

A busy week in pensions - Regulator and UK Government announcements

“Members’ loss?” Regulator publishes new guidance on incentive exercises

Following several months’ consultation, the Pensions Regulator has published new guidance on incentive exercises. This replaces the Regulator’s original guidance published in January 2007.

The new guidance is much more bearish than the original guidance, and suggests that trustees should be involved in “policing” incentive exercises. The Regulator thinks it unlikely that an exercise could be a “win-win” for members and employer: “the employer’s gain may well be the members’ loss”.

WHAT IS AN INCENTIVE EXERCISE?

An incentive exercise is an arrangement whereby an employer seeks to reduce pension scheme liabilities by persuading members to transfer or modify their benefits. The most common examples are:

- transfer incentive arrangements – the employer encourages deferred pensioners to transfer out their benefits, for example by offering a top-up to transfer values, or cash payments.
- pension increase exchanges – the employer offers pensioners the chance to give up non-statutory pension increases in return for an immediate uplift in their pensions.

WHAT DOES THE NEW GUIDANCE SAY?

The Regulator’s main points are as follows.

Trustees should start from the presumption that an incentive exercise will not be in most members’ interests.

Fully independent financial advice should be made available to the relevant members, and should be promoted in the strongest possible terms. In almost all circumstances, the exercise should require members to take advice before accepting the employer’s offer.

Trustees should engage in the offer process and apply a high level of scrutiny to ensure that members’ interests are protected.

The employer’s offer should comply with five principles:

1. it should be clear, fair and not misleading
2. it should be open and transparent
3. conflicts of interest should be suitably managed
4. the trustees should be consulted and their concerns should be addressed
5. provision should be made for independent financial advice, as mentioned above.

To comply with principle (2), an employer may (for example) need to:

- explain why the incentive exercise is being proposed
- summarise the scheme’s long-term funding objectives
- refer members to the guidance.

WHERE DOES THIS LEAVE TRUSTEES?

The Regulator reminds trustees that they must comply with any applicable legislation – for example, as to:

- modification of schemes
- surrender of benefits
- member consultation
- data protection.

But the Regulator’s expectations go well beyond this. Trustees are told that they should play an active role in any incentive exercise. This despite the fact that, in many cases, the offer to members will come from the employer – and trustees have not, traditionally, had a duty to “advise or warn”.

The key point, in the Regulator’s eyes, is that members should be put in a position where they can make free and informed choices. The Regulator acknowledges

that final responsibility will then lie with members themselves: “trustees are not expected to make the members’ decisions for them”.

Other developments - an introduction

The Government has issued a number of other papers of interest this week. These include:

- a consultation paper discussing future changes to pensions legislation following the Government’s decision to use the Consumer Prices Index to fix the minimum increases to deferred pensions and (certain) pensions in payment;
- a statement in that consultation paper that, where a scheme’s rules governing accrued pensions promise increases based on the Retail Prices Index and do not specifically reserve a power to use another Index, the Government does *not* intend to give schemes any new powers to change the increases promised;
- the first revaluation order and the first pension increase order which use the Consumer Prices Index as the measure of inflation;
- more information about the new £50,000 annual allowance charge for tax purposes, including the detail of the proposed exemption from the charge where a member retires on grounds of “major” ill-health; this exemption will apply only where a doctor has confirmed that the member is unlikely ever to earn more than an “insignificant” level of income;
- confirmation that the reduction in the “lifetime allowance” on tax-efficient pension saving, from £1.8m to £1.5m, will apply from 6 April **2012**;
- more information about how the reduced lifetime allowance will affect members who opted for so-called primary protection or enhanced protection of the rights they had built up before 6 April 2006;
- details about the new “frozen” lifetime allowance of £1.8m for members who expect their current pension saving to exceed £1.5m when they come into payment and agree to cease further accrual; and
- new rules which seem to be intended to create a new tax charge where sums or assets are paid to an unregistered pension scheme, or are used to secure the benefits promised by an unregistered pension scheme.

We will issue further updates on these topics next week.

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