Barnett Waddingham
Corporate Consulting

Pensions news for employers
January 2012

Welcome to the January 2012 edition of pensions news for employers. The newsletter covers a number of topical issues which companies need to be aware of and/or should be addressing over the coming months. For further information, please contact your usual Barnett Waddingham consultant or email **corporateconsulting@barnett-waddingham.co.uk**.

For more detail on a wider range of pensions issues affecting both employers and trustees, please see our monthly "Pensions News" and our quarterly "Current Pension Issues" published on our website.

Pension Protection Fund (PPF) News

Final 2012/13 PPF Levy Determination

The PPF has published its final levy determination for 2012/13 which confirms the total expected levy bill for the year as £550 million (£50 million lower than last year). As expected the levy parameters, which are fixed for the next three years, are unchanged from the proposals:

1) The PPF has used a range of factors in determining the amount it collects including, on the one hand, the improved financial position of the fund and the effect of PPF compensation now being increased in line with the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI) but also the uncertain economic outlook following the global financial crisis. The PPF also expects to raise £550 million in 2013/14 and 2014/15 and, subject to certain regulatory constraints, the levy scaling factor, the scheme-based multiplier and risk-based levy cap will remain the same.
2) The levy scaling factor (LSF) will be 0.89 from 2012/13 to 2014/15.
3) The Scheme-based levy multiplier (SLM) will be 0.000085 from 2012/13 to 2014/15.
4) The cap on the risk-based levy will be maintained at 0.75% of liabilities.

The PPF has also published guidance on how it will allow for investment risk, contingent assets and block transfers as well as levy practice guidance - these can be found on their website (click **here**).

There are still some actions that can be taken to reduce PPF levies ahead of the deadlines in March and April next year and companies should analyse the impact of determination on their expected levy for 2012/13; in particular, the scheme's investment risk is a new factor to the calculation that was not included in previous years.

Certification of Type A contingent assets

The PPF has strengthened the certification requirement in relation to Type A guarantees and will now require Trustees to certify the following:

"The trustees have no reason to believe that each guarantor, as at the date of the certificate, could not meet its full commitment under the contingent asset."

The PPF has noted that it does not generally expect trustees to undertake a covenant review of the guarantor. However, they do require trustees take...

"...proportionate and reasonable steps to reassure themselves as to whether the guarantor has sufficient value as a business".

Pension scheme sponsors will therefore need to take steps to ensure the Trustees have all the necessary information to satisfy themselves that the guarantor can meet all (or part of) the amount under the guarantee, and thus benefit from the inclusion of the guarantee in the levy calculation. The PPF will be performing its own analysis of the strength of the guarantor; if it comes to the view that a guarantor could not meet the amount certified then the guarantee will not be used in the levy calculation.

DWP paper: Short service refunds and small pension pots

The Pensions Minister, Steve Webb, has announced that the Government will abolish short service refunds for trust-based defined contribution schemes. In a recently published DWP consultation paper entitled "Meeting future workplace pensions challenges: improving transfers and dealing with small pension pots", the Government has set out possible ideas on how the resulting small pension pots can be consolidated in a drive to make pension saving more viable for people who move jobs often.

The Government anticipates that "automatic enrolment and a highly mobile jobs market will lead to 4.7 million additional small pension pots" in the future and recognises that "small pots are expensive to administer" and that it is "inefficient to have multiple providers managing multiple small pots for any individual".

The consultation runs until 23 March 2012 with further details on how small pension pots can be consolidated to be published shortly. The Government expects the rule change to happen as early as 2014, part of the next Pensions Bill.

The Government's proposals will move occupational schemes more into line with the personal pensions regime. Any efforts to mitigate the increases in administration costs likely to result will, of course, be welcomed by employers.

Solvency 2 and UK pension schemes

The Committee of European Insurers and Occupational Pensions Supervisors (CEIOPS), on behalf of the European Commission, have compiled a framework which toughens the capital requirements of insurers in order to more closely reflect individual insurers' overall financial positions, business profiles and risk management strategies. This directive is known as Solvency 2 and has been designed in a bid to make insurance companies more resistant to financial shocks.

