

## **Variations of Pensions Provisions**

This note provides guidance on the circumstances in which trustees and employers may amend the provisions of their occupational pension schemes. Broadly, trustees or employers cannot make changes that could detrimentally affect the pension rights members have accrued in the past, unless certain conditions are met or the members agree to the changes. It is possible to amend members' future rights without offending these provisions.

Occupational pension schemes are established under trust. A scheme's governing trust deed usually contains a specific power to amend the scheme. Additionally, section 68 of the Pensions Act 1995 (PA 1995) confers a statutory power of amendment in certain situations. In most cases, the scheme amendment power contains restrictions that limit its use. There are also statutory restrictions on amendments, contained in section 67 of the PA 1995.

### **Scheme amendment powers**

A scheme's sponsoring employer or the trustees usually exercise amendment powers jointly, or on their own account. Sometimes one party will need to obtain the agreement of the other to amendments. Before amending the scheme rules, the party with power to make the amendment must consider:

- The scope of the amendment power.
- Issues arising on its exercise, including:
  - the employer's duty of good faith;
  - any restrictions imposed on the trustees;
  - whether retrospective amendments may be made;
- Any necessary amendment formalities.

Pension schemes usually contain express amendment powers. It is necessary to determine

the scope of these powers before making an amendment. Amendment powers vary enormously in scope between schemes. Trustees and employers need to take particular care in analysing the precise words of an amendment power. Even a wide express power is likely to have some implied limitations on it. However, the key to determining the scope is to construe the power in such a way as to give reasonable and practical effect to the scheme, bearing in mind that it is operated against a commercial background.

When the employer exercises the amendment power (or gives or withholds its consent to an amendment), it must act in good faith. The employer must not, without reasonable and proper cause, act in a way "calculated or likely to destroy or seriously damage the relationship of confidence and trust between employer and employee" (*Re Imperial Tobacco*). The duty of good faith, as explained in *Imperial Tobacco*, requires that:

- Employers and trustees must exercise the scheme power for the purpose for which it was conferred and not for some other purpose;
- It is not acceptable for the employer to threaten the exercise or non-exercise of the power in order to secure other ends. This appears to be the case even where the threat would, if performed, be entirely lawful; and
- There is no requirement for the employer to set aside its own interests (including its financial interests) when considering the exercise of the power. Equally, there is no requirement for the employer to exercise its powers reasonably.

### **Statutory restrictions on scheme amendment powers**

The statutory restrictions are:

- The regime applying under section 67 of the PA 1995.
- For contracted-out schemes, section 37 of the Pension Schemes Act 1993 (PSA 1993)

Section 67 provides that no modification may be made to a scheme that would or might:

Convert a member's subsisting rights from salary-related benefits to money purchase benefits without the member's consent.

Reduce any pension in payment without the pensioner's consent.

These first two bullet points are referred to as protected modifications.

Have a detrimental effect on a member's subsisting rights unless either the member consents or the scheme actuary has provided the trustees with a statement that the benefits provided immediately before and after the change are actuarially equivalent (referred to as detrimental modifications).

The party with the power to make an amendment may not use it unless they have notified the affected members of the proposed change and informed them of its impact on their subsisting rights.

The trustees' consent to the proposed amendment is needed, even if the amendment power in the scheme rules is not vested in them.

Section 67 applies to occupational pension schemes regardless of their benefit structure.

Schemes which are exempt from Section 67 are:

- Public service pension schemes.
- Schemes with fewer than two members.
- Schemes which are not registered pension schemes.

### **What are a member's subsisting rights?**

A member's subsisting rights are:

- Any right which a member has accrued to future benefits under the scheme rules. This includes pension credit rights. In ascertaining the member's rights, he is deemed to have left pensionable service just before the proposed amendment.
- Any entitlement to present payment of a pension or other benefit which they have under the scheme's rules.

