Autumn 2009

Review

Human Capital (Pensions)

Welcome to our Autumn Review.

Legislation to be introduced from October 2012 will require employers to automatically enrol eligible employees into either a pension arrangement that meets minimum standards or into a new national pension scheme, known as the personal accounts scheme. Technically, the new employer duty does not include contributing to such arrangements for all eligible employees (because an employee could opt out), but the effect of inertia will inevitably mean increased employer contributions. This is a major change, requiring planning and budgeting at corporate level.

At our September breakfast seminar series, two-thirds of the audiences said that the introduction of the personal accounts scheme would make them rethink their current retirement benefit proposition. In this Review we assess the state of play following the recent deluge of consultation documents and draft regulations issued by the Department for Work and Pensions (DWP) and we consider some of the strategy decisions facing employers.

As well as looking to the future, we also look at the current challenges for companies and trustees of occupational pension schemes. In addition to the financial matters that continue to dominate the press, what should be on your agenda for forthcoming pensions meetings?

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The introduction of new employer duties from 2012 represents a major change, requiring planning and budgeting at corporate level.

A FEW WORDS OF EXPLANATION OF TERMS USED IN THIS REVIEW…

The **"personal accounts scheme"** is a nationwide trust-based defined contribution scheme that will effectively be the default vehicle for satisfying employer automatic enrolment duties from 2012.

"Qualifying earnings" are total earnings between £5,035 and £33,540 per annum (this band of earnings will be subject to annual review).

The definition of a **"jobholder"** is extremely broad. In brief, it covers certain UK workers who are aged between 16 and 75 and who earn over £5,035 per annum (this threshold will be subject to annual review).

Automatic enrolment explained

Quoting an estimate that seven million people in Britain are not saving enough to generate the pension income they are likely to want, or expect, for their retirement, the Government is taking radical steps to encourage these individuals to help themselves. It is intended that a new requirement on employers to automatically enrol eligible employees into a pension arrangement will act as the cornerstone of a package of reforms aimed at tackling under-saving, by overcoming the inertia that prevents many individuals from joining a pension scheme. In this article we take a closer look at the new automatic enrolment duties to be imposed on employers, what these will cost and the controversial proposals regarding the procedures employers will have to follow to automatically enrol eligible employees into suitable pension arrangements.

The draft regulations were prescriptive and burdensome. The DWP has now made significant amendments.

WHAT IS AUTOMATIC ENROLMENT?

In brief, automatic enrolment is the duty that will be imposed on an employer to automatically enrol eligible jobholders into an "automatic enrolment scheme", which could be either the personal accounts scheme or a designated pension scheme that meets specified conditions.

Critically, and unlike the current rules for stakeholder pensions, there is an obligation on the employer to contribute to the chosen scheme if the jobholder does not opt out. If it is the personal accounts scheme, a money purchase or personal pension scheme, the employer will (eventually) be obliged to contribute at least 3% of the amount of the employee's qualifying earnings. In addition, the total contributions from employer and employee must be no less than 8% of those earnings.

If the designated pension scheme is a defined benefit (DB) scheme there is no minimum level of contributions required, but the scheme must provide a minimum level of benefits.

The options open to employers regarding their choice of automatic enrolment scheme, the practical considerations and cost implications for employers in complying with their new duties are discussed in the article "Employer strategy from now to 2012" below.

WHICH EMPLOYEES WILL BE CAUGHT?

An employer will be obliged to automatically enrol into the designated scheme jobholders who are aged between 22 years old and state pension age (plus certain other employees on request). Due to the wide definition of "jobholder", employers with a large number of temporary, part-time, low paid or seasonal workers are likely to incur extra costs in contributing to pension arrangements particularly if they do not currently provide pensions for these workers.

WHEN WILL EMPLOYERS BE CAUGHT BY THE NEW AUTOMATIC ENROLMENT DUTIES?

The DWP published a consultation paper in September which covered proposals concerning how the automatic enrolment duties will be phased in from October 2012. It is intended that the duties will be gradually applied to employers over a three year implementation period from this date, broadly applying to the largest employers first and eventually applying to the smallest. Employer size will be ascertained using Pay-As-You-Earn (PAYE) data. It is proposed that all employers will therefore be subject to the automatic enrolment duties by October 2015.

WHAT TRANSITIONAL ARRANGEMENTS ARE PROPOSED?

