Barnett Waddingham
a **true partnership** approach

Pensions news for employers

Autumn 2013

Welcome to the latest edition of pensions news for employers. This newsletter covers a number of topical issues which companies should be aware of.

Pension Protection Fund – 2014/15 Levy and other news

The Pension Protection Fund (PPF) has published its consultation documents in relation to the 2014/15 pension protection levy and has announced that its 2014/15 levy will be £695m, which is a 10% increase on the 2013/14 levy. The PPF has however confirmed that it will not amend its formula for calculating the levy and confirmed that the increase is mainly due to market movements. It highlighted that while the overall levy will increase by 10%, there will be a wider variation in the individual levy bills reflecting changes in individual risk combined with the smaller universe of eligible schemes.

Copies of the document, 'The 2014/15 Pension Protection Levy Consultation Document', can be found on the PPF website at: *www.pensionprotectionfund.org.uk/levy/Pages/PensionProtectionLevy.aspx*.

Increases in compensation cap for longer serving members

The Department for Work and Pensions had previously revealed that it intends to increase the PPF compensation cap for long-serving scheme members. The cost of this increase will be met by existing levy payers – estimates suggest that the change will increase levies by around 4% over the period to 2030.

The proposal is for the standard compensation cap to increase by 3% for each year of service over 20 years, up to a maximum of twice the standard cap i.e. it will require about 53 years' service to reach this maximum and therefore we do not expect anyone to reach it. People who are already in receipt of capped compensation may receive an increase when the relevant legislation is in place, but the increase will not be backdated.

The PPF has confirmed that its £695m levy estimate calculation makes no allowance for these planned increases to the compensation cap.

PPF takes on UK Coal

During the summer, it was announced that the defined benefit (DB) pension scheme of UK Coal plc will move into the PPF as part of a wider restructuring under the terms of the group's administration. The deal is expected to secure benefits for around 7,000 scheme members as well as secure 2,000 jobs of its mining operation. The PPF will take on the pension scheme deficit and in return will receive regular payments from a new company which are expected to be materially higher than the amount it could have received had the company become insolvent.

Although the PPF will not own the new company, its interest in the new company will consist of a series of debt instruments.

This deal constitutes one of the largest deficits yet assimilated by the PPF. In early 2013, a report by The Pensions Regulator (TPR) estimated the aggregate deficit to be £900m on a 'buy-out' basis.

A report by the Pensions Regulator (TPR) in January 2013 estimated the aggregate deficit (across the UK Coal sections of two industry-wide schemes) to be £900m on a buy-out basis, or £543m on a PPF Section 179 basis, against assets of £451m.

PPF replaces Dun & Bradstreet with Experian

The PPF also announced that they will replace Dun & Bradstreet (D&B) with Experian as their assessor of the insolvency risk posed by sponsoring employers for the 2015/16 levy.

The D&B rating system was not without controversy and many of our clients spent a great deal of time challenging and correcting the data held by D&B to ensure their failure score correctly reflects the risk they pose to the PPF. The change to Experian could have significant consequences for future PPF levies incurred. The PPF are now working with Experian to develop a bespoke scoring system to be used to calculate PPF levies.

New three year period for the levy – 2015/16 to 2017/18

The 2014/15 PPF levy year is the last year in the current policy framework (released back in Autumn 2011).

As well as working with Experian to develop the bespoke scoring system, the PPF are considering their policy for the new three year period for the levy and a consultation on the rules is expected to be issued in early 2014.

The consultation will include the impact of the new bespoke scoring system and hence the switch from D&B to Experian.

The PPF have confirmed that under the new framework, they will continue to use information from the annual scheme return that is submitted via TPR's Exchange system to calculate levies. The deadline for submission is 5pm on Monday 31 March 2014.

Key Dates

Monthly D&B Failure Scores	Each month end from 30 April 2013 to 31 March 2014
Submit scheme returns on Exchange	31 March 2014 (5pm)
Reference period over which funding is smoothed	5 years ending 31 March 2014
Certification of Contingent Assets	31 March 2014 (5pm)
Certification of deficit reduction contributions	30 April 2014 (5pm)
Certification of full block transfers	30 June 2014 (5pm)
Invoicing starts	Autumn 2014

Barnett Waddingham comment

To date, the PPF has collected over £4 billion in levies from sponsoring employers. However, despite measures put in place by sponsoring employers to manage their PPF levy, other recent announcements by the PPF (e.g. taking on UK Coal Plc and compensation cap increases) only suggest further increases are likely in the amount the PPF will need to collect each year from employers.