A survivor's subsisting rights are:

- Any right (including a pension credit right) to future benefits which they have under the scheme rules in respect of the member.
- Any entitlement to benefits which they have under the scheme rules in respect of the member.

### **What kind of modification would adversely affect a person's subsisting rights?**

A modification would or might adversely affect a person's subsisting rights if it would alter the nature or extent of the entitlement or right, so that the benefits (or future benefits) to which the entitlement or right relates could or might be less generous.

### **What are the employer's responsibilities?**

The Modification Code sets out the responsibilities of the scheme employer. It makes clear that even if the trustees have no role in making or approving scheme amendments, section 67 overrides scheme rules so that the employer may make no protected or detrimental modification unless the trustees consent and the necessary legislative requirements have been satisfied.

### **What is a protected modification?**

A protected modification is a change which:

- On taking effect would or might result in any subsisting right (other than a right or entitlement to money purchase benefits) of a member or survivor becoming or being replaced with a right or entitlement to money purchase benefits.
- Would or might result in a reduction to any pension in payment.

### **Protected modifications: what are the consent requirements?**

Before making an amendment, the trustees must:

- Inform each affected member in writing about the nature of the proposed change and the effect it will have on them.

The Modification Code comments that the affected members must be able to compare their position before and after the proposed change. While the information provided may be generic, trustees are encouraged to provide individual illustrations, if possible.

Notify affected members in writing that they may make representations to the trustees about the proposals. Trustees must give members a reasonable opportunity to make any representations.

The Modification Code states that trustees should give affected members four weeks (although this may vary depending on the proposed amendments and the number and location of the members) to make representations about the proposed change. Members should not feel under any pressure to make a decision without adequate time and opportunity to make their views known and to ask questions.

- Notify affected members in writing that the consent requirements apply.

The Modification Code makes clear that the consent requirements apply to each affected member. It is important to note that if an affected member does not consent to the change, his or her subsisting rights will remain unchanged. Trustees (and employers) need to prepare for this eventuality.

Once the trustees have satisfied the consent requirements and the affected members have consented, the modification must take place within a reasonable period of time. The Modification Code comments that the amendment should be implemented within a maximum of six months.

### **What is a detrimental modification?**

A detrimental modification is a change to an occupational pension scheme which would or might adversely affect any subsisting rights of any members or survivors when it took effect.

Employers or trustees may make a detrimental modification either with the consent of the affected members or by following the actuarial equivalence route.

### **Detrimental modifications: what is the actuarial equivalence route?**

The actuarial equivalence route is relevant only if the trustees decide to apply it. Broadly speaking, it requires that the affected members' subsisting rights must be actuarially equivalent immediately before and after the proposed change. As with the consent requirements for protected modifications, the actuarial equivalence test must be satisfied in relation to each affected member. The trustees will need to take actuarial advice as to whether this requirement is satisfied.

## **Detrimental modifications: the consent route?**

The consent requirements are identical to those that protected modifications must satisfy.

### **Trustee approval requirement**

Trustees may approve a regulated modification either when they are exercising the scheme's power of amendment themselves or when someone else (usually the employer) asks them to approve an amendment. In both cases they need to ensure that:

- The scheme's amendment power allows the proposed change.
- The proposed modification would be a proper use of the amendment power.

In addition to the above, the trustees must also ensure that:

- If the modification is a protected modification, they (or the employer) have obtained the informed consent of all affected members.
- If the modification is not a protected modification, they have either obtained the informed consent of affected members, met the information and actuarial value requirements, or both.
- They determine to make the modification (or consent to it) within a reasonable period of the first consent being received from an affected member. The Modification Code comments that the modification should be made within a maximum period of six months from the receipt of the first affected member's consent.

### **Trustee reporting requirement**

The trustees must inform affected members that they have decided to make a regulated modification (or consented to the modification being made):

- Within one month of taking that decision.
- Before the modification takes effect.