There has been much speculation on whether Solvency 2 will ultimately be applied to UK occupational pension schemes since the pension products of insurance companies (annuities, self-invested personal pensions, stakeholder pensions etc) will be affected. In October this year the European Insurance and Occupational Pensions Authority (EIOPA) launched a consultation in response to the European Commission suggesting the funding requirements of pension schemes should be harmonised across Europe and requested views on how this should be achieved.

One of the main objectives of the European Commission is to provide greater security for members' pension benefits. However, Barnett Waddingham does not believe that Solvency 2 will provide the right platform to achieve this, given the fundamental differences between occupational pension schemes (which are backed by sponsoring employers) and insurance companies (which are focussed on making a profit).

Further, the traditions of pension provision across Europe vary significantly. We do not believe that designing a unified regulatory system can realistically be implemented and, more importantly, are concerned that the extra cost of implementing Solvency 2 for occupational pension schemes will most likely be passed on to pension scheme sponsors.

Many commentators believe that the impact on funding for UK defined benefit pension schemes will be far more significant than for their European counterparts. This is mainly due to the fact that accrued pension benefits in the UK are guaranteed i.e. pension scheme sponsors cannot, by law, reduce past pension benefits already earned by members.

The current regulations already require the prudent funding of members' benefits, ideally with the backing of a strong employer covenant, and the existence of the Pension Protection Fund compensates pension scheme members where the sponsor goes into insolvency.

There is a real fear that applying Solvency 2 in its current form could result in significantly increased costs for companies, both from increased funding targets and the additional compliance requirements .

Although, in theory, implementation of Solvency 2 for occupation pension schemes could lead to increased security for members' benefits, the increased burden on UK pension scheme sponsors is very likely to force many sponsors to further reduce levels of future benefit provision and, for some, to cease future accrual altogether.

The Confederation of British Industry (CBI), the National Association of Pension Funds (NAPF) as well as the DWP Pensions Minister, Steve Webb, have all commented on the negative impact that Solvency 2 could have on the funding requirements of UK pension schemes.

The EIOPA consultation closed on 2 January 2012. We will provide further updates on this in due course.

Finance Bill 2012: changes to the tax rules for asset-backed pension contributions

Draft legislation for the Finance Bill 2012, published on 29 November 2011, includes a provision to change the tax relief granted to employers in respect of asset-backed pension funding arrangements. This follows a consultation earlier this year. The use of assets other than cash to fill pension fund deficits has grown in popularity recently with a number of high profile companies, including Sainbury's, John Lewis, Marks and Spencer and Diageo, using this method.

Under these arrangements a "Special Purpose Vehicle" (SPV) is set up into which the company transfers assets. These assets are normally property but some companies have transferred the rights to receive payments for use of a brand name. The company and the pension fund then take a stake in the SPV with rights to receive future payments. For example, the scheme may receive a fixed amount of any rental income received from the property in the SPV over the period needed to pay off the deficit in the fund.

One advantage of this arrangement over cash funding is that the value of the fund's interest in the SPV can usually be taken as an asset on the fund's balance sheet – so if the value of the interest is equal to the shortfall, the deficit is immediately removed even though the fund will only receive cash payments when they actually fall due. Another advantage of these arrangements is that the transfer of the asset by the company could qualify for immediate tax relief on the whole of the value transferred. The government has, however, recognised that some of these arrangements have resulted in unintended tax reliefs being granted.

A particular concern was that in addition to tax relief being granted immediately some companies could effectively be getting relief at double the value of the payments made to the pension fund – for example on the full value of the property transferred to the SPV at the outset then, if the company leases back the property, on any rental payments made to the SPV.

The new legislation aims to tackle the cases where companies benefit from this "excessive" tax relief with the relief granted on the upfront value of the contributions being denied in some cases. The new rules could also have a retrospective effect on existing arrangements. Although the new rules are likely to mean the tax benefits of such arrangements will be reduced, this is not, in our view, their main purpose. The arrangements are, and will remain, an important option for companies in funding their pension schemes, particularly if they have suitable assets available.