Consultation is also underway regarding the phasing in of employer contribution levels over a four year period. It is proposed that during the three year implementation period identified above, if an employer enrols its employees into a defined contribution (DC) scheme, it will be obliged to contribute at least 1% of the jobholder's qualifying earnings to the scheme. The overall contribution to the scheme from both employer and employee must be at least 2% of qualifying earnings. The minimum employer contribution and the minimum total contribution will then increase to 2% and 5% respectively for a further year, ie from October 2015. From October 2016 the full minimum employer contribution of 3% of qualifying earnings and total contribution of 8% of qualifying earnings will apply.

If an employer wants to enrol its employees into a qualifying DB scheme or hybrid scheme then it is intended that the employer will be permitted to delay automatic enrolment of those employees until the three year implementation period has ended, ie until October 2015 (subject to certain conditions being satisfied). This looks like an opportunity to arbitrage the rules by allowing employers to later change their minds and switch to a DC scheme. However, if the employer does this and/or closes the DB scheme before 2015, it will have to make up the missed accrual cost.

WHAT WILL EMPLOYERS HAVE TO DO TO IMPLEMENT AUTOMATIC ENROLMENT?

The DWP published draft regulations for consultation in March this year, setting out how the Government proposed employers should implement automatic enrolment within their workforces. These regulations proved extremely controversial and the measures were criticised for being too prescriptive and burdensome on employers and imposing too short timescales. In response the DWP has made significant amendments to the draft regulations, which will now be called The Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010 (the Regulations).

We summarise below some of the key enrolment obligations proposed under the revised Regulations.

- The clock starts ticking from what is termed the “automatic enrolment date”. Put simply, this is the date from which automatic enrolment legislation first applies to an eligible employee. This could be the date from which the new legislation first applies to an existing employee; the first day of employment for a new employee; or the date on which the employee first meets the automatic enrolment criteria, for example, by reaching age 22 or earning over £5,035 per annum. In some cases the automatic enrolment date can be postponed – we discuss this further below.
- The employer will have up to one month from the automatic enrolment date to provide specified information to the employee regarding his/her enrolment into the designated automatic enrolment scheme and to enrol that employee into the scheme. The employee’s membership of the scheme will be backdated to the automatic enrolment date.
- Where the employee is already an active member of a qualifying scheme at the automatic enrolment date, the employer will have two months to provide that employee with a written statement setting out the name and contact details of his/her scheme, confirmation that the scheme is a “qualifying scheme” and that he/she may remain in the scheme without employer interference (unless the jobholder becomes an active member of another qualifying scheme). The point of this last requirement is that the Pensions Act 2008 prohibits employers from taking any action or making any omission by which active membership of a qualifying pension scheme ceases (without providing an alternative qualifying scheme).

Employers offering more generous pensions arrangements can postpone automatic enrolment.

CAN EMPLOYEES OPT OUT OF AUTOMATIC ENROLMENT?

Yes. Employees will have the option to opt out, so that they will be treated as if they had never become a member of the relevant pension scheme on that occasion. Employee and employer contributions that have been paid will be refunded.

The legislation contains robust safeguards to ensure that employers do not induce their employees to opt out, or indicate that recruitment may be determined on whether or not candidates will opt out of the designated pension arrangement. The Regulations also impose strict time limits for opting out and prescribe detailed processes that must be followed.

The Regulations propose a window of one month within which the employee can opt out. Where the employee has been automatically enrolled into an occupational pension scheme, the one month window will start from the date on which the employee became an active member of that scheme or, if later, from the date on which the employee is provided with the required information regarding his/her automatic enrolment. Where the employee has been automatically enrolled into a personal pension scheme, the one month opt out window will start from the date the employee was deemed to have entered into an agreement to be an active member of the personal pension scheme.

The Regulations also propose that employees should only be able to obtain opt out forms from the pension scheme – to guard against the risk of employers encouraging employees to opt out by providing them with the forms. However, if it is established practice that pensions administration is delegated to an HR officer, that officer can process the forms. The Regulations specify the content of those forms and set out a formal process for opting out and paying refunds of contributions.

It is worth noting that the Regulations provide that every three years employers will have to automatically re-enrol into the scheme all employees who have previously opted out and who remain eligible for automatic enrolment (unless they opted out or chose to leave pension saving within the last twelve months of the re-enrolment date). Of course, the employee has the option to opt out again.

