer contributions to personal pension schemes to ensure that they are paid by their due date. If payments were not made by their due dates, reports had to be made to Opra and the member had to be told. There are similar provisions in place for occupational pension schemes in Section 49 Pensions Act 1995 (for contributions deducted from employees' earnings) and Section 88 Pensions Act 1995 (for contributions to money purchase schemes).

In practice, Opra found itself inundated with reports of late payment and found the volume difficult to deal with.

#### 19.2 Payments by employers to personal pension schemes

##### 19.2.1 Act

Section 111A Pension Schemes Act 1993 has been amended so that there is no longer an automatic duty for trustees to notify the Regulator and the members if employer contributions are not paid on time. Notification need only be given if *"the failure to pay the contributions is likely to be of 'material significance' in the exercise by the Regulatory Authority of any of their functions"*. There is no longer any obligation on the employer to maintain a record of payments, although in practice it would still need to maintain some records as the trustees can demand payment information and if the employer does not comply within a reasonable time, the trustees will need to notify the Regulator. (Section 268)

##### 19.2.2 Regulations

The Personal Pension Schemes (Payments by Employers) Regulations 2000 which relate to Section 111A, have been amended by the Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2006 to delete the requirements about record keeping and introduce new requirements about issuing payment statements to employees.

##### 19.2.3 Codes of Practice

Code of Practice No. 6 (which came into force on 30 May 2006) looks at reporting late payment of contributions to personal pension schemes. The Code says that a reasonable period for employers to provide payment information to trustees or managers would be 30 days and if such information is not provided, a

reasonable period for reporting this to the Regulator would be 60 days from the original request.

When trustees or managers are deciding whether to report late payment of contributions they should use their judgement. Circumstances which are likely to be of material significance and require reports to be made include cases where:

- there has been dishonesty or a misuse of assets
- contributions remain unpaid after 90 days (other than as a result of an isolated administrative error which is corrected as soon as possible)
- failure to pay contributions carries a criminal penalty
- where there are inadequate procedures in place to ensure correct and timely payment of contributions
- where there is no early prospect of outstanding contributions being paid.

## 19.3 Payments by employers and members to occupational pension schemes

### 19.3.1 Act

Sections 49 and 88 Pensions Act 1995 have been amended so that there is no longer an automatic duty for trustees to notify the Regulator and members if contributions deducted from members' earnings or employer contributions to money purchase schemes are not paid by their due date. Notification need only be given if "*the failure to pay the contributions is likely to be of material significance in the exercise by the Authority of any of their functions*". (Section 269)

### 19.3.2 Regulations

The Occupational Pension Schemes (Scheme Administration) Regulations 1996 which relate to Sections 49 and 88 Pensions Act 1995 have been amended by the Occupational Pension Schemes (Administration and Audited Accounts) (Amendment) Regulations 2005 to reflect the changes to these sections.

### 19.3.3 Codes of Practice

Code of Practice No. 5 (which came into force on 30 May 2006) looks at reporting late payment of contributions to occupational money purchase schemes and the Regulator has also published a briefing note on reporting late payment of contributions to occupational pension schemes which covers the position for defined benefit schemes until they become subject to the new scheme specific funding requirement (see Part 5 - Scheme Funding).

When trustees or managers are deciding whether to report late payment of contributions they should use their judgement. Circumstances which are likely to be of material significance and require reports to be made include cases where:

- there has been dishonesty or a misuse of assets
- contributions remain unpaid after 90 days (other than as a result of an isolated administrative error which is corrected as soon as possible)

- ▶ failure to pay contributions carries a criminal penalty
- ▶ where there are inadequate procedures in place to ensure correct and timely payment of contributions
- ▶ where there is no early prospect of outstanding contributions being paid.

A reasonable period to make a report to the Regulator will usually be within 10 working days of identifying that a late payment is material and a reasonable period to notify members will usually be within 30 days.

#### **19.4 Timetable**

These provisions came into force on 6 April 2006.

#### **19.5 Comment**

This is statutory recognition of the difficulties facing any regulator that receives large numbers of trivial reports and is consistent with a policy of having a regulator that will focus more on cases where there is a genuine risk to members.

## 20. Winding up

### Section 270 Pensions Act

#### 20.1 Background

Section 73 of the Pensions Act 1995 and related Regulations provided for a priority order of benefits to be secured on the winding up of final salary schemes. The priority order was:

- ✔ benefits from additional voluntary contributions (AVCs)
- ✔ benefits covered by insurance contracts taken out before 6 April 1997 which cannot be surrendered
- ✔ pensions in payment (excluding increases)
- ✔ pensions for other members (again excluding all pension increases) and refunds of contributions for those with less than two years' service
- ✔ increases to pensions in payment
- ✔ increases to pensions not in payment.

The Act has amended this order in recognition of the introduction of the Pension Protection Fund (PPF).

#### 20.2 Amendments to Section 73 Pensions Act 1995

##### 20.2.1 Act

Under the revised Section 73, final salary scheme assets must be used to meet benefits in the following order:

- ✔ benefits covered by insurance contracts taken out before 6 April 1997 which cannot be surrendered
- ✔ all other benefits up to the corresponding PPF liabilities
- ✔ benefits from AVCs
- ✔ all other benefits under the scheme.

Any money purchase benefits are treated entirely separately. One of the effects of this is that AVCs paid on a money purchase basis have effective priority. However, AVCs that have been used to secure extra final salary benefits e.g. added years, will lose their priority and instead come below any benefits that would be secured up to the PPF level.

During a winding up, the trustees must only pay benefits that are reduced to reflect the liabilities in accordance with this Section 73 priority order. They can take steps to recover any overpayments (or indeed any shortfall) e.g. by adjusting future pension payments.

No benefits (other than investment growth on money purchase assets) can accrue under the scheme during a wind up.

Consequential amendments are also made to Section 74 of the Pensions Act 1995, which gives trustees statutory powers for securing benefits on winding up. A further method of securing benefits on winding up is added and that is the payment of a cash sum in circumstances to be prescribed (this echoes a similar possibility for the Board of the PPF).

