

New Funding Code of Practice

In early December, The Pensions Regulator (TPR) launched [a consultation](#) on how it will regulate the funding of occupational defined benefit (DB) pension schemes. As part of this, TPR is consulting on a re-draft of its code of practice number 3 (funding defined benefits).

The consultation follows TPR's [2013 annual funding statement](#) and the new statutory objective for TPR in relation to scheme funding (which will be introduced via the Pensions Bill 2013): '...to minimise any adverse impact on the sustainable growth of an employer.'

The revised code sets out some 'universally applicable' funding principles including:

- Trustees and employers are expected to work collaboratively 'in an open and transparent manner' to reach solutions that meet the needs of the scheme, and the employer's plans for sustainable growth.
- Trustees should seek to integrate management of covenant, investment and funding risks and set clear triggers for action.
- Where trustees take funding or investment risk, they should be confident that the employer is able to mitigate likely adverse outcomes with appropriate contingency plans. Trustees are reminded that pensions should be treated as 'deferred pay' for the scheme's members.
- Trustees should take a long-term view of the employer covenant and funding and investment targets.
- Trustees should act proportionately, taking into account their scheme's size, complexity and circumstances.
- Trustees will need to balance the interests of members against the employers' sustainable growth plans and long-term ability to support the scheme. Trustees should not take decisions that involve 'excessive or unnecessary risks'.
- Trustees should adopt good governance standards.
- Trustees should seek to ensure that the scheme is treated fairly amongst competing demands on the employer, in a manner 'consistent with its equivalent creditor status'.
- Trustees should 'aim for any funding shortfall to be eliminated as quickly as the employer can reasonably afford' and should start off by considering whether the current level of deficit repair contributions can be maintained.

On the face of it, TPR is not materially changing its stance in relation to funding DB schemes. Instead, it is reframing its policy so as to place appropriate emphasis on what it describes as the four key areas of risk focus (namely employer covenant, funding, investment, and governance). To a large extent, this reflects the evolution in TPR's approach that we have seen since the original code of practice came into force.

In particular, there is a greater emphasis on the link between employer covenant, investment strategy and funding with the suggestion that some trustees may need to carry out more detailed analysis of the risks faced by their scheme.

The consultation runs until 7 February 2014, and code of practice is expected to come into force in July 2014. However, TPR states that the draft code ought to be taken into account for valuations which are being carried out before the code comes into force.

Latest from TPR and PPF

Purple Book published

The Pension Protection Fund (PPF) and TPR have jointly published the latest version of their Purple Book. [The Purple Book](#) monitors the risks faced by private sector DB schemes in the UK. Much of the analysis is based on scheme returns provided to TPR between December 2012 and March 2013, and highlights include:

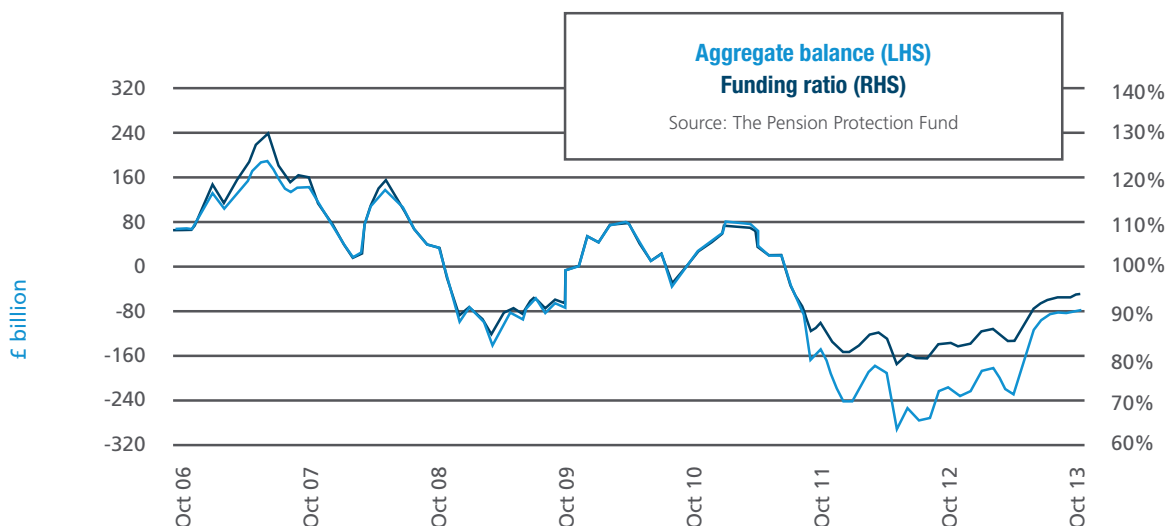
- The total section 179 funding position of the schemes in the 'Purple 2013 dataset' (around 99% of PPF-eligible schemes) was a deficit of £210.8 billion in 2013 (84% funded) compared with £204.2 billion in 2012 (83% funded).
- The proportion of scheme assets allocated to equities fell from 38.5% in 2012 to 35.1% in 2013, while the proportion of gilts and fixed interest rose from 43.2% in 2012 to 44.8% in 2013. The average proportion of equities invested in overseas companies (not weighted by size of scheme) was greater than the proportion invested in UK companies for the first time.
- The proportion of schemes that are open to new members and new accruals was broadly unchanged over the year at 14%.
- Due to the changes to the levy formula, 19% of schemes paid no risk based levy in 2012/13, compared with 5% in 2011/12.
- Approximately £28.5 billion of Deficit Reduction Contributions were certified by April 2013, compared with £36.3 billion certified for the previous year.