POSTPONEMENT OF THE AUTOMATIC ENROLMENT DATE

The Pensions Act 2008 provides that the automatic enrolment date applying to an individual can be postponed in prescribed cases. This is designed to encourage employers to offer more generous pension arrangements to their employees than the statutory minimum required under the automatic enrolment legislation.

The Regulations propose that the automatic enrolment date applying to an individual can be postponed by three months where that individual will be subsequently enrolled into either:

- a qualifying DC scheme to which the employer contributes at least 6% of the employee's qualifying earnings and the total amount of contributions payable by the employer and the employee amount to at least 11% of those qualifying earnings; or
- a DB scheme (which provides a minimum level of benefits).

However, controversially, the Regulations provide that employers cannot postpone the automatic enrolment date of jobholders on short term contracts of less than three months. This proposal was introduced in response to concerns that the ability to postpone automatic enrolment dates could otherwise prevent such workers from ever saving in a pension scheme.

WHAT ARE THE SANCTIONS FOR NON-COMPLIANCE?

The Pensions Regulator will be responsible for ensuring that employers comply with the requirements of automatic enrolment. It has been given considerable powers to do so and to penalise non-compliance. Failure on behalf of an employer can lead to the Regulator issuing compliance notices. The Regulator can also require employers to pay unpaid contributions and can issue penalty notices imposing fines (draft regulations propose penalties ranging from a standard flat-rate fixed penalty of £500 to escalating penalties of up to £10,000 per day depending on employer size). Moreover, an offence is committed by an employer who wilfully fails to comply with the key automatic enrolment duties and, if found guilty of this offence, the penalties applied can extend to imprisonment and/or fines. Individuals such as directors, managers and other officers of an employer can also be found guilty of this offence.

Whilst the pensions industry has become used to the Regulator's expression of propensity to take a certain action usually being sufficient discouragement for order to be restored, the Regulator seems to be aware that this will not work on its new and much wider audience, many of whom will never have heard of the Regulator, or its powers, before. The Regulator has stated that, whilst its preferred approach will be to educate employers, it will not shirk from enforcement where appropriate.

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WHAT DOES THE FUTURE HOLD?

Finally, although employers should be considering now what steps they need to be taking to get ready for 2012 and beyond, they will no doubt be wondering whether the landscape will change if the next general election brings about a change of Government. Teresa May, Shadow Secretary of State for Work and Pensions, has stated that automatic enrolment will be a vital step forward, indeed one that should not necessarily wait until 2012. So whilst she has indicated that, should the Conservatives be elected to Government, a review will be held of the personal accounts scheme, it seems fairly certain that automatic enrolment will still become a fact of life and it may even be accelerated. Employers should therefore start thinking now about how they are going to comply with this new duty, bearing in mind the strategy issues outlined in our next article.

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Employer strategy from now to 2012

WHY SHOULD EMPLOYERS BE CONCERNED ABOUT 2012?

The automatic enrolment provisions may seem like a long way off. The London Olympics may also seem like a long way off, but construction of the new sports developments in East London is well underway. It is time for employers to start planning for their new duties, working out the cost of compliance and assessing whether changes to existing pension arrangements are needed. Don't be left in the starting blocks.

HOW CAN EMPLOYERS SATISFY THEIR DUTY?

Employers can make use of the personal accounts scheme to comply with their automatic enrolment obligations. Alternatively, employers can use their existing pension schemes or establish new schemes, provided that they meet the “qualifying schemes” criteria. Qualifying schemes can be DB, trust-based DC or contract-based DC.

The first step is for employers to assess whether they have an existing scheme that would meet the requirements for a qualifying scheme, and, if not, whether it would be beneficial to make changes to achieve this.

QUALIFYING SCHEMES

The main criteria for a qualifying scheme are as follows.

- A DB scheme which has a contracting-out certificate on the reference scheme basis or which meets a “test scheme standard” under the Pensions Act 2008. In summary, the test scheme standard requires a pension to be paid from age 65 for life, based on pensionable service of up to 40 years at an accrual rate of 1/120th of average qualifying earnings in the last three full tax years worked. For a DB qualifying scheme there is a propsed 10% tolerance level in terms of passing the test.
- A DC scheme (trust or contract-based) with contributions of at least 8% of qualifying earnings of which at least 3% is an employer contribution. DC schemes have different definitions of pensionable pay and so the employer will be required to certify each year that it is broadly on track to meet the overall contribution requirements and will need to carry out an annual reconciliation at the year end. Under current proposals, employers will be able to certify their DC scheme themselves but only if it does not fail certain “shortfall” tests. Where the annual reconcilation reveals a contribution shortfall, employers will not be required to make any retrospective contributions where:
  - the shortfall is not more than 5% for any one jobholder;
  - no more than 10% of jobholders suffer any shortfall; and
  - no single jobholder suffers any shortfall more than once in 2 years.

