News on...

Barnett Waddingham

Current Pensions Issues

Autumn 2012

Auto-enrolment Update

Self-certification Guidance

The Department for Work and Pensions (DWP) has published ***guidance for employers*** who wish to use their defined benefit (DB) or hybrid scheme to meet the auto-enrolment requirements. The following types of arrangement may be self-certified by sponsoring employers:

- Career average schemes and final salary schemes that are:
  - contracted-out of the State Second Pension (S2P), or
  - contracted-in and satisfy a "test scheme" standard.

Career average scheme must also offer a minimum level of revaluation on accrued benefits.

- "Hybrid" schemes that:
  - meet the "test scheme" standard and/or
  - meet one of the requirements for defined contribution (DC) schemes, as appropriate.

Employers will be able to self-certify in cases where actuarial calculations are not required - for example, where all the benefits provided are at least as generous as the "test scheme" basis. Otherwise the Scheme Actuary will have to carry out a value-based comparison of scheme benefits with "test scheme" benefits. The key features of the "test scheme" pension benefits are:

- they are payable from age 65 (increasing in line with changes to State Pension Age)
- they accrue at 1/120th of "Qualifying Earnings" each year for up to 40 years, and
- pre- and post-retirement increases are at least in line with statutory minimum requirements.

Staging Dates Extended

Following an earlier consultation the DWP has made *further changes* to auto-enrolment staging dates for smaller employers. The revised timetable will affect employers who previously had staging dates from April 2014.

The DWP has also addressed concerns of small employers who previously might have had an artificially early staging date by virtue of sharing a PAYE scheme with a larger employer or including pensions paid to past employees through their payroll. The new provisions permit small employers to determine their staging date by taking account of only "the number of workers in their PAYE scheme".

The first transitional period for DC schemes, during which the minimum employer contribution is 1% of Qualifying Earnings, has been extended to September 2017. This change will ensure that all existing employers are staged in before the minimum employer contribution increases to 2% in October 2017 (and then to 3% in October 2018).

The transitional period for DB and hybrid schemes, during which an employer may be able to delay automatic enrolment for certain "eligible jobholders", has similarly been extended.

Letter Templates and Language Guide

The Pensions Regulator (TPR) has launched a ***tool*** to help employers write to workers about auto-enrolment. Template letters have been designed to help employers fulfill their legal obligations, although TPR stresses that it is the employer's responsibility to ensure that all of the information sent to employees is correct. Meanwhile, the DWP has published an updated version of its auto-enrolment and pensions language guide, which is intended to help people understand pensions. The document sets out principles for communicating key messages to workers and some approaches to reducing the use of jargon.

Salary Sacrifice Guidance

HM Revenue & Customs (HMRC) has updated its ***Question and Answer (Q&A) document*** on salary sacrifice arrangements with additional information on workplace pension schemes and auto-enrolment.

There had been some doubt over whether salary sacrifice schemes could meet auto-enrolment requirements because employees are typically only able to vary their choices under salary sacrifice arrangements once a year (whereas auto-enrolment rules require that employees are able to opt out whenever they wish). HMRC has now confirmed that members can opt out of salary sacrifice arrangements for pension contributions at any time, provided any appropriate changes to terms and conditions of employment have been made.

Regulator's Strategy

TPR has set out its ***strategy*** for tackling non-compliance with the new auto-enrolment regime.

The Regulator aims to be "firm but fair", providing information and support so that employers know what they need to do to fulfill their new duties, and working with employers who have not understood their duties or who have been unable to comply. However, employers who ignore their new duties will be subject to TPR's powers, including statutory notices, fixed or escalating penalties and, ultimately, court action.

Our Services

Barnett Waddingham provides professional services spanning pensions, life and general insurance.