## 20.2.2 Regulations

The Occupational Pension Schemes (Winding up etc) Regulations 2005 set out how the scheme's assets and liabilities are to be determined and how certain benefits are to be treated. They also exempt certain schemes from these requirements.

The Occupational Pension Schemes (Winding Up) (Modification for Multi-employer Schemes and Miscellaneous Amendments) Regulations 2005 provide that:

- where a post-April 2005 insolvency event occurs
- with an employer in a multi-employer scheme
- that has no partial wind up rule and
- the trustees have determined in the previous 3 months that it is probable that the scheme will enter a PPF assessment period in the next 12 months,

the trustees may pay full PPF level benefits to members during the winding up (rather than being obliged to pay reduced benefits to members according to the Section 73 winding up priorities).

If the trustees no longer anticipate that the scheme will enter an assessment period, they can recover any excessive payments that were made.

## 20.2.3 Codes of practice

None currently.

## 20.3 Timetable

These provisions came into force on 6 April 2005.

## 20.4 Comment

The previous statutory winding up provisions inevitably needed to be amended with the introduction of the PPF. However, the relegation of priority for non-money purchase AVCs has caused some controversy. It means that individuals who were previously pretty much guaranteed that the benefits they earned by their own contributions would be fully secured now no longer have that protection if the scheme's assets are insufficient to cover PPF benefits.

The relative benefit security position on winding up for schemes considering a merger with another scheme is always an important factor and these changes could make it

harder for some schemes to merge. For example, where an executive scheme is in PPF surplus, but would merge into a staff scheme and end up with an overall PPF deficit. Conversely, some mergers may be made easier where both schemes are in PPF deficit.

## 21. Scheme deficits and debt on the employer

### Sections 271-272 Pensions Act

#### 21.1 Background

Section 75 Pensions Act 1995 provides that where a final salary scheme is winding up with not enough assets to secure liabilities, the deficit is a debt payable by the employer to the trustees.

The amendments made by the Pensions Act 2004 largely deal with when the debt should be calculated in the light of the new insolvency provisions and the Pension Protection Fund (PPF) and allow greater flexibility in calculating the debt where an employer leaves a multi-employer scheme.

#### 21.2 Amendments to Section 75 Pensions Act 1995

##### 21.2.1 Act

Where the scheme is being wound up with a solvent employer (and the Board of the PPF has not been told the employer is unlikely to continue as a going concern), the trustees can determine when the assets and liabilities are valued for determining the debt due from the employer.

Where there is a deficit and a "relevant event" occurs (the employer becomes insolvent, enters members' voluntary winding-up i.e. a solvent liquidation or the Board of the PPF has been told that certain types of employer are unlikely to continue as a going concern), the debt is determined immediately before the relevant event.

Where the scheme was not being wound up and a relevant event occurs, the debt due is conditional upon:

- ▼ a notice being issued that a scheme rescue is not possible (under Section 122 or 130 as appropriate) which becomes binding, the employer not having gone into members' voluntary liquidation before the notice is issued and no "cessation event" having occurred (e.g. a subsequent notice that a scheme rescue has occurred or that no insolvency event is likely to occur), or
- ▼ the scheme starting winding up before:
  - (a) a notice is issued that a scheme rescue is not possible,
  - (b) the employer's insolvency practitioner issues a notice that a scheme rescue has occurred, or a rescue is not possible, or the insolvency practitioner says that he is unable to confirm the status of the scheme and that notice becomes binding,
  - (c) where the relevant event is a notice under Section 129 that the employer is unlikely to continue as a going concern (relevant only to certain types of employer), the Board of the PPF confirms that a scheme rescue has occurred, or

(d) the employer has entered member's voluntary winding up.

(Section 271)

### 21.2.2 Regulations

The Occupational Pension Schemes (Employer Debt Regulations) 2005 (as amended by the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2008) deal with the valuation of scheme assets and liabilities for schemes not in wind-up before 6 April 2005. They also deal with certain debts owed by money purchase scheme employers. The 2008 amending regulations provide that when valuing a scheme's assets and liabilities to determine the amount of any debt, money purchase assets and liabilities are to be disregarded. Where the only liabilities in relation to a particular employer are money purchase, the debt provisions will not apply to that employer.

### 21.2.3 Codes of Practice

None currently.

## 21.3 Multi-employer schemes

### 21.3.1 Act

A new Section 75A has been introduced to the Pensions Act 1995 to allow greater flexibility in calculating the Section 75 debt where an employer leaves a multi-employer scheme. According to the Government, this is designed (in tandem with Sections 38-42 – see 2.6 above) *"to avoid situations where, whether by chance or design, withdrawal from multi-employer arrangements leaves pension liabilities situated in a company which is substantially weaker than the rest/other parts of the group"*. (Section 272)

### 21.3.2 Regulations

The Occupational Pension Schemes (Employer Debt Regulations) 2005 (as amended by the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2008) make certain provisions for calculating debts in multi-employer schemes.

The key proposals are as follows:

- An employer will be treated as ceasing to participate in a multi-employer scheme when it ceases to have active members. There is a 12 month period of grace if the employer notifies the trustees that it intends to have active members again within that period.
- The debt due from a leaving employer will be based on its share of the liabilities, unless one of the alternatives set out below applies. Liabilities attributable to each employer are determined by reference to pensionable service with that employer. If a member has had pensionable service with several employers and it is not possible to attribute pensionable service to each employer or a "disproportionate cost" would be incurred in doing so, it will be attributed to the last employer. If it is not possible to ascertain the last employer then it will be treated as orphan liabilities.

