

Guide: Talking to your employees

TPR and the Financial Services Authority (FSA) have published a joint leaflet for employers designed to encourage better interaction with their employees in relation to defined contribution (DC) pension schemes. The Regulator has said the leaflet will also be relevant to employers with defined benefit schemes.

The leaflet – “Guide for employers: talking to your employees about pensions” – sets out possible answers to pensions-related questions that scheme members may ask the employer, along with useful sources of information. For more details see www.tpr.gov.uk.

Publication of the leaflet follows TPR’s statement promoting higher standards of DC pension provision.

Section 75 Debts

The Department for Work and Pensions (DWP) has issued a consultation paper setting out draft amendments to employer debt regulations. This follows an informal consultation in November 2008.

The DWP has proposed that selected corporate restructurings will no longer trigger a section 75 debt in a multi employer scheme, as they will not be considered an “Employment Cessation Event”. It is estimated that up to 50% of corporate restructures could be helped by these proposals.

Minimum Retirement Age

In April 2010, the minimum age at which a registered pension scheme can pay authorised pension benefits (other than in cases of ill-health) is rising from 50 to 55. The legislation will be overriding so scheme rules may not necessarily need to be amended. Schemes may still choose to incorporate the increase ahead of April 2010 and to inform affected members of the impending change.

Trivial Commutation

On 1 December 2009, the rules relating to the commutation of trivial pensions changed. Schemes are now able to make trivial commutation payments of up to £2,000 to a member without needing to consider their other pension arrangements.

The DWP has subsequently admitted to a drafting error in the new legislation. The error means that Guaranteed Minimum Pensions (GMPs) cannot be commuted as part of these de minimis payments until the error is corrected in April 2010.

ASB: Risk-free Discounting

In November, the UK Accounting Standards Board (ASB) issued a report to its international counterpart (the IASB) recommending that pension scheme liabilities should be discounted at the “risk-free rate” in company accounts, rather than using rates based on corporate bond yields.

The IASB has been planning a fundamental review of accounting standard IAS 19 but a timetable has not yet been set out. If adopted, the ASB’s proposal could lead to a significant increase in pension liabilities disclosed in company accounts.

Equitable Life – Update

The High Court has upheld many of the Government’s rejections of the Parliamentary Ombudsman’s recommendations of compensation for former Equitable Life members.

However, the court said the Government’s response “lacked cogency” and “fell short of the statutory requirement”. The court supported the Ombudsman’s recommendation that compensation should cover losses since 1991 and not 1999 as the Government originally proposed.

PPF: GMP Equalisation

The Board of the PPF has “approved” a PPF-specific solution to address the differences in GMP entitlements between men and women. Further details are expected over the coming months as the PPF considers the exact calculation requirements. In the meantime, the PPF is keen that this issue should not prevent schemes near the end of their assessment period from completing the process.

This bulletin is a summary of some recent developments and not a comprehensive description. Although we try to ensure its accuracy, Barnett Waddingham LLP accepts no liability for any errors or omissions it may contain. Readers should take professional advice in relation to their own circumstances and/or refer to the original source material as appropriate. Barnett Waddingham LLP holds your contact details for its own communication purposes only. We do not disclose these details to third parties. If you would prefer us not to use this information for any purpose other than letting you receive this newsletter, or if you no longer wish to receive newsletters from us, please let us know.

Chalfont Court
Hill Avenue
Amersham HP6 5BB
Tel: 01494 788100
Fax: 01494 788800

Rigby Hall, Rigby Lane
Bromsgrove B60 2EW
Tel: 01527 559111
Fax: 01527 559222

St James’s House
St James’s Square
Cheltenham GL50 3PR
Tel: 01242 538500
Fax: 01242 538501

163 West George Street
Glasgow G2 2JJ
Tel: 0141 243 4400
Fax: 0141 243 4432

West Riding House
67 Albion Street
Leeds LS1 5AA
Tel: 0113 394 3700
Fax: 0113 394 3760

Port of Liverpool Building
Pier Head
Liverpool L3 1BW
Tel: 0151 235 6600
Fax: 0151 235 6640

Cheapside House
138 Cheapside
London EC2V 6BW
Tel: 020 7776 2200
Fax: 020 7776 3800

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Existence of PPF “not a relevant factor” for trustee decisions

In the case of *Independent Trustee Services Limited v Hope and Others*, involving the Ilford Pension Scheme, the High Court determined that, although trustees do not owe a duty to the Pension Protection Fund (PPF), they should not attempt to “game” it. Although the ruling relates to specific circumstances, it sets a principle that trustees should exercise caution when making any decisions that might have been different had it not been for the existence of the PPF.

Ilford Limited went into administrative receivership in August 2004 – before the creation of the PPF. The Scheme had a significant funding deficit and a “qualifying insolvency event” (in this case, liquidation) was needed to trigger a PPF assessment period and ultimately lead to the members receiving compensation.

