

Welcome to the latest edition of pensions news for employers. The newsletter covers a number of topical issues which companies should be considering. For further information, please contact your usual Barnett Waddingham consultant or email corporateconsulting@barnett-waddingham.co.uk.

Pensions taxation issues for high earners

On 5 December 2012, the Government announced that:

- From 6 April 2014 the annual allowance (AA) (the maximum amount of tax-privileged pension savings an individual can make in a single year) will be reduced from £50,000 to £40,000.
- In addition, the lifetime allowance (LTA) (the maximum amount of tax-privileged pension savings an individual can make over their whole lifetime) will be reduced from £1.5million to £1.25million. The new limit equates to a defined benefit (DB) pension of £62,500 pa if no lump sum is taken at retirement.

If an individual's pension savings exceed the AA in any year, a tax charge is applied via self-assessment based on their marginal rate of income tax. Effectively, contributions or benefit accrual above the AA receives no tax relief.

If an individual exceeds the LTA at retirement, a tax charge is applied to their retirement benefits. The amount of the charge depends on whether the excess funds are taken as pension or cash. If the excess funds are taken as pension, the tax charge is 25% of the value of this pension (and the remaining pension is then taxed as income). If the excess funds are taken as a lump sum, the tax charge is 55% of the lump sum (with no income tax due on the remaining lump sum amount).

The Government will introduce another "Fixed Protection" regime, expected to operate in the same way as the Fixed Protection offered as at 6 April 2012. It will also consult shortly (Spring 2013) on the details of an "Individual Protection" regime for those with pension rights above £1.25million as at 6 April 2014. This form of protection is expected to enable ongoing accrual of benefits within certain limits, but no details are yet known.

Trustees and scheme sponsors should identify who may be caught by the revised allowances. If there are individuals affected, trustees and scheme sponsors will need to decide how much support to offer staff in their planning.

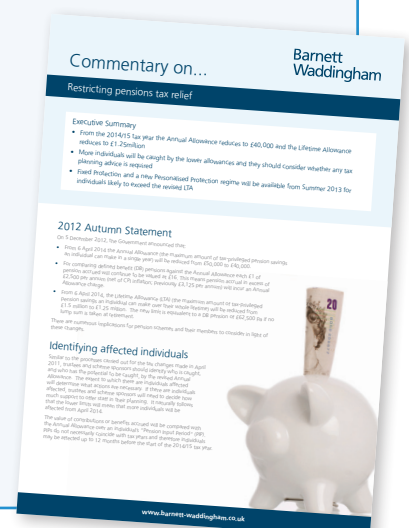
“”” Barnett Waddingham comment

The reduced AA is fairly easy to manage in respect of individuals with defined contribution (DC) provision. The most common approach is for employers to pay additional salary in lieu of pension contributions above the AA (often with adjustment for the extra employer's NI due). DB provision is more difficult to manage within the AA framework, but can provide better value for individuals.

Although the effective date of change sounds far away, it takes effect for Pension Input Periods (PIPs) ending after that date, i.e. starting as early as 6 April 2013. For DB schemes, action may need to be taken before the start of the relevant PIP, whereas DC arrangements can easily cease or reduce contributions during the PIP. Individuals who were not breaching the £50,000 allowance, but are expected to breach the £40,000 allowance may not need to make any changes yet, depending on their carry-forward allowance from the past three years.

We have produced a more detailed information note covering issues affecting high earners.

