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News on Pensions

SEPTEMBER 2015

TPR: monitoring the employer covenant

The Pensions Regulator (TPR) has published a new guidance for trustees of defined benefit (DB) schemes, on assessing and monitoring the employer covenant. The guide is the first in a series of factsheets helping trustees to apply the funding code of practice. Future editions will cover integrated risk management and investment strategy.

The guide is aimed at schemes undertaking a scheme funding valuation, but will also be helpful if there is, for example, a restructuring or a proposal to put a flexible apportionment arrangement in place.

The factsheet represents good practical guidance on how to assess and monitor a sponsoring employer's 'covenant' (i.e. their ability and willingness to financially support the scheme now and in the future). It includes examples designed to help trustees fulfil their obligations in this regard.

TPR's new guidance is accompanied by a series of supporting handouts, checklists and case studies which will give trustees further steer in certain circumstances, for example:

- in one standalone document, TPR has summarised the 10 key points made in the covenant guidance.
- TPR are not insisting that all schemes will need to carry out in-depth reviews of the employer covenant; a separate handout sets out the circumstances in which TPR considers it would be proportionate for trustees to carry out a less detailed review. For example, the trustees of a well-funded scheme where the sponsoring employer is profitable and generates a lot of free cashflow might decide not to incur the expense of an in-depth assessment.
- a one-page checklist can help trustees to decide whether to appoint a professional adviser, or to review the employer covenant themselves. TPR has also prepared a checklist for appointing an external assessor.
- a further TPR factsheet can help trustees to formulate an approach to ongoing monitoring of the covenant.

DC schemes: short-service refunds

From 1 October 2015, changes to short service refunds for defined contribution (DC) schemes came into effect. The changes are intended to help members build up pension pots, and bring the timescales for refunds more in line with the timescales for opting out of auto-enrolment.

Refund period reducing from 2 years to 30 days

Members joining a scheme after 1 October 2015 will only be able to take a refund of their contributions if their qualifying service is less than 30 days (rather than two years at present) if they are accruing DC benefits alone.

Members paying DC AVCs within, and alongside, accrual in a DB scheme will not be affected. Members of a DC scheme where benefits are subject to a DB underpin will also not be affected. However, members of a DC section in a hybrid scheme will be.

Individuals who joined a DC scheme before 1 October 2015 will continue to be subject to the previous two year timescale. Members joining from after this date, and leaving employment before retirement with more than 30 days' service, will be entitled to short service benefit - i.e. a preserved DC benefit within the scheme and a statutory right to a transfer value.

Actions for trustees

If a refund is paid outside of the 30 day period, this would now be an unauthorised payment and could incur tax charges. However the legislation will not automatically override schemes' rules and so trustees of DC schemes should check whether a rule amendment may be needed to avoid making unauthorised payments.

Affected members should be advised within three months of the change, i.e. before 1 January 2016. In practice, this requirement should be met by amending member communications such as new joiner / leaver information to reflect the changes. Trustees should also update their scheme's member booklet.

PPF: update

Funding strategy update

The Pensions Protection Fund (PPF) has published its Funding Strategy Update, which sets out its progress toward its funding target and how the risks the PPF faces can influence this progress in future. Alongside the risk of claim, the PPF notes it also faces significant longevity risk, risk of material financial loss and a mismatching risk due to the lack of suitable investment options.