A group of senior managers had previously drawn unreduced early retirement benefits from the Scheme. As these members had not yet reached Normal Retirement Age, their benefits would have been cut back – in some cases by more than half – had the Scheme entered the PPF, with the value of their foregone benefits being allocated to other members of the Scheme. The Trustee proposed using a power under the Rules to buy out the senior managers’ benefits in full with an insurance company before triggering PPF assessment. This would have avoided their benefits being reduced to PPF compensation levels and left the PPF to bridge a larger gap for the remaining members.

The Scheme’s Trustee asked the High Court to rule whether it could properly purchase these annuity policies.

If lawful and successfully implemented the arrangement would have resulted in a better outcome for these beneficiaries, with a higher cost ultimately falling on the PPF. The PPF and the Pensions Regulator (tPR) argued that the financial impact of the proposal on the PPF would be “very serious indeed” and lead to other schemes “gaming” the PPF.

The Judge believed that the proposal constituted an “improper use” of the Scheme’s rule giving the Trustee discretion to buy out members’ benefits. Using a disproportionately large share of assets in this way would not be justified if the PPF did not exist and would prejudice the position of other Scheme members generally. This would not be in line with the Trustee’s responsibility to treat all members fairly.

The Judge also considered that the PPF was set up by Parliament to be a “funder of last resort” and the compensation provided should not be viewed as an asset of the pension scheme. He did note, however, that there is “no single all-purpose answer” to the question of when it might be appropriate to take the existence of the PPF into account, stating that it would depend “on the context and purpose” of the power being used and the “particular way in which [trustees] wish to take the PPF into account”.

It remains to be seen where the courts will draw the line between valid trustee decisions and “playing the system”. Trustees should consider (probably with their legal advisers) whether any decision they take would be different if the PPF did not exist, and document their decision-making process.

PPF Levies: 2010/11

The Pension Protection Fund (PPF) has published its final determination for calculating levies for 2010/11, payable in late 2010. In total, the PPF aims to collect £720m for the 2010/11 levy year. In addition:

- Schemes’ “underfunding risks” and employers’ “insolvency risks” will be measured as at 31 March 2009.
- Risk-based levies will be capped at 0.5% (previously 1%) of a scheme’s total PPF (“section 179”) liabilities. It is estimated that this reduction will help around 10% of schemes, with the remaining 90% of schemes picking up the bill.
- The maximum employer insolvency risk used in the risk-based levy calculation will be capped at 3% (15% for 2009/10). This, along with the previous point, will increase the burden of the levy on better-funded schemes and those with stronger sponsoring employers.
- The “Levy scaling factor”, used to ensure that the target levy amount is met, is 1.64 (2.22 for 2009/10), reflecting the decline in average scheme funding levels seen during 2008/09.

Other changes, such as the way foreign employers’ insolvency probabilities are calculated and amendments to the contingent assets regime, are set out in the determination. For further information, including 2010/11 levy deadlines and practical advice on how schemes can manage their levy, please visit our Levy Forum website at www.thelevyforum.co.uk.

Pre-Budget Report '09



Originally announced in April's Budget 2009, tax relief on "pension input" (contributions to defined contribution arrangements and the value of additional accrual in a defined benefit arrangement) is to be restricted from April 2011 to the basic rate of income tax (currently 20%) for individuals earning above £180,000 in a tax year. The restriction will be tapered for individuals with annual earnings of between £150,000 and £180,000. The restriction on tax relief will apply to all pension input whether paid for by a member or their employer.

In his Pre-Budget Report, the Chancellor of the Exchequer announced that the restriction on tax relief will apply to all individuals with **gross incomes** of £150,000 pa and over, where gross income includes the value of pension benefits funded (or eventually funded) by their employer. The government has launched a consultation on the valuation of pension benefits in a defined benefit scheme for these purposes.

Affected individuals will suffer a recovery charge which will be processed via the self-assessment system.

A "floor" is to be introduced so that individuals whose pre-tax income (including individual, but not employer pension input) is below £130,000 pa will not need to establish the value of pension benefits funded by their employer. Individuals earning below £130,000 pa will not, therefore, be affected by the changes.

With effect from 9 December 2009, the transitional arrangements applicable for the current tax year and next year (2010/11) apply a "Special Annual Allowance" charge for individuals:

- whose income is £130,000 pa and over
- who change their "normal ongoing regular pension savings", and
- whose total pension input in a tax year exceeds £20,000 (or, if contributions are less frequent than quarterly, the lower of £30,000 and average contributions over the past three years).

The Special Annual Allowance charge for 2009/10 is 20%. For 2010/11 the charge will be determined on an individual basis.

Other measures announced in the Pre-Budget Report include:

- The Basic State Pension is to rise by 2.5% in April 2010.
- The new Personal Accounts Scheme is to be phased-in. Full implementation of the scheme is now expected by October 2017. Further details are provided to the right.
- State contributions to public sector pension schemes will be capped. The cost will be passed to public sector workers, with those earning above £100,000 pa paying more.
- Employee, Employer and Self-Employed rates of National Insurance Contributions (NIC) are to rise by an additional 0.5% from 2011/12. This is on top of the 0.5% increase announced in 2008.