To view the full note visit the following link <http://bwllp.co.uk/lqC>



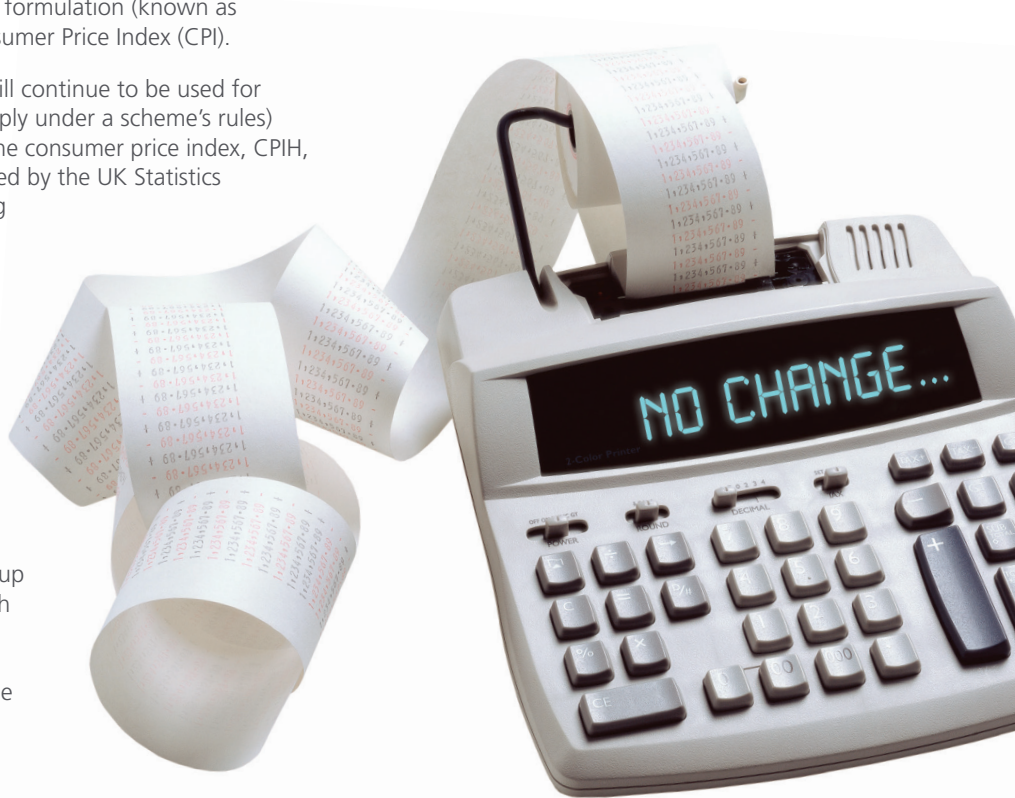
ONS consultation result: No change to RPI formula

After a three-month consultation, the National Statistician has unexpectedly announced that there will be no change to the way in which the Retail Price Index (RPI) is calculated. Instead, the National Statistician has recommended the creation of a new index – RPIJ – which will use a geometric formulation (known as “Jevons”) rather than an arithmetic formulation (known as “Carli”), aligning it more closely with the Consumer Price Index (CPI).

This will be published from March 2013. RPI will continue to be used for indexation of pensions (where CPI does not apply under a scheme’s rules) and for index-linked gilts. Another version of the consumer price index, CPIH, is also expected to be developed. If it is approved by the UK Statistics Authority, this measure, which includes housing costs, will be published anytime now.

Although the formula used to calculate RPI will not change, the National Statistician did recommend using an alternative data source for private housing rent.

This change is subject to a consultation with the Bank of England, but is expected to be implemented in calculating the February 2013 indices. The Office for National Statistics (ONS) previously estimated that this change would have added up to 0.09 percentage points to annual RPI growth and 0.05 percentage points to annual CPI growth between January 2008 and December 2011. The ONS intends to publish advice on the strengths and weaknesses of each index.



“““ Barnett Waddingham comment

It was widely expected that there would be some degree of change to bring RPI closer to CPI so the consultation result will come as a disappointment to many companies sponsoring occupational pension schemes.

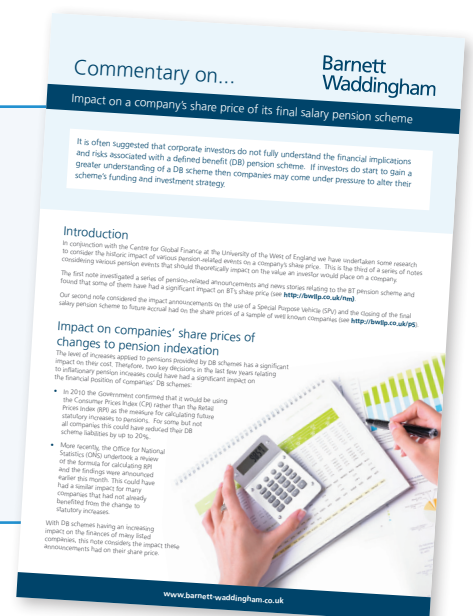
However, sponsoring employers of schemes that have retained the RPI inflation measure for future pension increases and/or revaluation of deferred pensions will be interested to understand in due course whether they have the option of switching to the lower (and therefore cheaper) RPIJ measure.

