

In Sight

Quarterly pension publication

February 2008/Issue 1

Introducing In Sight

This new quarterly publication from Hewitt provides a brief round up of current developments in pensions. It's for anyone involved in managing work-based pension schemes – trustees, company directors and others.

This quarter's round up

- [How much do you owe us?](#)
Under proposed amendments to legislation, trustees would play a central role in 'employer debt' decisions when an employer ceases to participate in a multi-employer scheme. Employers would also have additional options.
- [All the better to bite you with?](#)
The Regulator's latest consultation on clearance again raises the question of how sharp are its regulatory teeth. We summarise the proposed guidance which includes details of the steps trustees and employers should be taking well in advance.
- [Another Pension Bill...](#)
We discuss the main measures.
- [On target for 2012](#)
The Government is gradually developing the framework for Personal Accounts.
- [Transfer values: on your marks...](#)
After three years of discussions, will the new regulations make much difference? It is likely that trustees will need to understand the issues, and reach conclusions before 1 October, either way.
- [Announcing the levies](#)
The Pension Protection Fund (PPF) has published firm proposals for 2008/09. We look at the main differences to the current arrangements which may impact your scheme's levy.

Regular features

- [On the horizon](#)
Helps you get an early warning of potential developments.
- [Governance diary](#)
A regular reminder for your governance 'to-do' list.
- [Seminar dates](#)
The dates of our 2008 trustee training seminars



How much do you owe us?

When an employer ceases to participate in a multi-employer scheme, perhaps as a result of a corporate transaction or simply because they are no longer employing any active members, the employer often owes a significant debt to the scheme. The Government has drafted amendments to the debt on employer legislation for consultation. These provide much needed clarity and some additional flexibility.

Trustees would play a central role in deciding how assets and liabilities should be determined for debt calculation purposes. They should consider being trained in advance on these issues.

Departing employers would have more options to consider and to discuss with the trustees. (See the table below.)

Under the proposed legislation, a debt would be triggered when an employer ceased to employ “active members”. This caused some concern that a debt could be triggered if all employers in a multi-employer scheme stopped accruing benefits for existing members. The DWP has subsequently announced that this was not what they intended.

Approach	Immediate payment	Departing employer's future liability	Comment
Liability share	Employer pays a proportion of the full buy out debt, based on its liabilities and those of the remaining employers	None	<ul style="list-style-type: none"> Reasonably consistent with current legislation. Provides much needed clarity on the action to take where the data needed to share liabilities is incomplete. Additional clarity could lead to a significantly higher share of the debt than expected.
Apportionment arrangement	Employer pays a proportion of the full buy out debt, based on a method agreed between trustees and employer	None	<ul style="list-style-type: none"> Available in the past by amending scheme rules. Now requires trustee agreement in all cases, to help prevent employers abandoning a scheme.
Approved withdrawal arrangement	Trustees and employer agree (smaller) initial payment, approved by the Regulator	Guarantor liable for additional debt on wind up or insolvency	<ul style="list-style-type: none"> Available in the past, but rarely used because Regulator's test was very difficult to satisfy. Proposed new test appears more reasonable.
Cessation agreement	Trustees and employer agree (smaller) initial payment	Guarantor liable for additional debt on wind up or insolvency	<ul style="list-style-type: none"> A new option. A less prescriptive version of the approved withdrawal arrangement which would not require regulatory approval.

“Much of the content of this guidance is relevant to trustees and employers whether or not there is a type A event occurring.”

The Pensions Regulator

All the better to bite you with?

If you are associated or connected with an employer (particularly if you are involved in corporate transactions such as mergers or acquisitions), you have probably wondered “Just how powerful is the Regulator?”. Unfortunately, the answer is not yet clear. Although the Regulator has powers to issue employers and individuals with Contribution Notices and Financial Support Directions, we will only really find out how sharp its regulatory teeth are when case law is established. To minimise the risk of the Regulator using these powers, employers can apply to the Regulator to get particular actions cleared in advance.

