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ACTION AND REACTION: MNTS AND THE DEREGULATORY REVIEW

1 INTRODUCTION

Keeping up to date with legislative changes is a daily battle for pensions managers and trustees. Here we remind you of one they prepared earlier - the cessation of the transitional arrangements for member-nominated trustees and directors (MNTs) is looming so trustee boards need to check they will still be compliant after 31 October 2007.

But for regulatory overwhelmed trustees, is the recently published Government Response to the Deregulatory Review (the Response) a light at the end of the tunnel?

2 KEY POINTS

Action: MNTs

- Transitional provisions for schemes with opt-outs cease on 31 October 2007 and all schemes must have one-third MNTs (see section 3).

Reaction: Response to Deregulatory Review

- The Government is consulting on the cap on revaluation in deferment, the introduction of a statutory override to scheme amendment powers and risk-sharing schemes (see section 5).
- Further work will be carried out on a number of proposals – including return of surplus, the application of the employer debt provisions to group reconstructions, disclosure and pension sharing (see section 6).
- The Review's proposals to scrap LPI and focus TKU at board rather than individual level will not be taken forward (see section 7).

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3 MEMBER-NOMINATED TRUSTEES

The updated MNT requirements in the Pensions Act 2004 (PA 2004) applied to many pension schemes with effect from 6 April 2006. However, transitional arrangements ensured that schemes which had an “opt-out” (employer or trustee) in place as at that date did not need to take action until the earlier of the date their opt-out expired and 31 October 2007.

Timing

In brief, under PA 2004, trustees must ensure that within a “reasonable period” of the provisions applying to their scheme, arrangements are in place to provide for at least one-third MNTs and that those arrangements are implemented. In general¹, the Pensions Regulator considers that:

- a reasonable period within which arrangements should be put in place is six months; and
- a reasonable period for the nomination and selection processes to take place is six months from arrangements being put in place.

But, where an opt-out is due to expire, the Pensions Regulator states in its Code of Practice² that “trustees should consider what new arrangements are needed before the 'opt-out' ceases”. Therefore, regardless of the reasonable periods listed in the Code, schemes which have not made such preparations should aim to expedite discussions and ensure they have one-third MNTs as soon as possible.

What happens to the trustees who were appointed under the “opt-out”?

The Pensions Regulator has confirmed that whilst trustees appointed under the terms of an “opt-out” remain as trustees until their term of office expires (or they are removed), they will not count as MNTs after the deadline.

¹ Subject to the specific circumstances of the scheme

² For details of the Code, please see our Sackers Extra Alert, “Cracking the MNT Code!” dated 12 April 2006

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4 THE DEREGULATORY REVIEW

An ongoing examination of pensions legislation with a view to simplifying the regulatory framework was promised in the White Paper of May 2006. March 2007 saw the publication of a consultation paper which was followed, in July 2007, by the advisory group's final report (the Report)³. On 22 October 2007, the Government published the Response.

A copy of the Response can be found by following the link below:

<http://www.dwp.gov.uk/pensionsreform/pdfs/government-response.pdf>

In its Response, the Government acknowledges that in simplifying the regulatory framework "it is difficult to strike the right balance between removing legislative burdens and protecting members" but believes the proposals in the Response are "a step in the right direction". But there will be no changes which would affect member's benefits which have already accrued.

The Government Response falls into two broad categories:

- Government proposals for change on which views are sought (see section 5).
- An action list of future projects (see section 6).

The Government also identifies areas which it is not going to take forward (see section 7).

5 GOVERNMENT PROPOSALS

There are three proposals on which the Government are actively seeking comments. The consultation period closes on 15 November 2007.