Impact on a company’s share price of its final salary pension scheme

In association with the Centre for Global Finance at the University of the West of England, we have also examined the impact that this announcement had on the share prices of three FTSE100 companies which use RPI to index their pension liabilities as well as carrying out a similar analysis relating to an earlier government announcement that it was changing the inflation index used to calculate the statutory minimum level of increase from RPI to CPI.

This is the latest of a series of notes considering various pension events that should theoretically impact on the value an investor would place on a company.

To view the full note visit the following link <http://bwllp.co.uk/rz>



Are you ready for 2013?

2013 brings with it many challenges for employers: the double dip recession; continuing low gilt yields & the impact of DB pension scheme deficits; reporting to HMRC in real time and, for many, the introduction of auto-enrolment.

During 2013 employers with between 500 and 50,000 employees will face their auto-enrolment staging date. Even if you decide to postpone the start of auto-enrolment for up to the permitted 3 months, your staging date remains unchanged and statutory duties apply from that date.

It all sounds so easy

From a given date, set up & maintain a system so that all employees receive at least minimum pension contributions paid to a suitable pension scheme without any action required by the employee, unless an individual decides not to continue membership.

What could possibly go wrong...?

Who needs to be auto-enrolled?

- The starting point is "workers" - for many employers this is obvious but what about "self-employed" consultants; non-execs, secondees, those working abroad?
- The next step is to categorise workers into the following groups:
 - **Eligible job-holders** are those who are employed in the UK, aged over 22 and under state retirement age and earn over £8,105 pa (rising to £9,440 pa in April 2013). This group MUST BE auto-enrolled.
 - **Non eligible job-holders** are either those aged between 16 and 21 or between state pension age and 74 with earnings above £8,105 pa or those aged between 16 and 74 earning between £5,564 pa and £8,105 pa. This group must be provided with specified information and informed that they can 'OPT-IN' to the auto-enrolment scheme.
 - **Entitled workers** are those aged between 16 and 74, earning less than £5,564 pa (rising to £5,668 pa in April 2013). This category is oddly named as they can join a scheme but are not entitled to any contribution from the employer.
- Most employers will not have all of the data to categorise correctly (e.g. the state retirement age of each worker) and this categorisation needs to be applied at every pay date with the earnings triggers pro-rated accordingly. How about those with variable earnings or those on zero-hours contracts?

What do I do about those who choose to opt-out?

- Dependent upon the timing of the initial notification, it is possible that the first contribution will have been deducted from the employee's pay and possibly passed to the pension scheme by the time an employee opts-out. Company auditors will no doubt want to inspect a robust audit trail to track a potentially large number of these opt-out transactions each involving a small amount of money.
- Care must be taken not to induce opting-out, such as offering or withholding pay-rises. Care must also be taken if pension contributions are included in a flexible benefits scheme.

Which pension scheme shall I designate as the employer's auto-enrolment scheme?

- The majority of employers will wish to designate a defined contribution pension arrangement as their auto-enrolment scheme. It is possible to operate multiple auto-enrolment schemes for different categories of employee and keep existing schemes in use for future accrual as long as they meet the minimum requirements. The Pensions Regulator (TPR) must be notified of all schemes being used to meet the auto-enrolment requirements.

There are many types of pension scheme to consider for auto-enrolment purposes:

- Amend and use an existing scheme
- Use a new trust-based scheme
- Use a master-trust arrangement from an insurance company or from one of the new master-trust arrangements
- Use a contract-based arrangement.

Whichever type you choose you will need to consider what contribution structure and definition of pensionable pay to adopt as auto-enrolment applies minimum contributions to all earnings, within the given bands.

The definition of pensionable pay you choose to apply will have a bearing on the level of minimum contributions payable.

How should I communicate these changes to my workers?