Amendments to the Employer Debt Regulations

The DWP has announced that amendments to the Occupational Pension Schemes (Employer Debt) Regulations 2005 (the Employer Debt Regulations) will come into force in January 2012 following a consultation on the draft regulations in June 2011.

The new rules introduce a "Flexible Apportionment Arrangement" which will allow the liabilities of a departing employer to be reapportioned to a remaining sponsoring employer (or employers) without a debt being triggered. Effectively the remaining employer(s) will "step into the shoes" of the departing employer.

A few conditions will apply:

- The funding test, which is already in place for "scheme apportionment arrangements" must be met. Broadly this requires the remaining employers to be sufficiently strong to fund the scheme on the current funding basis, and that the arrangement does not weaken the covenant of the scheme sponsors to the extent that the security of members' benefits is reduced.
- The trustees and the employers involved must agree to the arrangement.
- The whole of the departing employer's liabilities must be apportioned to the remaining employer(s).
- Where a cessation event (which occurs when an employer ceases to employ active members, providing at least one other employer continues to do so) has already occurred, no part of the debt has been paid.
- The scheme is not in a PPF assessment period and it is unlikely that one will commence within the next 12 months.

Employers considering a corporate restructure will welcome the flexible apportionment arrangements and in particular the removal of the need of the scheme's rules to contain a permissive provision and for the section 75 liabilities to be calculated at the time of the employment-cessation event.

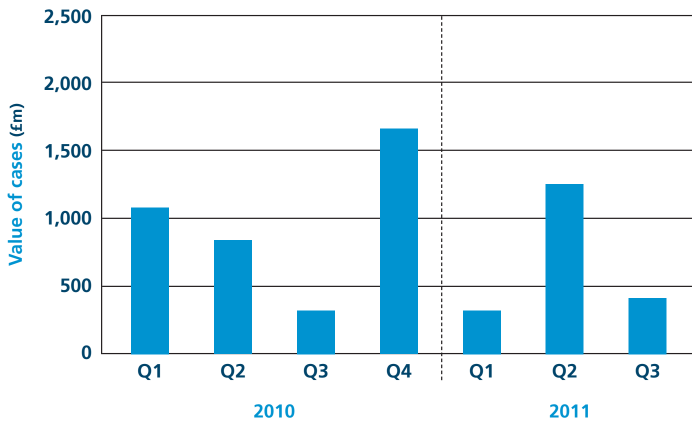
The introduction of flexible apportionment arrangements as an additional option for addressing section 75 liabilities will, however, further add to the complexity of the regulations.

There have also been a number of technical amendments to the regulations and trustees have been given the option to increase the "period of grace" under which an employer can employ another active member without triggering a debt from 12 to 36 months.

Buy-outs, buy-ins and longevity swaps

Buy-outs and buy-ins market business

The value of business completed in the first three quarters of 2011 was down slightly compared to 2010 although quarter 4 has seen two large deals completed by Legal & General and Rothesay Life so we expect the overall annual total to beat the 2010 figure. 2011 has also seen some new insurers joining the market.

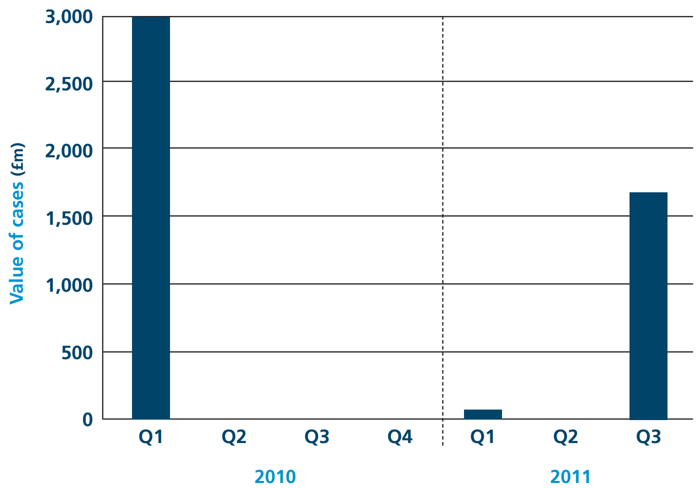


Source: Barnett Waddingham LLP

Longevity swaps market business

This market went very quiet for most of 2010 and early 2011 although the population index swap completed in Q1 was the first one of this type.