The legislation distinguishes between a scheme-wide DB test and an individually based DC test, prompting many industry voices to point out that the inevitable consequence of the DC regime is individual sampling.

- Hybrid schemes (ie those with an element of DB and DC) are rather more difficult to legislate for, as this term covers a number of different scheme designs (nine designs are identified in the consultation). Broadly, the draft legislation provides that these schemes will have to meet the standard for either DB or DC schemes. In some cases this will be a straightforward assessment: if the scheme only provides ancillary benefits on a DB or DC basis it will need to satisfy the test applying to the main scheme benefits provided. Schemes which are split into sections, where some sections offer DB benefits and others DC benefits, will need to satisfy both tests as though the sections are different schemes. Schemes offering DB benefits with a DC underpin will need to meet the quality test for a DB scheme, and those offering DC benefits with a DB underpin will need to meet the DC test. For other combinations (and believe it or not there are still a few that we have not covered here!) either the DC test or the DB test will apply with specific modifications to be set out in legislation.

Qualifying schemes must offer automatic enrolment with no restrictions on individuals joining the scheme and no requirement for jobholders to express a choice, or provide information, in order to remain active members. For example, employees joining a DC scheme will not be required to make a choice about investments so the scheme must have a default fund. Eligibility rules which give a discretion over joining linked to medical underwriting will also be invalid for the purpose of automatic enrolment.

HOW DOES YOUR SCHEME COMPLY?

Changes are likely to be needed to eligibility requirements in order for any existing pension scheme to become a qualifying scheme. Employers need to carefully consider whether other changes are needed, whether these are financially viable and, if not, what alternative pension provision should be offered to some or all employees.

> Employers need to consider whether changes are needed to existing pension arrangements and whether such changes are financially viable.

Let's look more closely at some key issues broken down by the type of pension provision offered at present.

Current pension provision	**Considerations**
DB pension scheme	The personal accounts scheme is not a genuine alternative to sophisticated salary related pension schemes. Employers with final salary or career average schemes are likely to rely on these in order to meet the exemption in respect of existing members. However, the cost of broadening the membership to the entire workforce may be prohibitive. Employers may want to consider reducing benefits in the DB arrangement to offset the cost of increased membership. Alternatively, they may wish to provide a cheaper alternative for new recruits and operate a two-tier approach to pension provision. Where schemes have been closed to new entrants (in line with the recent trend) a change in approach will potentially require amendments to be made to re-open the scheme.
Trust-based DC pension scheme	The discretionary powers inherent in trust structures cannot be replicated in a contract-based vehicle and will not be mirrored in the personal accounts scheme. We anticipate that employers with trust-based DC schemes may well therefore retain them, ensuring compliance as a qualifying scheme. DC schemes often calculate contributions on basic pay, whilst the qualifying scheme criteria uses gross pay. This does not necessarily mean that a change in contributions is required, but the overall amounts must satisfy the qualifying scheme minimum.
Hybrid scheme	The first step is to work out which of the qualifying scheme tests applies! The considerations for DB and/or DC schemes will apply as set out above.
Contract-based DC scheme	It may appear to be more cost-effective to use the personal accounts scheme for future contributions. But consider the transition costs and hassle of unwinding contract-based arrangements: is it worth it? The employer may prefer to retain the existing scheme and ensure that it meets the qualifying scheme requirements. Employers may wish to offer the wider investment choice available through their own arrangement and the option of branding it as a company arrangement ("white labelling").
Little or no pension provision	Employers who are not subject to stakeholder pension obligations or who have complied with them to the bare minimum (by designating a scheme but not offering any employer contributions to it) are not likely to want to introduce any sophisticated arrangements now. These employers are the target market for the personal accounts scheme. Employers wanting more flexibility (for example allowing transfers in and out) may elect to put in place a contract-based DC scheme and perhaps a separate life assurance trust.

