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

The Pensions Regulator flexibility and impact analysis

On 10 October 2012, The Pensions Regulator (TPR) published evidence showing how some of the flexibilities in the UK defined benefit (DB) funding regime have been used by pension schemes and sponsoring employers.

This analysis is designed to show that the flexibilities within the existing structure are sufficient despite the difficult economic environment within which employers are operating.

The analysis illustrates the following:

- Contributions as a percentage of liabilities vary significantly from scheme to scheme.
- Discount rates used by trustees vary significantly.
- Recovery plans for schemes in the current cycle increased by about 4.7 years in their last round of valuations three years ago. Recovery plans are assumed to increase on average by three years this time around, meaning an aggregate increase of 7.7 years since 2006.
- Use of guarantees, security and contingent assets in place of cash contributions has increased seven-fold since 2006/07.

TPR believes that the flexibilities offered by the UK DB funding regime provides a better approach to protecting both retirement savers and the Pension Protection Fund (PPF) as well as maintaining employer viability than the more rigid systems used by countries such as Denmark and Sweden.

In a speech at the Professional Pensions Show 2012, TPR chairman Michael O’Higgins warned trustees not to be “recklessly prudent” in the valuation assumptions they make and in the investment strategy they use. He emphasised that occasionally it might be preferable “for the employer and the scheme … to invest in the growth of the sponsoring company rather than making higher pension contributions”. He also highlighted the fact that “legislation does not require trustees to invest in gilts” and that schemes with a strong sponsoring employer “may be able to afford to take more risk”.

Comment

Many employers are experiencing difficult trading conditions and so additional demands on cash flow from pension schemes are unlikely to be welcome. There are many ways in which employers can take initiative to help manage their short term contribution requirements.
RPI/CPI: CPAC concludes “no justification” for differences

Over the last 20 years, the Consumer Prices Index (CPI) has been on average around 0.7% p.a. lower than the Retail Prices Index (RPI). Of this, 0.5% p.a. could be attributed to the “formula effect” resulting from technical differences in the way the two indices are calculated, and the remaining 0.2% p.a. could be attributed to differences between the composition of the two indices. In 2010 a change was made to the way the indices were calculated and this was expected to increase the difference between CPI and RPI going forward. The “formula effect” since 2010 has been observed to be between 0.8% p.a. and 1.0% p.a.

The Consumer Prices Advisory Committee (CPAC) advises the UK Statistics Authority on various issues relating to the calculation of RPI and CPI. The CPAC has recently concluded that there is no justification for using different methods in the calculation of RPI and CPI.

The ONS have now opened a public consultation until 30 November 2012, inviting views on a range of options for the way RPI is calculated. The options up for consultation would either keep the formula effect in place; amend RPI’s formula to reduce the gap with CPI; or remove the formula effect entirely.

The CPAC will need to consult with the Bank of England on whether the chosen adjustment to RPI, if any, would be “materially detrimental to the interests of the holders of relevant index-linked gilt edged securities”. If so, the Chancellor would need to agree to the new formula in order for it to proceed.

If all necessary parties agree to alter the RPI formula, the ONS is expected to introduce it with the annual update of the RPI when it is published on 19 March 2013.

Comment

Market commentators expect there to be at least some alteration to the calculation methodology and for RPI to become more closely aligned with CPI. One would expect the market prices of RPI-linked instruments to already reflect these expectations and this is generally believed to be the case – the intention to consult on the matter having been announced some months ago. However, there is still likely to be a step change in forecast RPI once the final outcome is announced. If the decision is to remove the formula effect then liabilities linked to RPI should see a corresponding step decrease.

Companies should keep a close eye on the issue as there could be a significant benefit for companies with liabilities linked to RPI that are not fully hedged.
Transition to new IAS19 standard – new disclosure requirements

The International Accounting Standards Board (IASB) published a revised IAS19 standard in June 2011 which is intended to simplify and improve the quality of disclosures made about employee benefits plans. It will also have a real impact on the disclosed profits of companies with defined benefit (DB) plans. The new standard was formally endorsed by the EU in June 2012 and is effective for accounting periods beginning on or after 1 January 2013, although earlier adoption is encouraged.

The 31 December 2013 year end is the earliest for which the revised standard will apply. The new standard amends the disclosure requirements to be more focused around the risk posed by the scheme to the company. In particular, the new requirements include:

- An explanation of the risks associated with the DB plan, including comment on significant concentration of any risk, as well as the actions being taken to address them
- Analysis of the sensitivity of results to changes in the key assumptions
- Commentary on the impact of future uncertain cash flows as well as information about the maturity profile of the DB plan.

