

## Pensions - May 2013

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### TPR: Annual Funding Statement 2013

In 2012, The Pensions Regulator (TPR) published its first statement on funding, setting out what TPR expected of trustees and employers undertaking valuations in 2011/12. TPR has now published a "[Defined Benefit Annual Funding Statement 2013](#)", which is aimed at trustees and employers undertaking valuations with effective dates between 22 September 2012 and 21 September 2013 (Tranche 8).

[TPR's analysis](#) shows that, on average, Tranche 8 schemes can expect to see an increase in deficits since their previous valuation, and will need to either increase contributions or make use of flexibilities under the funding framework:

- As a starting point, TPR expects trustees to consider whether the current level of contributions being paid by the sponsoring employer(s) can be maintained.
- Trustees should consider an integrated approach to assessing employer covenant, investment and funding risks. For example, when setting an investment strategy trustees should take into account the employer's ability to make up any further shortfalls that could arise.
- Trustees may change their assumptions to reflect changes in market conditions and the outlook for future investment returns, but should carefully document any reasons for changes and consider the risks involved.
- Trustees may use different assumptions for investment returns in the recovery plan to those used in the valuation of technical provisions. TPR comments that this should, however, be consistent with the scheme's overall risk management approach.

TPR is updating its regulatory approach to move away from mechanical triggers (such as the level of technical provisions and the length of recovery plans) instead focusing on issues such as deterioration in covenant strength, the shape of recovery plans and the investment performance assumed in the recovery plan.

TPR will also focus its efforts on the schemes it considers to pose the greatest risks, and will consult in the autumn on its approach.

As announced in the 2013 Budget (see [News on ... Pensions – April 2013](#)), the Government intends to give TPR a new statutory objective to take into account the impact of scheme funding arrangements on the sponsoring employer's growth prospects. The wording of the objective will be included in the next Pensions Bill<sup>1</sup> and discussed further later in the year. TPR will then amend its Code of Practice on Funding Defined Benefits. In the meantime TPR has reiterated that, if investment in the business is being prioritised at the expense of affordable deficit repair contributions, such investment should be used to improve the employer's covenant.

TPR also comments in its analysis accompanying the statement that sponsors' capacity to meet deficit contributions appears to have increased, relative to their EBTD (Earnings Before Taxes, Depreciation and Amortisation), although reasonable affordability remains an employer-specific consideration.

During June 2013, Barnett Waddingham is running a series of nationwide seminars on Scheme Funding. For further information, see below or visit [our website](#).

### IFoA elects President-elect

[Nick Salter](#), co-founder and Senior Partner of Barnett Waddingham, is [to become President-elect](#) of the Institute and Faculty of Actuaries (IFoA) for 2013/14.

Nick will assume the position on 24 June 2013, when David Hare becomes President and the current President, Phillip Scott, becomes Immediate Past President.

<sup>1</sup> At the time of going to press, the draft Pensions Bill has been published and includes wording describing TPR's new objective "...to minimise any adverse impact on the sustainable growth of an employer."

## Legislation Update

### Red Tape Challenge - Disclosures

As part of its "Red Tape Challenge", the Government has [revealed](#) a set of measures to help "ease the administrative and regulatory burden of private pension legislation on employers". Included in [the announcement](#) are details of proposed changes, including an overhaul of the disclosure of information regulations for pension schemes which, it is estimated, could save UK businesses £10 million per year.

The Government will also consider whether to make indexation for future accruals discretionary. Such changes would form part of the Government's proposals in relation to Defined Ambition pension schemes (see our [information sheet](#)).

### GMP Equalisation

The DWP has published an [interim response](#) to its earlier consultation (see [News On ... Pensions – February 2012](#)) on Guaranteed Minimum Pension (GMP) equalisation regulations. The regulations are intended to make it clear that pension schemes are required to equalise GMPs whether or not any member of the scheme qualifies as an opposite-sex "comparator".

The DWP has now confirmed that the regulations will be delayed so that the Government can consider the interaction of GMP equalisation and the conversion of GMPs into main scheme benefits. The DWP will not, however, publish a final version of the example methodology for equalising GMPs that was included in the original consultation, given strong objections to the approach described. The Government is considering how best to engage with industry in preparing guidance.

A full response to the consultation will be published "at a later date".

## Work and Pensions Committee: Scheme Governance

The Work and Pensions Committee has published a [report](#) on improving governance and best practice in workplace pensions. The committee's recommendations include:

- A single regulator should be established for workplace pensions.
- Active member discounts and member-borne adviser fees should be banned.
- The Government should work together with the pensions industry to improve member communications.
- Employers should be helped to set up governance committees for overseeing contract-based schemes.
- The Government should remove legislative and regulatory barriers to "Defined Ambition" schemes by 2016.