As the television awareness campaign continues, workers' general awareness of auto-enrolment might be enhanced. The key questions will generally be:

- Does this apply to me?
- How much will it cost me?
- Will other employee benefits be affected?
- What will happen to the pension scheme I have joined?
- Can I opt-out?

Good communication is key as employees will be frustrated if they unexpectedly have contributions deducted from their pay.

“““ Barnett Waddingham comment

Many employers are finding that preparing for auto-enrolment is more time-consuming than first envisaged. Barnett Waddingham has been helping clients to auto-enrol from the start of this year and is helping many other clients to prepare for up and coming staging dates.

TPR has issued a series of informative guides to auto-enrolment: a good starting point would be to read through these if you have not already done so – visit www.thepensionsregulator.gov.uk/automatic-enrolment.

Current issues in Financial Reporting

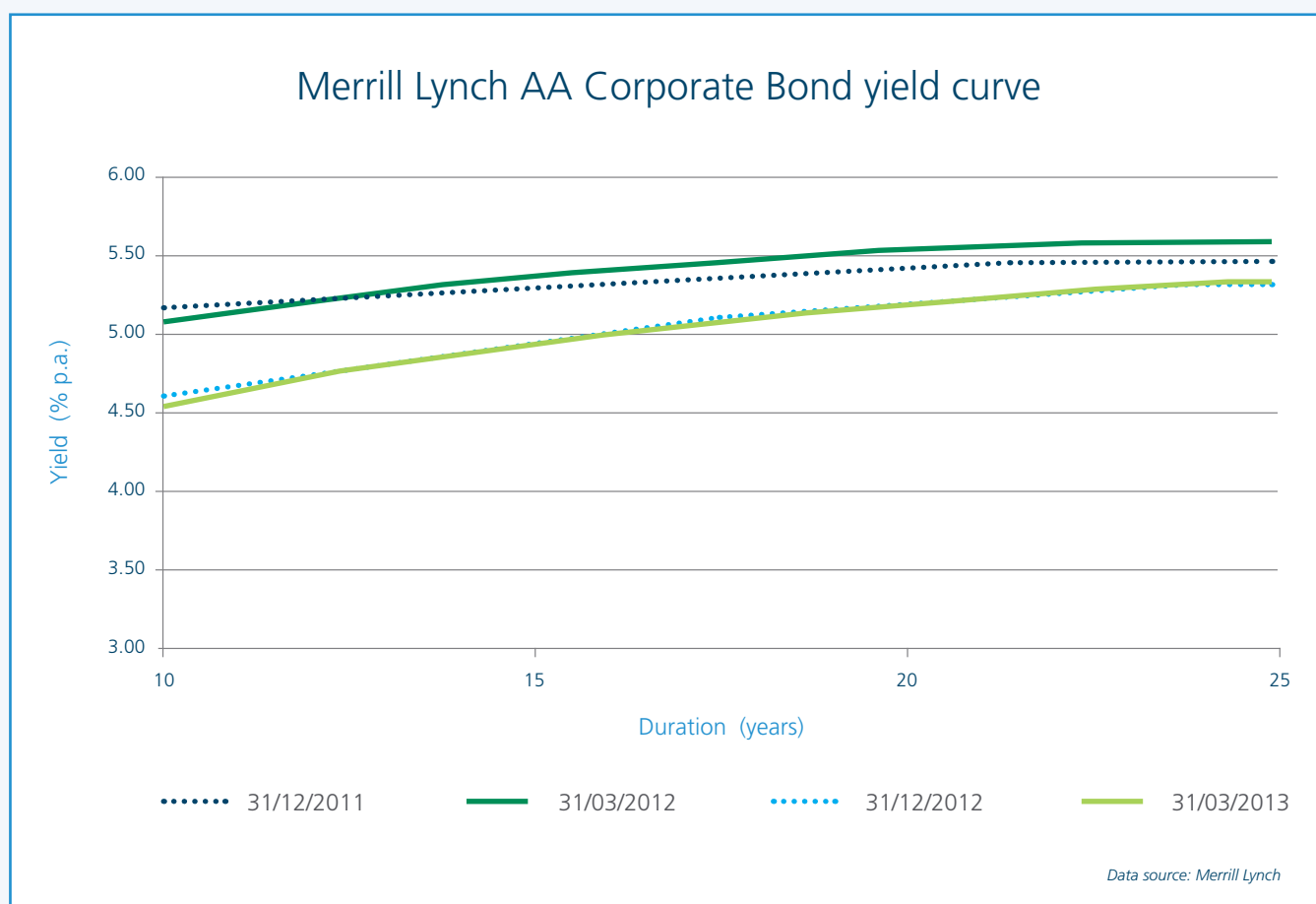
We recently released our latest note on "Current Issues in Pensions Financial Reporting". It covered the selection of key financial assumptions required for determining pension liabilities under UK and international accounting standards as at 31 March 2013.

