News on...

Barnett Waddingham

Current Pensions Issues

Spring 2012

Equalising GMPs… again*

Background

The judgement in the European Court of Justice case of "Barber" on 17 May 1990 required employers to provide equal pension benefits to men and women for comparable work from that date. In particular, Normal Retirement Ages (NRAs) must be equal for men and women doing the same job.

Whilst it was clear that overall pension benefits had to be equal, the position regarding Guaranteed Minimum Pension (GMP) was not determined. GMP forms an element of a member's pension where a scheme was contracted-out of the State Earnings-Related Pension Scheme (SERPS) on a salary-related basis before 1997.

Many commentators took the view that GMP equalisation was not required because, for example, GMPs form an underpin to scheme benefits and are a substitute for already unequal state benefits.

The Department for Work and Pensions (DWP) is now consulting on the matter and has said that, in its opinion, schemes are "already under an obligation" to equalise GMPs accrued between 17 May 1990 and 5 April 1997.

In general, anti-discrimination legislation requires equalisation only where the existence of an actual opposite sex "comparator" can be demonstrated. For GMPs, however, the Government's view is that case law requires that comparators should always be assumed to exist and, therefore, schemes are required to equalise GMPs in all cases.

As a consequence, even if all a scheme's members were the same sex during the period in question, GMPs should still be equalised.

The Government has said that it does not wish to prolong the uncertainty surrounding GMP equalisation. The DWP does not intend to bring a test case to the Court of Justice of the European Union (EU) as, in its view, there has always been a legislative requirement to equalise GMPs.

Method

Alongside the consultation, the DWP has set out its suggested methodology for equalising GMPs. For benefits earned between 1990 and 1997, schemes would:

- put the pension into payment at the earlier of the member's pension age under the rules and that of a notional comparator of the opposite sex,
- at the point the pension comes into payment, pay the higher of the overall pension due to the member under the scheme rules and the pension that would be paid to the comparator (taking account of the different GMP accrual rates for men and women), and
- review this calculation each time the pension in payment is reviewed (usually annually).

The DWP has said that schemes will not be required to use this method and that it should not be viewed as giving legal advice or a definitive statement of the correct approach. There may be other approaches to equalisation that are less costly or easier to administer.

Costs

This consultation raises several cost-related issues. Equalising GMPs could increase the liabilities of a scheme significantly, depending on the numbers of men and women in the scheme and the benefits offered.

In addition, there will be costs associated with:

- ensuring that members' GMP records are accurate and up-to-date,
- obtaining legal advice,
- calculating revised on-going pension entitlements and possibly back payments,
- reviewing pensions in payment annually to ensure that they remain equalised (if the trustees follow the method outlined in the consultation), and
- updating scheme documentation.

It is likely that these costs will be disproportionate to any additional benefits that might be available as a result.

Next Steps

Some lawyers are expressing doubt over whether the DWP is right to say that schemes are legally required to equalise GMPs. In addition, there is uncertainty on a number of issues including whether the requirements apply to former members who transferred their benefits out of a scheme a number of years ago.

Trustees may therefore wish to adopt a "wait and see" approach, at least until the consultation has run its course. The consultation closes on 12 April 2012.

In the meantime, trustees may want to consider whether the member data that they hold would be sufficient to carry out a GMP equalisation exercise. This could be carried out at the same time as a wider evaluation of the scheme's data in order to maximise efficiency.

*See our Spring 2010 Newsletter…

Our Services

Barnett Waddingham LLP provides professional services spanning pensions, life and general insurance.

Our services include:

- Scheme actuary and associated services to the trustees and employers associated with DB pension schemes.
- Advice to DC pension schemes.
- Pensions accounting for UK and international companies.
- Administration and management services including pensioner payroll, preparation of annual accounts and governance and secretarial services.
- Investment strategy reviews and advice on funding 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.

We also have a dedicated team that provides 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.

Update on Auto-enrolment

Revised Timetable

Following an announcement in 2011, the DWP has confirmed its revised timetable for auto-enrolment reforms. The planned increase in minimum employer contribution rates from 1% to 2% of qualifying earnings will now be delayed from 1 October 2016 until 1 October 2017 and the increase to 3% until 1 October 2018 (previously 1 October 2017).