Given the PPF are now working with Experian to develop a bespoke scoring system as well as considering their levy policy for the three years to 2017/18, there is an opportunity for our clients and contacts to feed into the process so that the comments can help shape the new Experian system.

As a result, we have opened our fourth forum survey and we would welcome your feedback on the issues raised. We would be grateful if you could spend a few minutes completing the short survey on our website at: *http://bwllp.co.uk/ej*. Our analysis of responses received up to 30 September will also be published on the website soon.

We previously introduced this forum to allow clients to have their say. The significant changes the PPF have made to the levy calculation over the last few years show that they are willing to listen to the pensions industry and hopefully our survey results, which were all passed to the PPF, have played a useful part in developing the current improved levy structure. One of the areas highlighted in previous surveys was the importance levy payers placed on the stability of the levy from year to year and this was a key objective of the most recent changes.

In the meantime, employers should take note of the key dates above, ensure that they have taken all measures to improve their D&B failure scores, and put in place (and submitted) any relevant deficit reducing mechanisms (e.g. contingent assets).

If you would like help comparing your current Experian credit rating against the D&B failure score then please contact us. The Experian scoring system used will be different from their current credit rating, but we expect there to be a substantial overlap in the general method and data used.

Bridging pension regulations

The PPF and Occupational Pension Schemes (Miscellaneous Amendments) Regulations 2013 came into force on 1 October 2013. The amendments introduced a limited power, subject to the employer's agreement, for the trustees of DB schemes which provide bridging pensions to modify their schemes' rules by resolution to take account of the impact of changes to State Pension Age (SPA) for members who have not yet retired. The regulations cannot be used to modify pensions already in payment. Although the draft regulations required employers to consult with affected members, the requirement was removed for the final version. We anticipate that all employers with schemes incorporating bridging pensions will wish to make the appropriate change under these regulations.

EIOPA consultation: valuing sponsor support

The European Insurance and Occupational Pensions Authority (EIOPA) released a discussion paper on valuing employer covenant in pension schemes, together with its final report on the Quantitative Impact Study (QIS) on Institutions for Occupational Retirement Provision (IORPs). The specifications for the QIS set out a stochastic valuation approach for valuing sponsor support. EIOPA have now suggested an alternative approach:

1. Rank the sponsor's strength from "very strong" to "very weak" based on credit ratios (EIOPA suggests income cover and asset cover);
2. Use the sponsor's strength ranking to assess the length of the recovery plan required and a probability of default;
3. Assess the contributions required assuming there is no default, and depending on the payments the sponsoring employer can afford; and
4. Value sponsor support as the discounted value of the contributions allowing for the probability of default.

Allowance can be made for group structures or judgements such as the value of goodwill or smoothing one-off items. The paper also suggests several sensitivities that could be required to be carried out to illustrate the effect of changing sponsor support on the IORP.

Barnett Waddingham comment

Although the European Commission has recently shelved its plans for new funding requirements for pension schemes, EIOPA is still very much in favour of its holistic balance sheet approach and it seems change, of some sort, may still be on the cards, albeit some years into the future. It is encouraging that EIOPA are willing to consult on the details, and with the QIS revealing many issues to be resolved and the political timetable no longer so tightly constrained, we would hope they take their time to get any proposals right.

The alternative approach represents a welcome simplification from the previous proposals. It builds on current practice for scheme funding valuations in the UK and will be more familiar to finance directors and trustees of pension schemes. In particular, small and medium-sized employers will be happy to see the reliance on published credit ratings removed, and charities and group structures will benefit from the additional flexibility. However, this is only part of the picture and, if EIOPA recommends valuing technical provisions using a risk-free interest rate, employers could still face a £150bn hike in pension scheme liabilities.

As with previous updates on this subject, employers should watch this space. However, they should not forget that the European Commission will be pressing ahead with a new directive addressing governance and disclosure. This could lead to changes in the way schemes are run and increased administration costs.

Life after auto-enrolment

Companies with over 4,000 employees have completed the first phase of auto-enrolment and it appears that opt-out rates (employees cancelling their new scheme membership within the first month) have been surprisingly low. This is most likely as a result of a combination of apathy, the initial low contribution levels required from employees and more positively perhaps a reflection that these companies have understood how, and can afford to, engage with their employees. Companies with over 250 employees will need to complete staging of auto-enrolment within the coming months.

