

**Pensions Act 2004**

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The Pensions Act 2004 will introduce a number of important changes to the UK pensions environment. A brief description of the major changes that will affect employers and members of the Scheme can be found below.

Many of the provisions of the Pensions Act 2004 will be published as regulations over the next few months. Further information will be provided once these regulations have been published.

### **1. Limited Price Indexation**

Currently any pension received in respect of service after 6 April 1997 must be increased by the lower of 5% or the increase in the Retail Prices Index (RPI). This is known as Limited Price Indexation (LPI).

With effect from 6 April 2005 LPI will become the lower of 2.5% or the increase in RPI for any pension received in respect of service after 6 April 2005. After due consideration by the Trustees we have decided to adopt this method and pension accrual will now revert to the new basis.

This change only applies to pension payments; deferred pensions in excess of the Guaranteed Minimum Pension (GMP) will continue to be increased by the lower of 5% or the increase in RPI.

The above changes only apply to defined benefit pension schemes. It will no longer be a statutory requirement to increase any pensions from defined contribution schemes that come into payment after 6 April 2005.

### **2. Short-service transfer requirement**

Currently, the only statutory requirement for members who leave a scheme with less than two years of pensionable service is to receive a refund of their own contributions.

With effect from 6 April 2005 once a member has completed 3 months of pensionable service in addition to offering the option of a refund the Pension Scheme must also offer a transfer value. A member will still only become statutorily entitled to a deferred pension on completion of 2 years pensionable service.

### **3. Additional Voluntary Contributions (AVCs)**

It will no longer be a legal requirement to allow members to pay AVCs. However, The Pension Scheme will continue to offer its existing AVC arrangements.

### **4. Disputes procedure**

Since 6 April 1997 all pension schemes have been required to have an internal Disputes Resolution (IDR) procedure to resolve member complaints. Currently, the IDR procedure must be a two stage process with the second stage being an appeal to the Trustee. With effect from 6 April 2005 it ceases to be a requirement to have a two stage procedure. However, The Scheme is not planning to change its existing process and therefore members will still be able to appeal to the Trustee if they are not satisfied with the resolution that they receive

## **5. The Pensions Regulator**

The Occupational Pensions Regulator (Opra) will cease to exist on 5 April 2005 and the Pensions Regulator will take over from 6 April 2005. The main objectives of the Regulator will be; to protect the benefits of members of company pension arrangements, to keep claims on the Pension Protection Fund to a minimum and to facilitate good pension scheme administration.

## **6. The Pension Protection Fund**

There is to be a new levy on all defined benefit schemes to pay for the new Pensions Protection Fund (PPF), which is an insurance scheme to protect members of an insolvent employer's defined benefit scheme.

As a compensation scheme, the PPF will offer a range of protection:

- A 100% of the original pension promise if the member is past the scheme's retiring age or is already receiving a pension
- For pensions earned from or after April 1997, increases at LPI up to 2.5% each year (no increases for earlier pensions)
- A 90% of the original pension for other members, capped initially at £25,000 a year as at age 65.

Details of the amount of the levy and exactly how it will be calculated will be published in regulations. However, the levy will be calculated in two parts: a flat rate levy based upon the number of members', and a risk based levy based upon the likelihood of the scheme making a claim on the PPF. In the first year only the flat rate levy will be payable and it is expected that the risk based levy will be introduced at a later stage.

## **7. Multi-employer scheme debts**

The new provisions mean that in future the Regulator will be able to issue a "contribution notice" stating that an Employer is liable to pay a specified sum to the Trustee, in respect of any Scheme debt (not just on insolvency of an Employer or winding-up of the scheme). For example, this could apply to an employer leaving a multi-employer scheme that is in deficit.

Further information will be provided on this subject once regulations have been issued.

## **8. Scheme Funding requirements**

The Pensions Act 2004 will replace the Minimum Funding Requirement (MFR) with the Statutory Funding Objective, which will be specific to each individual scheme. The Trustee must prepare a Statement of Funding Principles for each scheme, setting out the policy for achieving the Statutory Funding Objective.

Further information will be provided on this subject once regulations have been issued.

## **9. Business transfers (TUPE)**

Currently, pensions are not covered by the Transfer of Undertakings (Protection of Employment) regulations 1981 (TUPE). With effect from 6 April 2005, an employer acquiring another business will be obliged to provide pension rights for transferring employees who were or could have been members of the old scheme. There will be three options:

- To provide a replacement defined benefit scheme with a benefit structure at least equivalent to the minimum for contracting-out
- To provide a replacement defined contribution scheme with the employer matching employee contributions up to 6%
- To contribute at the same rate as above to a stakeholder arrangement for the employees.

## **10. Trustee “Knowledge and Understanding”**

A duty is now placed on all individual and corporate trustees each must have sufficient “knowledge and understanding” that is appropriate for the purpose of enabling the individual to properly exercise the function in question as trustee.

The Trustees are instigating an appropriate training programme and the Trustees will continue to employ a full range of professional advisers to ensure this obligation is always met.

## **11. Member Nominated Trustees**

The Pensions Act 2004 will require occupational pension schemes to have in place arrangements that will provide for at least one-third of the total number of trustees to be member-nominated. If the scheme has a corporate Trustee, at least one-third of directors must be member-nominated.

The Pensions Act 2004 also includes provision for the Secretary of State to change the member nominated trustee provisions in the future to require one-half of trustees, or directors in the case of a corporate Trustee, to be member-nominated.

## **12. Financial Planning in the workplace**

The Pensions Act 2004 contains powers to compel employers to provide their employees with access to information and advice about their pensions and savings for retirement. The idea is that shortfalls between current savings and what individuals need for retirement may be identified, and individuals can be provided with information on the savings options available to them. It is expected that pilot studies will be carried out but the results will not be known before summer 2005 at the earliest. The government is still to decide whether and how to introduce these provisions.

## **13. Requirement to consult on benefit changes**

Regulations are likely to be made that will require employers to consult with members on changes to schemes. Further information will be provided once the regulations are published.

## **14. Improvements in the incentives to defer State Pension**

Currently, individuals can defer drawing their State Pension for a maximum of 5 years. When the payment actually commences, it is increased by 1/7th of 1% for each week that retirement is deferred past State Pension Age.

The Pensions Act 2004 will allow individuals to defer drawing their State Pension indefinitely. The rate of State pension increase is being improved to 1/5th of 1% for each week that retirement is deferred past State Pension Age.

As an alternative to an increased pension, if an individual defers drawing their State pension for at least 12 months then they can claim a lump sum, which would be subject to tax. The lump sum is calculated as the amount of pension foregone, with allowance for interest.

Please note: The information provided in this document is based upon our current understanding of the Pensions Act 2004. Much of the detail of the Pensions Act 2004 is yet to be published in regulations and therefore information contained in this document may be subject to change.

### **15. Further information**

If you wish to discuss any of the issues raised in this bulletin then please contact our advisers, Michael Kirk & Partners Ltd:

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