**Introduction: Pension issues**

This section introduces some key pension issues for a company, including issues that might arise during a transaction

# An introduction to pensions

In its most basic form, a pension is simply a pot of money saved up over an employee’s working life, into which the employee and/or the employer make contributions, in order to provide the employee with income during retirement.

The money that an employee invests into a pension scheme has the benefit of **relief from income tax**, subject to certain limits. In short, pension contributions are not taxed on their way into a scheme - only on retirement.

Saving money in a pension scheme is, therefore, a **tax efficient form** of investing for the future.

An employer may provide pension benefits under **an occupational pension scheme** or by making contributions to a **personal pension scheme**.

We will now examine these two types of pension schemes in more detail.

# Occupational pension schemes

An occupational pension scheme is a scheme set up and operated by an employer under a trust arrangement in order to provide benefits for employees on retirement or death. There are **two main types: defined contribution (DC) schemes** and **defined benefit (DB) schemes**.

A **defined contribution scheme** is also known as a money purchase scheme. The employer will agree in advance the level of contributions it will make on behalf of the employees who join the scheme, and **its liability will be fixed to this amount**. This is usually expressed as a percentage of each member employee's annual salary. The employees are usually required to make contributions into the scheme as well, set at a fixed percentage of salary.

Defined contribution schemes are often cheaper for an employer to provide. They also give the employer greater certainty as to its pension costs.

The most common type of **defined benefit** scheme is a final salary scheme. The purpose of a defined benefit scheme is to provide a pension for life on retirement, from a specified age calculated as a percentage (more often fraction) of the employee’s salary at or close to retirement (for a final salary scheme) or as earned during their membership of the scheme (career average scheme). The relevant percentage is usually dependent on the number of years’ service whilst in the scheme.

Note that the employer bears the balance of the cost of providing the benefits.

# Structure of an occupational pension scheme

Occupational pension schemes are structured using a trust to hold the pension assets, so the key parties to an occupational scheme are:

* The **Employing Company/Companies** that sponsor and contribute to the scheme - and have responsibility for funding a DB scheme
* The **Trustee(s)** of the scheme who safeguard the pension assets and manage funding/investment requirements
* The **Members** of the scheme who pay into the scheme and receive pension benefits

Some occupational schemes will have a single sponsoring employer; but in a corporate group, a pension scheme is likely to be a **'multi-employer'** scheme, providing pensions for employees from a number of companies within the group.  
  
Many corporate groups have both DB and DC schemes for their employees: many defined benefit schemes have been **closed to new members** and/or to **future accruals** by the existing members (which means that the members will not be able to build up further rights to an additional proportion of their salary on retirement) - new occupational schemes will generally be defined contribution schemes.

**Personal pension schemes**

A **personal pension scheme** is a **contractua**l arrangement between an individual member and an authorised provider, such as an insurance company. Contributions can be made by the member alone or the member’s employer or both.

All personal pensions work on a defined contribution basis.

A **group personal pension scheme** is where an employer arranges with an authorised provider for employees to set up personal pension schemes.

The employer makes contributions to the group personal pension scheme and pays across any employee contributions deducted from salary (contribution terms will be part of the employment contract, not the pension scheme terms).

**Pensions obligations**

**Auto- Enrolment**

The Pensions Act 2008 introduced obligations on employers requiring them to **automatically enrol** eligible employees into qualifying workplace pension arrangements.

Under the auto-enrolment provisions, an employer is required to enrol each **'eligible jobholder'** as an active member of a **'qualifying scheme'** and to make certain **minimum contributions** to the scheme on the employee’s behalf.

The employee may also be required to make contributions to their own scheme, which will be deducted from his salary. The employee will be able **to opt out** of the scheme but if they do so then the employer must automatically re-enrol them once every three years (at which time the employee may opt out again).

**Issues relating to defined benefit schemes**

Defined benefit schemes often require **additional finance** from the sponsoring employer(s), but if an employer becomes insolvent and cannot meet its funding obligations (and certain other conditions are met), the scheme will instead 'fall in' to the **Pension Protection Fund** (a government created scheme), which will partially cover the pension obligations.  In order to protect against this, defined benefit schemes are subject to additional statutory provisions.

# Key due diligence issues to investigate

The key due diligence issues for investigation will vary between defined benefit and defined contribution schemes:

**Defined contribution schemes**

* Cost to employer of the scheme – monthly contributions.
* Whether the target is up to date with auto-enrolment obligations.

**Any occupational scheme on an asset sale**

* Obligations that might transfer across to the buyer under TUPE.
* These would comprise 'Beckmann' liabilities relating to benefits other than old age, invalidity or survivors (for example, a right to enhanced early retirement on redundancy).

**Defined benefit schemes**

* The funding level of the scheme – and in particular any deficit.
* The likely impact of the transaction on the funding obligations of the target company to the scheme.
* Any notifications of the transaction required to be made to the Pensions Regulator (‘**TPR**’).
* Any risk of a Contribution Notice or Financial Support Direction being served on the target company (NB: This risk might arise even if the target itself is not an employer in the scheme – the parties might wish to guard against any risk by seeking a clearance from TPR).

# Pensions due diligence

As part of the due diligence process, it is essential to obtain **full details** of the pension arrangements for the employees of the target business or company. This will generally include:

* details of, and copy of the **governing documentation** relating to, each pension scheme;
* confirmation that each scheme is **registered with HMRC** and whether any defined benefit scheme is **open or closed** to future accruals;
* confirmation that the target has complied with its **auto-enrolment obligations**;
* confirmation that all the contributions to each scheme are **up to date**;
* the identities of the **participating employers** and the names of the current trustees of each scheme;
* copies of the latest **trustee annual reports** and audited accounts for each scheme;
* full details of any **claims** against any of the trustees of any of the schemes;
* copies of all **contracting out certificates** (this is where a pension scheme has contracted out of the additional State pension);
* confirmation that any **defined benefit** scheme is **sufficiently funded**, with copies of the latest statutory funding documentation; and
* details of any contributions which the target has agreed to pay to **personal pension scheme**s.

**Summary**

* Investing in a pension is a **tax efficient** way for employees to save for the future. The introduction of **auto-enrolment** imposes duties on both the employer and employee to contribute to workplace pensions.
* An occupational pension scheme may be either a **defined benefit** scheme or a **defined contribution** scheme. Employers prefer defined contribution schemes because their contribution liability is fixed.
* The pension under a defined benefit scheme is **fixed by reference to a member's salary** at a current or future date and may increase in respect of inflation and is payable for life. It can therefore be very expensive and its cost is uncertain. There are statutory protections provided for defined benefit schemes, that are overseen by the **Pensions Regulator**.
* Where a scheme is in deficit, the Pensions Regulator may also be able to serve **Contribution Notices** or **Financial Support Directions** on employers or certain other parties.