According to The Purple Book 2012 (*http://bit.ly/VxvD05*) 86% of DB schemes are closed to new entrants. It is not surprising, therefore, that defined contribution (DC) schemes, both trust based and contract based, have been the primary pensions vehicles for auto-enrolment. The focus should now be on scheme governance to ensure delivery of good member outcomes. TPR, amongst other respected industry associations, are strongly promoting DC governance at present.

Embracing governance in DC can enable employers to deliver DC pension schemes of real value and return to employees. Our leaflet "Life after auto-enrolment" (see our website *http://bwllp.co.uk/kq*) gives further details on how companies can achieve this. The areas of interest include; Investment options, member engagement, and wider benefits such as life cover and income protection.

TO DO LIST

To do list — IMPORTANT

- [x] AUTO-ENROLMENT
- [ ] GOVERNANCE
- [ ] INVESTMENT
- [ ] ENGAGEMENT
- [ ] CONSOLIDATION
- [ ] WIDER BENEFITS

Reductions of Annual and Lifetime Allowances and Lifetime Allowance Protections

Legislation has come into effect reducing the Lifetime Allowance (LTA) from £1.5m to £1.25m and the Annual Allowance (AA) from £50,000 to £40,000 from 6 April 2014, as well as the introduction of Fixed Protection 2014 (FP14) intended for those who think they may be affected by the reduction in the LTA.

The government has also announced that Individual Protection 2014 (IP14) will be introduced to give individuals greater flexibility in protecting pension savings from LTA tax. Her Majesty's Revenue and Customs (HMRC) has consulted on the detail and implementation of IP14, and final details are expected before the end of the year.

- FP14: Under FP14, savers will retain an LTA of £1.5m, provided they make no new pension savings after 5 April 2014. HMRC is now accepting applications for FP14 which must be received by them on or before 5 April 2014.
- IP14: Under IP14, savers will have a "personalised" LTA based on the value of their savings at 5 April 2014 (minimum of £1.25m and up to a maximum of £1.5m). Individuals could continue to make contributions without paying an LTA charge on savings up to their personalised LTA, but would pay LTA charges on additional savings. Individuals will have three years from 6 April 2014 to apply for IP14.

It is also proposed that individuals be allowed to hold both IP14 and FP14 (or its predecessor fixed protection 2012) subject to meeting eligibility conditions. Fixed Protection will take precedence, with protection reverting back to IP14 if fixed protection is lost. Individuals with Primary Protection will not be able to apply for IP14 and the result of the consultation is awaited to see if HMRC will allow individuals with Enhanced Protection to register for IP14. Employers and trustees may wish to flag the need for action with pension scheme members who could be affected – including any deferred members – by the changes to the LTA and AA.

To maintain valid Enhanced Protection or Fixed Protection, or to mitigate the AA and LTA tax charges, employers might wish to consider changes to pension provisions and offer alternative options to their senior executives.

Barnett Waddingham comment

Our Executive Pensions practice was set up to advise employers and their senior staff on all issues relating to pension planning. The members of the team have substantial experience of advising employers and their high earners on tax efficient pension provision and negotiations on any pension promise. The team includes actuaries and other pension specialists.

Please contact Bhargaw Buddhdev by emailing *executivepensions@barnett-waddingham.co.uk* if you would like to discuss any similar issues in more detail.

New funding code of practice and TPR strategy

The interim chief executive of TPR, Stephen Soper, spoke recently at an event held by the Association of Consulting Actuaries. He confirmed that TPR intends to consult in November on both a new funding code of practice and TPR's strategy for regulating compliance with scheme funding legislation. The main points of his talk are summarised below:

- He acknowledged that the new objective (to minimise the impact of recovery plan contributions on the sustainable growth of employers) is a genuinely new requirement for TPR and welcomed the greater symmetry (between trustees and employers) this brings to the funding framework.
- He highlighted that the interpretation of "sustainable growth" would differ between employers. Growth could be a realistic possibility for some sectors, while maintaining position or damage limitation was more applicable for other sectors.
- As previously, TPR's approach will reflect their view that a strong employer provides the best support for a scheme, allied to an appropriate funding plan.
- He stressed the importance of "integrated risk management" and confirmed this will form a key part of the code. He highlighted engagement between parties as being integral, as well as the need to manage the overall risks rather than any particular risk in isolation.
- TPR intends for the new code to be "principles based" rather than prescriptive, including details of how they will look at schemes using their risk assessment framework to target their resources effectively. We also understand that TPR expect to actively engage in just 25 schemes during the current tranche of valuations (with effective dates between 22 September 2012 and 21 September 2013).

