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Winding-up a pension scheme

A guide for members

policy

May 2007



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the pensions
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trustees
benefits
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The Pensions Advisory Service provides information and guidance to members of the public on pension matters generally. We also help to resolve disputes and complaints about private pension arrangements (company pensions, personal pensions and stakeholder pensions).

Our service is free and is provided by a nationwide network of volunteer advisers who are supported by technical and administrative staff in London.

All our advisers are pensions professionals with many years of experience in the pensions industry.

The Pensions Advisory Service is an independent voluntary organisation that is grant-aided by the Department for Work and Pensions.

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This can be an extremely worrying and frustrating time for scheme members. It is a prolonged process and, unfortunately, there are no short cuts. This leaflet sets out to explain the winding-up process but, for more in-depth information on this subject, why not visit the Pension Rights section of our website: www.pensionsadvisoryservice.org.uk

Why does the winding-up process start?

If a company can no longer (or no longer wishes to) make the required contributions to its pension scheme then its rules usually require it to be wound-up. This is a process which requires the trustees to organise each member's benefits to be secured outside the scheme by means of an insurance policy or a transfer to another approved pension arrangement. Quite often contributions stop because the employer is insolvent and has ceased trading or gone out of business and either a receiver or liquidator has been appointed.

The purpose of this leaflet is to explain in general terms what happens when a pension scheme is wound-up and why delays can occur. The leaflet does not represent the circumstances of a particular pension scheme and is not an explanation of the law. Please do not use this guide instead of dealing with the trustees of your pension scheme.

What is the role of the Trustees?

Nearly all pension schemes have trustees whose duty is to look after the interests of scheme members while acting strictly in accordance with the rules of the scheme. On winding-up due to insolvency it is often a legal requirement that an Independent Trustee is appointed. Frequently this will be a company rather than an individual charged with ensuring that all members' interests are fully protected. Remember that the Independent Trustee is there to help.

Why not share out the money immediately?

If the trustees share out the money too soon some legitimate claims may be overlooked thus invalidating what has been done earlier. To avoid this, the trustees prefer to delay any distribution until everything can be done at once. In some cases, the trustees will exceptionally agree to the payment of benefits (for example, upon a member reaching normal retirement age) but this will depend upon the trustees being certain that adequate monies are available, so that other members' rights are not prejudiced.

Where transfers are paid by the trustees, they can be reduced to ensure that other members' rights are not prejudiced. No member needs to accept the transfer quote. The member is not legally entitled to another quote within 12 months.

The trustees will need to ascertain, if the scheme is what is known as a defined benefit arrangement, whether there are sufficient assets to meet all its liabilities. If they have more than enough money to do this, then the scheme is 'in surplus'. If however they do not, then the scheme is 'in deficit'.

What happens if there is a surplus?

This will depend primarily upon the rules of a particular scheme. Sometimes the trustees might have to give some of the surplus back to the company even when it is insolvent. However, if they take this action, they will always have to set aside, as a first step, enough of the surplus to provide for a statutory level of pension increases to all members. Sometimes, the trustees have discretion over the use of the surplus. In this situation, they will probably take professional advice from an actuary and from lawyers before they decide what to do.

There are some measures the trustees can take to reduce the debt, other than relying on the company.

A claim may be made to the State redundancy fund in respect of relevant contributions due, but unpaid, by an insolvent employer. Relevant contributions are those due in the 12 months prior to the date of insolvency subject, in the case of an employer's contributions, to a maximum amount equal to 10% of wages paid, or payable, to members during that period. Relevant contributions also include any contributions deducted by the company from scheme members but not passed on to the trustees.

If the shortfall in the scheme assets is due to fraud or theft, it may be possible to recover some of the money from the Pensions Compensation Board.

What happens if there is a deficit?

It is possible to claim back the shortfall from the company (if it still exists). Under a final salary scheme where the scheme's liabilities exceed its assets, the shortfall becomes a debt owed by the employer to the trustees of the scheme.