PPF: 7800 Index

The [latest update](#) of the PPF 7800 Index of schemes' funding (on the s179 basis) has been published. The data on which the index is based has been updated to reflect schemes that have wound-up, merged or transferred to the PPF over the last year. There are 6,150 schemes in the new dataset compared with 6,316 in the old one.

The aggregate deficit of the 6,150 schemes in the index is estimated to have decreased over the month to £75.6 billion at the end of October 2013 (there was an aggregate deficit of £85.0 billion at the end of September 2013).

The funding ratio rose from 92.9% to 93.8%. There were 4,063 schemes in deficit and 2,087 schemes in surplus.



Latest from TPR and PPF

TPR: Guidance on ABCs

New guidance has been issued by TPR for trustees that are considering using [asset-backed contribution](#) (ABC) arrangements to fund pension schemes.

An ABC structure is a contractual arrangement between a DB pension scheme and the sponsoring employer. The employer (or another group company) agrees to transfer an asset to a 'special purpose vehicle'. The pension scheme then receives part of the income generated by the asset for a specified period.

The guidance is divided into four sections:

1. An explanation of ABCs
2. Perceived risks relating to ABCs
3. TPR's expectations of trustees
4. TPR's approach to ABC structures

Recently, there has been a significant rise in the number of defined benefit schemes using ABCs, but the statement makes clear that TPR perceives such arrangements to be high risk and potentially in breach of Employer-Related Investment rules (although this is yet to be tested through the courts).

Appropriate advice should therefore be sought and a due diligence process followed.

TPR highlights that it does not provide formal approval for ABC arrangements and will always challenge a trustee decision to enter into them in a risk-based proportionate manner. TPR will pay particular interest to the impact on schemes' funding positions.

DC code of practice in force

TPR's new DC [code of practice](#) and accompanying guidance has now come into effect. Trustees of trust-based DC pension schemes are required to demonstrate how they comply with the code.

The code, which TPR consulted on earlier this year (see [News on... Pensions – August 2013](#)), sets out practical guidance for trustees on meeting the underlying requirements, and also provides detailed information that will help trustees to embed the six DC principles into their scheme:

- Schemes should be durable, fair and deliver good outcomes for members.
- Schemes should establish a 'comprehensive governance framework' at the outset.
- Decision takers should understand their duties and be 'fit and proper' to carry them out.
- Ongoing governance should be 'effective'.
- Schemes should be 'well administered with timely, accurate and comprehensive processes and records'.
- Member communications should 'ensure members are able to make informed decisions'.

From next year, TPR will undertake compliance reviews and may take enforcement action if it identifies breaches of the law. TPR will also be publishing a template 'comply or explain' governance statement that DC trustees can use to inform interested parties whether they meet TPR's DC quality features.

Defined Ambition Consultation

The Department for Work and Pensions (DWP) has been consulting on "[Reshaping workplace pensions for future generations](#)". In the paper, the Government set out its proposals for a new regulatory framework for future pension provision to include 'defined ambition' (DA) schemes.

