

## UK - Update

# Is your automatic enrolment pension scheme lawsuit-proof?

As the introduction of the ground-breaking automatic pensions enrolment legislation continues, the focus is beginning to shift to the risks to employers of choosing the wrong scheme.

Automatic enrolment will result in an estimated 10 million workers, many of them financially unsophisticated, being enrolled into pension schemes for the first time. Experience from other countries suggests that up to 97% of them will go into their scheme's "default fund" rather than attempting to pick their own choice of investment funds for their contributions. If the default fund performs poorly, leading to an impoverished retirement for members, the members may take legal action against the employer.

In the past, default funds have generally followed a "one-size-fits-all" model in which an individual's contributions are invested for most of her working life in riskier investments (equities) before being switched into safer assets according to a predetermined formula as retirement approaches. However, academic research into default funds has identified real differences in their levels of performance, as well as questioning whether the "one-size-fits-all" structure itself is still appropriate.

Another concern for employers will be the level of charges, which may also provoke complaints from members. Recent research has identified a difference of 100% in the level of pensions paid out to members who have been placed in the lowest- and highest-charging default funds. The risk that members will receive poor value in terms of charges is greatest where employers use old schemes set up in the 1990s and 2000s. Some of these schemes will have charge rates of up to six times those of more modern schemes.

We have been here before. When personal pension plans were first introduced in 1988, a major misselling scandal unfolded. The regulators became involved in 1993, and by 2002 the Financial Services Authority estimated that the industry had had to pay out GBP 11.8 billion to consumers in compensation.

In this case, choosing poor or inappropriate pension arrangements for automatic enrolment could mean that employers will face ombudsman complaints, unwelcome attention from regulators, and even lawsuits for negligence.

Similar developments can already be seen in the United States. A series of American companies have found themselves forced to pay out considerable sums as a result of lawsuits attacking shortcomings in their pension plans. Recurrent grounds for litigation include inappropriate investment options and excessive charges. Cases in the last few years have involved ABB (damages of USD 36.9 million), Caterpillar (settled for USD 16.5 million), Walmart (settled for USD 13.5 million), Kraft Foods Global (settled for USD 9.5 million) and RadioShack (settled for USD 2.4 million).

If you are an employer preparing to comply with automatic enrolment, we can help you to protect yourself against legal risks of this sort. With our extensive experience and industry contacts, we can assist you in choosing a robust and appropriate pension offering for your workers. Please feel free to give us a call to arrange a no-obligation conversation with one of our specialist pensions solicitors.

### **Further information**

If you would like further information on any issue raised in this update please contact:

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