If the company is insolvent when the scheme starts to wind-up, the trustees' claims have to rank equally with all other non-preferential and unsecured creditors, so any recovery of the debt is highly unlikely.

The current position can be split into four situations:

- Where the company is solvent and started to wind-up the scheme before 11 June 2003, the debt is calculated on the basis of providing immediate annuities for scheme pensioners and transfer values for active members and deferred pensioners. Even where the debt is recovered, the value of the benefits of those members who have not yet reached retirement age is based upon their transfer value, and this means that they will not receive their full promised pension benefit. If the transfer value was to be paid to an insurance company to buy an amount of deferred pension, that amount may normally vary from 40% to 80% of the member's full pension entitlement. The younger the scheme member, the greater the percentage reduction.
- Where the company is solvent and started to wind-up the scheme on or after 11 June 2003, the debt is determined by valuing the benefits on the basis that they are bought out in full via immediate annuities for pensioners and deferred annuities for non-pensioners.
- If the company became insolvent before 28 February 2007 but after 1 January 1997 and the trustees had started to wind-up the scheme between 1 January 1997 and 6 April 2005, the **Financial Assistance Scheme (FAS)** established by the Government on 14 May 2004 will provide assistance to those members with little or no pension. The FAS will pay out pension to those individuals (or the survivor of such

an individual) who were within 15 years of their retirement on 14 May 2004 and to those individuals who are terminally ill. Survivors of eligible members will receive payouts from the FAS regardless of their age. Provided their pension scheme is fully wound up, the FAS will pay out up to 80% of the individual's basic benefits under the scheme but with a maximum of £12,000 per annum. There will be no future increases on the pension payouts.

Schemes which are affected should have registered for help with the FAS by 28 February 2006. Individuals who believe they are eligible for help should contact their scheme or FAS. The FAS address is: The Department of Work and Pensions
FAS Operational Unit
P O Box 702
York YO32 9XR

It is proposed that the FAS will be further extended to include all eligible members regardless of their age. The FAS will pay out up to 80% of the individual's basic benefits but with an improved maximum of £26,000 a year. These changes are yet to be adopted by the FAS.

- If the company becomes insolvent after 6 April 2005 leaving a pension scheme in deficit, an insurance scheme known as the **Pensions Protection Fund** may be available to help members of the scheme. In broad terms, it will provide 90% of pension benefits for members under the scheme pension age (subject to a cap equating to £26,050 per annum at age 65) and 100% of pension for members over scheme pension age.

Once the assets have been applied in accordance with the legislative requirements, members and beneficiaries (except deferred pensioners who cannot be traced) must be told of their benefit entitlements within three months, together with details as to who is responsible for paying these benefits and the extent to which any benefits were reduced because the assets were insufficient.

- Assets - Selling the assets is not as easy as might be imagined. There could, for example, be property owned by the scheme to be sold, or perhaps loans to realise. This can take time.
- Making Decisions - It is sometimes difficult to trace key individuals when a company has collapsed. This can delay trustees' decisions.

What information am I entitled to?

When a scheme is being wound-up, the trustees must issue a notice to inform all members and beneficiaries (except deferred pensioners who cannot be traced) in writing within one month of the winding-up having commenced.

In addition, this notice must:

- Give the reasons that the scheme is being wound-up
- Give a statement to active members as to whether death benefits will continue to be provided
- Inform members, where relevant, that an Independent Trustee has been appointed
- Supply a contact name and address.

Why does the winding-up process take so long?

There are many reasons why a delay can occur. Some of them are:

- Data - Records are often incomplete and the trustees have to be satisfied that everyone entitled to benefit has been included in the winding-up. Also the basic information (like members' dates of joining and leaving the scheme) has to be verified.
- HM Revenue and Customs (HMRC) reconciliation - If the scheme was contracted-out of the State Earnings Related Pension Scheme (SERPS), then it may have to provide certain minimum levels of pension benefit which have to be agreed with the HMRC National Insurance Contributions Office.
- Contribution Claims - It is possible for the receiver or liquidator of a company to claim from the State any contributions that were not paid in the final 12 months of the company's existence. To do this certain checks have to be made and certificates provided.

