

## Amending pension schemes

August 2010

Pensions Briefing

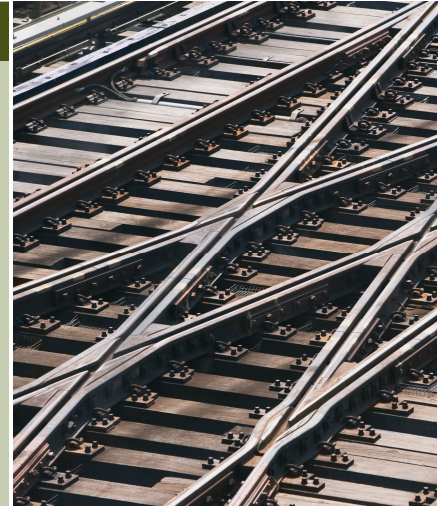
### HIGHLIGHTS

There is an increasing trend for changes to be made to occupational pension schemes to implement benefit restructuring. This note looks at the pension issues arising for trustees and sponsoring employers when schemes are altered.

In most cases, the scheme amendment power contains restrictions that limit its use and there are invariably trust law considerations in terms of the duties of the employer and the trustees when using the amendment power. There are also statutory restrictions on amendments, contained in section 67 of the Pensions Act 1995, as well as statutory consultation requirements. These restrictions will impact on any proposal to amend the scheme.

This note also touches on the employment law issues which companies will have to consider but does not discuss these in detail.

A checklist flowchart at the end of the note summarises the key issues.



### USE OF THE AMENDMENT POWER

It is possible (albeit unlikely) that a change to the rules of a pension scheme might not entail the use of the scheme's amendment power. For instance, some schemes give the employer a unilateral power to stop benefits accruing. It is worth considering this point at the outset. However, most alterations will come within its scope.

Before using the amendment power, its precise terms must be considered, including:

- **which parties exercise the power:** the sponsoring employer or the trustees, or both parties jointly? Or does one party need to obtain the agreement of the other to amendments? Note that section 67 can mean that trustees' approval is needed in any event (see below)
- **are there any restrictions** on its use? For example, the power may specify that accrued rights must not be affected; pensions in payment must not be reduced; or the actuary must advise whether the changes are fair or equitable. In general, it is not possible to change the amendment power to remove restrictions
- **when is the amendment to take effect?** If it is to be retrospective, the amendment power must allow this
- **what are the formalities?** In many cases, a deed will be required, although sometimes a written resolution may suffice. If the consent of either the employer or the trustees is required, there should be written evidence of this consent. Restrictions in amendment powers are generally narrowly construed; see the *Courage* case (box below).

Trustees are fiduciaries and must act in accordance with the scheme's provisions and in the best interests of the members. This applies when trustees exercise the amendment power.

The employer is not a fiduciary and so can take its own interests into account when exercising the amendment power (or giving or withholding consent to an amendment). However, it must comply with the duty of good faith, as set

out in the *Imperial* case (*Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd 1991*): the employer must not exercise its rights and powers "in a manner calculated or likely to destroy or seriously damage the relationship of confidence and trust between employer and employee".

### The *Courage* case

In *Re Courage Group's Pension Schemes, 1986*, the scheme contained a power of amendment which was subject to a restriction that "no such alteration ... shall ... vary or affect any benefits already secured by past contributions in respect of any member without his consent in writing." The Court held that this included any benefit to which a member was prospectively entitled in respect of future service.

In other words, benefits accrued up to the date of the amendment had to be protected by reference to the member's final pensionable salary on leaving the scheme. The *Courage* case has been the subject of some criticism over the years but was upheld as good law in the *IMG Pension Plan* case last year (see box below).

### STATUTORY RESTRICTIONS ON AMENDMENTS

Section 67 of the Pensions Act 1995, which was amended in 2006, restricts scheme amendments. There are some limited situations where section 67 does not apply; it affects HMRC registered schemes only and some changes can be made to comply with legislation, such as the Finance Act 2004 and the legislation governing member-nominated trustees and age discrimination, without section 67 concerns. Otherwise, section 67 applies to all **regulated modifications**, which include **protected** and **detrimental** modifications. **Protected** modifications are:

- changes from defined benefit to defined contribution, in respect of accrued rights
- reduction of pensions in payment.

