

## Pensions News – July 2010

### In this edition:

- RPI vs CPI
- MPs' Pensions
- Latest news from the Pensions Regulator and the Pension Protection Fund
- Restricting Pensions Tax Relief
- Compulsory Annuitisation
- Default Retirement Age
- Solvency II
- Equitable Life
- State Pension Age
- HMRC: Transfers
- BT Pension Scheme

## Latest from Parliament

### RPI vs CPI

The Minister of State for Pensions, Steve Webb MP, has announced the Government's intention to start using the Consumer Price Index (CPI) instead of the Retail Prices Index (RPI) for calculating the statutory minimum pension increases payable by occupational pension schemes. Further details have since been published on the [DWP's website](#).

The Government said it "will bring forward legislation at the earliest opportunity" so that references to price inflation in pensions law are consistent with using CPI as the measure of inflation.

The wording in pension schemes' rules will determine how and whether the change will actually apply, or whether amendments will be required. There may also be implications in amending members' accrued rights which will require the trustees to obtain legal advice and possibly consult with affected members.

It is expected that the use of CPI will apply to the following statutory minimum increases:

*Pensioner members:* Future minimum increases will be in line with CPI, rather than RPI. Pension increases already awarded will not be affected.

*Deferred members:* Future revaluation will be in line with CPI, rather than RPI. Increases already awarded between leaving and now will not be affected. When the pension is put into payment, statutory minimum increases will be calculated in relation to CPI.

*Active members:* If the member leaves the scheme before retirement, revaluation will be in line with CPI. When the pension is put into payment, statutory minimum increases will be calculated in relation to CPI.

RPI has generally been higher than CPI and the average "gap" over the last 20 years has been around 0.5% per annum. Some analysts expect the gap to be greater still in the future (perhaps around 0.75% per annum). If this trend continues then we would expect future increases to be lower than previously projected, which would reduce pension schemes' liabilities.

The Pensions Regulator (tPR) has issued a [statement](#) suggesting that, if the proposed changes result in lower estimated liabilities for schemes, it "would expect that this would generally lead to shorter recovery plans", rather than a reduction in employer contributions.

The Government also intends to amend legislation so that CPI can be used for relevant increases in respect of PPF and FAS compensation.

### MPs' Pensions

The Senior Salaries Review Body (SSRB) review of pension arrangements for Members of Parliament has been [published](#) by the Government. The report recommends significant changes to the Parliamentary Contributory Pension Fund, including:

- changing the basis of pension accrual from final salary to career average
- increasing retirement age from 65 to 68
- restricting the rate of indexation to the lesser of RPI or 2.5%
- standardising the accrual rate at 1/60 of salary per year of service and the member contribution rate at 5.5% of pay, and
- freezing final salary benefits already accrued and revaluing them in line with the RPI.

## Latest news from the Regulator and the PPF

### Transfer Incentives

TPR is consulting on draft [updated guidance](#) relating to transfer incentives. The guidance is intended to clarify the role of the employer and trustee and aims to ensure that trustees become actively involved in managing the risks of such exercises.

The guidance says that in order for transfer exercises to be conducted in an open, fair and transparent way, tPR expects:

- members to be provided with clear information that is not misleading
- members to be provided with impartial and independent advice to ensure they make the right decisions
- trustees to engage in the offer process and apply a “high level of scrutiny” to ensure members’ interests are protected
- employers to ensure that offers are consistent with the principles in the guidance, and
- no pressure of any sort to be placed on members to accept the offer.

David Norgrove, chair of tPR is on record as saying that “trustees should start from the presumption that such exercises are not in members’ interests and should be approached with caution”.

The guidance is accompanied by a new e-learning module and a [joint statement](#) with the Financial Services Authority (FSA). The consultation closes on 5 October 2010.

## TPR: Annual Report and Accounts

TPR has published its [Annual Report and Accounts](#) for 2009/10. The accounts show that:

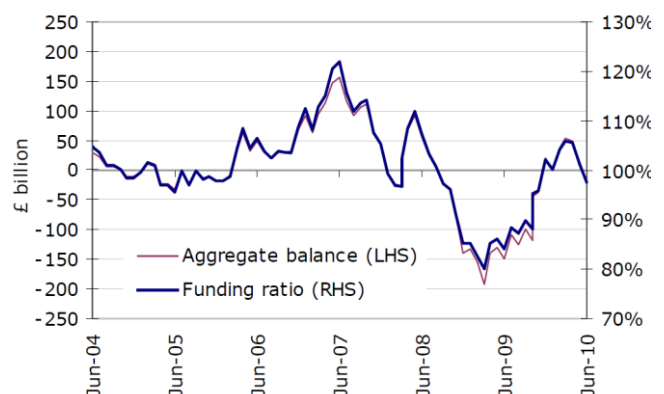
- over the year, TPR suspended the trustees of over 100 defined contribution schemes
- four individual trustees and four corporate trustees were prohibited from acting
- more than 30 anti-avoidance cases were being investigated at the end of March 2010

### PPF 7800 Index

The [latest update](#) of the Pension Protection Fund’s (PPF) 7800 Index of schemes’ funding (on a s179 basis) has been published. The aggregate funding position is estimated to have worsened in June 2010 to a deficit of £21.8 billion (compared<sup>1</sup> with a surplus of £11.7 billion at end of May 2010).

Scheme funding is better than it was a year ago (there was an aggregate deficit of £149.2 billion at the end of June 2009).

