News on...

Barnett Waddingham

Current Pensions Issues

Summer 2012

Scheme Funding in the Current Economic Environment

The Pensions Regulator's Statement

The Pensions Regulator (TPR) has issued its first annual statement on "Pension scheme funding in the current environment". The statement is aimed at trustees and employers of defined benefit (DB) schemes carrying out scheme funding valuations with effective dates between September 2011 and September 2012. A detailed summary of the TPR's statement is available ***on our website***.

TPR has not set out any material differences to the way in which it views scheme funding, nor to the way in which trustees and employers should approach the matter. However, the statement provides clarification on what kind of approaches may, and may not, be appropriate in the current economic environment.

Trustees may:

- take post-valuation experience into account in a Recovery Plan
- agree to a long Recovery Plan, with good reason
- take into account "strongly held views" on future improvements in investment markets in a Recovery Plan, but must put contingency plans in place if they do.

Trustees should avoid:

- cherry-picking a valuation date
- completing a valuation late
- reducing current deficit repair contributions if there is not a demonstrable change in the Employer's ability to pay
- smoothing discount rates.

TPR's statement comes at a time when the yields on long-dated government bonds reached historic lows. Low gilt yields tend to increase market-related measures of pension scheme liabilities. TPR recognises that this, together with lower than expected asset returns, may mean that funding deficits have worsened or, at best, remained at the level disclosed at a scheme's last funding valuation, despite significant deficit repair contributions having been paid by the employer.

TPR says that it "recognises that the current economic conditions will put pressure on pension scheme funding". However, TPR's view is that there is already "sufficient flexibility" in the current framework to take these circumstances into account. It also notes that planning for an uncertain financial future should be a key part of a scheme's funding strategy.

Case Studies

TPR also published three case studies illustrating how the approach is expected to work:

Example 1 – strong employer, small increase in deficit

TPR expects that only minor changes to the scheme's funding strategy will be required and suggests that the trustees might consider using an "escrow" account in relation to any new deficit that has emerged.

Example 2 – strong employer, large increase in deficit

TPR suggests that the trustees should explore ways in which the employer could give more support to the scheme via increased contributions or security over the employer's assets. The Regulator also suggests that trustees might consider requesting contingent assets that would transfer to the scheme in the event that the employer's covenant weakens.

Example 3 – struggling employer, large deficit

In this particular example there is a reasonable belief that the employer can be revived. TPR says that such schemes may consider factoring increased risk into the Recovery Plan in the short-term by making an additional allowance for investment returns, or by lengthening its term. However, TPR expects the trustees to critically evaluate the employer's business plans.

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 including group life assurance, private medical benefits and income protection benefits.

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

RPI / CPI – the Debate Continues

An e-petition calling for the Retail Prices Index (RPI) measure to be reintroduced for increases to public and private pensions received over 110,000 signatures and was debated and rejected in the House of Commons.

Meanwhile, union representatives who challenged a High Court decision which found that the Government's use of the Consumer Prices Index (CPI) for determining statutory pension increases was lawful have lost their appeal.

The High Court has also ruled* that, where trustees have a discretion in their rules to choose the index used to increase pension benefits, a switch from RPI to CPI would not breach Section 67 of the Pensions Act 1995, which protects members' accrued rights.

Meanwhile, the Consumer Prices Advisory Committee (CPAC) which advises the Office for National Statistics (ONS) has recommended that data collection for RPI purposes is amended to remove "unjustified causes" of differences between RPI and CPI measures of inflation. CPAC is also considering introducing housing costs and council tax into the calculation of CPI. Both of these should lead to a closing of the RPI-CPI "wedge".

Danks v QinetiQ [2012] EWHC 570 (Ch)

Tax News

Fixed Protection and Life Insurance

Her Majesty's Revenue and Customs (HMRC) has clarified that continuation of DB lump sum death-in-service benefits should not lead to the loss of "fixed protection" (used by individuals to protect benefits from the decrease in the Standard Lifetime Allowance from £1.8 to £1.5 million in April 2012). However, where pension scheme rules cap the amount of a death-in-service lump sum to that which is covered by an insurance policy, fixed protection may still be lost if cover is maintained.

HMRC has confirmed that schemes may re-instate life cover (if they had cancelled it because it was thought protection would otherwise be lost) without losing fixed protection - provided it is reinstated as soon as possible.

Tax Relief on Asset-Backed Contributions

Several schemes have negotiated asset-backed funding arrangements with their sponsoring employer or associated companies in recent months. New legislation will ensure that upfront tax relief will not be given on asset-backed contributions to a pension scheme unless all payments are fixed at the outset. Transitional arrangements will apply where contributions were paid under such arrangements before 22 February 2012.

Latest News from The Pensions Regulator

Governance Survey

TPR has published the results of its sixth occupational pension scheme governance survey. TPR notes that trustee boards of large schemes are more likely to meet regularly, provide training support and be aware of TPR's guidance. TPR views the frequency of trustee meetings as a strong indicator of good governance.

Areas highlighted for improvement include trustee training (the survey reveals that formal induction training for new trustees is declining) and trustees' communication with members.

BMI – Regulated Apportionment Arrangement

TPR has published a report explaining its decision to approve an "extremely uncommon" Regulated Apportionment Arrangement (RAA) in relation to the British Midland Airways Pension Scheme.

The scheme had an estimated deficit of around £450 million on a "buy-out" basis. TPR was asked for clearance in relation to a transfer of the scheme's liabilities to a shell company within the Lufthansa group (the 100% shareholder of the BMI group) as the sole sponsoring employer. Lufthansa had committed to provide voluntary support to the pension scheme over a 25-year Recovery Plan, despite having no legal obligation to fund the scheme.