The Regulator’s initial guidance on when to apply for clearance was highly prescriptive. The Regulator is now consulting on adopting a new principles-based approach. A key principle is that trustees and employers should recognise that a pension scheme in deficit should be treated in the same way as any other material creditor.

The examples in the table below are some of the events the Regulator has listed that have the potential to damage a scheme’s security and where you should consider applying for clearance.

Possible detrimental events

Scheme-related events

Compromise agreements

Apportionment of debt between employers

Non-payment of employer debt for an unreasonable period

An arrangement to prevent an employer debt triggering

Employer-related events

Change in creditor priorities

Return of capital

Change in group structure

Granting or repayment of inter-company loans

Employer-related events are only considered to be materially detrimental where the scheme is in deficit. Such events are referred to as “type A” events. The proposed guidance makes it clear that this deficit should usually be assessed against the highest of the scheme’s:

- technical provisions (the funding target used for the valuation);
- liabilities used for accounting purposes; and
- Section 179 valuation (the Pension Protection Fund’s assessment of the scheme’s liabilities).

The guidance gives information on the ‘mitigation’ trustees should look for if a proposed transaction leads to ‘material detriment’. It advises trustees to apply a potentially very onerous “no worse off” test to measure members’ security.

The proposed guidance published on the Regulator’s website is wider ranging than simply outlining the situations in which you should seek clearance. Trustees and employers should make themselves familiar with the proposals, which include that:

- they must put systems in place for identifying a detrimental event early and responding to it quickly;
- trustees should enter into negotiations for all detrimental events, regardless of whether the employers or others want to apply for clearance;
- trustees should consider contacting the Regulator themselves where inadequate mitigation is being offered; and
- trustees should monitor the employer covenant on an ongoing basis (the guidance suggests how).



Another Pensions Bill...

A new Pensions Bill had its second reading in the House of Commons on 7 January 2008. Its provisions take forward the implementation of Personal Accounts which was originally proposed in the Pensions Commission's 2005 report. The Bill's provisions for the introduction of Personal Accounts from 2012 are discussed in the next article. There are also measures to:

- Amend existing pensions legislation by allowing the cap on revaluation of deferred benefits to be reduced from 5% p.a. to 2.5% p.a. This relaxation will only apply to benefits earned after the date of implementation of this legislation.
- Provide the Pensions Regulator with additional powers to intervene if it believes that the scheme's technical provisions are not prudent enough, even if the trustees and employer are in agreement.

On target for 2012

The Government continues to develop the framework for the introduction of the Personal Accounts regime from 2012. The Pensions Bill in November 2007 fleshed out more of the detail. The Bill confirms that the Personal Accounts Delivery Authority will oversee the establishment of the new Personal Accounts scheme. It confirms the level of contributions and the salary on which they must be paid. The Bill also proposes how auto-enrolment will operate. Under its proposals, occupational pension schemes that use auto-enrolment will qualify the employer for exemption from the Personal Accounts regime if they are:

- Contracted-out DB schemes which satisfy the Reference Scheme Test for contracting out of S2P, although there are provisions for the test to be strengthened;
- Contracted-in DB schemes which satisfy a test mirroring the Reference Scheme Test but provide an accrual rate of at least 120ths; or
- DC schemes, including personal pensions, with a contribution rate of at least 8%, including at least 3% from the employer.

The maximum annual contribution to the Personal Account for any individual is expected to be set at £3,600. This means that, for many employees, it will not be a substitute for an occupational pension scheme.

From October 2008, trustees will be responsible for the determination of transfer values and should start their preparations for this new regime as soon as possible.

Transfer values: on your marks...

The Government has postponed the start of the new transfer value regulations to 1 October 2008. After over three years of discussion and consultation, the end result of these long-awaited regulations may not be very different from the existing guidance. Arguably, the only major changes in draft regulations are that, from October 2008:

- trustees and not the actuary will determine the transfer basis; and
- the requirements will form part of Regulations rather than Actuarial Professional Guidance.