³ We have produced information at each stage – see our Sackers Extra Alerts, "The Pensions White Paper" dated 25 May 2006, "The White Paper – a question of more pensions reform" dated 21 August 2006, "The Two Reviews – double trouble from the DWP" dated 21 March 2007 and "Deregulatory Review – the simple life?" dated 27 July 2007

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- *Reduction in the cap for revaluation of deferred rights from 5% to 2.5%*

Since 1986, schemes have been required to protect the value of early leavers' deferred pensions against inflation by increasing the pension payable from normal pension age by the increase in the retail price index over the period of deferment, or 5 per cent compound, whichever is the less (this is called revaluation). The Deregulatory Review looked at reducing the cap from 5% to 2.5% but "on balance" recommended no change.

However, the Government is "minded to reduce the cap", justifying the move on the basis that it would bring the cap into line with that on indexation for pensions in payment and could lead to long-run savings in schemes. In addition, the Government notes that such a move would restore the economic climate which existed at the time of the introduction of revaluation i.e. that it would not provide total protection against inflation.

- *Statutory override to scheme amendment powers*

The Report proposed the introduction of an override to restrictions on scheme amendment powers which prevent schemes from altering their rules to implement legislative changes to benefits for future service. In particular, it noted that certain schemes have been unable to take advantage of the PA 2004's reduction in the indexation cap from 5% to 2.5%.

The Government agreed that it would be appropriate to provide schemes with flexibility in relation to the latter issue (and any future change in the cap on revaluation), but only in respect of future benefits. In consulting on this issue it is seeking views, in particular, on whether such an override should only be available if the trustees and employer agree to the change or whether the employer should be able to use it unilaterally.

- *Risk-sharing schemes*

The Report did not recommend the creation of a specific category of risk-sharing schemes, as the reviewers considered that there is already scope within existing legislation for such schemes to develop. However, they

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did suggest a package of changes – including changes to the Pension Protection Fund levy (and compensation) and proposed clarification of section 67 to provide greater scope for risk-based defined benefit (DB) schemes to “flourish” – which the Government have said that they will keep under review.

Going one step further, the Government wishes to explore further the idea of introducing a third layer of legislation to make provision for risk-sharing schemes which would not have to comply with all the same requirements as current DB schemes. It seeks views on whether this would be appropriate.

6 FUTURE PROJECTS

The following are items on the Government's agenda for the future.

- Treatment of surplus – the Government is minded to accept the Report's proposal that the requirement for trustees to be satisfied that the return of surplus is in members' interests should be removed as it “encourages overly conservative behaviour”. But it does not agree that a return of surplus should, with trustees' agreement, be available once the scheme specific funding target is reached. It intends to “explore the scope” for addressing employers' concerns that excess funds will become trapped in pension schemes.
- Employer Debt – the Report's recommendation of a twelve month “period of grace” (whereby no debt will be triggered if an employer stops employing active members expecting to take on someone else within that time frame and does so) has been accepted⁴. They will also look at employer debt implications of group reorganisations.
- Disclosure – the Government plans to move towards a principles based approach to legislation with the disclosure requirements relating to the day to day running of a pension scheme being used as a test bed for that approach.

⁴ See our Sackers Extra Alert, “Draft Regulations – Forever in Your Debt” dated 10 August 2007

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- Pension sharing on divorce – it will repeal the legislative requirements on pension sharing which apply to safeguarded rights⁵ “at the next available opportunity” and review the remaining legislation applying to the payment of pension credit benefits.

7 NON-STARTERS

Finally, the Government has decided not to take forward the following proposals of the Deregulatory Review:

- *Requirement to increase pensions in payment (limited price indexation)*

Although scrapping the requirement to provide limited price indexation (LPI) for pensions in payment was on the agenda of the Deregulatory Review, the Report made no recommendation as the reviewers were “unable to agree”. The Government has decided that, in the absence of evidence that its removal would “have a direct and significant impact on employer [pension] provision”, this requirement should remain on the statute books. It considers that any savings for employers would be at the expense of future pensioners.

- *Trustee knowledge and understanding (TKU)*

The Report recommended concentrating the requirement for trustee “expertise” collectively at board level. But the Government does not agree. However, it accepts that there may be misconceptions as to the TKU requirement and will work with TPR to remedy this.

⁵ Pension credit benefits derived from contracted-out rights