

Pensions News – June 2010

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Emergency Budget

“Emergency” Budget & Finance Act 2010

Chancellor of the Exchequer, George Osborne, delivered his [“Emergency” Budget](#) on 22 June, which included several pensions-related measures:

- The Government [published a document](#) on the **restriction of pensions tax relief**: In summary:
 - The Government “has reservations” over the approach set out in Finance Act 2010 and earlier budgets for restricting tax relief on pension contributions for high earners, and intends to adopt an alternative approach. Existing legislation will be repealed in the summer.
 - An alternative will most likely centre around a reduction in the Annual Allowance.
 - In order to balance the books (ie maintain the additional tax income that the existing measures would generate from next April), the Annual Allowance would have to fall to between £30,000 and £45,000.
 - A consultation with “employers, pension schemes, experts and other interested parties” will follow.
 - There will be no immediate changes to the anti-forestalling arrangements currently in place.
 - In the same document, the Government has pledged to end the rules requiring **compulsory annuitisation at age 75**. A consultation on the detail will be published shortly. The [Finance Bill 2010/11](#) implements the transitional arrangements for those reaching age 75 before the changes take effect in April 2011. These [transitional arrangements](#) will effectively increase the age of compulsory annuitisation to 77.
- Her Majesty’s Revenue and Customs (HMRC) has published [technical guidance](#) on the interim rules. Further measures will be included in a third Finance Bill, expected this autumn.
- As previously announced, the Government will review the dates that the **State Pension Age** will rise to age 66.
 - The Government is to consult on how it will phase out the **default retirement age** from 2011.
 - As announced in the coalition agreement, the **Basic State Pension** will rise, from April 2011, in line with the higher of earnings inflation, price inflation or 2.5%pa. The Consumer Prices Index (CPI) will be used as the basis for the inflation measure, except for the April 2011 increase which will use the Retail Prices Index (RPI).
 - As previously announced, John Hutton (former Secretary of State for Work and Pensions) will lead a “fundamental structural review” of **public service pension provision** by the 2011 Budget. He will also consider whether any short-term savings can be made in an initial report due by September 2010.
 - The Government is supportive of **auto-enrolment** and will shortly announce details of a review of **private pension reforms**.
 - The March 2010 Budget announced action to tackle arrangements which use trusts and other vehicles to “avoid, defer or reduce liabilities of employees and directors” to income tax and national insurance, or to avoid restrictions on pensions tax relief.
- The Government has confirmed that **Employer Financed Retirement Benefit Schemes** are within the scope of this measure.

Latest news from the Regulator and the PPF

Employer Covenant

The Pensions Regulator (tPR) has recently [published](#) the first in a series of statements providing guidance for trustees on the issue of sponsoring employers' covenants. The statement sets out tPR's expectations of trustees, making the following points:

- Trustees should ask "probing questions" of the employer, getting professional advice where necessary.
- The covenant should be assessed objectively taking into account the scheme's exposure to risk.
- Trustees should monitor and review the covenant regularly.
- Trustees of multi-employer schemes need to understand the liabilities of each employer.
- Trustees should plan for additional support (for example contingent assets) in advance of this being needed.
- Small schemes should adopt a proportionate approach, but should still consider alternative security.

tPR is also consulting on [draft guidance for trustees](#) on monitoring employer support for their pension scheme. The guidance sets out standard practice that tPR expects trustees to follow in "assessing, monitoring, and taking action in relation to their employer covenant" and replaces contingent assets guidance first published by the Regulator in May 2006.

The guidance, which is under consultation until 7 September 2010, covers issues such as:

- the concept of covenant and why it needs to be assessed,
- understanding a group of companies' legal structure,
- considerations when assessing an employer's financial position,
- deciding whether to appoint a professional covenant assessor,
- alternative forms of scheme security, and how to value them,

- interaction of contingent assets with scheme funding and the Pension Protection Fund (PPF) levy, and
- regularly monitoring employer covenant.

Alongside this consultation, tPR has published a [short guide for employers](#) entitled "The employer covenant at a glance" and further [draft guidance](#) for trustees on understanding the support employers provide in multi-employer schemes.

The draft guidance also considers how to manage employer departures from multi-employer schemes.

tPR has also published several new [e-learning modules](#) alongside the draft guidance.

PPF 7800 Index

The [latest update](#) of the PPF's 7800 Index of schemes' funding (on a s179 basis) has been published. The aggregate funding position is estimated to have worsened in May 2010 to a deficit of £41.5 billion (compared with a deficit of £2.2 billion at end of April 2010).

Scheme funding is better than it was a year ago (there was an aggregate deficit of £179.3 billion at the end of May 2009).

The chart below shows how the estimated total assets less total s179 liabilities for relevant schemes has changed over the last six years.



Source: PPF7800 Index

Latest News from tPR and PPF continued....

Nortel Networks

The Court of Appeal in Ontario, Canada has upheld a ruling that prevented tPR from issuing a warning notice to recover £2.1bn from Nortel Networks in Canada.