**Detrimental** modifications are amendments that would or might adversely affect any **subsisting right** of a member or survivor. **Subsisting right** means a right earned by a member at the date of the change and it is tested by reference to the rights of members assuming they left pensionable service immediately before the amendment.

All deferred pensions and pensions in payment are subsisting rights. Other cases may not be so clear. For example, death-in-service and redundancy benefits do not usually amount to subsisting rights.

Protected modifications can only be made if they comply with **consent requirements** (see box below). Detrimental modifications can be made if they comply with consent requirements; or if they comply with the **actuarial equivalence requirements** (see box below).

Trustees' approval is always required for protected and detrimental modifications (even if the company has a unilateral power of amendment).

Amendments made in breach of section 67 are voidable but not void; the Pensions Regulator can declare amendments void in the event of non-compliance.

#### Consent requirements

- members must be given notice in writing; the notice must be adequate to explain the nature of the amendment and its effect on them
- members must be given a "reasonable opportunity" to make representations (the Regulator says at least four weeks)
- the trustees must give "due consideration" to any representations
- the members must consent in writing
- the amendment must take effect within a "reasonable period" after the consent (the Regulator says no more than seven months after consent).

#### Actuarial equivalence requirements

- actuarial equivalence must be explained to members
- information (and a reasonable period for representations) must be given to members, as for consent requirements. If material changes are made to the proposal following representations, the information requirement must be repeated
- the trustees must take the actuary's advice to confirm that actuarial value of each member's benefits will be maintained
- the actuary must certify (at least one month before the effective date of change) that the actuarial value of each member's subsisting rights after the change is no worse than it was before it.

If the scheme is contracted-out, section 37 Pension Schemes Act 1993 requires that the amendments do not affect the scheme's contracted-out status. For a salary related scheme, confirmation from the actuary to this effect must be obtained.

#### ALTERNATIVES TO SECTION 67

It used to be possible to get round section 67 by obtaining employee agreement to contractual variation, relying on the principle in *South West Trains Ltd v Wightman*. But the *IMG Pension Plan* case (see box below) makes this considerably more difficult in the context of scheme amendment powers. It must be clear to members what they are giving up and they must make an informed choice. There is an argument that the members have to be provided with advice and be specifically informed about the amendment power restriction.

#### CONSULTATION REQUIREMENTS

Under regulations made under the Pensions Act 2004, companies with 50 or more employees must consult **affected members** before making a **listed change** to the scheme.

**Listed changes** are those where an employer decides to:

- close a scheme to new members
- stop further benefit accrual for existing members
- change the basis on, or rate at which, members accrue benefits
- increase the normal pension age in the rules
- change the way pensionable earnings are calculated
- start, or increase the level of, member contributions
- stop or reduce employer contributions.

Employers have to consult affected members or their representatives before making a listed change. **Affected members** are:

- active members
- prospective members (those who are or may become eligible to join)

who would be impacted by the change.

The employer must follow a set consultation process, including providing information to affected members in advance of consultation.

### The *IMG Pension Plan* case

*IMG Pension Plan HR Trustees Ltd v German*, decided in November 2009, concerned amendments intended to change final salary benefits to money purchase benefits. The Court followed the *Courage* decision and held that the restriction in the scheme amendment power protected final salary linkage.

The Court also decided that contracts that had been entered into outside the scheme could not be used to get round the restriction. In the *South West Trains Ltd v Wightman* case, a term was implied into a collective bargaining agreement that employees would not claim pensions from the scheme at a higher level than that agreed in the collective bargaining. Therefore the trustee could execute an amending deed to give effect to the contractually agreed changes. In *IMG*, the Court decided that this principle could only apply where members had given fully informed consent.

For more information, see our separate Briefing Note: "*Amending pension scheme benefits - now more difficult?*"

