Hogan Lovells

Introduction to pension legislation for trustees

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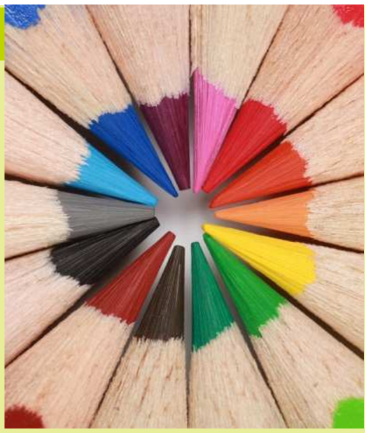
Pension briefing



HIGHLIGHTS

There are two levels of legislation:

- **primary legislation**: high level statutes called "Acts", which are passed by both Houses of Parliament;
- **secondary legislation**: created under delegated powers, usually by the relevant Secretary of State or HMRC. Secondary legislation often comes in the form of "Regulations" or "Orders" and contains the technical detail needed to support the high level principles contained in an Act.

The Courts do not create legislation but are frequently asked to interpret it.

Why should trustees be concerned with pension legislation? Legislation can override a scheme's trust deed and rules, so it is important to be are aware of when and how this can happen and how it may affect the running of a particular scheme.

The main statutes which concern occupational pension schemes are:

- The Pension Schemes Act 1993
- The Pension Act 1995
- The Welfare Reform and Pensions Act 1999
- The Pensions Act 2004
- The Finance Act 2004
- The Pensions Act 2008.

This note gives a brief overview of the main areas covered by these Acts. In most cases, the statutory provisions are supplemented by detailed requirements set out in regulations. Trustees should be aware that pensions law is affected by many different areas of law, not only the pension specific legislation listed here.

PENSION SCHEMES ACT 1993

The Pension Schemes Act 1993 ("PSA") is a consolidating Act, bringing together various provisions relating to pensions into a single legislative instrument. Areas covered by the Act include:

- **Contracting-out**: schemes may contract-out of the earnings-related part of the State pension (currently the State Second Pension (S2P)). Contracted-out schemes must provide members with minimum benefits set out in the Act and regulations. Contracting-out on a defined contribution (DC) basis was abolished in April 2012.
- **Guaranteed minimum pensions (GMPs)**: members in contracted-out service before April 1997 built up rights to GMPs. Many schemes still hold GMPs and complex rules apply in relation to them.
- **Preservation**: rights to a deferred pension for members who leave pensionable service before their scheme's normal pension age.
- **Revaluation**: giving members with deferred pensions some protection against inflation in the period before their pension comes into payment.
- **Cash equivalent transfer values (CETVs)**: members with a deferred pension who meet certain conditions have a right to transfer the value of their benefits out of their current scheme to an arrangement willing to accept transfers in.
- **Cash transfers**: members who leave pensionable service with between three months and two years of pensionable service, but without a right to a deferred pension, may transfer the value of their benefits to another arrangement or take a refund of their own contributions.
- **Pensions Ombudsman**: with powers to investigate pension disputes and to direct disputing parties to take particular action.
- **Independent trustees**: an independent trustee must be appointed on the insolvency of an employer.

PENSIONS ACT 1995

Areas covered by the Pensions Act 1995 include:

- **Member-nominated trustees**: the trustee board of an occupational pension schemes must include member-nominated trustees (or member-nominated directors where the trustee is a corporate body).
- **Investment powers**: power to invest the assets of a pension scheme rests with the trustees, overriding any obligation in the scheme rules for the employer's consent.
- **Investment requirements**: including that trustees must take proper advice before making investment decisions; must not breach statutory limits on employer-related investment; and must prepare a statement of investment principles (SIP).
- **Advisers**: requiring trustees to appoint an auditor and (for defined benefit schemes) an actuary and setting out

obligations for how they and other specified advisers are appointed.