During the period that it takes for the trustees to wind-up the scheme, they should inform members of the current situation with regard to the winding-up of the scheme at least once a year. This would normally take the form of a standard letter sent to all members, giving a summary of the current situation.

Members are entitled during this period to request copies of the scheme's Trust Deed and Rules, the Trustees Annual Report and Accounts and any Actuarial Valuations prepared by the trustees.

Can I help?

Yes, you can keep the trustees advised of changes in your address. This is very important. If the trustees cannot contact you at the time the winding-up is being completed you may lose out. You can also tell the trustees the whereabouts of any other members whose address is not known.

What options will I have?

Again, this will depend to a certain extent upon the rules of the scheme. Usually, however, you have two options open to you, provided that no benefits have already been paid to you.

Option A: Transfer of your pension entitlement to another pension arrangement or scheme

You have an option to take a transfer value to another pension arrangement or scheme. The amount of transfer value available to you would depend on whether the scheme is in surplus or deficit. If the scheme is in deficit the transfer value may be reduced to take account of this. The amount of reduction will reflect the proportion of the benefits that cannot be provided by the scheme assets.

You can only transfer your pension entitlement if the new pension arrangement or scheme will accept a transfer. The new pension arrangement or scheme must be approved by the Inland Revenue. You have the following choices:

- i You can transfer to your new employer's pension scheme which can be an occupational, personal or stakeholder pension scheme; or
- ii You can transfer to your chosen personal pension or stakeholder pension scheme; or
- iii You can transfer to your chosen individual insurance policy (known as section 32 buy-out policy).

If you decide to take the transfer value to another pension arrangement or scheme, the benefits you will get from the new pension arrangement or scheme will depend on the type of the arrangement or scheme it is. The benefits you will get from these arrangements will not necessarily be the same as those benefits bought out with another provider by the scheme trustees.

If you opt for a pension scheme or arrangement which is a money purchase scheme (also known as defined contribution scheme), there is a pot of money available to you to purchase a pension at retirement. The value of the pension will depend on the value of the fund allocated to you by the existing scheme trustees and the future investment growth that may accrue under the new pension scheme or arrangement.

If you opt for new employer's occupational pension scheme which is a final salary scheme (also known as defined benefit scheme) the amount of benefit available to you will either be a fixed pension or added years which may not be exactly the same amount of service as you had with the existing scheme.

Option B: Trustees securing your pension entitlement by effecting an insurance policy

You have an option for having your scheme benefits bought out with another pension provider, such as an insurance company, by the trustees.

If you opt for the scheme to buy out your benefits, the amount of benefit available to you will depend on whether the scheme is in surplus or deficit and whether the employer is solvent or gone into liquidation. If the scheme is in deficit and the employer is insolvent, then your benefits may be reduced to take account of this.

Your choice

You should think carefully before you decide which type of option to choose. You should consider getting advice from a regulated Independent Financial Adviser (IFA) who specialises in pension business, if necessary. You could telephone IFA promotions on 0800 085 3250 who will be able to let you have the names and addresses of some advisers in your area.

What is the priority of distribution on scheme benefits?

If the schemes' assets are not sufficient to allow the trustees to give everyone their full entitlement, the assets must be distributed according to an order of priority.

The order of priority used differs depending on whether the winding-up started:

- before 6 April 1997
- after 6 April 1997 but before 10 May 2004
- after 10 May 2004 but before 6 April 2005 or
- after 6 April 2005.

For schemes where the winding-up process started prior to 6 April 1997, the rules of the scheme dictate the priority order. Usually, all pensioners' benefits (including increases) receive a high priority.

For schemes, where the winding up started after 6 April 1997 the order of priority is laid down in legislation.