Staging dates for smaller employers will now fall between 1 June 2015 and 1 April 2017. Medium-sized employers will be reallocated automatic enrolment dates between April 2014 and April 2015. Employers with a staging date on or before 1 February 2014 will not be affected by the changes to staging dates.

Awareness

To encourage more people to save for retirement, the DWP is using mass advertising to promote the direct.gov.uk website as a source of further information on auto-enrolment.

At the same time, the Pensions Regulator (tPR) has published automatic enrolment research that suggests improving levels of awareness and understanding of the requirements among small and medium-sized employers. The research, "Employers' awareness, understanding and activity relating to workplace pension reforms", also shows that awareness of the reforms remains high among large employers.

TPR's Role

TPR has set out its strategy for maximising employer compliance with the new regime. It is also encouraging employers who offer Defined Contribution (DC) arrangements to provide access to "safe, durable and value-for-money" vehicles. TPR is aiming to establish a "pro-compliance" culture and to ensure that effective systems are in place for detecting and dealing with non-compliance.

Solvency II and the Holistic Balance Sheet

Solvency II is a European-led initiative designed to strengthen the capital backing of the liabilities of insurers. There has been much debate about whether a Solvency II - style regime should apply to occupational pension schemes.

In October 2011 the European Insurance and Occupational Pensions Authority (EIOPA) began consulting on changes to the Institutions for Occupational Retirement Provision (IORP) Directive. The European Commission (EC) asked EIOPA how funding requirements for pension arrangements should be harmonised with the requirements of other financial institutions. EIOPA has now published its final response to the EC.

The response considers using a "holistic balance sheet" approach for pension schemes instead of directly applying Solvency II. This would involve placing a value on the sponsoring company's covenant and the financial support of the Pension Protection Fund (PPF), both of which would be deemed as backing a scheme's liabilities in addition to its assets. EIOPA have also suggested that funding deficit recovery plans should be limited to 15 years.

EIOPA's recommendations contain proposals to enhance governance and risk management requirements to closer match the standards of insurance companies. EIOPA also recognises that understanding the financial impact of any changes to solvency requirements is important and will publish the results of a quantitative analysis later this year.

The EC has subsequently published a White Paper on the future of pensions in Europe. The paper, "An Agenda for Adequate, Safe and Sustainable Pensions" makes suggestions as to how the EU and its member states can work together to tackle the major challenges that an ageing population poses for pension provision.

Latest News from the Pensions Regulator

Pension Reciprocation Plans

TPR has issued a series of statements reminding individuals of the risks posed by firms offering the chance to cash in pension arrangements before retirement.

The Financial Services Authority (FSA) and Her Majesty's Revenue & Customs (HMRC) have joined forces with tPR in the latest communication.

This follows a High Court ruling that so-called Pension Reciprocation Plan (PRP) arrangements contravene pension law.

PRPs are pension products designed to allow members to withdraw up to half of their pension fund as cash, for example in the form of a loan. PRPs may also allow individuals access to their funds earlier than the statutory minimum pension age in good health (55).

Purple Book 2011

The PPF and TPR have published the 2011 edition of their Purple Book, highlighting the risks faced by private sector Defined Benefit (DB) pension schemes. The statistics are based on 6,432 schemes (around 98% of all PPF eligible schemes) and highlights include:

- a 3% increase over the year in the proportion of schemes that have closed to future benefit accrual,
- a 20% rise over the year in the total number of PPF-recognised contingent assets in place, and
- an increase of just over a year in the average length of scheme funding recovery plans (now 9.5 years).

DC Schemes: Good Design and Governance

TPR has set out principles it believes are necessary for good design and governance of workplace DC pension schemes. The principles, which will form the basis for TPR's regulatory approach, include:

- schemes should be durable, fair and deliver good outcomes for members
- a comprehensive scheme governance framework should be established at set-up
- schemes' decision-makers should understand their duties and be fit and proper to carry them out, and
- communications should ensure members can make informed decisions about retirement savings.

Hugh Mackay Trustees Banned

TPR has banned three trustees of the Hugh Mackay Retirement Benefits Scheme because of a breach of investment rules and failure to demonstrate sufficient "trustee knowledge and understanding". TPR deemed that the trustees had clearly acted in their own interests and without appreciating or managing conflicts.

