

## EMPLOYMENT LAW UPDATE FOR CHARITIES SEMINAR JULY 2007

### **Pensions Update**

*Presented by Simon Evans, Solicitor*

There has been a great deal of legislative and regulatory change in the field of pensions law over the last few years. Employers, trustees and pensions advisers are now 'enjoying' a period of 'bedding in' in relation to the various changes now in force. Here, we briefly consider 3 of the changes relevant to the employment/HR fields, as follows:

1. Pensions Consultation
2. Pension Contributions under TUPE
3. Pensions 'Moral Hazard'

### **Pensions Consultation**

Until the Pensions Act 2004, there was no specific pensions law requirement for employers to consult affected employees in relation to pension changes.

However, since April 2005, the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006 have required employers to consult in relation to various changes they might seek to impose as to an employee's pension terms.

#### **Which employers does pensions consultation apply to?**

Employers wishing to make a 'listed change' (see below) who have the required number of employees must comply with pensions consultation.

If the changes were to apply between April 2006 and April 2007 then employers with 150 or more employees must comply. Between April 2007 and April 2008, the threshold is reduced to 100 employees. From April 2008, the threshold is 50. So, if an employer has less than 50 employees, consultation under pensions law will not apply (but note any duties to consult under employment law may persist).

These limits match the employee thresholds for application of the Information and Consultation of Employees Regulations 2004.

#### **Which changes does pensions consultation apply to?**

Consultation is required in relation to 'listed changes'.

Where the proposed change relates to an occupational pension scheme (i.e. in general terms, schemes set up under trust which are provided by an employer and administered by a body of trustees), a 'listed change' includes proposals to:

- increase members' normal pension age,
- close the scheme to future benefit accrual,
- remove the employer's liability to contribute to the scheme,
- begin or increase the requirement for members to contribute to the scheme,
- reduce employer's contributions (if to a 'money purchase' scheme),
- change a 'defined benefit' scheme to a scheme providing 'money purchase' benefits,
- reduce the rate of accrual of benefit for future service, and
- make any reduction in the rate of future benefit accrual (this last one acts as something of a 'catch-all').

Where the proposed change relates to a personal pension arrangement (i.e. including a stakeholder pension, an employer provided group personal pension or simply a personal pension policy), a 'listed change' includes proposals to:

- reduce or cease employer contributions to the policy, and
- increase members' contributions.

### **What does pensions consultation require?**

There are a number of requirements that the employer must adhere to, as follows:

- the period of consultation must last for a minimum 60 days,
- at the start of the period, written notice must be supplied to all affected employees (providing sufficient information for them to understand the change and the impact on their interests),
- the employee must be given opportunity to raise queries/concerns, etc; and
- the employer must consider those queries/concerns before making a decision as to whether to implement the proposed change(s).

**What happens if the employer fails to comply with pensions consultation?**

Failure to consult does not nullify any listed changes that are made. However, failure to comply with the pensions consultation requirements can result in a complaint to the Pensions Regulator. At present it remains unclear exactly what consequences will follow and guidance is still awaited from the Regulators office, however the Regulators powers do include imposing fines on employers.

**Pension Contributions under the transfer of Undertaking (Protection of Employment) Regulations 2006 (TUPE)**

Here we identify the pensions obligations that arise for an employer receiving transferring employees under TUPE. Primarily, the employer's obligations relate to payment of employer contributions in respect of the transferring employee.

The legislation is different depending on whether the transferring employee was a member of an 'occupational pension scheme' pre-transfer or had their own personal pension arrangement (including an employer provided 'group personal pension'). TUPE applies differently to each arrangement.

**Transferring employee is/was a member of an occupational pension scheme**

Prior to April 2005, an employer was not required to pay pension contributions in respect of a transferring employee who was a member of an 'occupational pension scheme' immediately prior to transfer (due to the terms of the so called 'pensions exemption' from the general terms of TUPE).

However, under the Pensions Act 2004, from April 2005, employers are required to provide a minimum of 'matched' contributions up to 6% to an employee's pension policy (so, for example, where an employee pays 5%, the employer must match that rate and where the employee does not contribute there is no minimum payment required from the employer).

There is no transfer of the old occupational pension scheme or fund which remains with the transferor (the old employer) and scheme trustees. However the transferee (the new employer) does have the option whether to pay the required matched contributions to an occupational scheme it may have, to some new scheme established or to the employee's own pension policy.