In the report, the committee also expresses concern that the proposed "pot follows member" system (see article above) for small pension pots might be detrimental for some members.

### DWP: Pot Follows Member

The Department for Work and Pensions (DWP) has published a Command Paper on the subject of "[Automatic transfers: consolidating pension savings](#)".

For employees switching jobs, the DWP has confirmed its intention to implement a "pot follows member" system where accrued pension savings of under £10,000 will transfer with the employee. The transfer would be between money purchase schemes – there will be no corresponding requirement to automatically transfer Defined Benefit (DB) entitlements. Members will have the right to leave their pension pots with the previous employer's scheme, and the Government may in future prescribe standards for automatic transfer schemes.

The Government has said it will now work with the industry to develop a transfer process based on either a purpose-built IT system or "Pensions Transfer Information Documents". The Government also intends to withdraw short service refunds for those in money purchase schemes from 2014.

### DWP: Defined Ambition models

Speaking at a National Association of Pension Funds (NAPF) conference, DWP head of private pension policy Bridget Micklem has outlined the general workings of three favoured "DB-lite" Defined Ambition models:

- Schemes where the sponsoring employer is able to adjust retirement ages to take into account increases in life expectancy
- Schemes under which pension increases are discretionary and provision for dependants' pensions is not compulsory, and
- Members are promised a defined level of benefit while "active" but when they leave, retire or die, the benefit is converted to an equivalent cash sum which can be used to purchase an annuity.

The DWP are currently investigating these three models and considering the legislative changes that would be needed to make them possible. A discussion paper is expected in the summer.

## Dairy Crest's cheesy funding approach

Dairy Crest is to transfer the rights to the sale proceeds of [20 million kilograms of maturing cheese](#) to help cover the funding shortfall in its pension scheme. The company's pension scheme had a deficit of around [£84m](#) at the end of September 2012. It is estimated that the income from the sale of the cheese could be worth up to £60 million.

## Pension Schemes in Takeovers and Mergers

The Code Committee of the Panel on Takeovers & Mergers has published [new rules](#), which come into effect on 20 May 2013, in relation to the DB pension arrangements of publicly listed target companies subject to takeover bids. Under the new rules, the trustees of these schemes will be considered significant stakeholders (in a similar way to existing employees) and will therefore have to be provided with additional information, and be able to feed back their opinion on the impact of a takeover on the scheme.

In addition, offer announcements and documentation for bidders will have to contain much more information regarding the likely effects of the offer on of the target company's pension schemes.

## Single-tier State Pension

The Work and Pensions Committee has [published a report](#) on the proposed single-tier state pension. In the report, the Committee welcomes the improvements in retirement income and simplicity that the single-tier state pension will bring. However, the report warns that the new system (including transitional arrangements) should be carefully communicated, and that the Government should publish a revised impact assessment.

The report also encourages urgent engagement with employers and pension schemes regarding the accelerated ending of contracting-out.

Meanwhile, the DWP has updated its [policy paper](#), "The single-tier pension: a simple foundation for saving", following the Government's announcement that the introduction of the single-tier pension will be brought forward to April 2016. The DWP's [note](#) explains the effect of the single-tier proposals on women who were born between 6 April 1951 and 5 April 1953.

## PPF News

### 7800 Index

The [latest update](#) of the Pension Protection Fund's (PPF) 7800 Index of schemes' funding (on the s179 basis) has been published.

The aggregate deficit of the 6,316 schemes in the index is estimated to have increased over the month to £236.6 billion at the end of March 2013 (there was an aggregate deficit of £201.5 billion at the end of February 2013).

The funding ratio fell from 84.6% to 82.6% over the month. There were 5,080 schemes in deficit and 1,236 schemes in surplus.

### Late Retirement Factors

From 30 April 2013, individuals entitled to compensation from the PPF will be able to postpone payment of PPF compensation up until they reach age 75. The PPF has now published the [uplift factors](#) which will be applied to pension and lump sum benefits on late retirement.

## TPR: Auto-enrolment Registration

TPR has published its [first monthly report](#) on auto-enrolment. Data supplied to TPR by 84 registered employers suggests that at least 308,000 "eligible jobholders" were automatically enrolled into a pension scheme between July 2012 and the end of March 2013. 1,231,000 workers were already active members of a qualifying scheme on the staging date.

## IORP II: EIOPA release preliminary results of QIS

The European Insurance and Occupational Pensions Authority (EIOPA) has released the preliminary results of its [Quantitative Impact Study \(QIS\)](#) on Institutions for Occupational Retirement Provision (IORPs) (e.g. pension schemes). EIOPA have stated that a number of issues have not been resolved and therefore "the outcomes of this first QIS must be treated with caution".