- The proposed alternative ways of dealing with a leaving employer's liabilities are as follows:
- (a) **Scheme Apportionment Arrangements:** allow for arrangements which specify the amount to be paid by a leaving employer and apportion the balance of what would otherwise have been payable to some or all of the remaining employers. Such arrangements must be permitted under the scheme rules and be agreed to by the trustees. The scheme must also meet a funding test which means that the trustees must be reasonably satisfied that (a) the remaining employers will be reasonably likely to be able to fund the scheme, and (b) the effect of the arrangement will not be to adversely affect the security of members' benefits.
  - (b) **Regulated Apportionment Arrangements:** require the approval of the PPF and the Regulator and are intended to be rare. The Regulator may approve such an arrangement if it thinks that it will result in better funding for the scheme than if an employer insolvency event occurred in relation to one of the employers. The scheme must also be likely to enter a PPF assessment period in the next 12 months. Again, such arrangements must be permitted under the scheme rules, but there is no requirement for the scheme to meet a funding test.
  - (c) **Withdrawal Arrangement:** allows the leaving employer to pay to the trustees at least its share of any shortfall calculated on the scheme-specific funding basis (as opposed to the buy-out basis). This payment can be made in instalments. Guarantors must agree to pay the balance of that employer's share of the buy-out debt when the scheme winds-up or ceases to have any solvent employers. Before entering into a cessation agreement, the trustees must be satisfied that (a) at the date of the agreement the guarantors have sufficient financial resources to be likely to be able to pay the amount due from them and (b) the remaining employers will be reasonably likely to be able to fund the scheme.
  - (d) **Approved Withdrawal Arrangements:** If the Regulator agrees, the leaving employer may pay a smaller amount than would be required under a withdrawal arrangement.

### 21.3.3 Codes of Practice and Guidance

The Regulator has issued Guidance on withdrawal arrangements in multi-employer schemes. The Guidance looks at the process for applying for a withdrawal arrangement, the factors the Regulator will take into account when considering whether to approve it and what the parties to a withdrawal arrangement should take into account when negotiating it. The Regulator is also considering additional guidance on the other alternative ways of dealing with employer debts.

#### **21.4 Timetable**

The provisions in the Act came into force on 6 April 2005. The amendments to the Employer Debt Regulations came into force on 6 April 2008, although there are transitional provisions which deal with apportionment arrangements and transactions which were already in contemplation.

#### **21.5 Comment**

The requirement for a solvent employer to meet buy-out costs if it chooses to wind up a scheme on or after 11 June 2003 was introduced under the Occupational Pension Schemes (Winding Up and Deficiency on Winding Up etc) Amendment Regulations 2004, which came into force on 15 March 2004.

The provisions for multi-employer schemes are a further way of minimising claims on the PPF by ensuring that where there are financially healthy group companies, they bear the cost of pension liabilities as far as possible. This approach must be taken account of not only in corporate transactions such as a sale of a group company, but also where internal restructuring is taking place within a group e.g. employees all leaving one employer.

## 22. Internal Dispute Resolution

### Section 273 Pensions Act

#### 22.1 Background

The requirement for schemes to have an internal dispute resolution (“IDR”) procedure for disputes between beneficiaries and trustees was introduced in 1997 by the Pensions Act 1995. Schemes had to have a two stage IDR procedure, the second stage being a determination by the trustees themselves. Regulations set out detailed requirements on how the IDR procedure must be operated.

In the various consultation papers leading up to the Act, views were expressed (most notably by the Pensions Ombudsman) that the existing process was too restrictive, complicated and did not allow schemes to adapt the process to be more manageable for the particular scheme concerned. The Government endorsed these views and acknowledged that the existing requirements needed to be simplified.

Further changes were made to the internal dispute resolution provisions in the Pensions Act 2007.

#### 22.2 Internal dispute resolution procedure

##### 22.2.1 Act

The existing provisions in the Pensions Act 1995 are amended. Trustees must still have an IDR procedure, but it will differ from the current requirements in the following ways:

- it does not need two stages, although trustees may still have a second stage if they want to
- trustees must still ultimately make a decision about the dispute
- non-dependent beneficiaries potentially entitled to death benefits can now use IDR
- there are no longer detailed requirements on time limits for reaching and notifying decisions, although the trustees must do so within a reasonable time and a Code of Practice sets out what this means.

The procedure must include details about how an individual can apply for the IDR procedure, what needs to be included in their application and how decisions are to be reached and given to the applicant.

(Section 273 as amended by section 16 Pensions Act 2007).

##### 22.2.2 Regulations

The Occupational Pension Schemes (Internal Dispute Resolutions Procedure and Consequential Miscellaneous Amendments) Regulations 2008 set out the content of the notice that trustees must issue to members when they reach their decision, a number of exemptions to the types of schemes and disputes covered by the requirements and transitional provisions for disputes underway when the Regulations came into force

### 22.2.3 Codes of Practice

The Regulator has published Code of Practice No.11, Dispute Resolution – Reasonable Periods. The Code says that the Regulator expects that disputes will be decided, and the applicant notified of the decision, within 4 months of receiving the application (where a scheme has retained a 2 stage procedure, 4 months will be allowed for each stage). In any event, applicants should be notified of the decision usually no later than 15 working days after a decision has been made. Applications to use the procedure must generally be made within 6 months of ceasing to have an interest in the scheme (although trustees may accept complaints made out of time).

### 22.3 Timetable

These provisions came into force on 6 April 2008.

### 22.4 Comment

Trustees need to review their existing procedures. Many schemes may choose to drop the formal stage one decision, which should accelerate the conclusion of some disputes. If trustees do decide to make changes to their IDR procedure, they will need to consider the extent to which the changes need to be notified to members as information in relation to the IDR procedure forms part of the basic scheme information which members are entitled to under pensions legislation.

## 23. Pensions Ombudsman

### Sections 274-276 Pensions Act

#### 23.1 Background

Some parts of the Child Support, Pensions and Social Security Act 2000 potentially extended the Pensions Ombudsman's powers and jurisdiction but were not brought into force pending the outcome of the simplification review and it now seems they never will be.

Instead, a small number of new provisions have been introduced in relation to the Pensions Ombudsman, in particular to help him deal with his ever increasing workload. The changes are much more limited than those mooted in the Government's consultation exercise on the matter.