Our services include:

- Scheme actuary and associated services to the trustees and employers associated with defined benefit pension schemes.
- Advice in relation to defined contribution schemes.
- Pension accounting for UK and international companies.
- Administration and management services including pensioner payroll, preparation of annual accounts and secretarial services.
- Investment strategy reviews and advice on scheme evolution strategy.
- Management of closed schemes, wind-ups and reconstructions and schemes in PPF assessment.
- Employer risk management through buy out options, transfer exercises and PPF levy management.
- Advice on group personal pensions, stakeholder schemes and personal accounts.
- Group risk advice covering group life assurance, private medical benefits and income protection benefits.

We have also have a dedicated team that provides a wide range of services to the life assurance and general insurance industries in the UK and overseas including statutory actuarial roles.

Through our associated company, Barnett Waddingham Investments LLP, we provide assistance to individuals in respect of all aspects of their financial wealth management. These services include investment advice together with executive pension counselling, and retirement option advice including an annuity bureau.

Barnett Waddingham is also a leader in the provision of self invested personal pensions (SIPPs), small self administered pension schemes (SSASs), specialist executive pension plans (EPPs) and other retirement arrangements.

Solvency II for Pension Schemes – Impact Study

The European Insurance and Occupational Pensions Authority (EIOPA) recently conducted a public consultation on measuring the impact of a Solvency II-style regime on pension schemes (see our *Spring 2012 newsletter*).

EIOPA's proposed impact study will focus solely on numerical calculations relating to the "holistic balance sheet", rather than wider implications relating to funding, governance and disclosure, and will be carried out later in the Autumn.

TPR has since confirmed that it will be submitting impact calculations to the study on behalf of UK pension schemes, although larger schemes may still consider participating voluntarily.

Pensions Minister Steve Webb has said that the Government will fight plans to apply Solvency II to UK pension schemes. Barnett Waddingham also submitted a ***response*** to the consultation criticising the approach.

Focus on: De-risking

Some pension schemes have taken advantage of recent high gilt valuations to insure their pensioner liabilities with a bulk annuity provider. They have found that the value of their schemes' gilt holdings has risen faster than annuity prices, so they have been able to swap their gilts for a "buy-in" policy at an affordable rate.

Some schemes have considered insuring the benefits of only part of their pensioner membership – for example older members or those with larger liabilities.

The use of medical underwriting by the bulk annuity market is also gaining interest, with several insurance companies offering products on this theme. By providing information on the medical status or lifestyle habits of members, some insurers claim that savings can be made relative to the standard bulk annuity insurers as they are able to price with greater certainty and with lower risk margins. On the other hand, there is concern that going down this route will have an adverse effect on the scheme's ability to insure the remaining members at a later date.

For further information on either of these topics please speak to your usual Barnett Waddingham consultant, or contact our ***Corporate Consulting team***.

Impact of DB Schemes on FTSE350 Companies

Barnett Waddingham has *published* the results of research on the financial impact that DB schemes have on FTSE350 companies.

The results show that, for 29 FTSE350 companies, it would take more than a year to repay the DB scheme deficit using all cash generated from day to day operations. The research also shows that over 49 companies have deficit contributions that exceed their free cashflow.

News in Brief

RPI to CPI Switch "Not Unreasonable"

The Deputy Pensions Ombudsman has ruled that the trustees of the Innospec Limited Pension Plan did not act unreasonably in switching from using the Retail Prices Index (RPI) to the Consumer Prices Index (CPI) as the measure of inflation used to calculate pension increases. The trustees argued that they were continuing to use the Government's preferred interpretation of the cost of living, as provided by their scheme's trust deed and rules.

RPI/CPI – more changes to come?

The Office for National Statistics (ONS) is consulting on potential changes to the construction of the RPI during October and November 2012. One particular approach that is being considered is to align the calculation of the RPI with that of the CPI, effectively removing the so-called "formula effect" and thereby potentially reducing pension liabilities that are linked to the RPI. Other differences between RPI and CPI however (such as the composition of the "baskets of goods" that make up the indices) may yet remain.

We will set out further detail in our Winter 2012/13 newsletter. Any changes to the calculation of RPI are expected to take effect from March 2013.