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.

🗨️ Barnett Waddingham comment

The Accounting Standards require the discount rate to be based on yields of high quality (usually AA-rated) corporate bonds of appropriate currency and duration, taking into account the nature and term of the relevant pension scheme's liabilities. Hence, long-term corporate bond indices are often used as a proxy to determine the discount rate.

Of particular importance for this accounting period is the duration of pension scheme liabilities. Over the last year the shape of the yield curve on AA corporate bonds has become steeper (see graph). There is a danger of overstating a scheme's liabilities by taking the simplistic approach of using a long-term corporate bond index. This is because as the duration of a long term corporate bond index tends to be shorter than the duration of most pension scheme's liabilities, resulting in a lower discount rate assumption.



Considering changes from year to year, the green lines in the above graph show the yield curve as at 31 March 2012 and 2013. The falls in yields are much greater at the shorter durations (fall in the yield of ~1.0% p.a. at 10 year duration and ~0.5% p.a. at 25 year duration). As a result it may be inappropriate to use an index based approach for most schemes as this does not allow for the movements in the shape of the yield curve as illustrated above.

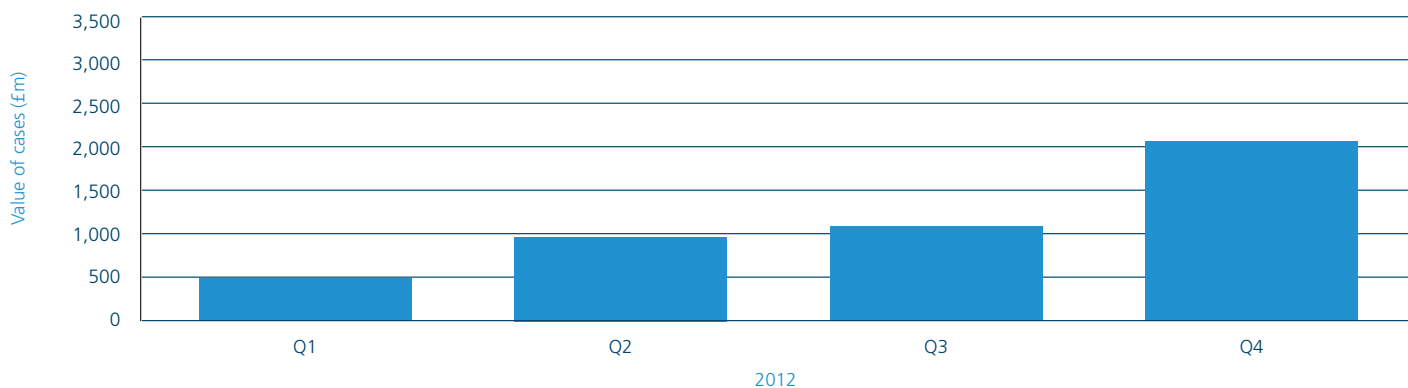
Many companies are reviewing their assumptions to better allow for duration. It is important to be consistent from year to year and across the different assumptions.

