



Retaining an employer's right to scheme surpluses – and maybe other payments

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Employers should consider asking their pension scheme trustees to pass a resolution to retain a power for the scheme to make payments to employers. Trustees would need to pass this resolution before 6 April 2011, but would need to give three months' notice to members – so early action may be advisable.

Introduction

Section 251 of the Pensions Act 2004 is headed 'Payments of surplus to employers: transitional power to amend schemes'. This makes it look as though the section only deals with payments of surplus (unusual in an on-going scheme) and just contains a transitional power to help amend the scheme if this is needed.

However, a literal construction of section 251 means that it prohibits any payments (not just surplus) from a scheme to an employer, unless the trustees pass a relevant resolution before 6 April next year and after three months' notice has been given to all members.

It may be that a court ultimately interprets section 251 in a more favourable way, but this cannot be guaranteed. Predicting the attitude of the courts to such a purposeful interpretation of an argument is notoriously difficult.

Given this uncertainty, employers should consider if a prohibition on payments out of a scheme to them is a significant concern (eg because of the risk of a funding surplus in the future or for company accounting reasons under international accounting standard (IAS) 19 and its interpretation (IFRIC 14) by the international financial reporting interpretations committee).

If it is, then there are three potential ways forward:

- take a view (but keep an eye on developments);
- seek further clarification – eg a counsel's opinion or court decision; or
- arrange for a resolution to be passed by the trustees.

The third option is the safest course, but will involve:

- convincing the trustees to act before 6 April 2011; and
- sending a written notice to all members about the proposed trustee resolution before the end of 2010. This may be undesirable from the point of view of member relations.

Section 251 of the Pensions Act 2004

Section 251 of the Pensions Act 2004 appears from its heading to give a transitional power to schemes to retain a provision allowing payments of surplus out of a scheme to an employer. But it states that 'no payment' can be made to the employer out of the scheme unless trustees pass a resolution before 6 April 2011. Among other things, trustees must also give the employer and all scheme members at least three months' notice before the resolution is to have effect. Section 251 applies only to schemes in existence before 6 April 2006.

The commonsense purpose of this legislation seems to be to give *on-going* schemes the opportunity to retain a statutory power to pay surpluses to the employer, where this power would otherwise be lost because of changes made to other legislation in April 2006 (section 37 of the Pensions Act 1995).

Unfortunately, the legislation is badly drafted and could have an almost opposite effect to the commonsense interpretation. This may make it urgent for employers to consider taking action.

Taken literally, this legislation could prevent payments to the employer regardless of whether the scheme is on-going or winding up. Although employers may not be anticipating a surplus refund at the moment (other provisions would apply and would require all benefits to be secured first), this could still be important now. For example:

- if the scheme gets near to being funded on a buy-out basis, employers will be concerned about the risk of overfunding if they cannot be certain that any surplus would be returned to them; and
- the position on use of surplus can have an impact on the recognition of an asset in the balance sheet of the company under IAS 19. This can depend on whether there is a surplus provision on winding up (see IFRIC 14).

At its worst, section 251 could be interpreted as prohibiting schemes from making payments *of any kind* to the employer (unless the trustee resolution is passed). This could prevent surpluses being paid to the employer but it could also prohibit a number of seemingly benign payments, such as repayments of amounts owing to the employer, payments made under a lien or forfeiture rule and payments for administering the scheme.

To add to the pain, trustees have just one chance to pass this resolution correctly before 6 April 2011. Failure to pass a resolution could mean that schemes permanently lose the ability to make any payments to the employer.

Section 251 does not compel trustees to pass a resolution. Even if the trustees do pass a resolution, they can either agree to payments being made on the scheme's existing terms or specify different (perhaps more restrictive) terms. So it will ultimately be for the employer to persuade the trustees to pass the resolution it wants. This gives trustees potentially significant (and unexpected) bargaining power. They may be willing to pass such a resolution because, for example, the employer is more likely to fund the scheme to a higher level if it is able to recover any overfunding.

Taking such action may be undesirable for a number of reasons – for example, members need to be informed that the trustees are allowing payments (eg of a surplus) to be made to the employer. This can be a difficult message to get across, especially because many employers have recently been closing schemes or changing pension benefits to control deepening deficits.

Where employers are unwilling to ask trustees to pass a resolution, they can perhaps take the view that the courts will interpret section 251 so that it achieves its commonsense purpose (or that parliament may change the legislation). However, relying on the courts to interpret this provision favourably is inevitably risky. So it is safest to ask trustees to pass a resolution.

Employers should factor in the need for a three-month notice period when they decide when to approach the trustees. For example, if this notice is to be sent as part of the scheme's annual report then this may need to be done in 2010. Trustees may also need to arrange trustee meetings to pass a resolution, which may further affect the timetable.

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