The following chart shows how aggregate funding (total assets less total s179 liabilities) has changed over the last six years:



Source: PPF7800 Index

#### Note:

1. The PPF has updated the dataset on which the 7800 Index is based. The latest dataset includes data collected up to 31 March 2009 for the 2010/11 levy, and resulted in a £53.2 billion improvement in the estimated funding position at the end of May 2010. The estimated number of schemes eligible for PPF assistance (and therefore included in the index) has fallen from 7,342 to 6,533. The £11.7 billion figure (at the end of May 2010) is based on the new dataset.

## Restricting Pensions Tax Relief

Her Majesty's (HM) Treasury and HM Revenue and Customs (HMRC) have published a [discussion document](#) on an alternative approach to restricting pensions tax relief.

The Government announced in the June Budget that it will continue with plans to raise revenue by restricting pensions tax relief. However, it has "reservations" about the approach adopted by the previous government. It is therefore considering an alternative approach involving the reform of existing allowances from April 2011:

- It is proposed that the Annual Allowance – the annual limit on tax-relievable pension savings – will reduce from its present level of £255,000 to between £30,000 and £45,000.
- The Annual Allowance does not currently apply in the year the member retires. The Government plans to withdraw that exemption.

- For defined benefits, the Annual Allowance is compared with the *value* of pension built up in a year. This value is currently calculated as ten times the amount of additional pension accrued. The Government is considering changing this multiplier to somewhere in the range 15:1 to 20:1.
- The Government is also proposing changing the recovery charge on benefits in excess of the Annual Allowance from a flat-rate of 40% to the individual's marginal rate of tax (eg 50% for certain high earners).
- In addition, the Government has said it is looking into decreasing the Lifetime Allowance from £1.8 million to around £1.5million. The government is also going to review the 20:1 valuation factor used when comparing defined benefit scheme pensions to the Lifetime Allowance.

The consultation closes on 27 August 2010.

## Compulsory Annuitisation

Following an announcement in June 2010's "Emergency" Budget, the Treasury has launched a [consultation](#) on "Removing the requirement to annuitise by age 75". Key points include the following:

- From April 2011, there will no longer be an age by which members of defined contribution schemes have to annuitise.
- Capped "drawdown" will be allowed to continue beyond age 75. The annual cap of 120% of the value of an equivalent annuity will be reviewed.
- Uncapped drawdown will be permitted, provided that the individual can demonstrate that they have sufficient income from other sources.
- Any unused funds on an individual's death will be subject to a recovery charge and additional inheritance tax (IHT) will not normally apply to unused funds.
- There will be no changes to the age at which the Lifetime Allowance test must be conducted. However, the age 75 limit on pension commencement lump sums and trivial commutation lump sums will be removed.

The consultation closes on 10 September 2010.

## Default Retirement Age

Under the Employment Equality (Age) Regulations 2006, discrimination in employment because of age is prohibited. Among other things, these regulations introduced a national Default Retirement Age (DRA) of 65 and prohibited compulsory retirement below 65 unless "objectively justified".

The Government has now announced that it will [scrap the DRA](#) from April 2011, with transitional arrangements covering the period until 1 October 2011. The Government is also proposing to remove the "administrative burden" of the right to request working beyond retirement, which an employer has a duty to consider.

Although the Government is proposing to remove the DRA, it will still be possible for individual employers to operate a compulsory retirement age, provided that they can objectively justify it.

The [consultation](#) closes on 21 October 2010.

## Solvency II

The European Commission has issued a [Green Paper](#) “towards adequate sustainable and safe European pensions systems”. The paper reopens the issue of solvency standards in pension schemes and may lead to a review of the European Union (EU) pensions legislation (the Directive on Institutions for Occupational Retirement Provision (the IORP Directive)), although changes would be unlikely to come into effect until 2014 at the earliest.

The Green paper discusses how and whether the Solvency II approach could be adjusted to account of the nature and duration of pension liabilities and also considers the possibility of an EU-wide private pension regulatory regime. The consultation period ends on 15 November 2010.

## Equitable Life

In its Coalition agreement, the Government said it would implement the Parliamentary Ombudsman’s recommendation to “make fair and transparent payments to Equitable Life policyholders” through an independent scheme covering members for their “relative loss as a consequence of regulatory failure”.

The Government has now [established an Independent Commission](#) and introduced the [Equitable Life \(Payments\) Bill 2010/11](#) to parliament which will enable payments to be made to Equitable Life policyholders. The Commission is expected to report by the end of January 2011.

The Government has also [published Sir John Chadwick’s report](#) in relation to losses suffered as a result of maladministration in the regulation of Equitable Life. Sir John was commissioned in January 2009 to advise the previous Government in determining losses suffered by policyholders.

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 the bulletin may contain. Readers should take professional advice in relation to their own circumstances and/or refer to the original source material as appropriate.

## State Pension Age

Work and Pensions Secretary Iain Duncan Smith has [indicated](#) that the State Pension Age is likely to rise to 68 by 2038, rather than by 2046 as currently set out in legislation.

## HMRC: Transfers

HMRC [has said](#) that it will bring forward regulations removing unauthorised payments tax charges where individuals aged between 50 and 55 transfer their pension in payment to another provider.

The issue arises from the change in normal minimum pension age from 50 to 55 on 6 April 2010. The new regulations will be back-dated to cover all transfers made on or after that date.

## BT Pension Scheme

The trustee of the BT Pension Scheme is seeking a ruling from the High Court on the scope of a Crown Guarantee affecting the scheme. Potentially it could force the government to support a £9bn deficit in the event of insolvency.

## 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:

- [RPI / CPI for Pension Schemes](#)
- [Current Pensions Issues – Summer 2010](#)

Our seminar programme for the remainder of 2010 is now [available online](#). The seminars focus on particular pensions issues for corporates (September) and trustees (October) and also investment (November) and accounting matters (December).

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