The consultation follows the DWP's earlier paper on 'Reinvigorating workplace pensions' (see [News on... Pensions – December 2012](#)) and was based partly on the advice of the Defined Ambition Industry Working Group established by Steve Webb and chaired by Barnett Waddingham Partner, Andrew Vaughan. In particular:

- The government proposes to review regulatory structure in order to allow 'sharing of risk' and to ensure that 'where promises are made, they are kept'.
- DWP research shows that the majority of employers would like to provide employees with more than individual DC, but find traditional DB schemes too costly. The DWP also found that there is demand from some individuals for more certainty about what they get in return for money put into DC pension arrangements.

Further research is in progress and the results are expected to be published in winter 2013/14.

DB schemes

The DWP have set out three proposed designs for new flexible DB models:

- An ability for schemes to pay benefits that fluctuate (e.g. a core DB pension plus a discretionary increase each year) as scheme funding levels vary.
- Automatic conversion to DC when member leaves employment before retirement.
- A scheme pension age which moves with general changes in life expectancy – with the aim that the proportion of time spent in retirement is kept constant.

Some of these features may be made available for existing DB schemes. The DWP is also considering whether to remove the statutory requirements to increase pensions in payment (in line with inflation) and to provide survivor pensions on death.

DC schemes

The DWP has also set out four designs which may provide more certain outcomes for members of DC schemes, including:

- Money-back guarantees
- Capital and investment return guarantee insurance
- Retirement income insurance (to ensure a minimum pension in retirement should funds 'run out')
- Pension income builder (where contributions are split each year between buying 'deferred annuities' and investing in a pooled risk-seeking fund which can be used to provide increases in future).

The DWP has looked at the scope for collective defined contribution (CDC) schemes in the UK and is proposing to explore further the changes to the legal framework that would be required to implement this type of structure in the UK.

The DWP has also posed questions on how appropriate governance, member communications, scheme funding, DB to DC conversion and other logistical issues would be dealt with in DA schemes.

The consultation closed on 19 December 2013.

Other News

DWP: Charges in DC schemes

The DWP has published research on [charges in defined contribution pension schemes](#). The DWP's report shows that the average annual management charge (AMC) for trust-based schemes was 0.75% with members of the largest schemes paying only 0.42%. However, where employers used a commission-based adviser or members were on low salaries and with low employer contributions, AMCs could exceed 1%.

The average AMC for contract-based schemes was 0.84% with members of the largest schemes paying a lower 0.51%. AMCs of over 1% were seen in older contract-based schemes, Stakeholder Pensions, smaller schemes and schemes with lower employer contributions.

CJEU: Age-related contributions 'objectively justified'?

The Court of Justice of the European Union has [ruled](#) that age-related contributions can be paid to an occupational DC scheme, provided that the employer can 'objectively justify' the difference in treatment. It also said that a further exemption in the EU Framework Directive that permits the use of age criteria only relates to the setting of admission ages and entitlement to benefits.

IAS 19: Member Contributions

The International Accounting Standards Board (IASB) has published [narrow scope amendments](#) in relation to reporting pension costs under International Accounting Standard IAS 19. In particular, the amendments relate to the treatment of member contributions. The revised version of IAS19 (effective for reporting periods beginning on or after 1 January 2013) could require entities to attribute member contributions to periods of service rather than simply applying the current practice of deducting these from the service cost in the period they are paid, potentially complicating the calculation of the figures under IAS19.

The amendment addresses this issue and allows the deduction of member contributions from service in the period in which they are paid where the contribution rate is independent of the number of years of service in the scheme (for example contribution rates which are a fixed percentage of salary).





The amendment takes effect from 1 July 2014 although earlier adoption is permitted.

ONS National Population Projections

The Office for National Statistics (ONS) has released '[National Population Projections, 2012-based projections](#)' which show that the UK population is projected to increase from around 63.7 million in mid-2012 to 68.0 million by mid-2022, and to 73.3 million over the 25 year period to mid-2037. In addition the number of people aged 80 and over in the UK is expected to more than double to 6 million by mid-2037.

The population projections are based around ONS assumptions of population longevity. The latest projections are based around estimates of life expectancy at age 65 of 18.3 years for men and 20.6 years for women - slightly lower than for previous years.

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

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