#### 23.2 Deputy Ombudsmen

##### 23.2.1 Act

The Pension Schemes Act 1993 has been amended to allow any number of Deputy Ombudsmen to be appointed on terms determined by the Secretary of State. A Deputy Ombudsman may perform the functions of the Pensions Ombudsman when the office is vacant, the Ombudsman is for some reason unable to discharge his functions or at any other time the Secretary of State agrees. A Deputy Ombudsman, Charles Gordon, has been appointed. (Section 274)

##### 23.2.2 Regulations

None currently.

##### 23.2.3 Codes of Practice

None currently.

#### 23.3 Jurisdiction

##### 23.3.1 Act

The Pensions Ombudsman has jurisdiction over complaints of maladministration relating to persons concerned with the administration of the scheme. There has been some argument in the courts over what constitutes an administrator for these purposes and the Act attempts to clarify (or, arguably, extend) the position. An administrator will now be defined as "*a person or body of persons ...responsible for carrying out an act of administration concerned with the scheme*". Therefore one-off acts of administration will definitely make someone an administrator. This amendment will only apply to matters occurring after it came into force (6 April 2005). (Section 275)

##### 23.3.2 Regulations

None currently.

##### 23.3.3 Codes of Practice

None currently.

## 23.4 Investigations

### 23.4.1 Act

Section 54 Child Support, Pensions and Social Security Act 2000 which would have allowed the Ombudsman to make determinations affecting scheme members as a whole through representation of interested classes has been repealed (without ever coming into force). (Section 276)

### 23.4.2 Regulations

None currently.

### 23.4.3 Codes of Practice

None currently.

## 23.5 Timetable

Section 274 came into force on 17 December 2004. Section 275 came into force on 6 April 2005.

## 23.6 Comment

The repeal of Section 54 Child Support, Pensions and Social Security Act 2000 means that we are still left with the position where the Pensions Ombudsman cannot, for example, make a determination about GMP equalisation without everyone (including scheme beneficiaries) who might be affected by that determination being consulted.

## 24. Pension increases

### Sections 278-280 Pensions Act

#### 24.1 Background

Prior to the Pensions Act 1995, there were no statutory requirements to increase pensions in payment other than for contracted-out benefits. The Pensions Act 1995 required pensions in respect of benefits earned on or after 6 April 1997 to be increased annually by RPI up to 5%.

In 2002 the Pickering Report on pensions simplification said that giving these pension increases was using a high percentage of overall contributions to pension schemes. It was suggested that regulation in this area might have become disproportionate and excessively prescriptive. However, the Government said that it still felt some form of indexation was desirable but accepted that the current level of compulsory inflation-proofing was excessive.

#### 24.2 Annual increase in rate of certain occupational pensions

##### 24.2.1 Act

No statutory increases are required for non-contracted out pensions relating to service before 6 April 1997, or in the case of money purchase schemes, contributions relating to service before 6 April 1997. This is the same as under the current provisions. However, for pensions in respect of service or contributions on or after 6 April 1997, the Act provides that pensions which relate to service/contributions:

- ▶ after 6 April 2005 must increase annually by at least RPI up to 2.5%, and
- ▶ between 6 April 1997 and 6 April 2005 must increase annually by at least RPI up to 5%.

Furthermore, the requirement for limited price indexation has been removed completely in respect of money purchase schemes where the pension comes into payment after 6 April 2005.

(Section 278)

##### 24.2.2 Regulations

The Personal and Occupational Pensions (Indexation and Disclosure of Information) (Amendment) Regulations 2005 provide that no indexation will be required for pre April 1997 protected rights. They also deal with the indexation of transfer payments.

##### 24.2.3 Codes of Practice

None currently.

**24.3 Annual increase in rate of certain personal pensions****24.3.1 Act**

Section 162 Pensions Act 1995 which makes similar increase provisions for the element of any personal pension arrangement derived from protected rights is amended to reflect the new provisions for money purchase occupational pension schemes. Therefore protected rights in personal pension schemes coming into payment after 6 April 2005 do not need to have limited price indexation. (Section 279)

**24.3.2 Regulations**

None currently.

**24.3.3 Codes of Practice**

None currently.

**24.4 Pension credits****24.4.1 Act**

The Welfare Reform and Pensions Act 1999 allows the Secretary of State to inflation-proof occupational pension benefits derived from pension sharing on divorce i.e. "pension credits". Previously annual increases could be required of RPI up to 5%. This has been amended to RPI up to 2.5% where the entitlement to the pension credit arises after 6 April 2005. Increases can continue to be required at RPI up to 5% in the case of pension credit benefits where the entitlement arose before that date. (Section 280)

**24.4.2 Regulations**

The Personal and Occupational Pensions (Indexation and Disclosure of Information) (Amendment) Regulations 2005 deal with indexation of pension credits.

**24.4.3 Codes of Practice**

None currently.

**24.5 Timetable**

Sections 278-280 came into force on 6 April 2005.

**24.6 Comment**

It must be appreciated that these provisions only *permit* final salary schemes to reduce the cap on inflation-proofing pensions in payment from 5% down to 2.5%. Therefore, where trustee consent is required to any relevant scheme amendments, trustees will need to consider the merits of any proposals from an employer to reduce the level of pension increases. The employer will also need to consult in advance with affected members (see Part 13 of this Guide).

The new provisions for money purchase schemes are, according to the Government, intended to *"help scheme members by giving them greater choice in the type of annuity that they will be able to purchase with their pension rights. The annuity choices that people make affect their income in retirement and therefore their quality of life. It will*

*therefore be crucial that those providing pensions ensure that people have the information they need to make a well informed choice".*

## 25. Revaluation

### Section 281 Pensions Act

#### 25.1 Background

Where a member has deferred benefits in a scheme, there are statutory provisions requiring the inflation-proofing or “revaluation” of those benefits before they come into payment. These provisions are in Section 84 and Schedule 3 Pension Schemes Act 1993 and are complex.

#### 25.2 Exemption from statutory revaluation requirement

##### 25.2.1 Act

Section 84 Pension Schemes Act 1993 has been amended to allow a scheme to satisfy the statutory revaluation requirements by revaluing the member’s benefits in line with RPI. (Section 281)

##### 25.2.2 Regulations

None currently.