Barnett Waddingham comment

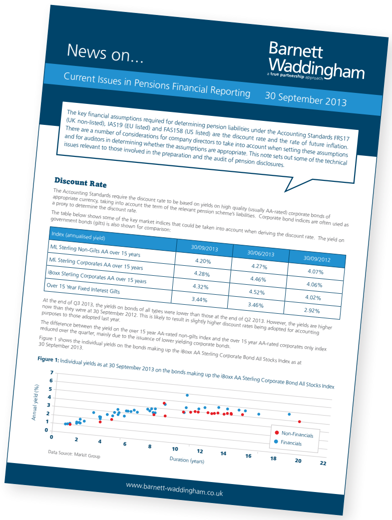
TPR's recognition of a shift in emphasis through the new objective is positive from a corporate perspective. Also, a principles based code may enable a greater level of flexibility, which could be helpful for companies. We believe that TPR will be looking to trustees to demonstrate suitable consideration of all the relevant risks in an integrated manner (i.e. funding, investment, covenant) and this will be an important factor for TPR in determining where to focus its resources.

Current issues in Financial Reporting

We recently published the latest edition of "Current Issues in Pensions Financial Reporting" which covers the selection of key financial assumptions required for determining pension liabilities under UK and international accounting standards as at 30 September 2013.

There are a number of considerations for company directors to take into account when setting these assumptions and for auditors in determining whether the assumptions are appropriate. Our note sets out some of the technical issues relevant to those involved in the preparation and the audit of pension disclosures. To view the full note, please visit http://bwllp.co.uk/y6.

You can also view our report on accounting assumptions adopted by FTSE100 companies at 31 December 2012. This provides detailed comparisons of assumptions adopted against market indicators, as well as analysis of the impact on disclosures: http://bwllp.co.uk/v2.



Directors pension disclosures from 1 October 2013

New Companies Act regulations for the reporting of directors' remuneration have now been published, which introduce measures proposed and consulted on by the Department for Business, Innovation and Skills. The legislation came into effect from 1 October 2013, but also applies to company years ended on 30 September 2013.

The basic principle of the new rules is to disclose a single figure for directors' remuneration from year to year, together with supporting additional information. The value of pension benefits earned over the year must be calculated in a similar way to that used to assess the liability for tax under the AA rules, but using a valuation factor of 20 rather than 16.

UK listed companies are also required to comply with the Listing Rules for accounting disclosures, which currently require an approach based on the change in Cash Equivalent Transfer Value (CETV) during the year. The Financial Conduct Authority (FCA) has proposed to remove this requirement, but only with effect from 1 January 2014.

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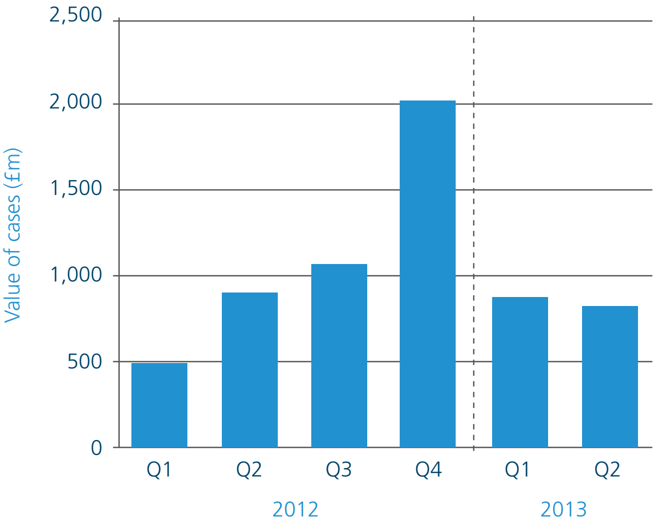
Barnett Waddingham comment

The new requirements will provide a more appropriate measure of the value of pension benefits earned during the year in most circumstances and are not onerous. It is disappointing, though, that UK listed companies with year end dates between 30 September and 31 December 2013 inclusive will need to comply with both the existing Listing Rules and the new Companies Act requirements together.

