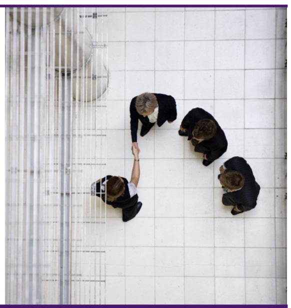
July 2010

Review

Pensions



Action needed to retain important surplus power

Surpluses may seem an unlikely prospect to many schemes at present, but a turn-around in the economy, fulfilment of employer deficit recovery plans and/or good investment decisions should see improvements in funding over the next few years. Without a crystal ball, this cannot be predicted with any certainty, but employers and trustees may find themselves lacking a useful power in the future if action is not taken now.

A quirk of legislation[1] requires trustees of occupational pension schemes to pass a resolution before 6 April 2011, if they wish to retain an existing power in their scheme rules to make a future payment of surplus to the employer either whilst the scheme is ongoing or potentially even upon a future wind-up. This legislation applies to schemes that were established before 6 April 2006 whose rules contained a power to make payments to the employer out of scheme funds[2]. Many schemes will have such a power[3].

Although the context of the legislation indicates that it is concerned purely with the payment of surplus, it is arguable that it could also apply to any other payment to an employer.

EMPLOYER AND TRUSTEE CONSIDERATIONS

Sponsoring employers have a vested interest in ensuring that the trustees consider this issue. Many employers are currently contributing a large percentage of payroll towards funding their scheme and may expect to preserve the possibility of a return of some contributions if the scheme becomes overfunded in the future - avoiding the so called “trapped surplus” problem. There are also accounting implications - for example, under IFRIC 14, an employer may currently be able to recognise a right to a return of a pension scheme surplus on its balance sheet which could now be jeopardised.

Trustees cannot simply act in a vacuum, however, but have to be satisfied that passing such a resolution is in the best interests of members. In reaching their decision, trustees should bear in mind that they are retaining and updating an existing power to give them the future option of returning a surplus. They are not creating a new power. Any actual return of surplus will still be subject to existing overriding restrictions: these include ongoing defined benefit schemes being fully funded on a buy-out basis, and schemes in wind-up having fully discharged their liabilities. Trustees may find that if the sponsoring company has no possibility of benefitting from a future surplus it may have a more conservative attitude towards setting its contribution rates.

ACTION NEEDED

1. Check the Trust Deed and Rules for relevant provisions regarding employer payments[4].
2. Trustees to consider whether it is appropriate to pass a resolution, and, if so, the precise scope of such a resolution.
3. Trustees will need to give 3 months notice to the employer (which should be a formality) and to the scheme members (which will need careful consideration, especially if the scheme has had to take cost cutting measures in the recent past).
4. Pass the resolution.

1. Section 251 of the Pensions Act 2004.
2. The legislation does not apply if the scheme was already in wind-up on that date.
3. Where schemes do not have this power then, as a seperate issue, employers may wish to consider amending their scheme rules.
4. The relevant provisions will be the rules that applied immediately before S251 of the Pensions Act 2004 came into effect on 6 April 2006.

This issue has provoked serious concerns within the pensions industry and it is considered that the legislation was not intended to work in this way. It is reported that one of the pensions industry representative bodies has raised concerns with the DWP in the hope that the timeframe can be extended or the legislation revised. We have no evidence to suggest that there will be a positive outcome to any representations made. We recommend that pension schemes now consider taking action on the basis that the legislation will not be amended – otherwise there is a real danger that time will run out and a valuable power will be lost. We will keep you updated on any further developments.

FURTHER INFORMATION

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