The scheme's principal employer was being paid by the scheme for "services" provided and paying salaries to the trustees. One trustee was a director and shareholder of the employer. The trustees had also purchased properties with scheme assets from a company of which one of the three trustees was a shareholder, without first obtaining independent valuations.

Executing Deeds: That which ought to be done…

The High Court has ruled that a formal deed of amendment is valid despite the trustees not complying with a technical formality in its execution.

The amendment clause set out in the rules of the Wembley 1989 Pension Scheme requires all the trustees to declare an amendment in writing. A declaration was drawn up and signed by four out of five of the trustees. The fifth trustee did not sign the amendment due to an administrative oversight, although she confirmed to the Court that she would have signed it at the time, and still would.

The judge's view was that the missing signature was an administrative error and that the maxim "equity regards as done that which ought to be done" should be applied. The amendment was therefore deemed to be valid.

The judgment may not necessarily have wider application. The exact wording of schemes' amendment powers and the paper trail leading up to any defective amendment will be key in determining whether such an amendment was effective.

April/May Seminars

In April/May we will be running the next in our series of seminars. The topic we will be looking at is "Solvency II".

The EC is currently considering proposals to apply the latest solvency regime for insurance companies (known as "Solvency II") to European pension schemes as well. This could mean pension schemes having to value their liabilities in a very conservative way, and holding risk reserves on top to protect against all but the most extreme contingencies. It is likely to have significant implication for investment strategies as well. In contrast to most other EU States, this would have a significant impact on pension schemes in the UK.

For more information please see our website or email **seminars@barnett-waddingham.co.uk**

News in Brief

Lifetime Allowance – Fixed Protection: A Reminder

The Standard Lifetime Allowance (LTA) will reduce from £1.8 million to £1.5 million with effect from 6 April 2012. Individuals can, however, apply for Fixed Protection to maintain the higher protection, provided no further pension provision is made by them or on their behalf.

Applications for Fixed Protection must be made to HMRC using a specified application form. The form cannot be submitted online – it must be printed, completed and posted to HMRC to arrive by 5 April 2012.

ASB: Financial Reporting Standards

The Accounting Standards Board (ASB) has proposed a major revamp of UK financial reporting standards with effect from 1 January 2015. The ASB recommends replacing all current accounting standards with a single Financial Reporting Standard (FRS) and introducing a reduced disclosure framework for certain companies.

The ASB is also planning to bring FRS17 (on reporting pension costs) back into line with the international equivalent IAS19. In particular, the expected return on assets component of profit and loss (P&L) charges is expected to be based on corporate bond yields, rather than being set by reference to the assets actually held by the pension scheme.

GMP: Revaluation

Legislation has been passed that increases the fixed rate of GMP revaluation from 4.0% to 4.75% pa. The revised rate will apply to individuals ceasing contracted-out salary related (COSR) employment after 5 April 2012.

PPF: 2012/13 Levy Framework Guidance

Following the announcement of changes to the calculation of the PPF levy from 2012/13 (see our Winter 2011/12 newsletter) the PPF has published an information booklet for levy payers.

Printed copies are being distributed by the PPF to all schemes. The PPF has also released a webcast on YouTube explaining the new levy framework.

Scheme Funding in 2012 - Expectations

TPR has said that it will publish a statement in April setting out what it expects from trustees who are about to embark on a scheme funding valuation.

It is intended that a statement will be issued annually to respond to changes in economic conditions. TPR hopes to reduce the number of recovery plans requiring its scrutiny.

RPI/CPI - Debate

An e-petition calling for the Retail Prices Index (RPI) to be reinstated as the inflation measure for determining increases to public and private pensions received over 110,000 signatures and was debated and rejected in the House of Commons on 1 March.

The statutory minimum increase rate will continue to be based on the Consumer Prices Index (CPI).

HMRC: Trivial Commutation

HMRC has published draft guidance setting out the way in which new rules relating to commutation of small personal pension pots should be applied.

The guidance follows legislation enacted in February 2012 enabling individuals aged 60 or over to commute a maximum of two personal pension pots worth £2,000 or less in a lifetime from 6 April 2012.

Test-Achats: Actuarial Factors

The EC has issued guidelines stating that the "Test-Achats" ruling (requiring gender equality for pricing insurance contracts - see our Spring 2011 Newsletter) does not mean that occupational pension schemes have to adopt unisex actuarial factors for early retirement or commutation.

March 2012
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