Buy-outs, buy-ins and longevity swaps

Bulk annuity market business

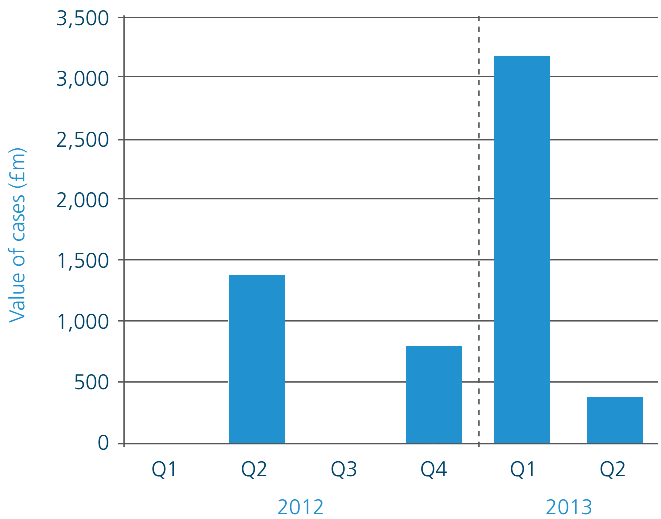
Just over £800m worth of bulk annuity business was completed during Quarter 2. Pension Insurance Corporation were the most successful insurer during the quarter, completing transactions worth over £500m. In early July, Pension Insurance Corporation completed a £1.5bn buy-out with the EMI Group Pension Fund which was the largest buy-out ever completed.



Source: Barnett Waddingham LLP

Longevity swaps market business

One longevity swap transaction was completed in Quarter 2 – the Bentley pension scheme's transaction with Abbey Life covering liabilities worth £400m. No longevity swap transactions were announced in Quarter 3.



Source: Barnett Waddingham LLP

Impact of pensions on UK business

We recently published our third annual report considering the impact that pension provision is having on UK business. We believe that it is unique in considering the financial impact of DB pension schemes within the context of the wider finances of FTSE350 companies. In producing our report we have again combined our experience of the issues facing our clients with academic input from the Centre for Global Finance at the University of the West of England.

This year's report highlights a number of new areas including the impact large pension scheme deficits are having on shareholder returns.

23 – The number of FTSE350 companies that have paid more towards clearing their DB scheme deficit than they did to shareholders in the form of dividends.

£35bn – The amount FTSE350 firms have paid in deficit contributions over the last three years with little impact.

IAS19 deficits still persists despite significant levels of contributions being paid. Companies continue to explore new approaches for financing their scheme, which allow the trustees to fulfill their obligations, whilst minimising the impact it is having on their business.

Other sector specific highlights include:

Companies in the Utilities sector paid on average £5,400 more per employee to reduce pension deficits than the average FTSE350 company.

Companies operating in the UK Consumer Discretionary sector, it would take on average nearly 11 months to repay the DB scheme deficit using all cash generated from day to day operations. This compares to 8 months for the average FTSE350 company.

Research showed that in 2012 deficit contributions as a proportion of free cash flow was once again highest for the Industrials sector with almost 13% of 2012 operating profit was paid in deficit contributions to the pension scheme

Companies in the Financial sector continue to pay most per employee in pension plan contributions. This figure, which includes all contributions to both DB and DC plans, was on average £13,500 per employee - four times more than some sectors.

Despite £1bn of cash contributions aimed at improving pension scheme funding, in 2012 the aggregate deficit within the Energy sector increased by £0.7bn to £14bn and has nearly doubled since 2009.

We hope you find our report informative and thought provoking by allowing you to consider how you stand, relative to your peers, in terms of the costs and risks associated with your DB scheme.

To view the full note visit the following link *http://bwllp.co.uk/wh*.

Company news

InterContinental Hotels Group's share price rose 3.75% following an announcement that it had agreed a £440m all-risk buyout of its UK pension plan with Rothesay Life. The market did not appear to pick up on the news, though, until it was incorporated within a UBS upgrade of the stock a day or two after the earliest announcements.

Royal Mail employees had more to complain about than the stock market listing – strike action was also threatened in relation to capping of pensionable salary increases within the final salary section of the pension scheme. The scheme provides CARE benefits for current service (Career Average Revalued Earnings), so the proposed cap would have had impacted most heavily on the longer serving members.

