Barnett Waddingham
a **true partnership** approach

Current Pensions Issues

SUMMER 2014

Stop Press! No ban on DB to DC transfers!

HM Treasury has issued a response to its consultation on 'Freedom and Choice in Pensions', which was announced by the Chancellor of the Exchequer in his 2014 Budget as 'the most far-reaching reform to the taxation of pensions since the regime was introduced in 1921'.

In the response the government confirms that it will press ahead with plans to allow members of defined contribution (DC) pension schemes full flexibility in accessing pension savings. In addition there will be no ban on transfers from private sector occupational defined benefit (DB) schemes to DC schemes. Turn to page 3 for more details.

TPR's New Code of Practice

Following a consultation issued in December last year (see Current Pensions Issues: Winter 2014), The Pensions Regulator (TPR) has issued the final version of its revised Code of Practice No. 3 on Funding Defined Benefits. TPR has also published a short 'essential guide' to help trustees navigate through the code.

As a result of the consultation, TPR made a number of changes to the Code. In particular, TPR recognised that different approaches to risk management may be appropriate for different pension schemes and that trustees are not required to analyse every conceivable risk. TPR has also updated its phraseology – in particular the Code now refers to 'managing' risks, rather than 'mitigating' them, recognising that schemes may choose to take controlled, well-understood risks if this is believed to be of benefit to members.

The Code explicitly notes TPR's view that schemes can take a proportionate approach to assessing employer covenant.

TPR has reviewed the emphasis on affordability of employer contributions. The Code now requires trustees to consider the 'risks to the scheme and the impact on the employer' when assessing the appropriateness of a recovery plan rather than requiring deficits to be paid 'as quickly as reasonably affordable'.

TPR has clarified that trustees are only expected to scrutinise the employer's business decisions where they could impact materially on the scheme's funding position or the employer covenant. Where employers are asking to pay lower contributions to the scheme in order to invest in the business, trustees should assess the nature of the company's plans and the likely impact on the overall covenant.

The new Code was laid before Parliament and came into force on 29 July. TPR expects trustees with valuations in progress to take the new Code into account 'as far as it is reasonable given where they are in their valuation cycle'.

Annual funding statement

Alongside the Code, TPR has published its 2014 annual funding statement. The statement is intended as guidance for schemes with a valuation date between 22 September 2013 and 21 September 2014. The statement anticipates that current low bond yields will persist, and encourages trustees to plan for a longer period of low yields than previously expected.

Regulatory framework

TPR has also published two documents dealing with how it will regulate defined benefit pension schemes - the defined benefit regulatory strategy and the funding regulatory and enforcement policy. The funding regulatory and enforcement policy sets out high-level details of a new 'funding risk indicator' that will be used as part of a range of risk indicators to identify schemes TPR may choose to engage with.

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Statistics

TPR has published its latest annual funding statistics for UK defined benefit and hybrid schemes. The research is based on valuations submitted by 'Tranche 7' schemes (schemes with effective valuation dates falling between 22 September 2011 and 21 September 2012).

TPR has compared these with valuations submitted in Tranche 4 (broadly the same schemes, three years earlier).

The headline result is that Tranche 7 schemes had an average funding level of 81%, compared with 74% for Tranche 4 schemes.

Barnett Waddingham's Valuation Results Modeller

Barnett Waddingham's new online funding modeller illuminate has been developed to coincide with the new Code of Practice on funding. The modeller will help trustees through the valuation process by showing how their scheme funding deficit changes depending on the level of prudence adopted; how the recovery plan to pay off the deficit varies depending on affordability for the sponsor; and factoring in the impact on funding of different investment strategies.

This powerful tool, which is available for clients to access online, provides trustees with a straightforward and cost-effective way of understanding the interaction between funding, covenant and investment strategy. In this way, trustees can comply with the new Code, and gain a much better understanding the dynamics of their scheme.

Scheme sponsors and their advisers can also access illuminate to assist in negotiations over funding strategy, meaning different scenarios can be considered around the negotiating table. This can bring significant savings, reducing advisers' fees and reducing the amount of time needed to agree the actuarial valuation results. For further information, please speak to your usual Barnett Waddingham consultant, or see www.barnett-waddingham.co.uk/illuminate.

PPF Levies: 2015/16 - 2017/18

The Pension Protection Fund (PPF) has published a consultation setting out its plans for the next three levy years, including plans for the use of a new insolvency risk model.

