

**Barnett
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a true partnership approach

News on Pensions

JUNE 2014

Pensions Act 2014

The Pensions Bill 2013/14 has received Royal Assent, becoming the [Pensions Act 2014](#). We summarise the key provisions below.

- **The Pensions Regulator – Statutory Objective.** The Act adds a new statutory objective for The Pensions Regulator (TPR) to 'minimise any adverse impact on the sustainable growth of sponsoring employers' when exercising its functions in relation to scheme funding.
- **PPF Compensation.** The Act includes [measures](#) to restructure the Pension Protection Fund (PPF) compensation cap such that long-serving members of qualifying schemes (with more than 20 years' service) could receive greater PPF compensation.
- **State pension reforms.** The Act paves the way for the single-tier state pension to replace the current basic state pension and additional state pension with a flat-rate pension for those reaching State Pension Age (SPA) from April 2016. The Act also legislates for the gradual rise in the SPA from 66 to 67 between 2026 and 2028, and introduces a framework for regular future reviews of the SPA.
- **Contracting-out Statutory Override.** In April 2016, contracting-out on a defined benefits (DB) basis will end. The Act includes provision allowing sponsoring employers to amend their scheme to offset the lost NI rebates. The government is consulting on draft regulations setting out how the override will operate (see below).
- **Automatic transfers of small pension pots.** Individual pension pots below a certain value (expected to be £10,000) will automatically follow members to their new pension scheme when they change jobs. The Department for Work and Pensions (DWP) is expected to consult shortly on the finer detail.
- **Pension scheme charges.** The Act will allow the government to cap annual charges (at 0.75% of funds under management) in defined contribution (DC) schemes used for auto-enrolment. 'Active member discounts' will also be banned. The act also includes a clause requiring the disclosure of information about transaction costs.
- **Governance.** Powers allowing the government to introduce minimum governance and administration standards are included in the Act.
- **Incentives to transfer.** The government now has the power to make regulations prohibiting enhanced / incentivised transfer exercises. It is not clear whether the option to use this power will be taken up before it lapses in July 2021.
- **Short service refunds.** The Act includes provision (not yet in force) for abolishing short service refunds for people who leave a DC pension scheme after 30 days but within 2 years.

Employer override regulations

The DWP has published [a consultation](#) and draft regulations on the 'employer override' power relating to the abolition of contracting-out for DB schemes in April 2016. The regulations set out the steps to be taken where employers wish to utilise clauses in the Pensions Act 2014 to amend future benefits or contributions to reflect the increased costs of contracting back in, without having to obtain trustee consent.

Actuarial certification will be required that the increase in employee contributions and/or the value of the reduction in accruing benefits is not more than the annual increase in employer NICs (i.e. the 'lost' rebate of 3.4% of earnings between the Lower Earnings Limit and Upper Accrual Point).

In carrying out this test, the actuary is required to use a method and assumptions consistent with the calculations for the latest Scheme Funding valuation. However, if instructed to do so by the employer, the actuary can use a 'neutral' basis, consistent with the approach for calculating Cash Equivalent Transfer Values. The draft regulations also note that the Principal Employer appoints the certifying actuary, although with trustee approval the Scheme Actuary may perform this role.

Defining 'money purchase'

DWP consultation

In May 2014, the DWP published a response to its consultation on implementing a new definition of money purchase benefits (see [News on... Pensions - November 2013](#)). Since then, the final regulations published alongside the consultation response [have been withdrawn](#). We understand this is a procedural point requiring that the regulations are split into two separate statutory instruments, both still expected to come into effect by the end of July.

As of 30 June, the consultation response is no longer available on the DWP's website, whilst the changes noted above are incorporated.

As well as a number of technical changes, the DWP's response, before it was withdrawn, said that transitional protections for schemes that had previously treated benefits as money purchase (which will now be classed as non-money purchase) have been extended. In particular, most decisions made on the assumption that the scheme benefits were money purchase between 1 January 1997 and the date the regulations come into force will be considered valid. The DWP was previously proposing that only decisions up to 28 July 2011 (the date of the DWP's statement on its intention to legislate) would not need to be revisited.

This change does not apply in the case of historic debt on employer calculations where trustees will not necessarily be required to revisit previous events, but may need to review their funding approach.

Following consultation, the DWP has also extended the scope of transitional protections to cover money purchase benefits with DB underpins, top-up benefits, Protected Rights and Additional Voluntary Contributions (AVCs).

Out of cycle 'section 179' valuations

The PPF has published [a consultation](#) proposing to call for out of cycle 'section 179' (s179) valuations for schemes which are no longer treated as money purchase under the new statutory definition in Section 29 of the Pensions Act 2011. The PPF uses s179 valuations to set schemes' annual levies.