To view the full note visit the following link <http://bwllp.co.uk/pH>

Buy-outs, buy-ins and longevity swaps

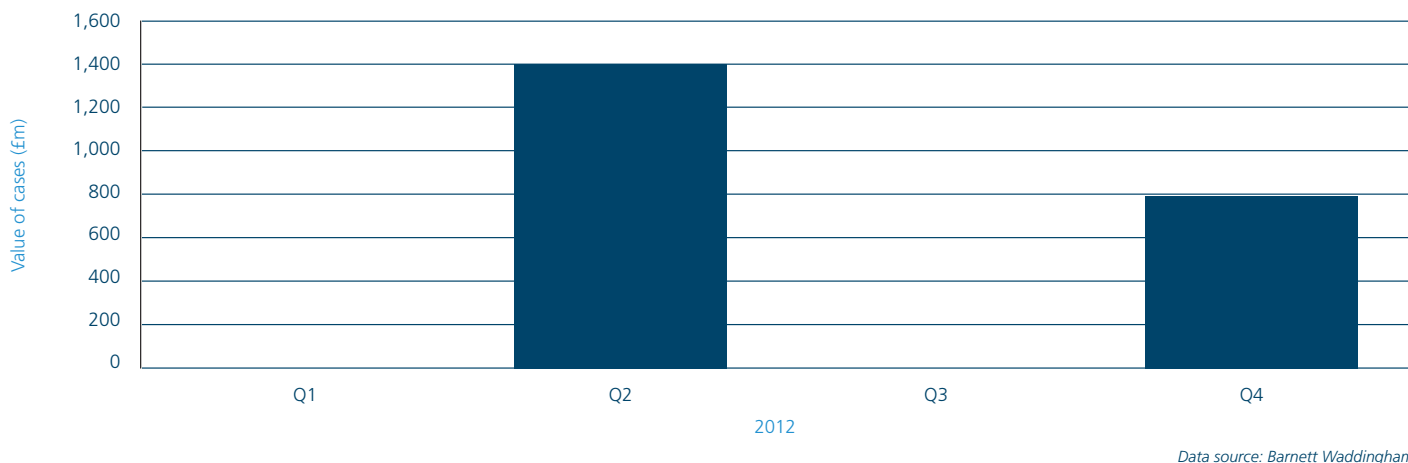
Bulk annuity market business

Just over £1bn of bulk annuity business was completed during Quarter 3. Legal & General were the most successful insurer during the quarter, completing transactions worth over £400m.



Longevity swaps market business

One longevity swap transaction was completed in the second half of 2012 - Swiss Re completed an £800m transaction with the LV= Employee Pension Scheme. Legal & General completed a £3.2bn longevity swap with the BAE Systems 2000 Plan in February 2013.



Company news

The most recent innovation in the de-risking market for pensioner liabilities is the use of medical underwriting as part of the bulk annuity pricing process. February saw the first two of these transactions being announced, where £3.5m and £1m of liabilities were insured with Partnership.

It has been reported that the construction company Interserve has reduced its pension scheme deficit by almost 40% to £95m by transferring a portfolio of 19 private finance initiatives (PFI) to its pension scheme. It is said that the company's annual deficit funding contributions will halve to £12m as a result of the deal.

The Industry-Wide Mineworkers' Pension Scheme (IWMPs) and the Industry-Wide Coal Staff Superannuation Scheme (IWCSSS) have invested £30m in UK Coal in exchange for a 75% share in a property company in a deal designed to reduce the £450m combined pension deficit.



Government White Paper: end of contracting-out for defined benefit schemes

The Department for Work and Pensions (DWP) has published a White Paper setting out its plans for the reform of the State Pension system. In particular, the current dual-tier state pension system (and associated means-tested benefits) will be replaced by a single-tier pension of around £144 per week in today's terms. In the 20 March Budget, the Chancellor announced that the single-tier state pension will be introduced from April 2016 rather than in April 2017.

One of the consequences of these reforms is that contracting-out on a salary-related basis will no longer be possible under the new system and National Insurance (NI) rebates will stop. As a result, employers sponsoring DB pension schemes that are open to benefit accrual and contract-out of the state second pension will face an increased NI cost of 3.4% of relevant earnings (which for 2012/13 is earnings between £5,564 and £40,040) for each member, and the members will pay an additional 1.4%. The members will receive additional state pension which the Government believes is worth much more than members' increased NI contribution. For the employer, however, the change represents an increased NI bill with no gain.

It is anticipated, therefore, that employers will wish to amend scheme benefits in some way to even out their employment costs. The Government has said that it will legislate so that employers can amend their scheme benefit structures to reflect the end of contracting-out without the need for the trustees' approval (even if the scheme rules would otherwise require trustee agreement). Members will, however, have to be informed and possibly consulted on any changes to the scheme's benefits.