The order of priority for schemes where the winding-up started after 6 April 1997 but before 10 May 2004 is as follows:

- a. Pensions and other benefits bought by additional voluntary contributions
- b. Pensions and other benefits already payable and secured before 6 April 1997 by insurance policies, including contingent benefits but excluding increases

- c. Pensions and other benefits already payable but not covered by b), including contingent benefits but excluding increases
- d. Contracted-out rights, excluding increases and refunds of contributions for members with less than two years' pensionable service and no accrued rights
- e. Pension increases on benefits in categories b) and c) above
- f. Pension increases on benefits in category d) above
- g. Other accrued benefits including pension increases.

The order of priority for schemes where the winding-up started after 10 May 2004 but before 6 April 2005, is as follows:

- a. Pensions and other benefits bought by additional voluntary contributions
- b. Pensions and other benefits already payable and secured before 6 April 1997 by insurance policies, including contingent benefits but excluding increases
- c. Pensions and other benefits already payable but not covered by b), including contingent benefits but excluding increases
- d. Other accrued benefits including pension increases
- e. Pension increases on benefits in categories b) and c) above.

The order of priority for schemes where the winding-up started after 6 April 2005, is as follows:

- a. Pensions and other benefits already payable and secured before 6 April 1997 by insurance policies, including contingent benefits and pension increases, which cannot be surrendered
- b. Pension and other benefits but not exceeding the benefits that the Pension Protection Fund would pay to those members whose employer becomes insolvent
- c. Pensions and other benefits bought by additional voluntary contributions
- d. Other accrued benefits including pension increases.

Supervision

Legislation designed to speed up the winding-up process for occupational pension schemes came into force on 1 April 2002.

From 1 April 2002 the trustees of occupational pension schemes must keep written records of their decision to wind-up the scheme, or to defer winding-up, and the steps which should be taken for these purposes. The records should also include the date of wind-up.

For any scheme that began to wind-up on or after 1 April 1973 the trustees must make periodic reports to the Pensions Regulator about the progress of the winding-up if it has not been completed within three years.

For schemes that began to wind-up prior to 1 April 2002, the deadline for reporting is being phased in. If the wind-up began:

- Before 1 January 1990 - first report due by 1 June 2002
- Between 1 January 1990 and 31 December 1992 - first report due by 1 April 2003
- Between 1 January 1993 and 31 December 1995 - first report due by 1 April 2004
- Between 1 January 1996 and 31 December 1998 - first report due by 1 April 2005
- Between 1 January 1999 and 31 March 2002 - first report due by 1 April 2006.

If the wind-up begins on or after 1 April 2002 and before 1 April 2003, once the scheme has been in wind-up for three years, the trustees will have one year to submit their first report.

For schemes winding-up after 1 April 2003, once the scheme has been winding-up for three years, the trustees will have three months to submit their first report. Subsequent reports are to be made at least once every 12 months.

On request, trustees must provide members or beneficiaries with a copy of any report, which has been made to the Pensions Regulator in connection with the wind-up. The copy must be provided within two months of the request.

If the Pensions Regulator believes that progress is being hindered and is unlikely to be completed within a reasonable time period without intervention, then the Regulator may make directions about the scheme to facilitate wind-up.

Anything else?

Be patient. Remember the winding-up of a pension scheme is a very complicated process and delays are not normally, in our experience, the fault of the trustees of the scheme. It is in their interests that matters are resolved as soon as possible. Finally, just remember that it is the duty of the trustees to look after your interests. Allow them time to sort things out.

If you have any queries or complaints regarding your pension, you should initially take these up in writing with the trustees of the scheme. If you are not satisfied with the response you receive from the trustees, you should write to us.

If you have not been informed of the level of your benefits by the third anniversary of the effective date of the winding-up, please contact us. We should stress that this does not necessarily mean there is a problem with the winding-up. Rather this is something we are happy to check out for you.