As a result of changes to the definition, certain schemes' benefits are expected to become eligible for PPF protection - the regulations give the PPF an explicit power to instruct trustees to commission valuations to include benefits that were formerly classed as money purchase. In particular:

- Schemes that have not previously been covered for PPF protection (Newly Eligible Schemes) must submit their first s179 valuation by 31 March 2015 and will become eligible for PPF protection from 1 April 2015.

- The PPF will have a discretionary power to call for out of cycle s179 valuations for schemes that have additional benefits that become eligible for PPF protection (Increased Liability Schemes), where s179 valuations on the Regulator's Exchange system as at 31 March 2015 would not otherwise include the additional liabilities.

There will be flexibility for valuations already in progress to be updated to reflect the additional liabilities, even where the valuation date is before March 2015.

In the consultation, the PPF notes that out of cycle s179 valuations will only be required where the impact on the scheme's surplus or deficit is deemed 'material' – i.e. where the deficit/surplus changes by more than 10% and by more than £5m. The PPF intends to publish further valuation guidance in due course, and will be writing to all currently eligible schemes to explain the changes.

PPF news

PPF levies 2015/16 – 2017/18

The PPF has published [a consultation](#) setting out its levy plans for the next three years, including further detail on the new insolvency risk model developed with Experian.

Proposed new insolvency risk model

The PPF has confirmed its intention to implement a PPF-specific model (PPFSM) in the calculation of levies from 2015/16. The PPFSM has been developed in partnership with Experian and will replace the Dun & Bradstreet (D&B) model that has been used since the PPF's inception. Unlike the commercial D&B model, the PPFSM is based only on companies that sponsor PPF-eligible pension schemes.

The proposed model will apply one of eight different scorecards (including one solely for not-for-profit organisations) to each employer. Statistics from the latest published accounts of the company, as well as assessments of the strength of any parent company, the age of the latest mortgage/charge registered with Companies House, the age of the company and how late the company pays its bills will be taken into account to varying degrees, depending on which of the eight scorecards is deemed to apply.

The PPF is also consulting on a number of other aspects of its assessment of insolvency risk. In particular it has proposed that it will continue to categorise employers into one of 10 insolvency risk bands. Changes to the structure are however expected to result in fewer companies being in the least-risk band (Band 1) than under D&B (20% compared with 35%).

The PPF consultation considers whether transitional protections should be used to reduce the impact of the change in model. The consultation also includes [an analysis](#) of the impact of moving to the PPF-specific model, based on [research by Barnett Waddingham](#).

Other changes

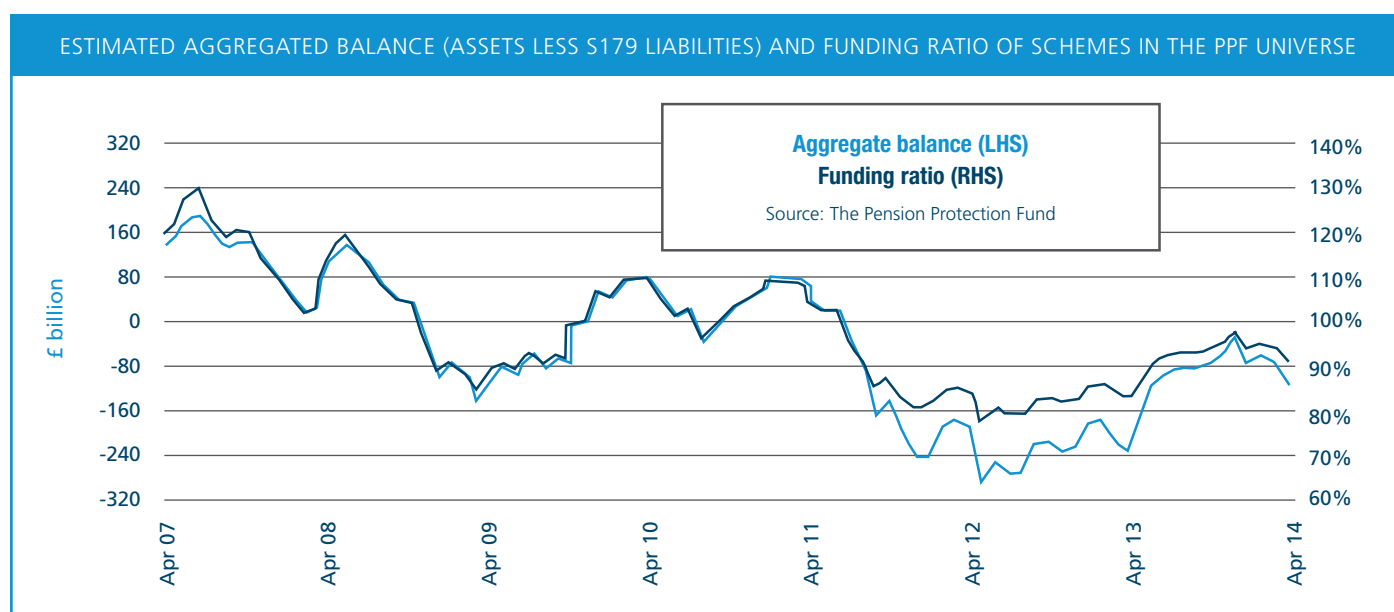
The PPF is also proposing the following changes:

- Levy rules regarding 'Type A' contingent assets (guarantees provided by parent or group companies) will be amended. In particular, trustees will be required to certify a fixed monetary amount that they expect the guarantor could afford (known as the 'Realisable Recovery').
- The discount given to associated (i.e. non-centralised) last man standing schemes will be linked to the spread of members between participating employers.
- Contingent asset standard agreements will be revised. The PPF intends to release updated drafts as part of its consultation on the 2015/16 levy determination in September. Agreements put in place using the older standard forms will continue to be recognised.
- Only Asset Back Contributions (ABCs) with underlying UK property assets will be recognised for levy purposes. The value of such arrangements will reflect the lower of the 'Net Present Value' of expected future cashflows and the value of the asset on an insolvency basis.

PPF 7800 Index

The [latest update](#) of the PPF's 7800 Index of schemes' funding (on their s179 basis) has been published, showing a fall in the s179 funding ratio from 94.3% to 91.1% between March 2014 and April 2014.

This update takes account of recent changes to the s179 valuation approach from 1 May 2014. Without the change in assumptions, scheme funding would have fallen from 94.3% to 94.2%.



TPR update

Corporate plan 2014-17

TPR has set out its priorities for the next three years in its [corporate plan](#) for 2014-17. The plan outlines the regulator's 'strategic approach' to regulating DB and DC schemes and the implementation of auto-enrolment.

The plan also details how TPR will 'maximise compliance with automatic enrolment duties among the country's medium, small and micro employers, investigate pension liberation activity and fulfil its extended remit of regulating the governance and administration of public service pension schemes'.

Scheme funding statistics

TPR has published its [latest annual funding statistics](#) for UK DB and hybrid schemes. The research is based on valuations submitted by 'Tranche 7' schemes (with effective valuation dates falling between 22 September 2011 and 21 September 2012).

The report shows that Tranche 7 schemes had an average funding level of 81% compared with 74% three years earlier (i.e. broadly the same schemes when in Tranche 4). The improvement reflected an average increase in assets of 41% compared to the average increase in technical provisions of 28%:

- The increase in assets was largely due to positive investment returns and employer contributions.
- The increase in technical provisions is primarily due to lower discount rates, reflecting yields on UK gilts. The average life expectancy for a male aged 45 has also increased from 89.2 years in Tranche 4 to 89.9 years in Tranche 7.

As a result of the improved funding levels, the mean recovery plan length has fallen from 9.7 years to 8.4 years between Tranche 4 and Tranche 7.

Governance survey

TPR's 8th Annual Governance Survey [has been published](#), and includes new information on auto-enrolment and actions taken by schemes to tackle pension liberation fraud. Key findings include:

- Large schemes are more likely to be aware of pension liberation fraud (99%) than small schemes (88%). Among the schemes aware of pension liberation fraud 78% schemes have processes in place to combat liberation fraud, with 1 in 7 having suspected such activity in transfer requests.
- 28% of schemes surveyed are being used (or are planned to be used) for auto-enrolment. These schemes are more likely to demonstrate positive governance traits. Such schemes are more likely to have documented internal controls (82% compared to 71%) and more likely to receive formal reports on administration standards at least quarterly (56% compared to 40%).

Barnett Waddingham's free governance healthcheck for occupational schemes can be found on [our website](#).





Coming up...

In the July edition of 'News on...Pensions', we will look in more detail at the announcements in the Queen's Speech on Collective DC Schemes, as well as TPR's new Code of Practice on Scheme Funding.

In the meantime, you may find our upcoming Scheme Funding seminars of interest. For further information, please visit our [seminar events page](#).

- Amersham - 8 July
- London - 9 July
- Leeds - 10 July
- Birmingham - 15 July

To discuss these issues in more detail please contact your usual Barnett Waddingham consultant or use the following:

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