Three scheme experience swaps have been announced in the last half of the year – one in Q3 and two so far in Q4.



Source: Barnett Waddingham LLP

Provider News

Abbey Life have joined the bulk annuity market and are actively quoting. In the long run, they expect to concentrate on deals of over £100m but they may quote on smaller ones initially. Abbey Life have already completed a longevity swap through their parent, *Deutsche Bank*, and they are continuing to quote on these.

Nomura are also planning to join the bulk annuity and longevity swap markets shortly. At the moment, they are hiring staff and are waiting for authorisation from the Financial Services Authority. They are targeting transactions of at least £100m.

PensionsFirst have also announced that they expect to rejoin the markets for these products in 2012.

Legal & General have launched a product for insuring individual pensioners with liabilities costing between £2m and £5m. Medical underwriting for these members would be required but this could reduce the cost of insuring these members as Legal & General would have more certainty about the longevity risk posed by these members. The product is called LIDBA – Large Individual Defined Benefit Annuities. It can be included as part of a buy-in exercise or as individual annuities.

It appears likely that full implementation of *Solvency 2* for insurers will be delayed until 1 January 2014, a delay of one year. As UK insurers have been working towards a 1 January 2013 deadline, there have been concerns that additional costs will be incurred if the implementation is delayed.

Significant deals completed

The *Uniq Pension Scheme* has signed a £830m buy-in deal with *Rothesay Life*. This follows the "debt for equity" swap agreed earlier in the year

Deutsche Bank have completed a £3bn longevity swap with the *Rolls-Royce* Pension Fund.

British Airways have extended their longevity swap deal with *Rothesay Life* to cover 40% of pensions in payment from the *Airways Pension Scheme*. This follows the original deal in 2010 to insure 20% of the pensions in payment.

Pensions Training Videos for Employers

Barnett Waddingham have developed a series of short training videos designed to give employers a straightforward explanation on various topical issues affecting their pension scheme.

We have recently added four new videos (please click to view each one):

- **New Benefit Design**
- **Early Retirement Exercises**
- **Enhanced Transfer Values**
- **The Pensions Regulator: "Anti-avoidance powers and recent cases"**

The videos are hosted via YouTube (click **here**) and can also be downloaded as free podcasts via iTunes (click **here**)

Corporate Consulting Blog

Looking for concise up to date commentary on the key pensions issues you face as an employer with a defined benefit scheme?

Why not set up an RSS feed to our blog **http://bwllp.co.uk/gU**

Corporate Consulting Predictions League 2011

The 2011 Predictions League has now come to an end and we can now announce the winners!

2011 was a turbulent year and there were certainly things that very few people predicted! Only one person entering the competition predicted that we would end the year with long term government gilt yields anywhere near 2.8%! Inflation figures also seemed to surprise people with nearly everybody underestimating inflation over 2012 but overestimating where long term inflation expectations would be at the end of the year. After combining all the results the best predictors were:

Overall winner - Chris Crighton (TLT Solicitors)

Runner-up - Richard 'Nostradamus' Harris (Lafarge)

Top Advisor - Ben Benanke (Eversheds)

Top Finance Director - Paul Vincent (BMS)

Congratulations to all the winners. Visit our Predictions League page (click **here**) to see the final league table with all the remaining results.

Predictions League 2012

Details of the Predictions League 2012 – *"What are the prospects for gold?"* have been announced. Further information on the event can be found on our website (click **here**).

If you have any queries, please contact your usual Barnett Waddingham consultant or email **corporateconsulting@barnett-waddingham.co.uk**

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