The DWP and HMRC are expected to produce a series of factsheets for employers to use when communicating to employees. The DWP will also consider the lessons learned from the end of contracting-out on a Money Purchase (COMP) basis in terms of the process of reconciling NI records with minimal fuss.

“”” Barnett Waddingham comment

Many employers may wish to take the opportunity to make more substantial changes to their scheme benefit structures and it is not clear to what extent the exemption above will apply to such changes. We expect that any changes which have expected cost savings significantly above 3.4% will not be covered by the exemption.

In many cases, though, employers looking to make substantial changes to benefits would be looking at a new scheme, rather than amending the rules of the existing scheme, and so this would be subject to the usual requirements in any case.

There are particular issues for employers with outsourcing contracts involving public sector employees. It is unlikely that employers will be able to reduce benefits for public sector outsourced workers, so there would be an increased employment cost of 3.4% of relevant earnings.

The most urgent issue here is to ensure that any contracts entered into from now allow for this either by permitting benefits to be reduced, or - more likely at present - allowing the extra costs arising to be passed through. Employers may wish to investigate existing contracts if they will last beyond 2016 and the extra employment cost of 3.4% of relevant earnings is seen as a substantial issue. The contract terms might permit the extra costs to be passed on, or it may be possible to negotiate some extra payment.



What are the pension challenges facing your company and how have other organisations been tackling them?

*Barnett Waddingham is hosting their Annual Employer Conference: Navigating the evolving pensions landscape on **21 May 2013** at **One Great George Street, London**.*

The conference will focus on pensions issues from a corporate perspective and will provide practical examples of the challenges and obstacles employers are facing and how they have been tackled. Opening the conference will be Philip Coggan from the Economist who will examine how the economic outlook will affect the pension industry. This will be followed by a choice of sessions relevant to corporate sponsors of both Defined Benefit and Defined Contribution arrangements.

For further details and to secure your place at the conference, please email our events team at employerconference@barnett-waddingham.co.uk

Forthcoming Barnett Waddingham seminars

Barnett Waddingham holds a wide variety of events which take place at various locations across the UK. Our events cover a full range of topics aimed at keeping all our contacts up to date with the latest news, legislation and trends in our industry.

Please visit the events page on our website <http://bwllp.co.uk/C> or email seminars@barnett-waddingham.co.uk for further information.



Connect, learn & share

Our Corporate Consulting Practice keeps you connected with the latest news, thinking and developments in pensions through our online channels.

Online Pensions Guide for Finance Directors

Visit our online pensions guide for Finance Directors www.fdpensions.co.uk for a single source of clearly written up to date information on defined benefit pension schemes.



Pensions Training Videos For Employers

We have produced a series of short training videos covering issues that will be important to employers with a defined benefit pension scheme.

These can be viewed on our website <http://bwllp.co.uk/gd>, through our YouTube channel, or by searching for 'Barnett' in the podcast section of iTunes.