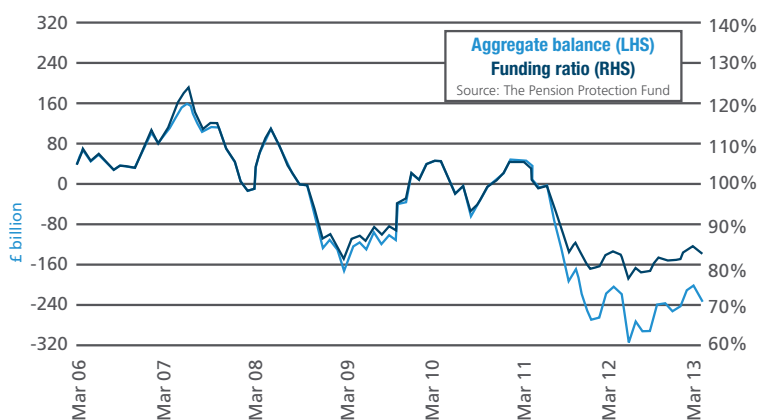
The QIS was requested by the European Commission to help in its analysis of different policy options (analogous to Solvency II for insurance companies) being considered for the review of the IORP Directive. All of the policy options are based on a "holistic balance sheet" approach starting with a risk-free discount rate. The approach aims to calculate solvency figures on a common and consistent basis for European defined benefit IORPs. EIOPA received a number of comments from QIS respondents that the calculations required were very complex, extensive and certainly too costly for small pension schemes.

TPR's response to the QIS (on behalf of UK pension schemes) showed an estimated increase of £450bn (€527bn) in UK DB scheme deficits.

EIOPA intends to publish the final QIS report in June 2013.

### Stop Press!

The EU Commissioner for Internal Market and Services, Michel Barnier, has announced that Pillar 1 (ie the funding and solvency aspects) will not be included in the revised IORP directive when it is introduced in the Autumn. Further details will be included in News On... Pensions - June 2013.



## “Monkeys” outperform market cap index

[Research](#) by Cass Business School has suggested that monkeys selecting stocks at random would have easily outperformed the US stock market over the 43 years to 2011.

The researchers simulated 10 million ‘monkey’ fund managers by programming a computer to randomly pick and weight portfolios from a universe of 1,000 stocks. They found nearly every one of the monkey managers beat the performance of an index weighted by market capitalisation (i.e. the size of the company).

The research suggests that certain “smart-beta” tracker funds could therefore produce better returns than a market-cap weighted index. For example, in the study some funds which invested in the same companies’ shares but weighted by other factors (e.g. dividend payments) actually outperformed the monkeys.

## Kodak Pension Plan

The UK Kodak Pension Plan has made a deal with its US parent company under which the pension plan is to give up a £1.8 billion claim in return for shares in Kodak’s personal film and document imaging operations.

The pension plan had a funding deficit which was substantial compared with the UK sponsoring companies. However, the US parent (Eastman Kodak) had provided a contingent guarantee to the plan. The guarantee forms the basis of the pension plan’s £1.8 billion claim against Eastman Kodak, following commencement of “Chapter 11” bankruptcy proceedings in the US, whilst the UK businesses continue to trade.

It is understood that members of the UK pension plan will be able to choose whether to transfer their benefits to a new scheme, with benefits reduced below those initially promised by Eastman Kodak (but at a higher level than PPF compensation) or to remain in the UK plan which would then be expected to transfer into the PPF.

The deal is still to be examined in the US bankruptcy courts. However, it is understood that TPR and the PPF are happy with the arrangements and that TPR will consider publishing a report relating to the matter in due course.

## Further Information

We are running a series of nationwide seminars during June 2013, looking at the likely challenges for trustees and employers carrying out scheme funding valuations over the coming year, and the potential impact of The Pensions Regulator’s new statutory objective. Seminars are being held in:

- Leeds on 18 June (am)
- Birmingham on 19 June (am)
- Liverpool on 20 June (am)
- London on 25 June (pm), and
- Amersham on 26 June (pm)

Please see [our website](#) for further details and for booking information.

You might also find our recent publications on the following topics useful:

- [Current Pensions Issues \(Spring 2013\)](#)
- [Pensions News for Employers \(Spring 2013\)](#)
- [Investment Markets and the less-than-great rotation](#)
- [Current Issues in Pensions Financial Reporting \(31 March 2013\)](#)
- [Buy-outs, buy-ins and longevity swaps \(Spring 2013\)](#)

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively contact us via the following:

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