The actuary will no longer set the transfer basis, but the trustees must obtain the actuary's advice before deciding on the economic, financial and demographic assumptions to be used for calculating the cash equivalent. Assumptions are to be "best estimate", although this term is not defined. The supporting documentation suggests

that this should take its ordinary everyday meaning and refers to the best estimate approach required for FRS17 accounting purposes. This suggests a different approach to the 'prudent' assumptions adopted for valuation purposes.

It will still be possible for transfer values to be reduced in line with any underfunding of the scheme based on an 'insufficiency report'. This report replaces the current GN11 report.

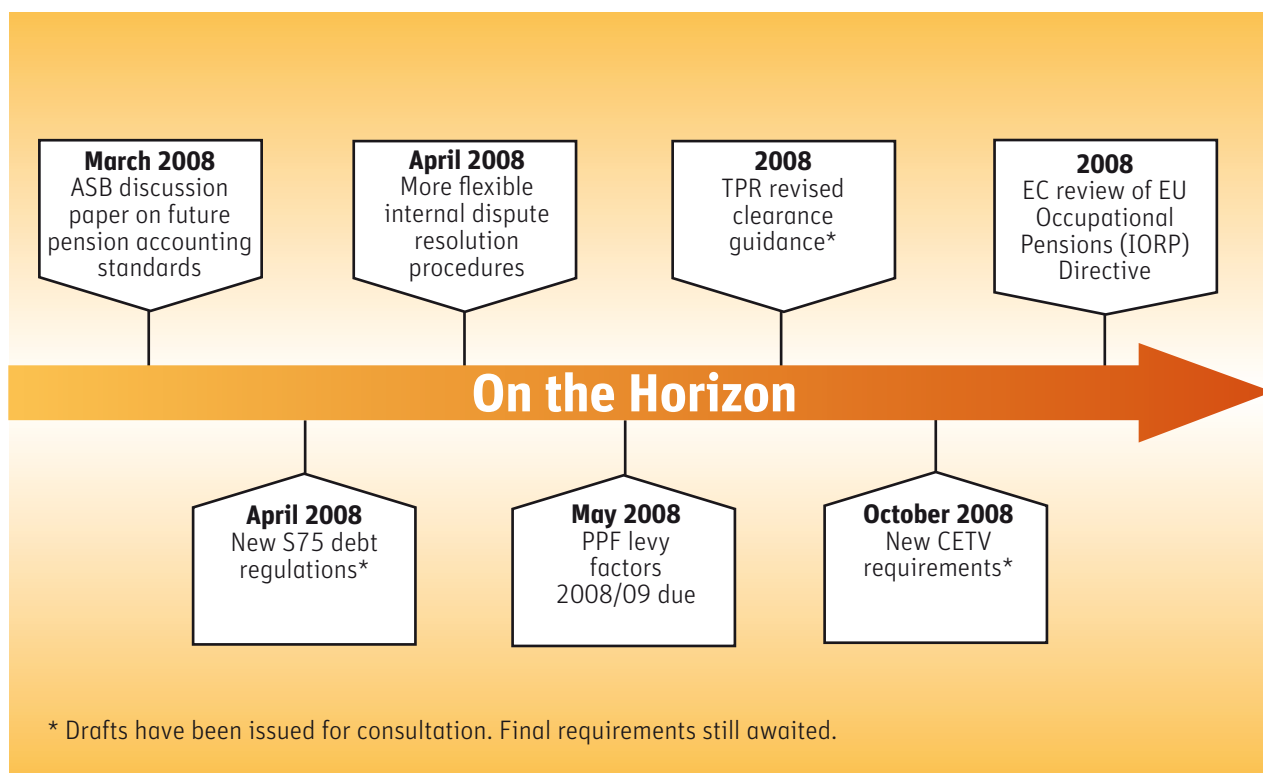
At the time of printing, we can only speculate the content of the final regulations. There is little doubt that considerable redrafting will be needed – as the industry's response to the draft regulations showed that several important details will need to be reconsidered. However, there is unlikely to be any radical rethink. Final regulations can be expected by April 2008 if trustees are to be given sufficient time to prepare.