Proposed changes to directors’ disclosures

The Government issued a consultation in the summer in relation to directors’ remuneration reports, including pension disclosures. This move comes in response to what the Business Secretary, Vince Cable, describes as “compelling evidence of a disconnect between pay and performance in large UK listed companies”.

Changes in the value of defined benefit (DB) pensions are currently calculated using the cash equivalent transfer value (CETV) basis and disclosures need to comply with both the Companies Act and the Listing Rules. The proposed new method is to have a single figure for remuneration, incorporating all pay, bonuses, share schemes, pension arrangements, etc.

The Government will liaise with the UK Listing Authority to see if their rules should also be changed, but if not the disclosure using the CETV approach would still apply to listed companies in addition to the proposed new method.

Under the new proposals, the increase in DB pension would be determined using the Annual Allowance method, but using an annual multiplier of 20 instead of 16. It would also be a requirement for unfunded arrangements (both defined contribution (DC) and DB) and pension entitlement through non-UK schemes to be included.

Comment

Companies with a 31 December year end may want to consider the implications of the new disclosure requirements and obtain projections of next year’s disclosures to better understand the impact of the revised standard.
Stronger funding targets? - Solvency II and UK pension schemes

The European Commission has asked The European Insurance and Occupational Pensions Authority (EIOPA) to conduct an impact assessment study on the proposed Institutions of Retirement Provision (IORP) Directive. This will include an analysis of the impact of applying Solvency II rules to occupational pension schemes.

There has been much opposition to the proposal to apply Solvency II style capital requirements to occupational pension schemes, with many critics citing the fundamental differences between occupational pension schemes (which are backed by sponsoring employers) and insurance companies (which are focused on making a profit from the pension arrangement).

In a speech at the National Association of Pension Funds (NAPF) annual conference, the NAPF chairman, Mark Hyde Harrison, described the argument behind the IORP Directive as being based on “flawed logic”, emphasising that pension schemes face different risks to banks and insurers and therefore should not be considered in the same manner. He urged delegates to get involved in the impact assessment study put together by EIOPA.

At the same conference, the chairman of EIOPA, Gabriel Bernardino, defended the IORP Directive and insisted that it would help to revive defined benefit (DB) schemes – “our objective is not to kill DB, on the contrary, it’s to create conditions [for it] to be possible to have DB in the future.”

The impact assessment study will run until 17 December 2012 and the subsequent report is expected to be released in spring 2013.

Comment

Companies should watch this space as the introduction of insurance solvency rules for pension schemes would bring about huge costs and certainly lead to the closure of more DB schemes.
Auto-enrolment: impact on Enhanced Protection and Fixed Protection

New legislation is now in force to get people saving for retirement into pension schemes by legally requiring employers to make minimum pension contributions for their employees. The new requirements are being introduced in stages from 1 October 2012 beginning with the largest employers.

One of the key conditions of maintaining Enhanced Protection or Fixed Protection is that neither the individual nor the employer makes any pension contribution to a new pension arrangement or a money purchase arrangement. If a pension contribution is made to one of these arrangements by the individual or on their behalf, protection will be lost exposing the individual to a tax charge when benefits are taken.

HM Revenue & Customs have written to those with Enhanced Protection with a warning that this valuable protection could be lost if they are auto-enrolled into a company pension scheme and do not opt-out within 30 days. Similarly anyone with Fixed Protection can lose this protection if they are auto-enrolled and do not opt-out within 30 days.

To retain Enhanced Protection or Fixed Protection, individuals should make sure that they opt out of auto-enrolment once their employer starts the auto-enrolment process.

As employers must automatically re-enrol opted out employees every three years, individuals will need to opt out within 30 days each time this happens.

Comment

Individuals with Enhanced or Fixed Protection against the Lifetime Allowance should speak to their employer about their plans for auto-enrolment and how to go about opting out when the time comes.

For further information about Barnett Waddingham’s retirement planning services for Executives, see our website - http://www.barnett-waddingham.co.uk/executive-pensions/
Company news

Costain Group plc, a leading engineering solutions provider has announced that it has shed approximately £35m of pension scheme liability for a one off accounting cost of £2.7m having completed a series of transfer value exercises (ETV) and pension increase exchange (PIE) offers. The company also made a £20m asset-backed contribution to the pension scheme which resulted in a £10.5m accounting profit.

