Technical Briefing

No. 43

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Payment of Surpluses Under the Pensions Act 2004

Introduction

Whilst most pension schemes now have significant ongoing deficits to contend with under the current financial climate, the situation was very different a few decades ago and it is possible that pension schemes could again return to surplus, although for most this would likely be well into the future.

Most pension scheme rules contain provisions for the payment of surpluses to be made to the sponsoring employer under certain circumstances, however legislation contained in the Pensions Act 2004 removed this power from the Trustees. There is, however, a transitional power contained in Section 251 of the Pensions Act 2004 which the Trustees can take advantage of to restore their original powers and what conditions, if any, to which any payment should be subject to but this must be done before 6 April 2011.

The amendment to the Scheme Rules can only be made to retain an existing provision. It cannot be made to introduce a new power to pay surpluses to the sponsoring employer where such power is not already written into the Scheme Rules.

Why Should Trustees Consider Making This Amendment?

There are some good arguments for the Trustees to consider when deciding on whether or not to make an amendment to the Scheme Rules, to retain the power to pay surpluses to the sponsoring employer, although for many schemes this may seem to be an unlikely scenario. These include:

- Sponsoring employers may be more likely to fund pension schemes to a higher level, perhaps something akin to buy-out, if they were certain that any future surpluses arising would be returned.
- As Trustees seek to de-risk, the solvency position of the pension scheme can become highly volatile leading to unexpected overfunding emerging as the liabilities are gradually managed down.
- The amendment could give the Trustees an unexpected bargaining power over the sponsoring employer. Furthermore, the resolution could be drafted to contain more restrictive conditions under which the Trustees will agree to make a payment of surplus to the sponsoring employer.
- Whether or not the sponsoring employer can receive a refund of surplus could impact on the recognition of an asset in the company's balance sheet under accounting standard IAS19 by virtue of IFRIC14.
- There is concern in the industry that the loose wording in the legislation may unintentionally prevent the Trustees making any payments at all to the sponsoring employer. Failure to pass a resolution could mean that the scheme permanently losses the ability to make any payments to the sponsoring employer.

What Trustees Need to Do to Retain This Power?

The following conditions need to be met:

- The Trustees are satisfied that the amendment is in the best interests of the scheme members.

No. 43

- The decision to amend the Scheme Rules can only be made once and must be done so by 6 April 2011.

- Written notice must be given to the sponsoring employer and all scheme members on the proposed change to the Scheme Rules on payments to the sponsoring employer, as detailed in The Occupational Pension Schemes (Payment to Employers) Regulations 2006.

Timing of Any Rule Amendment

The transitional regulations came into effect on 6 April 2006, and only applies to pension schemes in existence before that date, and provided for a 5 year window within which the Trustees would be able to pass a suitable resolution to continue to pay surpluses to the sponsoring employer – which closes on 5 April 2011.

Furthermore, the Trustees must send written notice to all members about the proposed resolution 3 months before it takes effect, which in practical terms means that action needs to be taken by 5 January 2011. This may be unattractive as a member relation point, however this could be mitigated somewhat by advising members of any tightening up the conditions that a surplus payment would be made to the sponsoring employer.

Therefore if no action is taken by 5 January 2011 then the Trustees will effectively lose the power to make payments of any scheme surplus to the sponsoring employer, and potentially any other payment to the employer.

Plan of Action

The Trustees should:

- Review their Scheme Rules to ascertain whether or not they already contain the power to pay surpluses to the sponsoring employer. If not, then this power cannot now be introduced.

- If the Scheme Rules currently permit the payment of surpluses to the sponsoring employer then the Trustees should decide whether or not they wish to retain this power, and if so they should also consider whether to revise the conditions under which surplus payments would be made in the future.

- If the Trustees wish to retain this power then they first need to give 3 months' written notice of their intentions to the sponsoring employer and all scheme members.

- Trustees would then need to pass a suitable resolution before 6 April 2011 to allow them to retain the power to make payments to the sponsoring employer if the scheme is fully funded on a buy-out basis.

Please contact your usual **cprm** consultant if you have any questions on the contents of this Technical Briefing or would like some additional information.

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