**Transferring employee is/was in receipt of employer contributions to a personal pension arrangement**

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In respect of personal pension arrangements, the basic position under TUPE persists - i.e. the transferring employee's terms and conditions transfer. For example an employee may, as part of their overall benefits package, be entitled to an employer's contribution of 4% to a stakeholder pension or some personal pension plan.

Accordingly, a term in the employee's contract pre-transfer to benefit from employer contributions to some form of personal pension arrangement survives the transfer and must be met by the receiving employer. In other words, the receiving employer is required to continue to pay the same level of employer contributions to a transferring employee's personal pension.

## **Pensions 'Moral Hazard'**

The 'new' Pensions Regulator was established in April 2005. It has far greater powers than its predecessor. In particular, it has powers which can be implemented where there is a concern as to the future funding prospects for a 'defined benefit' occupational pension scheme.

Corporate activity - such as a merger - is high on the Regulator's agenda as such transactions can lead to schemes being 'left behind' when the financial strength supporting a scheme is transferred to another employer. This is not simply a matter which is restricted to the 'for-profit' sector and the increasing number of mergers involving charities, or where charities take over other businesses, may be caught.

As a guide, but no more than that as this situation remains unclear, where a charity is taking on staff and assets under TUPE it will not generally need be concerned about any potential Moral Hazard. However the position should be considered and the transferor may have a risk. The concern and greater risk for any charity falls into full mergers where pension liabilities will need full consideration.

Parties to transactions such as a merger may choose to seek 'clearance' from the Regulator prior to completion in order to ensure that the Regulator will not use its new powers to require that the relevant scheme(s) is properly funded after completion of the transaction.

In short, the Regulator's powers are as follows:

## **Contribution Notices**

Where the Regulator believes that a person (whether corporate entity or natural person) has acted (or failed to act) to prevent recovery of all or part of a pension deficit liability, it can issue a contribution notice.

The notice will specify an amount payable by the recipient to the trustees of the relevant pension scheme (up to the amount of the deficit liability so avoided).

The notice can be issued any time within 6 years after the date of the act or failure and can relate to acts/failures that took place on or after 26 April 2004.

The Regulator's guidance as to contribution notices states that the type of events that will fall foul of its powers are "*events which are financially detrimental to the ability of a defined benefit scheme to meet its liabilities*".

These events are detailed as:

- 'Change in priority' - a change in the level of security given to creditors with the consequence that the pension creditor might receive a reduced dividend in the event of insolvency (for example, granting of a fixed or floating charge to an otherwise unsecured creditor);
- 'Return of capital' - a reduction in the overall assets of the company which could otherwise have been used to fund a pension deficit (for example, dividends, share buy backs); and
- 'Change in control structure' - a change or partial change in the group structure of an employer, which reduces the overall employer covenant, and could affect the ability of an employer to meet its funding liabilities (for example, change of employer or participating employer, change of parties connected or associated with the employer).

### **Who can be a recipient of a Contribution Notice?**

The Regulator can issue a contribution notice to an employer participating in the pension scheme and anyone who is connected or associated with that employer.

'Connected' and 'associated' are widely drawn definitions and include directors of the employer, shareholders of the employer, directors and shareholders of an associated employer, family members of such directors/shareholders and individuals/companies controlling the employer.

This creates a very wide group of potential recipients. However, the Regulator can only issue a contribution notice:

- to persons who are a party to the act or failure; and
- where in the Regulator's opinion, it is reasonable to issue a notice to that person, taking into account relevant factors such as:
  - the degree of involvement in the act of the person;

- the purpose of the event; and
- the financial means of the person.

### **Financial Support Directions**

The Regulator also has power to issue a financial support direction where it believes an employer has insufficient resources to meet its pension liabilities.

Whether an employer is insufficiently resourced will be measured by reference to a prescribed percentage of the estimated funding deficiency in the scheme.

The direction will require that the recipient puts in place financial support for the scheme (such as security over assets or additional funding from other sources within the employer's group).

### **Who can be a recipient of a Financial Support Direction?**

The Regulator can issue a financial support direction to an employer participating in the pension scheme and any person connected or associated with the employer.

Unlike a contribution notice, a financial support direction cannot be issued to an individual (i.e. directors, shareholders and their families).

The above, by its nature is a very short overview of some of the recent changes affecting an employer's pension provision for its employees. If there are any matters of concern to you please give me a call.

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