##### 25.2.3 Codes of Practice

None currently.

#### 25.3 Timetable

These provisions came into force on 18 November 2004.

#### 25.4 Comment

This is a straightforward change.

It should be noted that there are provisions in the Pensions Bill 2008 which will allow schemes to cap revaluation at 2.5% in relation to benefits which are accrued after the new provision comes into force (and there is no date for this yet).

## 26. Contracting-out

### Sections 282-284 Pensions Act

#### 26.1 Background

Contracting-out is one of the most complex areas of pensions legislation and was certainly singled out as being in need of simplification in the responses to the Government's consultation papers.

The Government said that they would introduce a variety of measures to simplify contracting-out including, most importantly, simplifying the administration of Guaranteed Minimum Pensions (GMPs). However, the amendments in the Act only make fairly trivial changes.

#### 26.2 Meaning of "working life" in Pension Schemes Act 1993

##### 26.2.1 Act

"Working life" is a term used in relation to GMPs. The definition in Section 181 Pension Schemes Act 1993 provided that a person's working life is between the tax year when he reaches age 16 and the tax year before he reaches pensionable age. Pensionable age for this purpose is state pension age which is currently 65 for men and 60 for women, but will be gradually equalised at 65 between 2010 and 2020. However, as pensionable age for the purposes of GMPs will remain at 60 for women and 65 for men after 2010, the definition of working life has been amended to reflect this. (Section 282)

##### 26.2.2 Regulations

None currently.

##### 26.2.3 Codes of Practice

None currently.

#### 26.3 Power to prescribe conditions by reference to Revenue approval

##### 26.3.1 Act

The Pension Schemes Act 1993 sets out a variety of requirements for schemes to satisfy to be certified as contracted-out. A provision has been added to Section 9 Pension Schemes Act 1993 so that control over whether a scheme can contract-out can be linked to the scheme's tax status. (Section 283)

##### 26.3.2 Regulations

None currently.

##### 26.3.3 Codes of Practice

None currently.

## 26.4 Restrictions on commutation and age at which benefits may be received

### 26.4.1 Act

One of the Government's promised reforms on contracting-out was to "*relax some restrictions on contracted-out rights forming part of the tax-free lump sum permitted under Inland Revenue rules*".

Section 21 Pension Schemes Act 1993 only permitted commutation of contracted-out salary related benefits for triviality. This provision is amended to remove the restrictions on commutation of such rights (subject to the possibility of additional regulatory restrictions). However, where a spouse's pension becomes payable, any commutation will be ignored for the purposes of calculating their GMPs. (Section 284)

There are similar restrictions on taking protected rights as a lump sum and additional age related restrictions, although commutation may be permitted in some circumstances on grounds of serious ill-health. The restrictions are deleted, although as above, there is a possibility that additional restrictions may be added by Regulations. (Section 284)

### 26.4.2 Regulations

The Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2006 deal with commutation of contracted-out benefits.

### 26.4.3 Codes of Practice

None currently.

## 26.5 Timetable

Section 282 on the meaning of "working life" came into force on 6 April 2005. The commutation provisions came into force on 6 April 2006.

## 26.6 Comment

Whilst the reforms on commutation are welcome, these provisions fall a long way short of the radical overhaul of contracting-out that was hoped for, although some additional minor changes have been made in other legislation.

The Pensions Act 2007 contains provisions which will abolish defined contribution contracting-out and allow for the conversion of GMPs into other benefits, but these provisions are not intended to come into force before 2012.

## 27. Stakeholder pensions

### Section 285 Pensions Act

#### 27.1 Background

Stakeholder schemes were introduced from 1 October 2000 by the Welfare Reform and Pensions Act 1999. The intention was that they would encourage pension saving among those who did not have access to an occupational pension scheme by providing simple, easy to understand, low cost pensions.

#### 27.2 Meaning of stakeholder pension scheme

##### 27.2.1 Act

Section 1(5) Welfare Reform and Pensions Act 1999 limited the amount by which the value of members' rights under a stakeholder scheme can be reduced by administration expenses. This has been amended to clarify that the restriction applies equally to contributions made by third parties (such as a member's relatives) and employers.

Section 1 has also been amended to clarify that stakeholder schemes must be contracted-out to allow individual members the choice of whether to contract out.

##### 27.2.2 Regulations

The Stakeholder Pension Schemes (Amendment) Regulations 2005 make various changes to the existing stakeholder regime, including the introduction of a lifestyling requirement for members approaching retirement.

##### 27.2.3 Codes of Practice

None currently.

#### 27.3 Timetable

Section 285 came into force on 6 April 2005.

#### 27.4 Comment

These amendments are minor technical changes and of relatively little significance.

## 28. Financial assistance scheme

### Section 286 Pensions Act

#### 28.1 Background

In response to considerable pressure, the Government agreed to establish a financial assistance scheme to help those *“who were members of a defined benefit occupational pension scheme that is winding-up, underfunded to such an extent that the members will not have their accrued benefits secured”*.

Very few details on how these arrangements will work are contained in the Act. The Government initially said that it would make available a fund of £400 million spread over 20 years but announced in May 2006 that it was planning to extend this to over £2 billion and then further extended it to £8 billion and then to £11.9 billion

The Financial Assistance Scheme (FAS) has remained under review and in a state of flux from the outset as the Government continues to consider who it should actually cover. Further changes to the legislation to extend the coverage of the financial assistance scheme are due in 2008.

#### 28.2 Financial assistance scheme

##### 28.2.1 Act

A financial assistance scheme has been established which is available to make payments to those members who, at the relevant time:

- were members of the underfunded scheme, or
- had ceased to be members but lost benefits due to a deficit.

The scheme must be a “qualifying scheme” which means it must:

- not be a money purchase scheme, or a scheme of a prescribed description,
- have begun winding up in a prescribed period (between 1 January 1997 and 5 April 2005 in the Regulations – see 28.2.2 below) and the winding up may be complete, and
- the employer satisfies prescribed conditions.