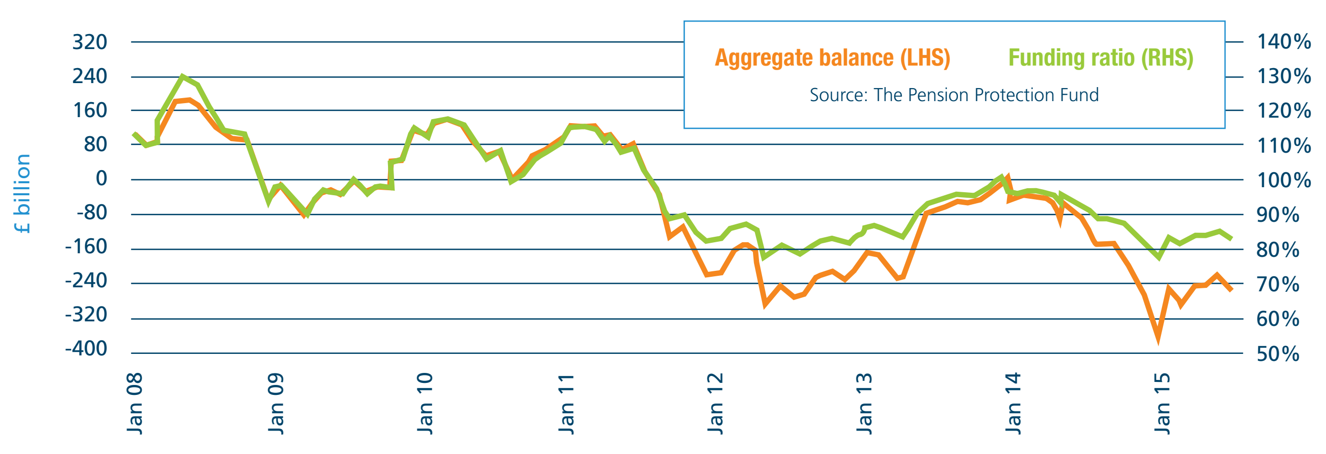
To address the particular risk that it will have insufficient assets to meet its liabilities, the PPF has several options at its disposal, including alterations to its investment strategy, restrictions on compensation increases and a reduction in the compensation offered. However, the PPF makes it clear that it would only consider these actions in exceptional circumstances.

The PPF 7800 Index (see below) is highlighted as one tool used to monitor underfunding risk. The PPF has also developed a new stress scenario to model the impact of several simultaneous insolvency events leading to large unexpected claims.

PPF 7800 Index

The latest update of the PPF's 7800 Index of schemes' funding (on the s179 basis) has been published showing a decrease in the s179 funding ratio from 84.8% to 83.2% between June and July 2015.

ESTIMATED AGGREGATED BALANCE (ASSETS LESS S179 LIABILITIES) AND FUNDING RATIO OF SCHEMES IN THE PPF UNIVERSE



The aggregate deficit of the 6,057 schemes in the PPF 7800 index is estimated to have increased over the month to £254.2 billion at the end of July 2015, from a deficit of £223.1 billion at the end of June 2015. There were 4,891 schemes in deficit and 1,166 schemes in surplus.

Other news

HM Treasury: exit charges and barriers to flexibilities

HM Treasury has launched a consultation and survey which both look at exit charges and other barriers to members accessing pensions flexibilities and whether these can be cut, capped or removed altogether. The stated aim of the consultation is to ensure that everyone has "the opportunity to transfer their pension at a reasonable cost and within a reasonable timeframe".

One particular issue under investigation is early exit charges, which can be "unjustifiable" and prohibit members from accessing the new DC freedoms. Depending on the evidence gathered during the consultation, the government may consider imposing a cap on exit charges for members aged 55 and over.

A second focus is the transfer process; some schemes that cannot offer flexible access make it necessary to transfer out of the scheme to a provider or scheme that does. The consultation looks at how this process could be made more efficient and cost-effective for the member, explores some of the concerns relating to the need for financial advice, and hopes to make the circumstances in which someone should seek financial advice clearer.

TPR: charge caps and governance (DC schemes)

TPR has issued a reminder to trustees to ensure their DC schemes are on track to meet charge capping and governance requirements introduced last April.

The new responsibilities include meeting new governance standards and justifying this within the annual chair's statement, having an appointed chair that signs the annual statement, and ensuring compliance with the new charge controls relating to schemes used as "qualifying schemes" for auto-enrolment.

TPR explicitly states that producing the chair's statement should be "a priority" for all DC schemes and that previous processes used to produce voluntary governance statements may be helpful in meeting this new requirement.

The new regulations also limit charges and specify how they may be structured. For example, even if your charges are below the limit, you may still be in breach of the law if the charging structure in use is not allowed by legislation. In this case, you may be subject to fines from TPR.

TPR: auto-enrolment spreadsheet

TPR has issued its response to its earlier consultation on proposals to develop a basic tool for automatic enrolment for small and micro employers. TPR will proceed with developing software to support employers who use HMRC's basic PAYE tools to comply with their auto-enrolment duties. The downloadable spreadsheet, which is expected to be ready by the end of 2015, will help employers assess workers and calculate contributions.

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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