Employers can generally offer different pension provisions for different groups of employees without falling foul of age discrimination legislation (but should also be aware of the potential for other discrimination claims, such as on grounds of sex).

TIMING ISSUES

Determination of size by PAYE scheme

As mentioned in the first article “Automatic enrolment explained” it is proposed that the new employer duties will start to apply at some point between October 2012 and October 2015 depending on the number of employments attributed to the company’s PAYE scheme. If an employer runs more than one PAYE scheme it will need to meet the requirements for all workers as soon as the duties apply to the first (ie largest) PAYE scheme. Employers should be able to work out when the provisions will apply to them, and if the timing is vital, could consider making changes to PAYE size.

Early automatic enrolment

Employers who offer only contract-based DC schemes won’t be able to start automatic enrolment until they have a legal obligation to do so. The reasons for this derive from European financial services law. The same restrictions do not apply to trust-based schemes. We do not imagine that many employers will be clamouring to bring their duties forward, but in some cases it may make sense to align automatic enrolment with the start of the company’s financial year or tax year, or to avoid the new duties starting during a particularly busy business period. Application can be made to the Pensions Regulator who will need to be satisfied that the employer has the provisions in place to cope with early automatic enrolment.

Project plan to 2012

A typical employer’s action plan could look something like this.

1. **Impact assessment.** Assess the potential cost of complying with the new employer duty. Large employers currently offering little in terms of pension provision will suffer the highest costs.

2. **Consider options.** Employers may be largely influenced by affordability, but should also take into account industrial relations and market forces.

3. **Take advice.** Build a full picture of the pros and cons of all options.

4. **Develop proposal.** Based upon the advice received, select the preferred option and develop a more detailed implementation timetable. As part of this, consider:

    - whether any additional costs can be offset by salary sacrifice, or by reduction in remuneration packages;

    - the potential for efficiency savings in the existing pensions portfolio by implementing scheme mergers and streamlining processes; and

    - the possibility of cutting the cost of DB liabilities by undertaking enhanced transfer value exercises or other liability reduction strategies.

5. **Internal sign off.** For larger employers with some form of reward and benefits committee, there could be a lengthy process involved in obtaining internal sign off.

6. **Consultation.** If the proposal involves a change to the terms and conditions of existing employees it may be necessary to go through a 60 day consultation process. Where a workforce is unionised it would also be helpful to gauge union reaction to any proposed changes.

    A change to a trust-based pension scheme is likely to require trustee agreement. Check the amendment power and engage with the trustees at an early stage, as they may need to take their own advice.

7. **Implementation.** Work with the trustees or pension scheme provider to implement the changes. Communication with employees will be key. Where employers are offering more than the statutory minimum, make sure that employees are aware of this. To protect the employer’s position, it should recommend that employees take independent financial advice on any decisions regarding pensions.

8. **Compliance.** There are ongoing compliance requirements, in terms of automatic enrolment and re-enrolment, payment of contributions, information provision, registration and record keeping. Penalties can be imposed for non-compliance, so employers should take an active interest in this area.

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The personal accounts scheme: what will it look like and who should join?

In April this year the DWP and the Personal Accounts Delivery Authority (PADA) published a consultation paper setting out the draft Order and Rules for the proposed personal accounts scheme (the Scheme). Incidentally, we do not yet know what the Scheme will be called; PADA is conducting market research into the subject, but we await the outcome with interest! This was one of a number of different consultation exercises carried out by the Government and PADA (others relate to investment choices, charging structures and securing retirement income), but it contains the most detailed legal description of the operation of the Scheme from 2012. We now have the opportunity to consider what the Scheme will look like and how it will differ from the existing occupational and personal pension schemes which employers may offer their workforces currently.

The personal accounts scheme should be an exemplar of good governance.

LEGAL STRUCTURE

The legal structure of the Scheme is partly governed by the statutory provisions of the Pensions Act 2008 (the Act), but more particularly by a combination of a statutory instrument (referred to in the consultation paper as the Order) and the Rules of the new Scheme which will be appended to the Order. In general terms the Order reflects the contents that one would normally expect to see in a trust deed, although there are some administrative provisions and trustee powers which appeared in the draft Rules rather than the Order.