The exact level of the payments to be made and the conditions for payment are left to Regulations (see 28.2.2 below).

Members cannot be means-tested for qualification for help under the scheme.

No levy or charge can be made on any party for funding the scheme, so Government funding must be relied on (despite earlier suggestions that “industry” may have to contribute to its cost).

##### 28.2.2 Regulations

The Financial Assistance Scheme Regulations 2005 (as amended by the Financial Assistance Scheme (Miscellaneous Amendments) Regulations 2006, The Financial

Assistance Scheme (Miscellaneous Amendments) Regulations 2007 and the Financial Assistance Scheme (Miscellaneous Provisions) Regulations 2008) provide that to be eligible, a scheme (a) must have commenced winding up between 1 January 1997 and 5 April 2005 and (b) the employer must be insolvent and in the opinion of the trustees that insolvency must be linked to the wind-up of the scheme (this is assumed for insolvencies that occur up to 1 January 2009) or, alternatively a compromise agreement is in place and enforcing the debt against the employer would have forced the employer into insolvency.

In September 2007, the Financial Assistance Scheme (Halting Annuitisation) Regulations 2007 were issued which prevented relevant schemes from purchasing annuities for a 9 month period while the Government considered the position.

The Government announced in December 2007 that the following extensions would be made to the FAS:

- members will be guaranteed 90% of accrued pension at the date their scheme began wind-up (subject to a cap of £26,000)
- assistance payments derived from pension accrued post-6 April 1997 will be increased each year in payment in line with inflation
- assistance will be paid from each failed scheme's normal retirement age, subject to a lower age limit of 60
- people who are unable to work due to ill health will also be able to apply for early access to payments from age 60
- members will be able to draw a tax-free lump sum, up to their full lump sum entitlement, if their share of scheme funds allows
- help will be extended to members of schemes wound up by qualifying solvent employers (it is not currently known exactly what this will cover but it may for example cover those schemes which were fully funded on the MFR basis but where there is a buy-out deficit which the employer is not willing to cover)

Regulations have been issued to implement most of these changes.

Further information on the operation of and applications to the FAS is set out in the Financial Assistance Scheme (Internal Review) Regulations 2005 and the Financial Assistance Scheme (Provision of Information and Administration of Payments) Regulations 2005.

### 28.2.3 Codes of Practice

None currently.

## 28.3 Timetable

The provisions in the Act came into force on 1 June 2005. Provisions extending the financial assistance scheme came into force on 4 June 2008.

**28.4 Comment**

The initial coverage of benefits by the FAS was limited and fell short of what many members and MPs expected following the Government's assurances in Parliamentary debates on the issue. As a result the Government has amended the several times and commissioned a review. It accepted the findings of the review and improved FAS as a result.

## 29. Cross-border schemes

### Sections 287-295 Pensions Act

#### 29.1 Background

One of the aims of the European Pensions Directive was to put in place a regulatory framework to enable an occupational pension scheme located in one state within the European Economic Area ("EEA") to accept contributions from an employer based in another.

#### 29.2 UK scheme receiving contributions from EEA employer

##### 29.2.1 Act

Before a UK scheme can begin to operate as a cross-border scheme, it must:

- be authorised by the Regulator to engage in such activity,
- have been approved by the Regulator to receive contributions in respect of a specific employer from a different EEA State, and
- have been notified by the Regulator of the social and labour law of the host EEA State (but if 2 months have elapsed since the Regulator notified the scheme that it is approved and this information has not been provided, this condition is satisfied in the absence of approval).

(Section 287)

The authorisation process is set out in Regulations. The Regulator has the power to refuse authorisation and, where necessary, to revoke an existing authorisation. (Section 288)

Once a scheme has received authorisation for cross-border activities, the trustees must notify the Regulator about the specific employer(s) they wish to receive contributions from and obtain the approval of the Regulator. The Regulator must forward the information to the appropriate regulatory authority in the employer's EEA State. (Section 289). That authority should then give the Regulator details of relevant "*social and labour law*" and the Regulator should pass this on to the trustees. Similarly, if changes to these details are received, the Regulator must pass these on as soon as reasonably practicable. (Section 290)

The trustees must ensure that, insofar as the scheme relates to members in another EEA State, it is operated in accordance with the social and labour laws of that EEA State. Failure to comply with this requirement can result in civil sanctions. (Section 291)

The Regulator may (in circumstances set out in Regulations,) give notice to the trustees requiring them to ring-fence some or all of the relevant assets or liabilities. Failure to comply with such a notice can result in civil sanctions. (Section 292)

##### 29.2.2 Regulations

The Occupational Pension Schemes (Cross-border Activities) Regulations 2005 have been published. The Regulations set out the funding levels required for

schemes applying for authorisation in relation to cross-border activities and deal with other conditions for authorisation and the authorisation process. They also contain various amendments to other legislation in the way in which it applies to cross border arrangements.

The Regulations have been amended by the Occupational Pension Schemes (Republic of Ireland Schemes Exemption (Revocation) and Tax Exempt Schemes (Miscellaneous Amendments)) Regulations 2006 and the Occupational Pension Schemes (Cross-border Activities) Amendment Regulations 2006. The amendments allowed trustees to apply for authorisation before 30 March 2006 without providing all of the required information, providing the rest of the information is provided before 16 May 2006. A scheme may withdraw its application before providing all the required information or before authorisation is given.

The list of countries covered by the cross-border regime was extended by the Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2007 to cover all countries in the EEA. Amendments were also made to the legislation by the Occupational Pension Schemes (EEA States) Regulations 2007 to refer to EEA states.

### 29.2.3 Codes of Practice and Guidance

The Regulator has published Guidance on cross-border schemes to help UK schemes determine if they are operating as a cross-border scheme or are likely to be in the future and looks at the treatment of seconded employees. In particular, it provides a list of factors for trustees to consider when trying to determine whether an individual is on secondment and suggests that secondments for a period of 5 years or less can generally be regarded by the trustees as secondments for the purposes of the legislation, but where a longer period is involved trustees will need to consider the matter more closely and it is more difficult to regard it as a secondment.