- **Dispute resolution**: a requirement for trustees to operate an internal dispute resolution procedure (IDRP) for members, or prospective members, with a complaint about the scheme.
- **Disclosure**: trustees must give specified information to members at particular times and must make other specified information available upon request.
- **Pension increases**: a statutory requirement to increase pensions in payment built up from April 1997 to give some protection against the effect of inflation.
- **Scheme amendments**: section 67 of the Act prohibits using scheme amendment powers to make changes which would have a detrimental effect on members' subsisting rights (broadly, rights they have built up before the date of the change), without the member's consent or a certificate of actuarial equivalence from the scheme actuary.
- **Scheme amendments**: section 68 of the Act allows trustees to be given statutory power to modify schemes for particular purposes, regardless of section 67 or any restrictions in the scheme's amendment power.
- **Employer debts**: section 75 of the Act sets out circumstances in which, where a defined benefit scheme is in deficit, a debt will be due from the employer(s) to the trustees. Section 75 debts can arise on an employer's insolvency, on the scheme entering winding-up, or on an employer in a multi-employer scheme ceasing to employ active members.
- **Schedule of payments to money purchase schemes**: trustees or managers of occupational money purchase (DC) schemes must ensure that a schedule of payments due to the scheme is maintained and must notify the Pensions Regulator if payments are not made in accordance with the schedule (unless certain conditions apply).

WELFARE REFORM AND PENSIONS ACT 1999

The Welfare Reform and Pensions Act 1999:

Introduced the requirement for employers to provide access to a **stakeholder pension scheme** for employees who did not already have a workplace pension available. The stakeholder designation requirement is expected to be repealed when the auto-enrolment requirements come into force (please see Pensions Act 2008 below).

Introduced the option of **pension sharing** on divorce.

Protects pension rights under a registered pension scheme from vesting in the trustee in **bankruptcy** where a member is made bankrupt.

PENSIONS ACT 2004

The Pensions Act 2004 developed pension protection further. Areas covered include:

- **The Pensions Regulator (tPR)**, which replaced the Occupational Pensions Regulatory Authority (OPRA), with extensive regulatory powers.
- **The Pensions Protection Fund (PPF)**: funded by a levy on defined benefit (DB) schemes, takes over DB schemes whose sponsoring employers are insolvent where the scheme funding is below a certain (PPF) level. The PPF provides benefits to affected members, though these will normally be less than would have been provided under the scheme rules.
- **The Financial Assistance Scheme (FAS)**: set up to provide a basic level of benefit to members of underfunded defined benefit schemes whose employers became insolvent before the PPF provisions were in force.
- **Moral hazard provisions**: empower tPR to issue "financial support directions" and "contribution notices" requiring group companies to put funding arrangements in place, or pay contributions, to support the financial position of underfunded defined benefit schemes. tPR's powers may be exercised against group companies of the scheme employers, whether or not the target companies have ever participated in the pension scheme.
- **Scheme specific funding**: trustees of defined benefit schemes are required to ascertain the value of the scheme's "technical provisions" (the benefits built up to date); to set a schedule of contributions and, where the scheme is in deficit, to decide a recovery plan for eliminating the deficit. In most cases, the technical provisions, schedule of contributions and recovery plan must be agreed with the employer.
- **Trustee knowledge and understanding**: a requirement for trustees to ensure that they have the necessary knowledge and understanding to carry out their functions properly.
- **Consultation requirements**: before making a "listed change" to a pension scheme, employers must consult affected members for a minimum of 60 days. Trustees are prohibited from making a listed change unless the consultation requirements have been complied with.

FINANCE ACT 2004

The Finance Act 2004 overhauled the taxation regime for pension schemes. Most UK pension schemes are now "registered schemes" for tax purposes. The Finance Act 2004 sets out:

- The **annual allowance**: limiting a member's tax-free benefit accrual in a given tax year.
- The **lifetime allowance**: applicable when a member starts to draw benefits, applying an additional tax charge on lifetime benefits over the £1.5m allowance (£1.25m from 6 April 2014).
- **Authorised payments**: that a scheme may make to members or the employer without additional tax charges applying.
- The **unauthorised payment charge** and **scheme sanction charge**: applicable where a scheme makes payments that are not authorised payments.

PENSIONS ACT 2008

The Pensions Act 2008 introduces a requirement for employers to "**auto-enrol**" their workers who meet certain criteria into a suitable pension arrangement and to contribute to their workers' pensions. The auto-enrolment obligations apply from an employer's "staging date", which will range from 1 October 2012 for the largest employers to dates in 2017 for very small employers.

OTHER AREAS OF LAW AFFECTING PENSIONS

Pensions are not only affected by the statutes specifically relating to pensions - many other areas also influence the way that pension schemes are regulated and run, such as:

- trust law
- contract law
- company law
- employment law
- anti-discrimination law
- European Union law
- financial services and consumer law
- data protection law
- criminal law.

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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