If the consent requirements apply, the trustees must notify each affected member. In contrast, if the actuarial equivalence requirements apply, the trustees are only obliged to take "all reasonable steps" to notify each affected member. The Modification Code confirms

that the "reasonable steps" requirement means that the modification may still proceed even if the affected members cannot be contacted (for example, if some of them have moved house). The Modification Code does not specify what type of steps are "reasonable" for the trustees to make, nor does it set out the contents of the notice to affected members.

## **Section 37 regime**

### **What is the section 37 regime?**

The section 37 regime sets out the circumstances in which employers or trustees may amend a contracted-out scheme and retain its contracted-out status after the amendment. The section 37 regime continues to apply to the scheme even after it has ceased to be contracted-out.

### **Requirements applying to defined benefit schemes**

Trustees or employers cannot amend the rules of a contracted-out salary-related (COSR) scheme unless:

- The trustees have informed the actuary in writing of the proposed amendment.
- The actuary has considered the proposed amendment and has confirmed to the trustees in writing that he or she is satisfied that the scheme would continue to satisfy the relevant statutory standard if the alteration were made.
- The amendment does not otherwise prevent the scheme from satisfying the necessary statutory conditions.

### **Requirements applying to money purchase schemes**

Trustees or employers cannot amend the rules of a contracted-out money purchase (COMP) scheme in relation to protected rights if the amendment would:

- Adversely affect any protected rights of any member if those rights were acquired before the amendment takes effect.
- Otherwise prevent the scheme from satisfying the relevant conditions.

## **The Pensions Consultation Regulations**

The Pensions Consultation Regulations apply to employers in the UK who sponsor occupational pension schemes or personal pension schemes including stakeholder pension schemes where there are direct payment arrangements in place that enable an employer to make contributions for its employees.

The requirement to consult applies to the number of employees an employer has, not to the number of members there are in the relevant pension scheme. Since 6 April 2008, they have been extended to cover employers with at least 50 employees.

The Multi-employer Regulations extend the Pensions Consultation Regulations to cover multi-employer pension schemes, so that they apply in situations where someone other than the immediate employer or trustees of the scheme has power to amend the scheme rules. The requirements apply to each employer in a multi-employer scheme, rather than to a group of companies as a whole.

### **Exemptions from the pensions consultation requirements**

Some employers fall outside the scope of the consultation regime. Exempted employers include those that participate in:

- Public service pension schemes.
- Small occupational schemes. These are defined as schemes with fewer than 12 members, all of whom are trustees of the scheme. The definition includes most small self-administered schemes.
- Schemes with fewer than two members.
- Unfunded pension arrangements, known as employer-financed retirement benefit schemes.
- Unregistered schemes outside the EU.

There are a number of situations that fall outside the scope of the measures entirely. These include:

- Changes made to comply with legislation.
- Changes made to comply with a determination made by the Pensions Regulator.



- A change that has no lasting effect on a person's rights to be admitted to a scheme or their benefits under the scheme. This covers areas such as pay alterations or reductions in working hours, and also insignificant changes, for example, those made purely for administrative reasons.
- A change to members' subsisting rights made in accordance with the requirements of section 67 of the Pensions Act 1995.

### **Who must employers consult?**

Employers have to consult "affected members" or their representatives in advance of making any change that falls within the scope of the regime.

### **Affected members**

Affected members are defined as:

- Active members of the scheme.
- Prospective members of the scheme.

There is no need to consult with a scheme's deferred members or pensioners.

Given the requirement to consult prospective as well as active members, the Pensions Consultation Regulations may catch an employer even where it sponsors a scheme with a fairly low take-up rate.

### **Representatives**

If there are certain existing employee representation arrangements in place when an employer proposes to make a change that falls within the requirements, the employer must consult in accordance with those existing arrangements.