PPF Levies: 2011/12 & beyond

The PPF has set out proposals that they hope will mean future levies (from 2011/12) will more accurately reflect the risk posed by sponsoring employers. The proposed changes include:

- A new insolvency probability table, which would impose more of the levy collection burden on schemes with strong employers.
- Capping of a subsidiary's failure score at that of its parent company where this is less than 10.
- Revision of the treatment of PPF contingent assets, geographical factors and industry factors.
- Collection of information on non-commercial sponsors from other sources (e.g. the Charity Commission).

Personal Accounts: "NEST"

The government has announced that the personal accounts scheme is to be renamed National Employment Savings Trust (NEST). Employers will be required to automatically enrol employees in, and contribute to, NEST or an alternative qualifying workplace pension scheme. Minimum employer contributions will be 3% of employees' qualifying earnings.

The requirement to automatically enrol members was due to come into effect in October 2012. The government has, however, recently announced that automatic enrolment will be phased in. It is expected that larger employers will be required to implement auto-enrolment before smaller employers. For further details, see www.padeliveryauthority.org.uk.

Pensions Regulator: Latest News

TKU Update

Following earlier consultation, the Regulator's revised Code of Practice on Trustee Knowledge and Understanding (TKU) came into effect in November 2009. Alongside the new Code of Practice, the Pensions Regulator (tPR) has published revised versions of its "Scope" guidance documents.

The documents were reviewed bearing in mind "changes in regulation, legislation, the market place and the focus of the Regulator". The changes made include the following:

- In order to know the key elements of a scheme's trust documentation, trustees are required to "read it all thoroughly".
- The code is more explicit that the regulator expects trustees to use the Trustee toolkit (www.trustee-toolkit.com) unless they can find an alternative learning programme.

If you would like more details of Barnett Waddingham's trustee training programme please visit www.barnett-waddingham.co.uk/about/events/trustee-training/.

Internal Controls Consultation

tPR is consulting on revised "internal controls" guidance. The guidance covers governance issues such as Trustee Knowledge and Understanding, conflicts of interest, record keeping, monitoring the employer covenant and investments.

A related module of the Regulator's learning toolkit has been added to www.trusteetoolkit.com.

Review of Retirement Information

tPR has issued a report on the provision of information to members retiring from DC pension schemes. The Regulator noted that the decisions members make on retirement are important and that trustees have the opportunity to help members by providing the "right information and support at the right time".

Overall, 30% of the schemes surveyed had breached at least one of the legal disclosure requirements. The majority of breaches related to the requirement to provide certain information at least six months before retirement. The Regulator felt that

schemes could provide clearer information and more could encourage members to make an active decision rather than taking the default retirement options.

In some cases, an open market review of annuity options results in a higher pension for the member. DC schemes are required to tell members about the right to purchase a retirement annuity on the open market. Two of the 97 schemes surveyed were found to be in breach of this requirement. The Regulator noted that around one in four of members retiring in 2008 did not exercise the open market option.

Enhanced Transfer Values

David Norgrove, chair of tPR, has called for "greater scrutiny of transfer incentives" claiming that "if a company is willing to encourage the transfer, the company's gain is likely to be the member's loss" and that "trustees should start from the presumption that such exercises are not in member interests".

He was particularly concerned about the potential for:

- companies to offer to pay for financial advice on the condition that the members acted on that advice, and
- companies putting "excessive pressure" on members to make a decision.

2009 Analysis of Recovery Plans

tPR has published its third annual analysis of pension schemes' Recovery Plans. The analysis looks at valuations with effective dates between September 2007 and September 2008 (although not all of these had been received by tPR at the time), comparing them with valuations from the previous two years.

The analysis included the following points:

- The proportion of Recovery Plans that triggered further investigation from the Regulator has risen from 52% to 60%.
- Almost one in five Recovery Plans "triggered" on the length of the Recovery Plan.
- Around one third (36%) of Recovery Plans triggered because of the degree of prudence in their technical provisions.
- The average length of Recovery Plans has increased from 6.1 to 8.3 years. The Regulator noted that there has also been an increase in "back-end loading" of Recovery Plans.

- Prudence in mortality assumptions had, as might be expected given tPR's stance on this, generally increased. A wide range of discount rates (or investment return assumptions) have been adopted. Many schemes continue to use a split discount rate approach, with different rates pre- and post-retirement, especially if these liabilities are notionally backed with different assets.
- tPR also confirmed that it is not averse to schemes adopting a higher "risk premium" in recovery plans than is implicit in the technical provisions on the basis that equity markets were depressed at the valuation date and had subsequently risen.

The Recovery Plans received after the closure of the survey might well exhibit different characteristics from those recorded. There was also an overall reduction in the number of applications for clearance for commercial transactions in the financial year 2008-09 relative to the previous financial year.