WHSmith had to restate its accounts for the year ending 31 August 2012, following a ruling by the Financial Reporting Council's conduct committee - reducing disclosed profits by £4m. This stemmed from a Schedule of Contributions between one of its subsidiary companies and its pension scheme trustees, with a value of £62m. The committee upheld that this obligation was a "minimum funding requirement" under IFRIC14 "IAS19 – The Limit on Defined Benefit Asset, Minimum Funding requirements and their interaction" and therefore had to be valued on the balance sheet.

Corporate Consulting Blog

New Fair Deal has landed...

Malcolm Rochowski
10 October 2013

...so do we have a bumpy ride ahead? Perhaps for those with "broadly comparable" schemes already in place, who will need to carefully assess their options going forward. For anyone else, it should be plain sailing.

The government's Fair Deal policy applies where staff are compulsorily transferred from the public sector to a private sector firm (e.g. through an outsourcing arrangement). The new employer had to give them access to an occupational pension scheme which was "broadly comparable" to the public service scheme they were leaving. Staff also had to choose whether to leave their past service entitlement in the public sector scheme (as a deferred pension) or transfer it to the new employer's broadly comparable scheme under a day-for-day (or equivalent) bulk transfer arrangement. The arrangements for members of the LGPS and other Local Government employees were (and still are) different – allowing the new employer to participate directly in the LGPS so that the employees' pension arrangements continued unaltered.

New Fair Deal applies with immediate effect where practicable and subject to the necessary changes being made to each public sector scheme (with a final deadline of April 2015). The new policy essentially adopts the LGPS approach for all public sector employers, except that participation is required in all but exceptional circumstances, rather than just being an option. Therefore, new outsourcing arrangements will generally involve the employer participating in public sector schemes in respect of the relevant employees. In our opinion this is a great improvement, but with any change comes complications for those already operating under the existing policy.

The main complication is in respect of existing contracts upon re-tendering and the terms for transferring service back into public sector schemes. The transfer terms out of a broadly comparable scheme will be set by that employer in line with the provisions of the existing contract, if applicable. The terms for securing the necessary service credits within the public sector scheme will be set by the Fund Actuary. If bidders feel that there is likely to be a shortfall between the two transfer amounts, they must request a pricing adjustment within their contact bid supported by a "Reasoned Statement of Need". In the event that a shortfall does arise in respect of members choosing to transfer their past service, the contracting authority will be required to meet the shortfall.

Of course, as "broadly comparable" schemes see some members transferring out and no new members coming in, those employers will eventually need to think about whether (and how) to start decommissioning the schemes. The new policy does allow for broadly comparable schemes to continue to be used for re-tendered contracts, where this is deemed to be the only viable course of action by the contracting authority. The policy also allows employees to be offered compensation in lieu of continued membership of their public sector scheme or membership of a broadly comparable scheme if neither option is deemed appropriate. In practice, we would expect these exceptions to be invoked in a very small proportion of cases, if at all.

For regular, concise and up-to-date commentary on the key pensions issues you face as an employer with a DB scheme, set up an RSS feed to our blog (http://bwllp.co.uk/gU).

Forthcoming Barnett Waddingham events

New Fair Deal – morning seminar

Barnett Waddingham and Nabarros' joint seminar on new Fair Deal will be held at Nabarros' offices in London on 28 November. It will examine the implications for private sector outsourcers of the new Fair Deal policy in relation to new and existing contracts.

Further details will be released on our website in due course. If you would like to reserve a place, then please email: seminars@barnett-waddingham.co.uk.

Investment Outlook 2014 Conference

Barnett Waddingham's annual Investment Outlook Conference will take place in Birmingham on Wednesday 15 January 2014 and in London on Wednesday 22 January 2014.

These one day conferences are free to attend and will focus on the outlook for key markets and the implications for pension schemes in 2014.

For further details and to reserve a place, please visit our events page: http://bwllp.co.uk/C or email: seminars@barnett-waddingham.co.uk.

2013 Actuarial Consultant of the Year

2013 UK Pensions & Actuarial Advisory Firm of the Year

UK Actuarial Advisory Firm of the Year

The information is written as a guide only and is not intended to provide and must not be construed as advice. Some information within the newsletter has been sourced from third parties. We are reliant upon these third parties for the veracity of the information supplied. For more detail on a wider range of pensions issues affecting both employers and trustees, please see our monthly and quarterly newsletters published on our website.

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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