This consultation confirms the PPF's intention to use a bespoke insolvency risk model in the calculation of PPF levies from 2015/16, replacing the Dun & Bradstreet (D&B) model that has been used since the inception of the PPF. The bespoke insolvency risk model, known as the PPF-specific model (PPFSM), has been developed in partnership with Experian, the credit rating agency now used by the PPF in place of D&B.

The PPF is also proposing to make a number of other important changes to the levy framework.

Proposed new insolvency risk model

There are a handful of key differences between the PPFSM and the outgoing D&B model, in particular:

- The PPFSM, unlike the D&B model, is based solely on companies that sponsor PPF-eligible pension schemes.
- The PPFSM places a much greater emphasis on financial indicators, such as scale of operations and profitability, whereas the D&B model used many more non-financial metrics. Some companies may see significant changes in the PPF's assessment of their insolvency risk as a result, with a corresponding impact on their levy.
- The PPFSM will incorporate a significant weighting (where applicable) to the strength of the parent company's corporate group.

The PPF is also consulting on whether transitional protections should apply to those most affected by the change in model.

The consultation includes an impact analysis of adopting the new model, based on research carried out for the PPF by Barnett Waddingham. Our research showed that insolvency risk ratings under the PPFSM are expected to be more stable than under the D&B model. However, ratings are sensitive to a small number of metrics and may still be volatile, particularly where new accounts are submitted.

Other proposals

In the consultation, the PPF has also announced proposals for a number of changes to the way levies are calculated for schemes who use Type A contingent assets and Asset Backed Contributions (ABCs) in their funding approach.

DC Pensions - 2014 Budget update

A surprise announcement during the Chancellor of the Exchequer's 2014 Budget speech (see Current Pensions Issues - Spring 2014) that 'no one will have to buy an annuity' has set the wheels in motion for significant changes to the DC pensions landscape. Since Budget Day:

- The government has announced that people will now have 18 months (instead of six) to choose how to use the remainder of their DC pension funds once they have drawn their 'tax-free' lump sum.
- Some insurers have developed one-year fixed annuities, which allow people to access retirement funds now whilst retaining the ability to benefit from the new rules from April 2015.
- HM Revenue and Customs (HMRC) has published guidance for those people who, in light of the Budget announcements, cancelled an annuity purchase within the provider's cooling-off period. Further guidance aimed at those who have drawn a lump sum but are yet to decide what to do with the rest of their pension savings is also available on their website.
- The Financial Conduct Authority (FCA) has published new guidance, with the aim of encouraging pension providers to inform customers of the Budget changes.

The Treasury has issued a response to its consultation on 'Freedom and Choice in Pensions', in which the government confirms that it is to continue with plans to allow members of DC schemes full flexibility in accessing their pension savings from next April.

In the consultation response, the Treasury also confirmed that:

- Members of private sector DB schemes will retain the right to transfer to a DC arrangement before retirement. Transferring members will be required to take independent financial advice before they transfer, which they will largely be expected to pay for themselves. The government will produce updated guidance for pension scheme trustees on the use of existing powers to delay transfer payments, and on taking account of scheme funding levels when setting transfer values.
- A 'permissive' statutory override will be introduced so that where they wish to, DC schemes are able to offer the new flexibilities to members without the trustees having to amend scheme rules.
- Guaranteed guidance for members retiring from DC schemes will be provided free of charge by independent organisations, rather than pension schemes themselves or pension providers. Trustees will be required to 'signpost' members to the guidance service as they approach retirement. The guidance will be funded by a levy on regulated financial services firms and will be policed by the FCA, who are consulting on proposed standards.
- The government will consult in due course on whether to allow members to make full or partial withdrawals directly from DB schemes, rather than first requiring the individuals to transfer to a DC scheme.
- The statutory minimum pension age will increase from 55 to 57 in 2028 and will remain 10 years below the State Pension Age thereafter.
- Draft legislation is expected in the autumn, which will set out the finer details and will include anti-abuse rules.

DWP: Contracting-out


Abolition of contracting out – consultation on a statutory override for Protected Persons Regulations

DWP

The DWP has published a consultation and draft regulations on the 'employer override' power relating to the abolition of contracting-out for DB schemes in April 2016.

