

For trustees

DB Matters

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Welcome to *DB Matters*, our regular newsletter for trustees. In this issue, Client Manager Gillian Lister kicks off our series of articles on scheme redesign and de-risking.



While the world of pension provision might not sit comfortably alongside mind-numbing celebrity gossip and the sensationalised antics of our national football team, it's probably fair to say it's been responsible for just as much tabloid ink over the past 20 years.

From well-documented controversies surrounding funding, surpluses and misappropriation of assets to

infamous reports of pension mis-selling and loss of guarantees, you only have to type 'pension' and 'scandal' into your favourite internet search engine to discover thousands upon thousands of results.

The ice age for final salary schemes?

Despite the fact that final salary schemes have managed to endure several of these long winters, dire economic conditions coupled with rising cost uncertainties may prove to be a bridge too far for what was once considered the benchmark of pension provision to overcome.

With increased regulation hopefully resigning pension scandals to a thing of the past, press attention has recently turned to 'gold plated' arrangements which, in the current climate, are seen to be an open drain on both private and public finances. Indeed, even the Pensions Regulator has warned of an 'end game' approaching on the horizon.

Compared to just four years ago, the percentage of final salary schemes closed to new entrants has risen from 44% to 58%. The percentage closed to future accrual has also jumped from 12% to 21%.*

Vulnerable, yes – but perhaps the road to extinction doesn't have to be as swift as the hysteria would have you believe. As the saying goes, there are many ways to skin a cat and employers and trustees might want to explore some of the alternatives before sounding the death knell for their scheme.

*David Norgrove, Chair at the Pensions Regulator, speaking at the NAPF annual trustee conference in December 2010.

De-risking diversity

We're going to look at a few of the more popular risk reduction options in this newsletter. This list isn't exhaustive and trustees should always discuss any future plans for your scheme with your Client Manager, your usual contact at AEGON, and/or your financial adviser.

In considering scheme redesign and de-risking, we also have to consider how we manage employees' expectations. Member communication is paramount. Employers need to enter into consultation with members should there be any proposed changes to future benefits. Scheme rules have to be changed and consideration needs to be given as to provision of life cover. Scheme records need to be updated and, in some cases, statements issued to members.

With the removal of some ongoing liability, a review of the funding position should be considered with a new recovery plan, statement of funding principles and schedule of contributions potentially being required.

Some of the following options would suggest an alternative trust-based defined contribution arrangement is put in place, or even a group personal pension, Stakeholder or NEST arrangement.

I'm sure this will give you some thought to the range of scheme redesign and de-risking options available out there. However, it's worth mentioning that, given the complexity of scheme rules and regulation, legal advice should be sought before making any changes to your scheme.

If you want to consider any of these options, please contact your Client Manager, your usual contact at AEGON and/or your financial adviser, who will be able to share practical experience and give you more information on the surrounding issues.

Gillian Lister
Client Manager

Scheme redesign	
Reduced accrual	Reducing the rate of benefit accrual in a scheme effectively reduces the level of benefits provided and in turn, the cost to the employer. Reducing the future accrual, for example from 60ths to 80ths, can help achieve cost savings.
Closure to new entrants	Closing the scheme to new members and allowing existing members to continue as before is another cost-saving measure. However, the scheme is still exposed to salary inflation and can have limited impact due to the past liability remaining.
Limiting future salary increases	By placing a cap on an employee's pensionable pay, the scheme will effectively remove the link between salary increases and the pension benefits being accrued. Increases in pensionable pay may be restricted to anything from zero to 2% or 2.5%, regardless of an employee's actual pay rise. This results in modest savings and may not go far enough to reduce savings as the past liability remains.
Ceasing future accrual	The most popular option is to cease future accrual. While this is an employer decision, employers and trustees normally decide on a suitable date. An employer consultation is entered into initially and then the decision may then be taken following that to close the scheme to future accrual. This option has by far the highest impact on reducing costs.
Career average earnings (CARE) scheme	Switching to a CARE scheme can also reduce costs. This is a defined benefit scheme where benefits are based on earnings throughout an employee's career, plus revaluation rather than the more common approach of basing benefits on earnings near retirement. The method is seen as a way of providing employers with greater stability of costs while still maintaining a valuable defined benefit arrangement for employees.