The Daily Mail and General Trust (DMGT) has set up a £150m partnership using contingent assets as part of the recovery plan agreed with the Trustees of the Harmsworth Pension Scheme. The pension scheme will receive £10.8m a year in interest from a loan note until 2026.

Graham & Brown, a designer wallpaper manufacturer based in Blackburn, has agreed a buy-in for £15m of liabilities relating to current pensioners in a deal which will see it spread the premium to the Pension Insurance Corporation (PIC) over the next five years. 50% of the premium is paid up front and the rest paid in instalments.

The materials science firm Cookson has agreed the biggest bulk annuity transaction of the year so far by agreeing a £320m buy-in with PIC covering some 60% of scheme liabilities in relation to over 3,000 pensioners. The company also eliminated 10% of liabilities (£50m worth) in an ETV exercise. The combination of this has meant that the firm is now showing an accounting surplus of £46.2m to the end of June.
Impact of pensions on UK business

The increasing size and volatility of DB pension scheme deficits are well reported but how significant are they and what impact are they having on UK Business?

Building on the research Barnett Waddingham carried out last year we have considered this issue with input from the Centre for Global Finance at the University of the West of England.

The key findings from the research were:

• for 29 FTSE350 companies, it would take over one year to repay the DB scheme deficit using all cash generated from day-to-day operations.
• Over 49 companies in the FTSE350 have deficit contributions that exceed their free cashflow.
• DB deficit contributions represent on average 1.1% of total revenue for FTSE350 companies
• For 75 companies in the FTSE350, annual DB deficit contributions were higher than those being paid in respect of pension benefits being earned each year for current employees.
• Over the last three years, deficit contributions to DB schemes have consumed 4½ months’ worth of cash generated by FTSE350 companies’ core activities.
• 78 companies in the FTSE350 could have funded a buy-out of their pension scheme at the end of 2011 using their cash holdings. Of these, 24 companies could have done this using only the extra cash holdings built up over the course of the year.
• Schemes’ equity holdings reduced from 49% to 43% as a result of falling equity values relative to bonds as well as gradual de-risking as schemes mature. For 16 companies, though, their schemes’ equity holdings still exceed 50% of the market capitalisation of the company.
• For 80% of companies changes in real yields have been a greater source of volatility than changes in equity markets.

Comment

The research emphasises the continuing effect DB schemes are having on UK business and should be of interest to Directors as it allows companies with DB schemes to benchmark themselves against their peers.

To view the full report please visit the following link - http://bwllp.co.uk/o0

Bulk Annuity Report

The market for buy-outs and buy-ins continues to attract interest from schemes. We have completed a review of the market over the last 12 months looking at:

• How the market has been performing
• The pricing opportunities that are available
• The options that insurers are offering to attract business.

To read the full review, please visit the following link - http://bwllp.co.uk/oq

Take part in our ‘Auto-Enrolment Opt Out Survey’

Barnett Waddingham are conducting a survey of companies’ anticipated auto-enrolment opt out rate and the demographics of those who might opt out. In due course we will run the same survey to collect actual opt out rates and then compare the two results.

Please visit our website www.surveymonkey.com/s/Barnett-Waddingham-Opt-Out-Rates to take part in the survey.
Forthcoming Barnett Waddingham Events

January and February 2013

After the Party - What Happens Next? Predictions League 2013

31 January - The Reform Club, London
5 February - Brasserie Blanc, Bristol
6 February - Leeds Club, Leeds
7 February - The Glasshouse, Edinburgh
12 February - Midland Hotel, Manchester

Leaving the economy aside, 2012 has been a year of celebrations with the Jubilee festivities and the Olympic gold rush but what happens after the party? What is needed for some of this year’s success stories in the corporate and sporting world to continue and can you predict which ones will succeed in 2013?

Following the success of previous years’ events, Barnett Waddingham’s Corporate Consulting Team would be delighted if you could join them for an informal evening of light entertainment where you will have the opportunity to make a number of financial, corporate and sporting predictions for next year. To help you out, we will have a few expert speakers from the world of sport and finance who will briefly present their thoughts on the year ahead.

If you would like to register your interest to attend or have any questions at this time, please email us: bwevents@barnett-waddingham.co.uk.

February 2013

Executive Pensions

6 venues around the country

Barnett Waddingham’s Executive Pensions team will run pension planning seminars for high earners in February 2013.

For more information on our forthcoming events, please visit the events page on our website http://bwllp.co.uk/C or email seminars@barnett-waddingham.co.uk

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