### DISCLOSURES

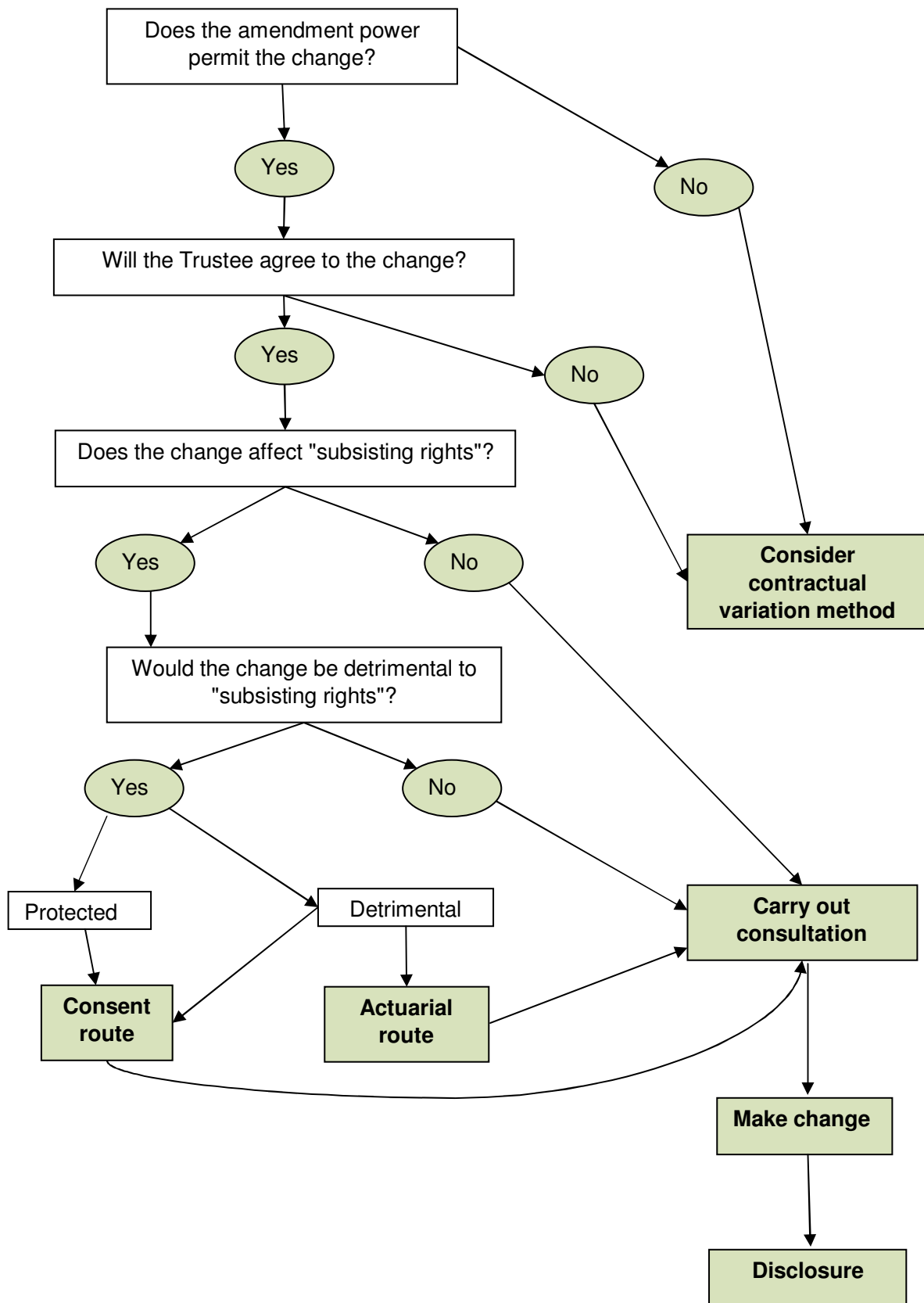
Under the *Occupational Pension Schemes (Disclosure of Information) Regulations 1996*, trustees must disclose certain basic scheme information (such as about membership, contributions and benefits) to members automatically on their joining the scheme. And, if any of this information changes materially, for example following a scheme amendment, the trustees must notify all members and beneficiaries, in writing, within three months of the change taking effect.

### EMPLOYMENT LAW ISSUES

Sponsoring employers must consider the pension promise (if any) made to employees at the time they were offered the opportunity to join the scheme and any subsequent changes to that promise, in order to ascertain whether the amendment proposal would constitute the variation to employees' contractual rights.

The extent to which employees have a contractual right to accrue specific pension benefits is a grey area. In short, in the absence of clear statements in the employment contract and the pensions booklet that the terms can be changed, employees may be able to argue that they have a contractual right to the benefits as they were when they joined and employees' consent to the changes will normally be required. Even if employees do not have contractual rights, there is a danger that the employer might, in making significant changes to the scheme, be in breach of its implied duty of trust and confidence to employees (referred to under "Use of the amendment power" above)

### CHECKLIST FOR AMENDING PENSION SCHEMES



Note: This chart does not cover employment issues

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

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