De-risking	
Pension increase exchange	One solution is to offer pensioners members a cash lump sum in exchange for future non-statutory increases that they're entitled to from the scheme, or alternatively give a one-off increase to their pension in place of future non-statutory increases. This enables the employer to reduce some of the longevity and inflation risk associated with payment of pensions.
Trivial commutation	Members with trivial amounts of pension can consider exchanging their pension in return for a cash amount. Scheme rules have to be checked for all cases to confirm this is allowable.
Early retirement	From April 2010, members can early retire from age 55. Provided the scheme rules allow, members could be offered early retirement to reduce their liability in the scheme.
Enhanced transfer exercises	This initiative is led by the employer. It's an offer from the employer to the member to give up their accrued rights in return for an enhanced transfer value or one-off cash payment (or a combination of both). Employees are motivated by the inducement while employers want to avoid the uncertainty of providing a member's pension. The Regulator has issued guidance that highlighted concern over these incentives and stated that employees must be given enough information to make an informed choice. Members should also be offered advice and excessive pressure should not be put on members to transfer.
Buy-in	This process allows the purchase of a contract with an insurance company as an investment to match some, or all, of a pension scheme's liabilities. Crucially, the liabilities remain in the scheme and the trustees retain responsibility until a wind-up event has been triggered.
Buy-out	This process is where a pension scheme's liabilities are transferred to an insurance company and the obligation for the scheme to provide these benefits ceases. Effectively, each member has an individual annuity policy with the insurer to cover his or her benefits.

In the news

There's been a fair bit of activity from the Pensions Protection Fund recently, along with some worrying taxation and legal loopholes you and your members need to be aware of. Read on to find out more...

'Stealth tax' for contracted-out final salary schemes

The government has added further gloom to the air surrounding final salary schemes by reducing the level of its contracted-out rebate.

Last month, the Department for Work and Pensions cut the rebate rate for employers from 3.7% to 3.4% and for employees from 1.6% to 1.4%.

The move, condemned as a 'stealth tax' by the National Association of Pension Funds, follows the government's five-yearly review of rebate levels.

Pensions minister Steve Webb said: 'The current reduction in National Insurance contributions is provided at considerable cost to the taxpayer. The government has a duty to ensure that the rebates are set at a level which is fair to all, and that the rates are not seen to favour those who are contracted out of the State Second Pension.'

Revised PPF levy framework for 2012/13

Following on from the last issue of DB Matters, the Pension Protection Fund (PPF) has now announced that it's set to implement its revised framework for calculating pension protection levies from 2012/13.

Sara Protheroe, co-director of strategy and policy at the PPF, said: 'We were pleased with the response to the recent consultation on the new levy formula, which was broadly welcomed by most of our stakeholders.'

'We are, therefore, happy to give an early indication of our direction of travel and provide schemes with clarity about the information they need to provide so we can calculate their levies correctly.'

The PPF added that it's still important for schemes to provide up-to-date information by 31 March **this year** as the PPF will use it to set the levy scaling factor – which schemes use to calculate their individual levy bills – for the first three years under the new framework.

To find out more about the PPF plans, visit its website at www.pensionprotectionfund.org.uk

PPF work on solution for GMP equalisation

The PPF has published a consultation on its planned approach to calculating compensation for men and women being assessed for entry into the lifeboat fund – or who have already been admitted – to make sure they're treated equally.

The approach also applies to men and women due to receive, or who are receiving, assistance from the Financial Assistance Scheme.

Differences in compensation or assistance payments for men and women can arise as a result of guaranteed minimum pensions (GMPs) – primarily brought about by differences in retirement ages.

After a long period of consulting stakeholders and seeking expert advice, the latest consultation explains in more detail about how GMPs will be taken account of when calculating member entitlements.

