

Pensions law update

June 2003

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Introduction

On 11 June 2003 the Government announced an "Action Plan" for Pensions Law. **One key element of this will come into effect from 11 June 2003 and may directly affect projects or transactions already in progress.**

The cost of winding up a pension scheme

An employer is not required to provide an occupational pension scheme for its staff so employers can close their pension schemes down and wind them up. Up until 10 June 2003, an employer who wound up a defined benefit (final salary) scheme was only obliged by law to fund it to the Minimum Funding Requirement ("MFR"). This statutory MFR level had become discredited as it was far below the level needed to match the benefits promised to employees and former employees, but it is still in force.

After 10 June 2003, if a solvent employer seeks to wind up a defined benefit scheme, it will need to provide the scheme with sufficient funds to buy out all benefits in full with an insurance company. The cost of this will be greatly in excess of the MFR cost and the exact figures will vary between schemes. As an example, for one client the additional cost appears to be £50,000 per member.

Where the cost-benefit analysis of a project, merger or acquisition includes winding up a pension scheme, the analysis will now have to be done again and is likely to produce a different answer. If continuing the scheme as a closed fund is an available option it is likely to be preferable in financial terms.

Legislative timing

The Government has published draft legislation to implement this change. It is planned that the legislation will come into effect in "autumn 2003". The draft legislation backdates the changes to 11 June 2003, i.e. the law will apply to any scheme which commenced winding-up on or after that date.

Effect on projects and transactions

If an employer is planning to wind-up a defined benefit occupational pension scheme, it will need to think again. It is highly unlikely that it will be able to afford the funding cost of so doing. Even if it can afford the cost, it is likely to be more cost effective to run the scheme on even if it is closed to new members and the accrual of new benefits. Whether this is possible without a scheme amendment will depend on the rules of the particular scheme involved.

Where an employer's intention is to continue a scheme indefinitely there should not be a direct effect from the change, although trustees may be able to negotiate higher funding rates.

The change does not affect the law relating to insolvent employers or defined contribution (money purchase) schemes.

Other changes

You may also have seen from press reports some detail of other changes. Whilst the Government has not provided full details on all of these, none is expected to come into force this year. The most notable are probably as follows:

- the Transfer of Undertakings (Protection of Employment) Regulations ("TUPE") will be extended to cover pensions in a limited form, probably from spring 2004;
- Creation of a Pensions Protection Fund, something between a mutual insurance scheme and a central discontinuance fund for wound-up schemes with insolvent employers, expected to come into force in April 2005 and financed by a levy on pension schemes; and
- A requirement to consult employees when making significant changes to their pension provision (again, April 2005 is the likely commencement date).

Specific Advice

The circumstances of individual schemes are important and this is only a general statement of the law.

Contacts

Our pensions law partner, Belinda Benney, leads a team of specialist and experienced pensions lawyers. If you need pensions advice or assistance please contact:

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FFW also has specialist **employment, investment products** and **tax** lawyers.

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