However, there is no automatic obligation to consult a recognised trade union in preference to other representatives (as would be the case in a collective redundancy or transfer of undertakings situation). Employers may therefore choose to consult with any of the following bodies:

- A recognised independent trade union, in respect of affected members covered by the recognition agreement.

- Representatives of the affected members under an information and consultation agreement, which may be a pre-existing agreement, a negotiated agreement or the standard information and consultation provisions under the Information and Consultation of Employees Regulations 2004 ("ICER"); or
- The affected members themselves, but only if a negotiated or pre-existing agreement under the ICER provides for direct consultation.

If the interests of some or all of the affected members are not represented by a representative under one of the above arrangements, the DWP recommends that the employer should hold an election to appoint pensions consultation representatives. There is no obligation to hold an election, and the employer may consult directly with the employees if it so chooses. Where such an election is held it must satisfy the requirements of the Pensions Consultation Regulations.

### **Changes requiring consultation**

There are a number of "listed changes" contained in the Pensions Consultation Regulations that trigger a requirement to consult. Whether a particular change requires consultation depends on the nature of the pension scheme involved.

The following changes apply to all kinds of occupational pension schemes:

- Increasing the normal pension age in the scheme rules.
- Closing a scheme to new members.
- Stopping further benefit accrual by existing members.
- Stopping the employer's liability to make further contributions to a scheme.
- Requiring member contributions, where these were not previously required.
- Increasing the level of member contributions.

In defined benefit schemes or hybrid schemes (but not pure money purchase schemes), the following additional items count as listed changes:

- Changing the scheme's benefits to pure money purchase benefits.

- Changing the basis of future benefit accruals, in whole or in part. For example, a change from final salary to a career-average basis.
- Modifying the rate of future accruals, either generally or with the employer's agreement, if trustees and the employer cannot agree on the appropriate level of employer contributions.

The following listed change applies only to money purchase schemes:

- Reducing the level of employer contributions.

### **Process employers must follow**

In the first place, the person proposing to make a listed change has to give written notice to all relevant employers of their intentions.

### **Information**

The information must be in writing and given before the start of consultation. It should:

- Describe the listed change and explain its effects on the scheme and its members.
- Provide any relevant background information.
- Set out the timescale for introducing the changes.
- Enable members (and their representatives) to study the proposals, and give their views on the impact of the changes to the employer.

### **What does "consult" mean?**

During the consultation process, the employer and the affected members (and their representatives) are under a duty to work in a spirit of co-operation, taking into account the interests of both sides. The DWP guidance states that consultation should include "an exchange of views and the establishment of a dialogue between the relevant employer and the persons he consults". It does not follow that the employer must reach agreement with those it consults on the proposed changes. The legal duty is simply for the employer to consider the responses it receives before deciding whether to go ahead and make the change.

## **The consultation process**

The employer should advise those it consults of the timetable for the process, including the dates for submitting written comments and so on. In any event, the consultation process must last at least 60 days.

## **Failing to comply with the pensions consultation requirements**

The power to enforce the consultation requirements lies with the Pensions Regulator. It has a general power to waive any of the specific provisions in the Pensions Consultation Regulations if it considers that this is necessary "in order to protect the interests of the generality of members of the scheme".

If the Regulator decides to take action against an employer who has breached the statutory requirements, it has the power to:

- Issue an improvement notice, specifying particular steps that an employer must take.
- Order a civil penalty of up to £5,000 against an individual or £50,000 against a company, if the employer does not comply with an improvement notice.

A person who receives a determination or fine from the Regulator has a right of appeal to the Pensions Regulator Tribunal, within 28 days of the decision.

The Regulator does not have the power to reverse a change that an employer has made without meeting the consultation requirements. Indeed, the legislation expressly provides that the validity of any such change is not affected by an employer's failure to comply with the requirements.

For more information please contact:

### **RACHEL MORRIS**

Solicitor

020 8394 6456

[rachel.morris@russell-cooke.co.uk](mailto:rachel.morris@russell-cooke.co.uk)

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