

## Design in practice

### Re-shaping DB benefits

It's the time of year when preliminary valuation results are being scrutinised, prompting sponsors to explore ways of managing their DB pensions liabilities. For sponsors of open plans, one option is to re-design the future benefit structure, for example by switching from final salary to CARE benefits. Proper planning is essential if the implementation process is to run smoothly and cost effectively. Here I'm sharing my top five tips for planning a benefit re-design.

#### 1. Start planning early

Ideally, begin planning at least 6-12 months before the implementation date. If business drivers don't allow for this, it might be possible to plan and implement the change within a period as short as 3-4 months. This is more likely to be achievable if a single change is desired (perhaps introducing a cap on final salary) and/or the workforce is relatively small and not unionised.

#### 2. Check the contractual position

Review employment contracts and plan literature to ascertain whether any employees have contractual rights to a particular level of DB benefit. For example, sometimes contracts specify that employees are entitled to membership of a final salary pension plan – or the named arrangement being re-designed. By identifying this at the outset, the employer can plan accordingly, typically by carrying out an employment / union consultation alongside the standard pensions consultation and seeking employees' agreement to a new contract which facilitates the benefit change.

#### 3. Identify any problematic plan rules

At the feasibility stage, it's important to identify any legal hurdles posed by the plan rules. The sponsor's lawyers will be able to advise on this. Some final salary plan rules contain a 'Courage style restriction' which means that it's not possible to amend the rules to break the link between accrued benefits and final salary. This doesn't prevent a change to future benefits, but does reduce the effectiveness of the change as a liability management tool. As another example, I advised an employer that their plan rules gave deferred members a right to retire early on a full pension from age 55. In light of this, and to prevent its oldest employees gaining this right and causing a funding strain, the employer decided to import a new benefit structure into the existing plan rather than move employees to a new arrangement.

#### 4. Produce a detailed benefit specification

Iron out the details of the new benefit structure at the planning stage. A CARE benefit, for example, will need to be revalued each year – what is the revaluation rate and the revaluation date to be and when will a CARE block begin to be revalued? If the new structure is DC, what contributions, charges and investment

structures are envisaged? An employer cannot properly consult with its employees without these details, plus a detailed specification will enable the sponsor's lawyers to highlight and help minimise any legal risks associated with the proposed structure. For example, setting a normal retirement date by reference to state pension age is age discriminatory – can this discrimination be objectively justified or will this element of the proposal need to be revised?

#### 5. Fully engage with stakeholders

Sponsors usually have a legal duty to consult with affected employees (directly or via employee representatives) for at least 60 days about proposed changes before deciding whether to implement them. The pensions consultation legislation is prescriptive – and failure to comply attracts a fine of up to £50,000 – so employers should design their consultation process carefully. It may be necessary to engage with trade unions and any non-associated participating employers. Also, plan rules usually require trustee agreement to the rule amendments needed to implement benefit changes, so the employer should issue a written proposal to the trustees early on. Most trustees recognise that pensions are part of the employer's remuneration package and are a matter for the employer to decide, but they will still want to satisfy themselves that a proper consultation with employees has been undertaken (typically, trustees are given the opportunity to comment on the draft consultation materials) and that there are no legal obstacles, before giving their agreement. A project plan, even if high level, will ensure all parties understand what is expected from them and when.

#### Your key contact



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