SQUIRE SANDERS

PENSIONS UPDATE
WHAT HAVE YOU MISSED?

October 2012

Welcome to the latest Squire Sanders Pensions Update. In this publication we turn our attention to a number of key pensions developments that may have passed you by whilst you were enjoying your summer break.

Improving Transfers and Dealing With Small Pension Pots

Forthcoming changes to refunds of contributions and transfers will have a financial and procedural impact on pension plans.

Refunds of Contributions

One of the Government's key aims is to encourage people to save more for their retirement. The Government believes that the current legislation – which allows occupational pension plans to offer refunds of contributions to members with less than two years of membership – does not assist this aim.

Back in December 2011 the Pensions Minister announced[1] his intention to abolish refunds of contributions from defined contribution plans. Following consultation, he restated his commitment to abolishing such refunds but did concede that retaining the ability to repay "tiny" amounts makes administrative sense. Changes to legislation are unlikely to come about before 2014 because the Government needs to reshape transfer legislation at the same time (see below).

The Need For Change

The introduction of automatic enrolment is intended to bring about a culture change where saving for retirement is the norm. Bringing more people into the pensions system means that there will be an increase in the number of small pension pots. The DWP estimates that the average person is expected to have 11 jobs in his working lifetime. If he is automatically enrolled into 11 different pension plans then when he retires his pension savings are likely to be distributed across multiple plans as the current transfer system presents too many barriers for most members to consolidate their benefits.

Small pension pots present a number of problems: members can lose track of their entitlements, find it difficult to calculate their expected benefits and have restricted options for purchasing annuities. From the employer's perspective it costs a disproportionate amount of money to administer small pension pots. The Government recognises that it cannot feasibly abolish refunds of contributions from defined contribution plans without massive simplifications to the transfer system; otherwise the number of small pension pots will grow and will act as a disincentive to individual savers.

1 In the DWP consultation document "Meeting future workplace pension challenges: improving transfers and dealing with small pension pots."

Transfer Reform

Last year the DWP consulted on three possible approaches to promote the consolidation of small pension entitlements. In July 2012 it announced its decision to pursue the most ambitious of those approaches: an automatic transfer system where an individual's pension pot will transfer to the pension plan of his new employer when he changes job.

There is a lot of work to do in terms of the practicalities of how the automatic transfer proposal will work. At this stage there are more questions than answers but the consultation response provides clarity on some key areas.

What We Know

- The compulsory transfer process will only apply to small pots from defined contribution pension plans that arise from automatic enrolment. Legacy small pension pots and defined benefit rights will be outside the scope of the automatic transfer proposal at this stage and will therefore remain as deferred pensions in the original plan unless a member decides to make a transfer to a pension plan that is willing to accept it.
- Members will be able to opt out of the automatic transfer process.
- Automatic transfers will be unadvised business (ie no financial advice is required).
- We can expect improvements to the current voluntary transfer system. This may help with the pension pots that fall outside the automatic transfer proposal. The Government is also exploring a "virtual amalgamation tool" to allow individuals to see all of their pensions savings in one place.

What We Don't Know

- The Government has yet to decide on the upper transfer limit, beyond which automatic transfers will not take place. As the pension pot transfers with a member it will increase over the member's lifetime – there will come a point where a member should start to make decisions and an automatic transfer will no longer be appropriate due to the size of the benefit.
- We await detail on the central pensions database that will be required in order for the transfer system to work, and who will be responsible for devising and maintaining this database.
- How the cost of automatic transfers will be met.
- What will happen where an individual has multiple jobs or a gap in employment.
- When (and how) legacy small pension pots and defined benefit rights will be brought into the automatic transfer process.

Employers and trustees should keep up to date with developments in this area.

Record Keeping

In June 2010 the Pensions Regulator set a target for pension plans to achieve by December 2012: 100% of "common" data – such as name, address and date of birth – to be in place for all member data created from the beginning of June 2010, and a 95% standard for member data created before June 2010. In addition, pension plan trustees in conjunction with administrators were tasked with setting targets for the standards of 'conditional' data (that is the extra data that is necessary to administer the pension plan in question).