DWP: Small Pension Pots

The DWP has announced that it will implement a system of "pot-follows-worker" where small DC funds will follow workers when they change jobs. The DWP estimates that by 2050, with the introduction of auto-enrolment and the possible banning of short service refunds, there could otherwise be 50 million dormant pension pots. The automatic transfer system is currently only intended to apply to auto-enrolment DC schemes.

The Government will also consider permitting the refund of "micro-pots" of around £200 or less.

New PPF Levy Framework

The Pension Protection Fund (PPF) has published a guide to the revised levy framework that will apply from this year (see our ***Winter 2011/12 newsletter***) to help pension schemes understand invoices due to be issued shortly. The PPF has also put sample invoices and some Frequently Asked Questions (FAQs) on its website.

PPF: Specialist Administration Services Panel

The PPF has launched a Specialist Administration Services Panel (SASP) to help pension schemes complete the PPF assessment and Financial Assistance Scheme (FAS) qualification periods more efficiently. This follows the establishment of the specialist Actuarial Panel in 2011.

Following a "robust procurement process", Barnett Waddingham is among those selected to be on the panel. Allocation of work to the SASP is scheduled to start shortly.

High Court Rules on Pensionable Salary Cap

In 2011 the BBC placed a cap on pensionable salary increases for pension calculation purposes of 1% a year, in the form of an agreement with members outside of the pension scheme. A member complaint, initially dismissed by the Pensions Ombudsman, has now also been dismissed in the High Court. A further hearing will consider whether the cap was a breach of the BBC's duty of good faith towards its employees.

HMRC: Short Service Refunds

HMRC has published ***draft guidance*** on new regulations that allow schemes to pay a partial refund of member contributions in certain circumstances. Before the abolition of contracting-out on a money purchase basis, short-service refunds that did not fully extinguish a member's benefit entitlement were not deemed to be unauthorised payments because of the legislative requirement not to refund Protected Rights (PR) pots.

Since the abolition, there has been no legislative override stopping partial refunds constituting unauthorised payments. This, however, conflicted with the rules of some schemes that require PRs to be retained in the scheme, even if other benefits are extinguished by a refund of contributions. HMRC's draft guidance explains that a partial refund from such schemes would not be an unauthorised payment, provided certain other requirements are met.

Directors' Pension Disclosures

The Department for Business Innovation and Skills is consulting on revised remuneration reporting regulations, including pension disclosures for directors, for reporting years ending after October 2013.

Changes in the value of a DB pension are currently determined using the scheme's cash equivalent transfer value (CETV) basis. Under the proposals a single figure for remuneration, incorporating all forms of pay including bonuses, share schemes and pension arrangements, will be disclosed. The value of increases in a director's pension will be calculated using a fixed factor of 20:1 (with an adjustment for inflation). The value of any early retirement enhancement would also have to be disclosed.

Depending on whether UK Listing Authority rules are also changed, the CETV approach may still apply in addition to the proposed new method.

Pension Trustees to be Given Information in Takeovers

The Takeover Panel is consulting on incorporating pension scheme trustee issues in its Takeover Code. Under the proposals, the Code will require disclosure of a bidder's intentions with regard to the target company's pension scheme(s). Trustees will need to be provided with copies of documents relating to the offer and will have a right to express their views on the offer.

The proposed Code will not require agreement on funding arrangements but, if such agreement is reached, a summary will be included in the offer document and disclosed to beneficiaries.

HMRC: Equalised Drawdown Rates

HMRC has updated its guidance on drawdown pensions following the European Court of Justice's ruling on the use of gender as a risk factor in insurance products (see our ***Spring 2011 newsletter***). HMRC's guidance instructs providers to use the same rates for women as for men to determine their maximum drawdown pension from 21 December 2012. This move will allow women to take a higher drawdown pension than before, whilst men should see no change (all other things being equal).