The regulations set out the steps to be taken where employers wish to utilise clauses in the Pensions Act 2014 to amend future benefits or contributions to reflect the increased costs of contracting back in, without having to obtain trustee consent.

Actuarial certification will be required that the increase in employee contributions and/or the value of any reduction in accruing benefits is not more than the annual increase in employer NICs (ie the 'lost' rebate of 3.4% of earnings between the Lower Earnings Limit and Upper Accrual Point).

In carrying out this test the actuary is required to use a method and assumptions consistent with calculations for the latest Scheme Funding valuation. However, if instructed to do so by the employer, the actuary can use a 'neutral' basis, consistent with the approach for calculating Cash Equivalent Transfer Values.

The draft regulations also note that the Principal Employer appoints the certifying actuary although, with trustee approval, the Scheme Actuary may perform this role.

Defining 'Money Purchase'

DWP consultation and TPR statement

The DWP has published a response to its earlier consultation on implementing a new definition of money purchase benefits (see Current Pensions Issues – Winter 2014).

The new statutory definition of money purchase came into effect on 24 July 2014. As well as a number of technical changes, the DWP has extended transitional protections for schemes that had previously treated benefits as money purchase that will, henceforth, be classed as non-money purchase. In particular, most decisions made between 1 January 1997 and the date the regulations came in to force, on the assumption that such benefits were money purchase, would be considered valid. The DWP had previously proposed that only decisions up to 28 July 2011 (the date of the DWP's statement on its intention to legislate) would not need to be revisited.

The DWP does not envisage historic debt on employer calculations being revisited in this regard, although trustees may need to review their funding approach where their scheme includes affected benefits.

Following the consultation, the DWP has also extended the scope of transitional protections to cover money purchase benefits with DB underpins, top-up benefits, Protected Rights and Additional Voluntary Contributions (AVCs).

Meanwhile, TPR has issued a statement setting out the actions that trustees of affected schemes should now be taking. In particular, TPR recommends that legal advice is sought and, if the scheme is affected by the new definition, trustees are expected to notify TPR immediately.

Out of cycle 'section 179' valuations

Following a consultation, the PPF has confirmed it will call for 'out of cycle' 'section 179' (s179) valuations for schemes which are no longer treated as Money Purchase under the new regulations. The PPF uses s179 valuations to set schemes' annual levies.

As a result of changes to the definition, certain schemes' benefits are expected to become eligible for PPF protection - the regulations give the PPF an explicit power to instruct trustees to commission valuations to include benefits that were formerly classed as money purchase.

In particular, schemes that have not previously been covered for PPF protection must submit their first s179 valuation by 31 March 2015. The PPF will use a discretionary power to call for out of cycle s179 valuations for schemes where additional benefits become eligible for PPF protection and the impact of the new definition is 'material'.

The PPF has updated its valuation guidance, and will shortly be writing to relevant schemes to explain the changes.

Upcoming events

Trustee training courses

All pension scheme trustees are legally required to have a minimum standard of knowledge and understanding.

With the pensions world constantly changing, good training is essential. Our one-day trustee training courses are aimed at both new trustees and those seeking a reminder of the basics of trusteeship. During 2014, courses will be run in the following locations. Due to popular demand, we are running an additional training day in London:

- Leeds – Thursday 18 September
- ****NEW**** London – Wednesday 19 November
- Bromsgrove – Wednesday 26 November

The health and wealth of your workforce

Does your Wellbeing plan merely help people when it is too late?

How about generating a Wellbeing strategy that creates a happy, healthy workforce whilst cutting down days lost due to absence and therefore curtailing spiralling benefit provision costs?

Our seminar will include answers to the above, along with industry insights and views from our speakers. In addition, we will have a short update from our Executive Pensions team, focussing on the changes from 6 April 2014 when the reduced Lifetime and Annual Allowances came into force.

- Amersham – Tuesday 30 September
- Liverpool – Thursday 2 October
- Leeds – Tuesday 7 October
- Cheltenham – Wednesday 8 October

For further information on our upcoming events please visit our website.

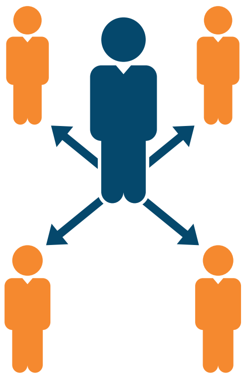
Annual pensions conference 2014

Our annual pensions conference, now in its fifth year, will be held on Wednesday 26 November 2014 in London. The conference is free to attend and will include a keynote speech from Sir John Gieve, KCB.

