Pensions Bulletin September 2010

The Regulator bares its teeth – first Contribution Notice served

Belgium firm Michel Van De Wiele (VDW) has been ordered to pay £5m to the pension scheme of its UK subsidiary, becoming the first recipient of a Contribution Notice from the Pensions Regulator.

Bonas UK Limited ("Bonas") was the sole participating employer in the Bonas Pension Scheme. VDW acquired Bonas in the late 1990s. The Trustees of the Scheme had asked VDW for a parent company guarantee in relation to the scheme, but this was rejected. The Pensions Regulator noted that VDW was controlling the decisions made in relation to the pension scheme, and also that VDW had supplied substantial contributions to the scheme in the past. Despite these contributions however the scheme remained in deficit.

In 2006 VDW embarked on a "pre-pack" sale of Bonas, putting them into administration and then selling the company on to another subsidiary of VDW. All creditors other than the pension scheme were to be paid by VDW before Bonas's entry into administration. Effectively, the plan resulted in VDW walking away from the pension scheme deficit whilst retaining the business and employees of Bonas.

According to the Regulator, the trustees were not told in advance about the sale and administration, and the information given by VDW to the trustees about its likely future support for the scheme was misleading.

Key to the Regulator's decision as to why it was reasonable to issue a contribution notice was the fact they thought it was clear that it was the parent company, VDW, who were pulling the strings, as was evidenced by their previous financial support for the scheme and their close involvement in all decision making in relation to the scheme.

Avoiding contribution notices

For companies and company directors to be sure that they will not be hit with a contribution notice they can apply to the Pensions Regulator for "Clearance" in relation to certain corporate transactions.

The Regulator will not consider an application for clearance unless the application is supported by the trustees of the scheme. In turn, the trustees of a scheme cannot support an application for clearance unless they are convinced that the transaction will not harm the interests of their scheme members. In many cases the Regulator and the trustees will require some "mitigation" – for example increased scheme contributions, guarantees, or charges over assets – before they could support an application.

To decide upon how an action impacts on the employer covenant, and upon what might be appropriate mitigation, trustee are expected to seek detailed advice from their lawyer, actuary, and probably an external expert in covenant assessment.

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Further detail on Clearance, Contribution Notices, and other actions the Regulator can take in relation to forcing an employer to provide assistance to a pension scheme, can be found in our November 2009 bulletin on our website.

CPI pension increases – what should trustees be doing right now?

The Government has announced that the measure of inflation used to calculate pension increases, both to deferred pensions before retirement and to pensions in payment, will change from RPI to CPI. This change will apply to State pensions, public sector pensions, and possibly private sector pensions, although whether your scheme will be affected will depend on the wording of your own scheme's rules and the wording of the final legislation.

Pension increases to September 2010 will continue to be by reference to RPI: the change to CPI will apply thereafter. However, the change would still impact on a member's past service accrued rights because future increases will still relate to benefits that were earned in the past. Generally, we would expect CPI to be lower than RPI, so that the value of many members' past service benefits could therefore be reduced by this change.

As the legislation that will impact on private sector schemes has not yet been released, what action, if any, should you be taking right now? For example, public sector schemes are no longer quoting transfer values; should private sector schemes be doing the same? Should actuarial valuations be delayed until the legislation is released?

In our opinion it should – in most cases - be business as usual for trustees of private sector schemes. We are still uncertain about the form of the final legislation, and when it does arrive we believe it is almost inevitable that there will be a legal challenge over this issue from or on behalf of members who have seen the value of their pension rights reduced. As it could therefore take some time to reach a conclusion on this matter it would seem to us to be unreasonable to delay transfer value quotations or other normal business until this issue is resolved.

Trustees could however consider issuing a communication to members on the subject, and instructing their lawyer to be ready to advise on the subject as soon as there is sufficient information available for a definitive opinion.

Abolition of DC contracting-out & impact on DB transfers

The DWP plans to abolish contracting-out on a defined contribution basis from April 2012, and have now issued a consultation paper on the consequential legislation arising from this.

The legislation is likely to prevent transfers from contracted out defined benefit schemes after 2012. The consultation in fact makes it clear that this is not an un-intended consequence of the legislation but is actually a feature already recognised by the DWP – so it appears unlikely that this feature might be changed in the final legislation.

Schemes looking to implement an enhanced transfer value exercise will therefore need to

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act quickly before the door is closed on them.

Enhanced transfer value exercises

The Pensions Regulator has issued further guidance in relation to transfer value exercises i.e. where an employer encourages a member to accept a transfer out of a scheme in return for some “inducement”, commonly a cash payment or a top-up to the transfer value.

The guidance does not say that these exercises cannot happen, but stresses the need for the trustees to ensure that the process is fair, that communications are not mis-leading, and that ideally the employer should be prepared to pay for the member to receive independent financial advice.

As mentioned above, most employers seeking to conduct such an exercise will need to act quickly to ensure it is all completed before April 2012.

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