Corporate Consulting Blog

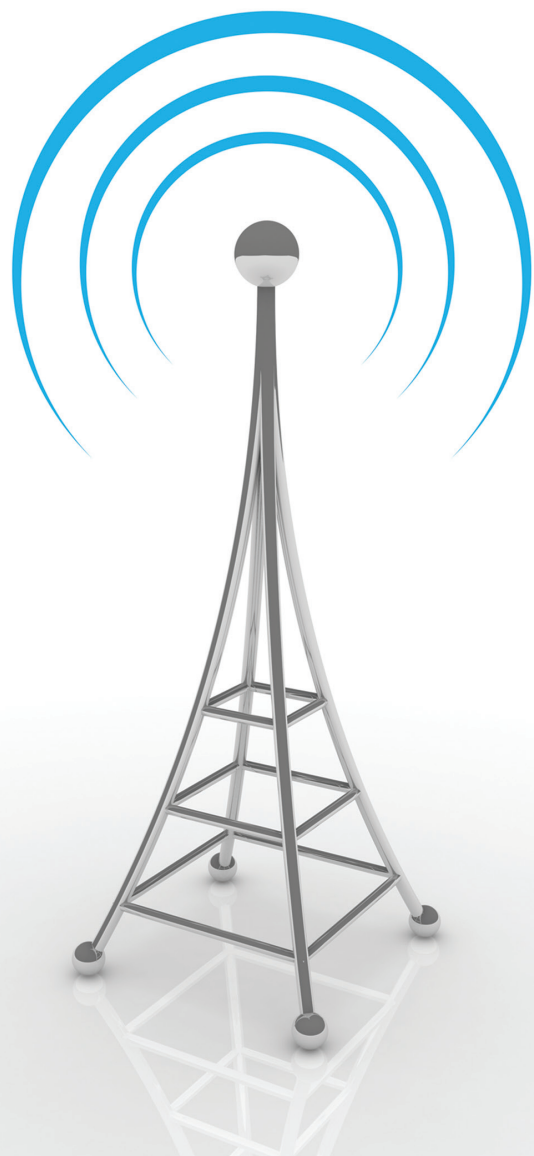
Looking for concise up to date commentary on the key pensions issues you face as an employer with a defined benefit scheme?

Use the following link to set up an RSS feed to our blog <http://bwllp.co.uk/gU>

BW Corporate Twitter

Follow us [@BWLLP_Corporate](https://twitter.com/BWLLP_Corporate) for bite sized updates on corporate pensions issues. We also tweet links to all of our more detailed newsletters and analysis, so it's the easy way to make sure you don't miss out.

For a full list of services and further information, visit our website at www.barnett-waddingham.co.uk



Impact on a company's share price of its final salary pension scheme

It is often suggested that corporate investors do not fully understand the financial implications and risks associated with a DB pension scheme. If investors do start to gain a greater understanding of a DB scheme then companies may come under pressure to alter their scheme's funding and investment strategy.

In conjunction with the Centre for Global Finance at the University of the West of England we have undertaken some research to consider the historic impact of various pension-related events on a company's share price. This is the second of a series of notes considering various pension events that should theoretically impact on the value an investor would place on a company. The first note investigated a series of pension-related announcements and news stories relating to the BT pension scheme and found that some of them have had a significant impact on BT's share price - see <http://bwlip.co.uk/nm>.

Additional Pension Funding through use of an SPV

SPVs allow a company to allocate certain assets and their associated future cashflow stream to a pension scheme without the company losing control of the assets. Using an SPV in this way will provide the pension scheme with extra security, which should allow the company to negotiate a longer recovery period with the trustees. For further details on SPVs please see our note which available on our website at www.bwlip.co.uk/n6.

As an SPV will have presumably allowed the company to negotiate lower immediate cash contributions to the scheme you might expect the announcement of an SPV to have a positive impact on the company's share price. Conversely does an SPV mean that the trustees are negotiating hard and there may be difficult funding negotiations at future valuations?

Our note analyses five companies that have used an SPV to provide additional security to their pension schemes. Our research highlights that a company considering the use of an SPV in its funding negotiations with trustees should not be put off by concerns about investor reactions to such a move.

Closure of DB scheme

Over the last few years the majority of companies with a DB pension scheme have been seeking ways to manage their mounting pension costs. One of the first steps has been to close the DB scheme to new entrants and the Association of Consulting Actuaries (ACA) 2011 pension trends survey showed that nine out of ten companies have now done this. The same survey shows that four out of ten companies have then gone on to close their scheme to future accrual for all members.

Closing the scheme to future accrual will stop the company building up further uncertain DB pension scheme liabilities and as a result, an announcement that it intends to do this might be viewed favourably by investors. However, the threat of industrial action often resulting from such changes can create uncertainty. Closing to accrual will also do nothing to tackle the pensions liabilities built up to date.

In order to consider how a company's announcement to close its DB scheme to future accrual impacts on its share price, we analysed six companies that have announced that they will be closing their DB schemes for existing employees. Our research showed a mixed reaction by the market with both positive and negative share price movements. It also highlights the length of time that share prices may take to adjust to this type of announcement.

To view the full note visit the following link <http://bwlip.co.uk/p5>

For further information on any of the news raised here or for any other corporate matter please contact:

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