Full details will be released later in the year.

Auto-enrolment section 89 report

TPR has published its first automatic enrolment section 89 report, which sets out the problems experienced by Dunelm Soft Furnishing Ltd in achieving compliance with its auto-enrolment duties. TPR is encouraging any employer who is experiencing challenges in meeting their automatic enrolment duties to contact them.



DB pension costs

TPR has released its pension costs research and a comparison tool for DB schemes. The tool gives a breakdown of costs based on membership size band and shows that costs per member are almost four times higher in small schemes than in large schemes. TPR's research covers investment, administration and actuarial fees as well as other costs such as fees for legal services, independent trustees and covenant services.

Record-keeping review

TPR has published the results of its review of scheme record-keeping and, as a result, opened seven cases for investigation. TPR will be monitoring progress, particularly in relation to conditional data, as part of its annual survey of record-keeping and has made it clear that trustees should not view data cleansing as a one-off exercise.

Equitable Life update

The Board of The Equitable Life Assurance Society (ELAS) has announced that, with effect from 1 April 2014, distribution of capital to policyholders who exit the with-profits fund will increase. The 25% enhancement to transferring funds could make a transfer more attractive than remaining in the ELAS with-profits fund, although policyholders should take appropriate advice before transferring.

Defined Ambition Bill

An earlier consultation by the DWP has shown public support for the introduction of 'defined ambition' pension schemes. The government has therefore presented a Pension Schemes Bill to Parliament that will allow the creation of risk-sharing defined contribution schemes and collective defined contribution schemes.

The DWP has decided not to pursue flexible defined benefit schemes, because there was little interest in allowing changes to existing DB pension plans without allowing the company to amend benefits already earned, which the government dismissed.

Scheme governance survey

TPR has published its 8th annual governance survey, which includes new information on action taken by schemes to tackle pension liberation fraud and automatic enrolment results.

Marriage (Same Sex Couples) Act 2013

The Marriage (Same Sex Couples) Act 2013 came into force on 13 March 2014, with the first marriages between same sex couples taking place from 29 March 2014. This has implications for the survivor benefits granted to spouses or partners in pension schemes. Trustees may have to take legal advice to determine how their scheme will be affected.

High Court: IBM

The High Court has ruled that in amending the benefits under its two UK pension schemes in 2009 (under 'Project Waltz'), IBM breached its duty to members. This was due to both the way in which it consulted with members over the changes, and the mismanagement of members' expectations.

Members argued that they were led to believe the schemes would remain open to future accrual following initial changes made in 2006.

The judgement highlights the need for employers to take care when making changes to DB pension schemes.

Court of Appeal: Honda

The Court of Appeal has upheld the decision made by the High Court that members of the Honda UK Pension Scheme are entitled to a higher level of pension benefits than originally thought, due to the way a Deed of Adherence was worded. It is estimated that the scheme's liabilities have increased by up to £70m on the ongoing funding basis.

High Court: Gleeds

Because sponsor signatures were not witnessed, the High Court has ruled that the deeds of amendment making changes to the Gleeds Retirement Benefits Scheme since 1990 were not valid. It is estimated that the ruling could increase the scheme's liabilities by around £45m. In addition, some employees who were thought to be members of the scheme had, in fact, never officially joined.

About Barnett Waddingham – Our Services

Barnett Waddingham provides professional services spanning pensions, life and general insurance.
Our services include:

- Scheme Actuary and associated services to the trustees and employers associated with defined benefit pension schemes.
- Advice in relation to defined contribution schemes.
- Pension accounting for UK and international companies.
- Administration and management services including pensioner payroll, preparation of annual accounts and secretarial services.
- Investment strategy reviews and advice on scheme evolution 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 benefits.
- Advice to individuals and employers on pension provision for executives, including pre-hire, advice upon early termination and tax efficiency in the lead up to retirement.
- Analysis and modelling of mortality and longevity risk for insurance companies, reinsurance companies, investment banks and pension schemes.

Barnett Waddingham is also a leader in the provision of self-invested personal pensions (SIPPs), small self-administered pension schemes (SSASs), specialist executive pension plans (EPPs) and other retirement arrangements.

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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