As part of a push to help trustees and administrators get their records in order by the end of the year, the Regulator has published a progress checklist for trustees and some frequently asked questions about measuring data.

All trustees should have plans in place for how their pension fund will meet the Regulator's expectations. These plans should be regularly monitored.

Pensions Incentive Exercises

A voluntary Code of Good Practice on pensions incentive exercises was issued in June 2012. This was produced by a pensions industry body in response to the Pensions Minister's concerns about "bad practices". See our 15 June 2012 communication: Pensions Incentive Exercises Clarified.

Employers and trustees who are involved in (or who are considering undertaking) an incentive exercise should be aware of the latest developments and should seek legal advice.

Takeover Code

Consultation on changes to the Takeover Code closed on 28 September 2012. If the proposals go ahead, pensions will have an increased profile on corporate transactions involving public companies.

Amongst the proposals, the bidding company would be required to state in the offer document its intentions regarding the target company's pension arrangements and whether or not its strategic plans for the target company are likely to have any impact on those pension arrangements.

The Code Committee of the Takeover Panel expect that if the proposals are implemented the effect would be to create a framework within which the target company's pension plans would become a debating point during the course of the offer and provide adequate opportunity for the pension plan trustees and the target company to express their views.

FSDs and Insolvency – the Regulator's Statement

The Pensions Regulator has issued a statement on how it will exercise its power to issue Financial Support Directions against companies in insolvency. This follows the High Court decision (upheld by the Court of Appeal in *Bloom v Pensions Regulator*[2]) that FSDs issued after an administrator has been appointed count as an expense of the administration, thus ranking above unsecured creditors, floating charge holders and the administrator's own fees. The decision is subject to an appeal to the Supreme Court in May 2013.

The Regulator's statement is intended to help the banking, restructuring and insolvency industries understand its approach to FSDs in insolvency situations and provide reassurance that the Regulator does not intend to "frustrate" the proper workings of the restructuring and rescue culture or the lending market.

Although the statement offers a degree of comfort, we have no certainty regarding how the Regulator will act in a specific case. This lack of certainty may influence the decisions of lenders and administrators pending the outcome of the appeal to the Supreme Court and/or a change in the law.

2 Bloom and others v Pensions Regulator and others, 2011.

Stakeholder Access Abolition

The requirement to provide access to a stakeholder pension plan was abolished with effect from 1 October 2012. However, where an employee is already a member of a stakeholder plan on 1 October 2012, and has had at least one pension deduction from his pay, the employer will still be under a duty to deduct and pay pension contributions to the stakeholder plan.

Employers should be aware of the change to legislation and consider how this affects pension arrangements offered to new employees.

Automatic Enrolment

Our update would not be complete without a few words about automatic enrolment. The largest employers had a staging date of 1 October 2012 – some of these employers chose to bring their staging date forwards. Employers who had 500 or more people in their PAYE scheme as at 1 April 2012 will have an automatic enrolment staging date before the end of next year. Those employers should now have plans in place to address their automatic enrolment duties.

Whilst the pensions industry is getting to grips with the practicalities of the recently finalised legislation, the DWP is consulting on the earnings thresholds for the tax year 2013/2014. The Government's provisional view is that the automatic enrolment trigger should be aligned with the PAYE threshold (£9,205), and the lower and upper limits of the qualifying earnings band aligned with the lower and upper earnings limits for NICs (£5,720 and £41,450 - projected values), but these are not the only options.

Employers with 2013 staging dates should now have plans in place to address their automatic enrolment duties.

Further Information

For further information please contact any of the partners listed below or your usual contact in the Squire Sanders pensions team.

Catherine McKenna
Partner, Leeds
T +44 113 284 7045
E catherine.mckenna@squiresanders.com

Wendy Hunter
Partner, London
T +44 20 7655 1119
E wendy.hunter@squiresanders.com

Ian Forrest
Partner, Birmingham
T +44 121 222 3418
E ian.forrest@squiresanders.com

Charmian Johnson
Partner, Manchester
T +44 161 830 5047
E charmian.johnson@squiresanders.com

7529/10/12