News on...

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Pensions – April 2013

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Budget 2013

The Chancellor of the Exchequer delivered his *2013 Budget* in the House of Commons on 20 March 2013.

An announcement was made bringing forward the introduction of the new flat-rate State Pension from April 2017 to 2016 and with it the abolition of contracting-out on a salary-related basis. This move is expected to save the Treasury £5.5bn.

The Pensions Regulator (TPR) will be given a new statutory objective to consider whether Scheme Funding recovery plans are "compatible with sustainable growth for sponsoring employers", with the precise wording to be set out in legislation published in spring 2013. TPR has confirmed that it will be reviewing its Code of Practice on Funding Defined Benefits in light of the new objective.

In theory, the new objective will lead to further flexibility for trustees and sponsoring employers in negotiating funding plans, particularly where the company wishes to retain funds to grow the business rather than locking them away in the pension scheme.

TPR responded to the news saying that it "will make the changes required … as part of a review of the Code of Practice … as soon as possible this year". In addition, TPR's statement on Scheme Funding in the current economic environment is expected to be published later in the Spring.

The Budget documentation also confirmed that the DWP's call for evidence (see *News On… Pensions – February 2013*) "did not reveal a strong case" for changing legislation so as to allow schemes to smooth assets and liabilities in Scheme Funding Valuations.

Other items arising in the 2013 Budget include:

- The Chancellor confirmed that the Finance Bill 2013 will set out the reduction to the standard Lifetime Allowance (LTA) (to £1.25 million) and Annual Allowance (AA) (to £40,000) from 2014/15.
- The Treasury will consult in the Spring on "individual protection" following the cut in the LTA to £1.25m. Legislation will be included in the Finance Bill 2014.
- Equitable Life with-profits annuitants who purchased annuities before 1992 (and therefore did not qualify for the original compensation scheme) will receive an "ex-gratia payment" of £5,000 each. Those on pension credit will receive a further £5,000.
- Quantitative Easing will remain in place for 2013/14.
- The Government is to explore ways in which pension schemes might be able to invest in projects where commercial properties are converted for residential use. This is likely to be of particular interest to Small Self-administered Schemes or Self-Invested Personal Pension arrangements.
- The personal income tax allowance will rise to £10,000 from April 2014.
- The Consumer Prices Index (CPI) inflation target of 2.0% pa will remain in place and the Monetary Policy Committee will in future issue explicit "forward guidance" on the path that interest rates are expected to follow, much like the Federal Reserve does in the US.

New UK Accounting Standard

The Financial Reporting Council (FRC) has published a new UK Financial Reporting Standard FRS 102. In relation to accounting for pensions costs, FRS 102 will replace the current standard FRS 17. As a result of the update, the UK standard will be brought into line with revisions to the international standard IAS 19. In particular:

- The key change is that an "expected return on assets" figure will no longer be used. Instead, the finance cost will be replaced by a "net interest" entry, calculated using the discount rate applying at the start of the period.
- Under FRS 102, discount rates are no longer specifically pegged to AA-rated bonds, only to "high quality corporate bonds". However, it is not expected that this will lead to blanket changes in the approach to setting discount rates.
- The cost of a defined benefit (DB) scheme will be divided into four elements, the first three of which will be included in profit / loss, the fourth in other comprehensive income:
    - Change in liability due to employee service during the reporting period (service cost)
    - Net interest on the net liability
    - Benefit changes, curtailments and settlements
    - Re-measurement of the liability (comprising actuarial gains and losses and the return on plan assets (excluding the net interest amount))
- FRS 102 refers to the "fair value" of assets rather than specifically requiring the use of bid values.
- It may also be more difficult to account for group plans (with more than one participating employer under common control) as defined contribution (DC) schemes in future, and it is only possible to take this approach for genuinely multi-employer arrangements (ie with more than one participating employer not under common control) if there is insufficient information to use DB accounting methods.

It is likely that entities will need to make disclosures as to the impact of the changes during the transition.

FRS 102 will be compulsory for accounting periods beginning on or after 1 January 2015, and early adoption is permitted for periods ending on or after 31 December 2012.

New Financial Regulators

The Financial Services Authority (FSA) closed on 1 April 2013 and its responsibilities for conduct of business regulation were transferred to the Financial Conduct Authority (FCA). HM Treasury has named the 12 members of the FCA Board and a business plan and risk outlook for 2013/14 have been published.

At the same time, the FSA's responsibilities for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms were transferred to the Prudential Regulation Authority (PRA).