The Scheme has been designed to be set up as an occupational pension scheme governed by trust law, whose trustee is referred to as a “trustee corporation”. We suspect this is a misnomer in that trust corporations have particular requirements under the Public Trustee Act 1906. The constitution of the trustee corporation itself is set out under the Act, which requires that body to have a board made up of no fewer than nine but not more than fifteen members at any particular time. The Secretary of State will have the power to appoint the initial board members, but once the trustee corporation is up and running, it will have the power to appoint new members. That power is subject to a requirement to consult with one of the other creations of the Act, the “members’ panel”. This body is to be established separately as a form of committee which has a role of oversight (but no real powers) in the running of the Scheme. It is a proxy for compliance with the member-nominated trustee legislation. The Act also makes provision for the establishment of an employers’ panel to perform a complementary role. Quite how these panels will operate in practice remains to be seen, given the enormous number of potential members and employers who could participate in the Scheme.

It is worth remembering that a conscious decision was taken to establish the scheme under a trust model, rather than as a contract-based scheme. The reasons for this are probably tied into the political objective of ensuring that the Scheme is an exemplar of good governance and the fact that the trust model has operated successfully in other industry-wide schemes. Whether it also reflects the short-comings of stakeholder pensions and the fact that there is a widely acknowledged governance vacuum in such arrangements is a matter of opinion, but there is certainly a perception that having a trustee body will give members confidence that their interests are being looked after independently of their employer.

PURPOSE OF THE SCHEME

It is important to understand in looking at the structure and benefit design of the Scheme that PADA was given a brief to create a simple benefit structure to provide for pensions savings of low to middle earners which, above all, would be capable of being run on a very low cost base. This fact underlines a lot of the differences between the Scheme and other occupational or personal pension arrangements.

DIFFERENCES FROM OTHER OCCUPATIONAL/PERSONAL PENSIONS

A major difference is that there is no concept of deferred membership of the Scheme. In other words, if a member joins the Scheme and does not opt out within the statutory period after automatic enrolment, he will retain the status of an active member until he retires. This means that there is no facility for a refund of contributions (other than if a member leaves the Scheme in the opt out period for automatic enrolment).

Another radical and connected simplification of membership terms is that the Scheme will not generally allow transfers in or out to be made, although there is a facility to suspend this rule in relation to pension sharing on divorce. Also removing the concept of deferred membership means that the transfer value regime will not apply to the Scheme.

Another key difference relates to the level of contributions which is fixed at a minimum of 8% of a member's "qualifying earnings" in the relevant pay reference period. Overall contributions are limited to £3,600 (in 2005 terms) but the Order includes a mechanism for increasing the limit in line with average earnings. Hence, within a normal occupational or even personal pension scheme, where it is possible to prescribe different elements of remuneration as being pensionable, the Scheme will allow no such tailoring to individual circumstances.

The role of the trustee in the Scheme has also been simplified to some extent by taking away many of the discretions which would normally be found in an occupational scheme. Hence, the ability to pay death in service benefits is merely described by reference to paying a lump sum to a person nominated by the member or to his personal representatives, the relatives of the deceased member, a charity or by purchase of a dependant's annuity. This represents a deliberate departure from the tax privileged provisions enjoyed by occupational pensions whereby discretionary trusts allow death benefits to be paid free of inheritance tax. The assumption behind these provisions is a practical one (ie that the number of potential members would make it physically impossible for the trustee to track down and investigate personal circumstances), but it also represents a judgment call on the liability of typical members of the Scheme to inheritance tax.

In a similar vein of simplification, at present the draft Scheme Order and Rules contain no facility for paying scheme pensions. PADA has separately consulted on the thorny question of "decumulation", ie how it is possible to pay pension benefits from the Scheme or whether it would be better to create a panel of insurance providers to provide lifetime annuities than attempt to pay pensions from the Scheme.

TARGET EMPLOYERS

The Scheme will be open to all employers who wish to join. It may be that some employers see their workforces as containing sufficiently large numbers of seasonal or transient workers as being ideally suited to the Scheme's simplicity.

However, against this simplicity factor, any employer who wishes to design a scheme which has any degree of tailoring will find the Scheme wanting, since it will allow for no branding or "white labelling" of funds. It is also in the nature of an industry-wide scheme such as the Scheme, that employers will have no power in determining how the Scheme is operated. To some, this may be a bonus (in that it removes any management commitment) but we suspect the reality will be that if problems do occur with the Scheme, either in the collection of contributions or the investment of those contributions, employees will almost inevitably try to take up complaints initially with their employers rather than the trustee of the Scheme.