However, this support was not expected to prevent deterioration in the scheme's funding position without significant investment outperformance in future. The Regulator's view, therefore, was that the proposal was not in members' or the PPF's interests.

Following further discussions, TPR agreed to a controlled entry to the PPF via a RAA. Under the RAA, the Scheme (and hence the PPF) received £16 million – much more than would have been received if the Scheme's existing statutory employer had become insolvent. Lufthansa provided a further £84 million to top up members' benefits outside the PPF.

Record-Keeping Survey

TPR has also published a report on its third survey of scheme record keeping. The survey demonstrates that there has been progress in this area, with an increased proportion of schemes having processes to measure common data and an improvement in the proportion of schemes with over 90% of "common data" present.

There is more for schemes to do before December 2012 to meet TPR's target of 100% of common data in place for members joining a scheme after June 2010 and 95% for members joining before then. TPR reminds trustees that they are solely accountable for their scheme's record keeping.

Trustee Toolkit Updated

TPR has re-launched its Trustee Toolkit following a layout re-design. The toolkit is intended to help trustees to meet the "Trustee Knowledge and Understanding" criteria set out in the Pensions Act 2004. The subject matter of the toolkit has not altered but additional modules and content are expected in due course.

Incentive Exercises – Code of Practice

An industry working group has formalised a code of practice (see *www.incentiveexercises.org.uk*) for employers, trustees and advisers involved in "incentive exercises".

Incentive exercises include enhanced transfer values (ETVs) (where available funds are increased as an incentive to the member to transfer out of a pension scheme) and pension increase exchanges (PIEs) (where members give up future increases in exchange for higher immediate pension) and are typically used by sponsoring employers to reduce risk and cost in their pension scheme.

The code, whilst not law, will effectively ban direct cash payments designed to encourage members to transfer out. It also requires the employer to pay for financial advice for members considering certain offers and that offers should not be made directly to pensioners aged over 80 unless they request them. For further details see our ***information sheet.***

PPF: Latest News

Ombudsman Ruling

The Pensions Ombudsman has ruled against a pension scheme member who claimed that pension benefits resulting from a severance payment should be classified as "money purchase". The scheme was admitted to the PPF following an employer insolvency event and, had the claim been successful, the £320,000 pot would not have been subject to PPF reductions. However, the Ombudsman ruled that the payment was not protected in the event of winding up and that PPF reductions therefore apply.

Guidance Updated

The PPF has published a guide for members of DB schemes whose employer has become insolvent. The document, "What is the Pension Protection Fund…and what do we do?" includes general information about the PPF, compensation provisions and the assessment period. The new guide replaces several earlier guides to the PPF.

News in Brief

Budget 2012 – the End of Contracting-Out?

Despite speculation, there were no significant changes to pensions tax relief in the March 2012 Budget. The Chancellor instead confirmed that the Government will press ahead with plans to implement a single-tier State Pension of around £140 a week. We expect the reforms will lead to the end of contracting-out for salary-related schemes and a consequent rise in costs for employers and employees who are currently contracted-out.

Pension Protection in Bankruptcy

The High Court has ruled that a bankrupt person's pension can be used to repay creditors not just where the benefit is in payment but also where, under the rules of the specific scheme, the bankrupt would be entitled to payment if he requested it.

Default Retirement Age

The Supreme Court has dismissed an appeal relating to age discrimination, confirming that direct age discrimination may be justified where the aims of an employer in forcing employees to retire at a specific age (eg for staff retention and workforce planning) are legitimate.

TUPE Clarified

The High Court has recently ruled on the treatment of early retirement benefits transferred under TUPE (the Transfer of Undertakings (Protection of Employment) Regulations) when companies sell part of their business. The court confirmed that, when DB scheme members are transferred, the new employer is only liable for benefits due between the early retirement date and the normal retirement date of a member and that the former employer remains responsible for retirement benefits after the normal retirement date of members.

Royal Mail Pension Plan

The European Commission has approved the UK Government's plans for the Royal Mail Group, including transferring pension plan funds to HM Treasury. The Government took on the plan's £28 billion of assets in April and intends to cancel the plan's £11 billion holding of gilts.

Update on Auto-enrolment

The Regulator's Strategy

TPR has published its strategy for maximising employer compliance with the automatic enrolment regime and encouraging those offering defined contribution schemes to provide safe, durable and value for money vehicles. The Regulator intends to provide information, tools and support for employers and to establish a "pro-compliance culture". TPR will implement systems for detecting and tackling non-compliance.

TPR has also launched an employer communication website, which will include templates for employers who are communicating with their staff about auto-enrolment.

Regulator – DC Schemes

TPR has published a tool to help employers check whether existing Defined Contribution (DC) arrangements meet the minimum criteria for use as an auto-enrolment scheme. TPR has also produced a leaflet for employers called "Selecting a good automatic enrolment scheme", which sets out a number of questions that employers may want to ask advisers or product providers when selecting arrangements or reviewing existing schemes.

New Regulations

The Department for Work and Pensions (DWP) has published several sets of draft regulations relating to auto-enrolment that will:

- allow companies to use career average revalued earnings (CARE) schemes with a mix of guaranteed and discretionary revaluation for auto-enrolment, provided the discretionary element is funded for,
- delay staging dates for smaller employers with fewer than 50 workers who are part of a multiple employer PAYE scheme and
- align the auto-enrolment earnings trigger with the PAYE tax threshold (£8,105 for 2012/13).

June 2012
BWNEWS1010