On the horizon

The outlook is for continuing legislative developments impacting occupational pension schemes over 2008, with key dates when changes are expected highlighted in the chart below.



“The next two levy years, 2008/09 and 2009/10, aim to continue to build a fair, simple and proportionate levy that is a better reflection of the distribution of risks posed by schemes than has previously been possible with the data available.”

PPF Response to the August 2007 PPF Levy Consultation

Announcing the levies

Following its earlier consultation document, the PPF has issued a 69 page document setting out its firm proposals for the levies to be raised in 2008/09 and 2009/10. The PPF comments that its proposals in the consultation were generally well supported and have therefore changed little.

The PPF intends to consider any comments on these proposals that it received before 11 January 2008, but it does not expect to make fundamental changes.

There are no changes to the submission dates for 2008/09. An important change is that for 2009/10, the levies will be based on the underfunding and insolvency risk determined in 2008:

Measurement date	2008/09	2009/10
Underfunding (S179 valuation)	31 October 2007	31 March 2008
Insolvency risk (D&B score)	31 March 2008	31 March 2008
Certification of contingent assets	31 March 2008	31 March 2009
Deficit reduction contributions	7 April 2008	7 April 2009

The table below compares the PPF's proposals for 2008/09 with the 2007/08 levy arrangements:

	2008/09 levy	2007/08 levy
Aggregate levy estimate	£675 million	No change
Minimum funding level at which no risk-based levy applies	140% funded on Section 179 valuation This will act to increase levies, but most significantly for those between 104% and 140% funded.	125% funded on Section 179 valuation
Cap on risk-based levy	1% of liabilities This has been reduced in order that it still affects the weakest 5% of schemes.	1.25% of liabilities
Indicative scaling factor for risk-based levy (The risk-based levy is calculated as: underfunding risk x probability of insolvency x 0.8 x scaling factor.)	1.6*	2.47
Indicative multiplier for scheme-based levy (The scheme-based levy is calculated as: protected liabilities x multiplier.)	0.0152%*	0.016%

**The final figures may not be published until 31 May 2008. In 2007/08, final figures differed significantly from the indicative figures previously quoted.*

Governance diary

With the new year upon us, most trustees are creating their business plans for 2008. For trustees of schemes with both defined benefit and defined contribution elements, 2008 should be the year when more focus is placed on defined contribution. Trustees' business plans should show an agenda item specific to defined contribution at every meeting in 2008, monitoring:

- Investment performance
- Charges
- Take-up rates
- Contribution rates and distribution by age and salary level
- The defaults – contribution rate and investment vehicle
- The continuing appropriateness of any life-style arrangement
- Scheme literature and communications with members
- Administration performance

The Regulator is thinking about all these things and trustees need to take a much more active interest in defined contribution than perhaps they have done in the past. Failure to monitor these areas of defined contribution process and performance could be storing up a crisis for the future and not win any sympathy from the Regulator.

If you have any questions, please speak to your usual Hewitt consultant or contact Maggie Cruise on:

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Seminar dates

Full day course	2008 Dates
Introduction to Trustees' Responsibilities	23 Jan, 6 Mar, 17 Apr 14 May (Bristol), 5 Jun, 16 Jul, 4 Sept, 8 Oct, 12 Nov, 10 Dec
Essentials for DB Trustees	26 Mar, 25 Jun, 30 Sept, 26 Nov
Essentials for DC Trustees	6 Feb, 22 May, 16 Sept
Investment Essentials for DB Trustees (half day)	27 Mar, 26 Jun, 1 Oct, 27 Nov
PMI Award in Pension Trusteeship (2 days)	27-28 Feb, 7-8 May, 22-23 Oct This course is held in Woking

Where we have not given the location in the table, the courses are held in central London.