The Regulator has revised its initial Guidance in May 2006 to provide its interpretation of "contributions" which might be covered by the legislation and trigger the need for authorisation. It says that contributions for these purposes would not include "*payments in respect of a deficit, payments of s75 debt and payments for revaluation of members' or survivors' benefits on a statutory basis (or on a fixed or limited basis expressed in the scheme rules), based on the members' salaries or benefits at the date they became deferred members*" (but care should be taken in relation to any increases to deferred benefits above statutory revaluation). This would mean that having overseas deferred members within the scheme would not generally trigger the cross-border requirements.

## 29.3 Scheme in EEA receiving contributions from UK employer

### 29.3.1 Act

Where the Regulator is notified of the intention of a scheme in another EEA State to accept contributions from a UK employer, it must inform the regulatory authority in the relevant EEA State within 2 months of the relevant UK legal requirements which must be complied with.

The Regulator must monitor the activities of a pension scheme in another EEA State that is accepting contributions from a UK employer, and notify the relevant regulatory authority of any breaches of UK legal requirements.

The Regulator can take action against a UK employer where a non-UK based pension scheme accepting contributions from that employer has breached relevant UK legal requirements.

(Section 293)

#### 29.3.2 Regulations

The Occupational Pension Schemes (Cross-border Activities) Regulations 2005 and The Occupational Pension Schemes (Cross-border Activities) Amendment Regulations 2006 have been published.

#### 29.3.3 Codes of Practice

None currently.

### 29.4 Assistance for other EEA pensions regulators

#### 29.4.1 Act

Where the Regulator receives a request from the appropriate authority of an EEA state to assist in prohibiting the disposal of UK held assets of another EEA pensions arrangement, the High Court may grant an injunction to restrain the disposal upon application by the Regulator. (Section 294)

#### 29.4.2 Regulations

The Occupational Pension Schemes (EEA States) Regulations 2007 amended the section to refer to EEA states rather than EU member states.

#### 29.4.3 Codes of Practice

None currently.

### 29.5 Timetable

These provisions generally came into force on 30 December 2005. For a scheme which existed on 23 September 2005 and had a "European employer" obliged to contribute, section 287 applies from the expiry of five months beginning with the date of application for authorisation under section 288 and approval under section 289. However, if no such application was made by 29 March 2006, then section 287 applied to the scheme from 30 March 2006.

### 29.6 Comment

The provisions about cross-border schemes are likely to be of interest to those employers with employees in several European countries. However, in the absence of tax harmonisation, the provisions fall somewhat short of genuine pan-European pension arrangements.

There is considerable concern about the effect of the legislation on seconded or overseas employees and schemes should consider the position of such employees and whether they will need to seek authorisation as a result or to remove those employees from the scheme. This issue needs to be considered extremely carefully because of the impact on the funding requirements applicable to a scheme if it is cross-border.

Schemes affected by the cross border requirements should note that some of the provisions discussed elsewhere in this guide are modified in their application to cross

border arrangements. In particular, the Funding Regulations (see Part 5 above) apply different rules for schemes undertaking cross-border activities e.g. for frequency of valuations and length of recovery periods.

In April 2008, DWP published a review (see <http://www.dwp.gov.uk/consultations/2007/rops-cba-regs05.pdf>) on how schemes had found the cross-border regime to date and what the Government's views were. The review does not propose any significant changes but does provide a useful insight as to how the Government views some of the provisions of the legislation.

## 30. State pensions

### Sections 296-299 Pensions Act and Schedule 11

#### 30.1 Background

In its December 2002 Green Paper, the Government recognised the role of state pensions in encouraging flexible retirement. *“If people wish to delay taking their State Pension, they should be paid an increased amount to take account of the fact that they will be receiving it for fewer years. The Government intends to ensure that people who choose to work beyond State Pension age and defer taking their pension are properly rewarded by the State system... As well as improving arrangements for deferral, the Government proposes to offer a choice of either an increased regular State Pension or a taxable lump-sum payment, to compensate people adequately for deferring their pension. Some people may find the prospect of a lump sum more attractive than a comparable regular pension increase”.*

#### 30.2 Entitlement to more than one pension

##### 30.2.1 Act

The amendments relate to category B retirement pensions (which are pensions payable to married women and surviving spouses). Section 43 Social Security Contributions and Benefits Act 1992 is amended to provide that where an individual is entitled to more than one category B pension, they can notify the State which one they would prefer to receive, otherwise they will receive the one most favourable to them. (Section 296)

##### 30.2.2 Regulations

None currently.

##### 30.2.3 Codes of Practice

None currently.

#### 30.3 Deferral of state pension

##### 30.3.1 Act

The key reform which the Government wanted to make about state pensions was to make it easier to defer, to help those wishing to work beyond state pension age. Deferral is possible under existing legislation and would currently mean that the individual received an increased state pension when it comes into payment. The member must defer all components of state pension (basic state pension, SERPS and State Second Pension).

The Pensions Act 1995 contained provisions to increase the rate by which deferral increases the state pension once it comes into payment (from 1/7th of one percent per week to 1/5th of one percent per week) in 2010. This increase was brought forward to 6 April 2005. (Section 297)

In addition, anyone who has deferred their state pension for at least 12 months will be able to take their deferred pension increase as a lump sum instead of an improved pension if they so choose. In default of a choice within a prescribed period, the individual will receive a lump sum. (Section 297)

There are detailed provisions for the calculation of the lump sum, but the Government say that the intention is that the lump sum will be equal to the pension the person would have received had they not deferred *“plus a rate of return that will be applied weekly and compounded. The pension foregone will be calculated at the rate that would have been applicable in each week... for which the person defers”*. (Sch. 11)

If an individual who has deferred his state benefits dies before taking his lump sum, his widow or widower will be able to elect whether to receive a lump sum or increased pension. Again, if they fail to make an election, they will receive a lump sum. (Sch. 11)

**30.3.2 Regulations**

None currently.