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> "PADA was given a brief to create a simple benefit structure to provide for pensions savings of low to middle earners, which above all, would be capable of being run on a very low cost base."

Keeping your house in order

We have so far focussed on the future shape of pension provision. Now let's consider some more immediate areas that trustees can tackle to ensure that their pension scheme remains in good working order.

FOSTER WHEELER – A NON-TECHNICAL SUMMARY

The much publicised *Foster Wheeler v Hanley* judgment in the Court of Appeal in July this year addressed the practical issue of sex equalisation in a pension scheme that used to have different retirement ages for men and women. Many schemes face this issue, as it used to appear sensible to provide pensions at age 65 for men and at age 60 for women in line with State pension provisions. For a period of time following the *Barber v Guardian Royal Exchange* judgment on 17 May 1990, retirement ages for men and women were equalised automatically at 60. Following further European judgments, most pension schemes subsequently amended their rules to equalise retirement ages to 65 (normally in 1993/94). This means that many members have some pension rights calculated with reference to a retirement age of 60 and some at age 65. This poses the question as to when members' benefits are actually payable?

"Court approval need not normally be sought for equalisation solutions."

In this case the Court of Appeal effectively ruled that members with retirement ages of both 60 and 65 should have all benefits paid at age 60, but any benefits built up in relation to a retirement age of 65 could be reduced for early payment. There will be different ways of achieving a practical equalisation solution following the guidance the Court gave, but these will depend on the rules of each scheme. Importantly, the judgment confirmed that Court approval need not normally be sought for equalisation solutions. Trustees should adopt the guiding approach of making "the least substantive alteration to the provisions of the scheme that is compatible with the required equalisation" without creating any detriment or windfall profit to the members. In other words, equalisation should be achieved fairly.

Our comment. In the light of this judgment trustees should reconsider their own scheme equalisation solutions and assess whether any modifications are needed.

CHANGE OF EARLY RETIREMENT AGE

The lowest age at which pension scheme members can take their retirement pensions will change from age 50 to age 55 from April 2010, except for individuals who have a "protected retirement age" below age 55. In very general terms, members will have a protected retirement age if, on 5 April 2006, they had a right to retire before age 55 without requiring employer/trustee consent, where this was written into the scheme rules as at 10 December 2003. The right usually remains following a block transfer to another pension scheme (and various conditions apply).

Our comment. Most schemes will have already communicated this change to members, but now is the time to consider whether enough has been done to forewarn those in the age bracket directly affected by this issue. Any remaining doubts regarding whether protected retirement ages exist are best clarified well in advance of April 2010.

HIGHER STANDARDS FOR DC SCHEMES

The Pensions Regulator has issued a statement on promoting higher standards for DC schemes. The aim is twofold: to encourage employers to engage with the pension arrangements that they provide to employees; and to ensure that trustees and providers are enabling members approaching retirement to make the right choices.

On the former aim, the Regulator and the Financial Services Authority have produced guidance for employers on the information and support that they can offer to employees who are members of trust and contract-based pension schemes. On the latter aim, the Regulator seeks improvements, as its research shows that over one-third of schemes have not reviewed their retirement processes for over three years (and some schemes have never done so).

The Regulator's chief executive Tony Hobman says: "It is more important than ever in these challenging economic times for members to make the right decisions to maximise value for money at retirement".

The Regulator believes that more can be done to improve member outcomes, and to this end has updated its own leaflet on retirement choices. The leaflet describes the range of options available to members approaching retirement, including annuity types and other alternatives. Importantly, the Regulator is also reviewing standards of pre-retirement literature and processes in a sample of schemes.

Although the statement is aimed at pure DC arrangements, most DB schemes still offer a DC Additional Voluntary Contribution facility to members. DB trustees have important fiduciary duties towards AVCs: including monitoring investment performance and ensuring that investment options offered to members are appropriate.

Our comment. Companies and trustees should be aware that their own scheme may come under scrutiny. They should consider whether any action is needed, including whether their current system for monitoring and reviewing AVC arrangements is sufficient.

Compliance and the Codes of Practice – make it work for you

The Pension Regulator's Codes of Practice set out its expectations of how trustees and others will comply with certain aspects of pensions law. The danger is that reviews and procedures can become 'tick box' exercises rather than adding value (as intended) to the management of pension schemes. We highlight some of the Regulator's expectations, and suggest ways in which these may best work for your scheme.

> "..trustees will be expected to read the trust documentation thoroughly."