Latest News from The Pensions Regulator

Employer Departures from Multi-employer Schemes

When a company leaves a multi-employer scheme it is usually obliged to pay its share of the scheme's liabilities – i.e. the section 75 debt. There are mechanisms, however, where this debt can be apportioned to a remaining employer, or avoided via a withdrawal arrangement.

TPR has published ***updated guidance*** on employer departures to help trustees understand the different approaches to dealing the debt of an employer departing from a scheme. In particular, since January 2012, a new mechanism known as a Flexible Apportionment Arrangement (FAA) has been available to departing employers (see our ***Autumn 2011 Newsletter***).

When agreeing to a FAA, TPR expects trustees to be satisfied that:

- the remaining employers are reasonably likely to be able to fund the scheme
- the FAA will not adversely affect the security of members' benefits, and
- the scheme is unlikely to enter a PPF assessment period in the following 12 months.

The Regulator also emphasises the importance for trustees of multi-employer schemes to take professional advice on the appropriateness of different options when an employer is departing a scheme.

Incentive Exercises – Updated Guidance

Following the recent publication of an industry code of practice (see our ***Summer 2012 newsletter***), TPR has replaced its own guidance on incentive exercises with a shorter, principles-based statement.

TPR's ***statement*** focuses on the role of trustees and sets out its view that trustees should approach incentive exercises (such as enhanced transfer value (ETV) offers and pension increase exchanges (PIEs)) with caution and start from the presumption that they will not be in most members' interests. Trustees should make sure they fully understand any incentive exercise and ensure that the industry code is applied.

TPR also set out five principles representing the "minimum standard" for conducting such exercises:

1. Exercises should be clear, fair and not misleading.
2. Communications should be open and transparent.
3. Conflicts of interest should be appropriately managed.
4. Trustees should be consulted and engaged throughout the exercise.
5. Independent financial advice should be made available to all affected members, although TPR notes that, for some exercises (such as PIEs), this may not be necessary.

DC Schemes

TPR has updated its ***statement*** on "enabling a good member outcome in DC pensions", having previously published a set of six principles for good design and governance of workplace DC schemes (see our ***Spring 2012 newsletter***).

TPR has now published some draft "***key features***" that it believes are more likely to result in a good outcome for members of DC schemes, together with details of how these features tie-in with the original six principles. Meanwhile, in order to help employers decide whether their DC scheme qualifies as an automatic enrolment scheme, TPR has launched an ***online tool*** and guidance on "***selecting a good automatic enrolment scheme***".

TPR has also published the results of its recent ***survey*** of DC pension scheme members.

The survey found that while 78% of active DC members consider their personal or occupational pension provision to be the main source of their retirement income, only 42% of recent retirees would recommend a pension scheme as a method of saving for retirement.

Updated Recovery Plan Analysis

TPR has published an ***update*** to its annual report on the funding of DB and hybrid schemes which have a funding deficit. The update is based on schemes with valuation dates between September 2009 and September 2010 – "Tranche 5" schemes. TPR's initial findings include:

- 5 out of 6 Tranche 5 schemes are closed to new entrants.
- 21% of Tranche 5 schemes used some form of contingent security (the majority of whom had a parent/group company guarantee in place) as part of their funding plans.
- Tranche 5 schemes were, on average, 78.8% funded on an ongoing basis.
- The average length of Tranche 5 recovery plans was 8.1 years, compared with 9.5 years for schemes in Tranche 4 (schemes with valuation dates between September 2008 and September 2009).

Statement on FSDs and Insolvency

TPR has published a ***statement*** on Financial Support Directions (FSDs), intended to help the insolvency industry understand TPR's approach to using its FSD powers in cases of insolvency.

The statement confirms that, following a 2011 Court of Appeal judgment (that found that FSD liabilities arising after an insolvency rank as an expense of the administration or liquidation), TPR does not intend to deliberately delay the issue of an FSD to take advantage of the post-insolvency priority ranking.

October 2012
NEWS0422