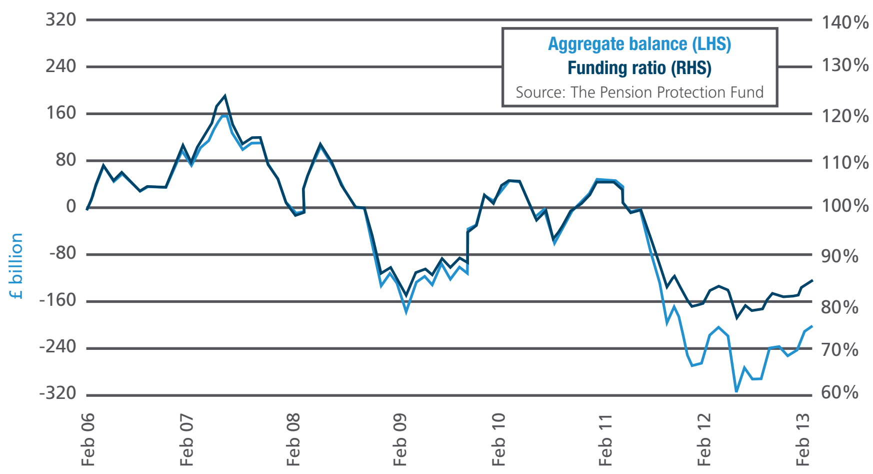
UK bulk annuity insurers will be regulated by both bodies (ie the FCA and the PRA). The FCA seeks to ensure that consumers are treated fairly in their dealings with insurers while the PRA aims to ensure that insurers will be able to meet claims from and material obligations to policyholders as they fall due.

PPF: 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 decreased over the month to £201.5 billion at the end of February 2013 (there was an aggregate deficit of £211.2 billion at the end of January 2013).

The funding ratio increased from 83.7 per cent to 84.6 per cent. There were 4,973 schemes in deficit and 1,343 schemes in surplus.



PPF: "Type A" contingent assets

The PPF has released, and then updated, some "Observations on the PPF's assessment of guarantor strength for selected Type A contingent assets certified/re-certified in 2012/13".

The original wording in the observations had potentially significant implications for schemes with a Type A contingent asset (a financial guarantee by a parent or group company) where the guarantor was a participating employer and the scheme was a last man standing scheme.

In brief, the original observations only permitted certification if the trustees could say that the guarantor would have sufficient assets assuming it was insolvent (which would be very difficult for trustees to certify in most cases). However, the PPF have since changed the observations to say that trustees can assume the guarantor remains solvent when giving the certification and can meet any debt over time.

VAT: Investment management fees

On 7 March 2013 the Court of Justice of the European Union (CJEU) ruled that DB pension schemes are not exempt from paying Value Added Tax (VAT) on investment management fees. The judgment resolves a case brought by the National Association of Pension Funds (NAPF) and Wheels Common Investment Fund Trustees (WCIF) against HM Revenue & Customs (HMRC).

The European Commission is currently reviewing the VAT Directive and the NAPF has said it will be "making strong representations as to why the management of pension funds should be VAT exempt under the proposed change to the current VAT regime".

PPF: Special Purpose Vehicles

The PPF has updated the frequently asked questions section of its website in relation to deficit reducing contributions (DRCs) for PPF levy purposes. In particular, the PPF has clarified when contributions paid for the trustees to invest in Special Purpose Vehicles (SPVs) can be treated as DRCs.

The main conditions are that the special contribution is capable of being assessed as a quantifiable cash contribution received by the trustees into the scheme, it is irrevocable and it has the effect of reducing the scheme's section 179 valuation deficit (or increasing its surplus).

Schemes have until 5pm on 30 April 2013 to certify DRCs in order to reduce their 2013/14 PPF Levy bills.

TPR: Chief Executive resigns

The Chief Executive of The Pensions Regulator (TPR), Bill Galvin, has announced his resignation, effective from the end of June 2013. Mr Galvin will move to the Universities Superannuation Scheme Ltd, where he will take the role of Group Chief Executive.

DWP: Auto-enrolment consultation

The Department for Work and Pensions (DWP) has published draft regulations and a consultation on technical changes to the automatic auto-enrolment process for employers. Through the draft regulations, the DWP is proposing to:

- Allow employers to define pay reference periods to be in line with their payroll systems
- Exclude from auto-enrolment requirements any employees who opted out of pension saving in the 12 months before the duty would otherwise have arisen
- Clarify that, although opt-out notices should be in substantially the same form as set out in regulations, schemes are expected to add branding and supplementary information about pension saving as appropriate, and
- Extend the "joining window" from one month to six weeks.

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:

info@barnett-waddingham.co.uk

+44 (0) 20 7776 2200

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