UPDATED TRUSTEE KNOWLEDGE AND UNDERSTANDING PROVISIONS

The Regulator states that existing trustees who have had insufficient opportunities for learning or have purely had induction training should "rectify the matter at once and their first task is to carry out a training needs analysis, using the relevant version of the scope guidance". This is a particularly strong statement, which is accompanied by other strong statements in the Regulator's updated draft Code that is currently laid before Parliament. The emphasis placed on completion of the Trustee toolkit (ie the e-learning modules at www.trusteetoolkit.com) has strengthened. The toolkit will become mandatory study for new trustees "unless they can find an alternative learning programme which covers all the items in the scope guidance at a level relevant for them". The Regulator is also raising the bar in terms of requiring trustees to understand the trust documentation – trustees will be expected to read the trust documentation thoroughly – this was not previously the case.

Our comment. If your scheme's trustees have "lapsed" in their assessment of training needs or their attendance at training events, then now is the time to re-energise them. A simple training plan should take shape from a training assessment. If the plan contains dates by which each aspect of training or learning should be achieved then it is more likely to happen. Discuss as a group how you feel about the new requirement to read the trust documentation thoroughly: are all trustees comfortable with this? Consider having trustee training as a standing item on meeting agendas, regularly reviewing what has been achieved and what else needs to be done. Remember that training can take many forms – but whatever form it takes, it needs to be done for all trustees.

REPORTING

The Regulator expects anyone with a "whistleblowing" duty under the Pensions Act 2004 to understand the requirements of the law and the Code of Practice. This duty not only includes trustees, participating companies and advisers, but also extends to any other person involved in aspects of pensions administration, including payroll staff. Additionally, all reporters "should establish a procedure for evaluating matters to determine whether a breach has occurred and, if it has, whether it is likely to be of material significance to the Pensions Regulator". Breaches and other notifications need to be reported "as soon as reasonably practicable" depending on the circumstances.

Our comment. The current requirement for reporting breaches of the law (and other specific "notifiable" events) has been in place since April 2005. It is likely that your scheme has seen changes of trustees, or changes of company personnel with pensions responsibilities since this date. Do all individuals with whistleblowing responsibilities understand their duties and are they aware of the scheme's procedures for dealing with such events?

INTERNAL CONTROLS

The Regulator recommends that trustees carry out a risk based assessment of their pension scheme which should be "reviewed periodically, at least on an annual basis, or sooner if substantial changes take place, such as a deterioration in funding, change in investment manager, or where a control has been found to be inadequate".

Our comment. Trustees should see risk management as an integral part of running their scheme. Identify and concentrate on the key risks: can any of these be mitigated, for example by closer monitoring, greater understanding or insurance? Make sure that your risk register is action focussed with responsibilities clearly allocated. Any action taken should serve to reduce the likelihood of the risk occurring or the potential impact if the risk did occur.

MEMBER NOMINATED TRUSTEES (MNTs)

The Regulator expects that trustees will review their rules for the nomination and selection of MNTs every three to five years. Trustees should consider an earlier review "if there is a material change to the scheme's circumstances and/or membership (for example, a bulk transfer in of new members or a large number of redundancies)".

Our comment. When reviewing your scheme's MNT rules consider whether the existing selection provisions are working as well as expected. Are potential MNTs given sufficient information about the requirements of the trustee role to understand what they are volunteering for, or to generate enough interest? If your selection process operates by ballot then the most popular candidate will be elected but this may or may not be the best candidate. Is there any merit in instead introducing an impartial selection panel, especially if the trustee board has a skills gap that needs to be filled?

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And finally… age discrimination? Watch this space!

Earlier this year, as part of what has been commonly termed "the *Heyday* case", the European Court referred back to the High Court the question of whether the default retirement age of 65 contained in the 2006 Age Regulations could be justified.

The High Court held that it can be justified. As a result, employers can, for the time being, continue to retire employees at age 65 lawfully, provided of course that they comply with the correct procedures.

The High Court's decision is unlikely to be the end of the matter. The judgment states that the outcome might have been different had the Government not already announced in July this year that it was bringing forward its review of the Age Regulations from 2011 to 2010 (although no specific review date was set). It is too early to say with any certainty what the likely outcome of the review will be. Will the Government decide to abolish the default retirement age altogether or will it increase the age threshold to, for example, 70? Employers will have to wait until 2010 to find out…