The previous decision blocked tPR's attempt to issue a warning notice because it breached the stay principle, which means that a new claim cannot be made upon the company in question during insolvency proceedings.

TPR's determinations panel has subsequently confirmed that it will issue a Financial Support Direction (FSD) against 25 companies in the Nortel Group.

Internal Controls

Following an earlier consultation, tPR has published final revised [internal controls guidance](#) together with a [response](#) to its earlier consultation. Changes made to the guidance as a result of the consultation process include:

- setting out further examples of risks and associated controls relating to information technology (IT) and investment,
- highlighting the importance of the scheme secretary in developing governance frameworks,
- clarifying the role of the actuary in assessing the accuracy of "core data",
- stressing the significant risk of poor control over investment-related activities, and
- considering the risks associated with stock lending.

Winding up Guidance

TPR has published revised [good practice guidance](#) for trustees involved in winding up pension schemes to help trustees meet the 2-year completion target. TPR maintains the target is "reasonable" and will be "intensively scrutinising those schemes that have failed to meet the target".

There have not been many changes to the guidance since the original version (June 2008). It suggests trustees should establish a budget for winding up tasks during planning and that social networking websites (e.g. Facebook) could be used as a tool for tracing members. There is no further guidance on the equalisation of Guaranteed Minimum Pensions (GMPs) for schemes winding up.

Record Keeping

TPR has published updated record-keeping guidance for Trustees. The update follows tPR's review findings that, although the original guidance (January 2009) was "generally well-received and welcomed ... there is no evidence of marked improvement in administration practices".

The revised guidance, whilst still focussing on "educating and enabling", sets out tPR's approach to enforcement where there is evidence of poor record-keeping. TPR expects all schemes to measure the quality of existing data and have plans in place for improvement where needed, with any outstanding data issues resolved by 31 December 2012. The [final guidance](#) describes:

- recommended specific targets for standards of "common data",
- how tPR will investigate record-keeping standards, including sampling of schemes for data audit,
- potential enforcement action where there is a breach of legislation, and
- the enhanced educational material available on tPR's website.

Contribution Notice

TPR has published a [determination notice](#) in which it sets out its intention to issue its first Contribution Notice (CN). The CN relates to the Bonas Group Pension Scheme and tPR is requiring that £5.089 million be paid, being the shortfall on the scheme's PPF solvency position.

In 2006, the parent company (Michel Van De Wiele) considered a "pre-pack" sale of Bonas, with no advance warning given to the trustees of the pension scheme or tPR. Under the pre-pack agreement, Bonas was to be put into administration and then immediately sold to another company (in this case another subsidiary). As a result of the arrangement, the parent company would be able to walk away from the pension scheme. The scheme entered the PPF's assessment period in January 2007.

It is understood that the parent company is to appeal the determination.

Basel III

Proposals aimed at strengthening global banking capital and liquidity regulations could potentially hit UK banks' regulatory balance sheets for billions of pounds in relation to defined benefit pension scheme deficits.

The proposals, first published in December 2009 and labelled "Basel III", will require that when calculating a bank's Tier 1 regulatory capital, the full cost of any pension scheme deficit be included. This does not reflect the fact that scheme deficits are generally not payable "on demand". The proposals could have a significant impact on banks with defined benefit pension schemes.

Funding Deficits with Whisky

Drinks company Diageo is reportedly using whisky to fund its pension scheme deficit. The company has formed a 15-year pension funding partnership (PFP) which will hold maturing whisky spirit as assets, generating anticipated income for its UK scheme of around £25m pa over the term of the PFP.

The PFP is expected to be in place for 15 years, after which time the trustee will be able to sell its PFP interests to the company for an amount expected to be no greater than the deficit at that time, up to a maximum of £430m.

The company has also agreed to make conditional cash contributions into escrow totalling £338m if an equivalent reduction in the funding deficit is not achieved over 10 years, in addition to a large immediate lump sum contribution.

Pilots' Scheme: s75

The High Court has handed down judgement in a case involving the Pilots National Pension Fund (PNPF) which may have implications for companies who participate in multi-employer pension arrangements. In particular, the case considered when an employer is deemed to have exited a multi-employer scheme, thus triggering a debt under section 75 of the Pensions Act 1995.

The PNPF is an industry-wide defined benefit scheme. Many of the issues arising are peculiar to the very specific structure of the scheme. The judgement implies that companies that ceased to employ active members, but still employed staff eligible to join the scheme, could potentially be liable for contributions under the scheme funding regime, even if a section 75 debt has already been paid.

Since April 2008, legislation deems an employer to have exited a scheme if it ceases to employ active members (whilst at least one other employer still has active members). However, before 2008, legislation referred to employing "persons in the description of employment" to which the scheme relates. The judge ruled in the PNPF case that this included eligible members as well as active members.

Further Information

For further information on any of the topics in this bulletin, please speak to your usual Barnett Waddingham consultant, or visit [our website](#).

You might also find our recent publications on the following topics useful:

- Pension increase exchanges
- Longevity Swaps
- Budget – Summary for Executives

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