**30.3.3 Codes of Practice**

None currently.

**30.4 Disclosure of state pension information**

**30.4.1 Act**

The Act provides for disclosure of state pension information to third parties providing services to trustees to help them provide advice or forecasts. The intention is to help the preparation of combined benefit forecasts in schemes where they are prepared by third parties rather than the trustees. The information which may be provided includes any lump sum the individual might be entitled to as a result of deferring state pension. (Section 298)

**30.4.2 Regulations**

None currently.

**30.4.3 Codes of Practice**

None currently.

**30.5 Reciprocal agreement with Australia**

**30.5.1 Act**

There are provisions in relation to claims for benefits following termination of a reciprocal agreement with Australia. This is outside the scope of this Guide. (Section 299)

**30.5.2 Regulations**

None currently.

**30.5.3 Codes of Practice**

None currently.

**30.6 Timetable**

These provisions came into force on 18 November 2004.

**30.7 Comment**

The most significant change to state benefits is the option of a lump sum for those who wish to defer state pension and continue working beyond state pension age. However, despite the Government's obvious desire to extend working lives, it seems unlikely that there will be a significant number of people wanting to take advantage of this provision.

## 31. Miscellaneous provisions

### Sections 300-325 Pensions Act

#### 31.1 Background

This section deals with a variety of miscellaneous provisions which deal with various practical issues on the way the Act works.

#### 31.2 Dissolution of existing regulatory bodies

##### 31.2.1 Act

Provision is made for the dissolution of Opra and the Pensions Compensation Board and transitional provisions to govern treatment of information initially passed to Opra. (Sections 300-302)

##### 31.2.2 Regulations

None currently.

##### 31.2.3 Codes of Practice

None currently.

#### 31.3 Service of notices and documents

##### 31.3.1 Act

Any notices to be served under the Act may be hand delivered or sent by post. In the case of a firm, they may be sent to a partner or manager at the principal place of business. Documents sent to a company can be sent to the company secretary at the company's registered office. (Section 303)

Documents may also be served electronically but the recipient must have indicated their willingness to receive documents in such a format and where service is to a regulatory authority, it must meet any additional requirements that the authority has. Regulations may set out when electronically served documents will be deemed to be received. (Sections 304-305)

##### 31.3.2 Regulations

None currently.

##### 31.3.3 Codes of Practice

None currently.

#### 31.4 Overriding requirements

##### 31.4.1 Act

Scheme rules will be overridden by conflicting provisions on the following matters:

- an order made by the Regulator
- a direction by the Regulator not to enforce a Section 75 debt where a contribution notice has been issued

- PPF provisions
- scheme funding requirements
- combined pension forecasts
- MNTs
- trustee knowledge and understanding, and
- employee protection on business transfers.

There are also provisions which override a company's memorandum and articles of association to the extent necessary to enable it to comply with the member-nominated director requirements.

(Section 306)

#### 31.4.2 Regulations

None currently.

#### 31.4.3 Codes of Practice

None currently.

### 31.5 Modifications in respect of certain schemes

#### 31.5.1 Act

Regulations may modify the provisions of the Act relating to the Regulator, the PPF, combined benefit forecasts, pension protection on business transfers, consultation by employers, and the provision of financial assistance to members of certain schemes as they relate to hybrid schemes (which provide final salary and money purchase benefits), multi-employer schemes or those where one of the employers is a partnership.

Regulations may also modify the provisions of the Act which deal with the PPF as they relate to a scheme in respect of which a public authority has:

- given a guarantee in relation to the scheme, any benefits payable under it or any member, or
- made any other arrangements for the purposes of securing that the assets of the scheme are sufficient to meet its liabilities.

(Section 307)

#### 31.5.2 Regulations

A number of sets of Regulations have been issued under this provision, particularly in relation to multi-employer and hybrid schemes. These Regulations are discussed elsewhere in this guide.

#### 31.5.3 Codes of Practice

None currently.

## 31.6 Offences by companies and partnerships

### 31.6.1 Act

In the case of any offence committed by a company under the Act, any director, company secretary or manager who consented to the offence, or whose neglect caused it, will be liable in addition to the company. A similar provision applies in relation to Scottish partnerships. (Section 309)

### 31.6.2 Regulations

None currently.

### 31.6.3 Codes of Practice

None currently.

## 31.7 Admissibility of statements

### 31.7.1 Act

Statements made in response to information requests under the Act will be admissible as evidence in any proceedings. However, where the person who made the statement is subject to criminal proceedings (except proceedings relating to the failure to provide or providing false information under the Act, or various other offences in relation to false statements or proceedings in which they may be required to pay a civil penalty under the Pension Schemes Act 1993 or the Pensions Act 1995), the statement may only be raised by the person who gave it. (Section 310)

### 31.7.2 Regulations

None currently.

### 31.7.3 Codes of Practice

None currently.

## 31.8 Producing documents

### 31.8.1 Act

A person may not be required by the provisions of the Act to produce communications between client and legal adviser which were in connection with the provision of legal advice or in contemplation of and for the purposes of legal proceedings. (Section 311)

If a person produces a document subject to a lien, its production does not affect the lien. (Section 312)

### 31.8.2 Regulations

None currently.

### 31.8.3 Codes of Practice

None currently.

## 31.9 Crown application

### 31.9.1 Act

The bulk of the provisions of the Act apply equally to pension schemes managed by or on behalf of the Crown. (Section 313)

### 31.9.2 Regulations

None currently.

### 31.9.3 Codes of Practice

None currently.

***Sections 314-325 of the Act contain various provisions in relation to Regulation-making, interpretation, consequential amendments and the coming into force of the provisions of the Act. Section 318 contains certain key definitions.***

## 31.10 Timetable

The provisions relating to Regulation-making, interpretation, commencement, the service of notices and documents and Crown application are in force.

Various other provisions in this Chapter have also been brought into force under the commencement orders issued so far.

## 31.11 Comment

Of particular note in this part of the Act are the provisions in Section 306 which specify which parts of the Act will override scheme rules.

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