

Pension Scheme Troubleshooting – A Sponsor's Guide

For many sponsoring employers, a defined benefit pension scheme can represent a large, volatile expense and business risk, which is important to manage.

Employers have a number of options available to control costs. Many may sound familiar and may even have been considered in the past, but the pensions environment is constantly changing and new opportunities have arisen in the last few years. Employers are well advised to consider their options and understand the potential benefits available.

Barnett Waddingham offers a high-level, “big picture”, troubleshooting analysis that considers a full range of pension scheme options for further, more in-depth consideration if required, including the following areas:

Buy-out or buy-in

Many employers would like to remove the risk inherent in their pension schemes by securing the benefits with an insurance company (a “buy-out” or “buy-in”). The cost of securing benefits in this way has reduced in recent years and some schemes have recently been able to reduce risk at a lower cost than the funding reserve. Working with Barnett Waddingham grants access to our exclusive small to medium sized scheme buy-out arrangement that can provide an indicative quotation within a matter of days, providing the employer with a quick, low cost viability assessment. Quotes can also be updated on a regular basis to monitor affordability and enable the scheme to identify any favourable opportunities and act accordingly.

A partial buy-in, eg securing the pensioner liabilities, can be an attractive option even for schemes in deficit and can often be transacted without affecting the scheme's long-term investment strategy.

Investment strategy

Maintaining an appropriate investment strategy through changing economic conditions is vital. Although the pension scheme trustees have the ultimate responsibility for determining the investment strategy, they are required to consult with the employer. The trustees will often look to the employer for guidance on an appropriate strategy as the investment strategy ultimately impacts on the employer.

It is vital for employers to understand the options available and the impact of different investment strategies on future costs, as well as the associated risks, but this is an area that is often overlooked.

Reducing your Pension Protection Fund (“PPF”) levy

The PPF levy has been described as a “tax on pension schemes” and is often very unpopular with trustees and sponsoring employers alike, who see the levy as dead money that could be better used to improve the scheme's funding position. Barnett Waddingham has built up considerable expertise on the factors determining the levy and has helped many schemes reduce their levies by thousands of pounds, often by making some very simple changes to the information used by the PPF.

Benefit review

Many pension schemes have historically granted discretionary benefits to their members and this may have become unquestioned practice. With the current pressures on scheme funding, it is important to review these benefits and options, such as early retirement and pension increases, to ensure schemes are not granting generous discretionary benefits at a time when affordability is an issue.

It is also important to review the overall benefit structure from time to time. As pensions have become more expensive to provide, employers have been reviewing pension provision and reducing benefits and/or increasing member contributions, while some have introduced more innovative structures that reduce risk whilst containing the impact on employees. Barnett Waddingham is well placed to review your scheme's benefit structure and benchmark it against other pension schemes.

Accounting assumptions

Pension schemes can have a significant impact on company accounts and managing volatility of the reported cost may be important. The assumptions used are crucial in determining the pension disclosures and Barnett Waddingham provides commercial and practical advice on appropriate assumptions. Our interactive accounting modeller can be used by employers to understand the sensitivity of results to changes in the assumptions and also to project future years' disclosures under different scenarios.

Risk and cost reduction exercises

Although members' accrued benefits are generally sacrosanct, it may be possible to amend them with consent. For example, employers may wish to consider offering pensioners higher current pensions in exchange for future pension increases. This can reduce future inflation and longevity risks and, depending on the terms of the exchange, may also reduce funding requirements whilst appealing to members.

Deferred members are entitled to transfer their benefits out of the Scheme. Incentivising members by, for example, to transfer an uplift to the transfer value or a direct cash payment, can produce savings for a Scheme and be attractive to at least some members.

Another method of reducing costs is "salary sacrifice". This can be applied to defined benefit and/or defined contribution arrangements and acts to reduce employer and employee National Insurance contributions without affecting the overall level of employee benefits. HM Revenue and Customs are generally comfortable with this and have recently issued communications on how an effective salary sacrifice arrangement should operate. These arrangements are becoming increasingly popular in light of recent and proposed increases to National Insurance contributions.

Other cost saving options may also be available. The feasibility of these exercises can change over time so they may be worth reviewing even if they have been previously considered.

Tackling overly prudent valuation assumptions

With increasing life expectancies, uncertain investment returns and pressure from the Pensions Regulator for trustees to be more prudent, each actuarial valuation can seem to show a worse funding position, despite contributions having been made to reduce the deficit. It is important that employers do not simply accept the trustees' proposed assumptions without understanding the rationale and the margins of prudence used and challenging anything they consider excessive or inappropriate. Even small changes in the valuation assumptions can have a big impact on the funding position and contribution requirements.

Often employers can benefit from being proactive in the valuation process on matters such as the strength of their covenant. Barnett Waddingham is experienced in advising employers on the relevant issues, helping them understand their options, guiding them throughout the valuation process and supporting them in negotiations with the trustees and their advisers.

Reviewing advisers' fees

Paying excessive fees to advisers only adds to the costs of running a pension scheme. Based on our experience of the pensions market we are able to comment on whether schemes appear to be paying a fair price for the services received, by benchmarking them against comparators.

We can cover the above and several other issues quickly and cheaply and only require limited documentation (the latest actuarial valuation report, scheme accounts and company accounts are usually sufficient).

For further information

If you would like us to carry out a troubleshooting analysis of your pension scheme or would like to find out more about any of the options described above please contact your usual Barnett Waddingham consultant.

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