You can read more about the consultation on the PPF website [here](#).

PPF – the sponsoring employer versus principal employer

There was recently an interesting, albeit slightly concerning, article reported in the financial press: a scheme whose company had been paying levies to the PPF and whose members suddenly discovered they didn't have PPF protection because of a legal technicality. The result – the PPF refusing to cover any pension losses following the failure of the employer.

Background

The scheme, with £2 million in assets, was already closed when its employer was bought out in 2002, with the buyer taking over responsibility for the scheme. Despite the second company paying levies to the PPF since 2002 as 'principal employer', the PPF didn't recognise the second employer as 'sponsoring employer' (as defined under Pensions Act 2004) as it didn't employ any of the scheme members at the time scheme benefits were accruing. The scheme was refused entry to the PPF and its levy payments refunded.

A spokesman for the PPF said he was unsure if this was the first time a scheme had been rejected on such grounds. He added: 'This is very much an issue related to the legislation. Our job is to implement the rules as they are.'

A DWP spokeswoman said gaps in legislation were a matter for the department and that it would act if schemes weren't protected appropriately.



Get advice

We strongly recommend that you're aware of all PPF entry requirements at all times. You should also make sure that you consider the PPF implications of any changes in principal employer, compromise agreements and employer debt arrangements so that you don't inadvertently bar your scheme from PPF entry. If you're in any doubt over any of these issues, contact your legal advisers.

Transitional provisions – deadline for action is almost upon us

In issue 15 of DB Matters, Documentation Manager Helen McBride outlined the concept of 'transitional provisions', what they mean for your scheme and, most importantly, the implications of trustees taking no action by 5 April 2011.

The deadline for action by you to make sure that the transitional provisions falling away doesn't impact scheme liabilities, and consequently scheme funding, is now almost here.

As Helen explained in May last year, a scheme that doesn't take action could now imminently find itself in the undesirable position of having members who were previously restricted by HM Revenue & Customs limits (for example, the earnings cap) have such restrictions fall away. The consequence could be immediate entitlement to higher benefits. Alongside this, there could also be costly tax implications for the scheme from the administrative side.

Our Documentation team have been actively reminding all of our clients about this subject over the last couple of years and have offered various documentary fixes depending on your current scheme provisions and the needs of you and your scheme.

Hopefully, you'll be able to sit back and relax while you read this safe in the knowledge that you and your legal advisers considered these implications long before now and took the appropriate action. However, if you have any questions or need any more information, our Documentation team are here to help. You can contact us by sending an email to helen.mcbride@aegon.co.uk



Feedback

Have you found *DB Matters* useful? Are there any subjects you'd like us to include in future issues? Let us know what you think. Please email your comments to atsmb@aegon.co.uk

The information in this newsletter is based on our understanding of current and proposed law, and HM Revenue & Customs practice, which may change.

Impact on schemes of gender discrimination ruling

Following a recent European Court of Justice ruling, gender can't be used as a basis for providing different insurance rates from the end of next year. Head of ATS Development, Kenny Tindall, looks at what effect this ruling could have on your defined benefit scheme.



On 1 March 2011, the European Court of Justice ruled on a legal case brought by a Belgian consumer group about the use of gender as a risk factor in pricing insurance. This case argued that a member's gender couldn't be used as a basis for different rates when calculating insurance premiums or benefits as this was discriminatory.

The ruling has outlined that, from 21 December 2012, it won't be possible to use gender as a basis for different rates in the provision of insurance.

Effect on defined benefit schemes

We've been watching this case closely as gender-specific actuarial factors are used in many actuarial calculations for defined benefit pension schemes. The main examples are:

- the calculation of transfer values – these calculations are almost always gender specific
- the rate at which pension at retirement can be given up to provide cash at retirement (cash commutation) – this is often gender specific

The ruling doesn't specifically address the use of actuarial factors in defined benefit schemes. While this ruling doesn't seem immediately applicable to these schemes, there are parallels between the calculation of premiums under insurance contracts and the calculation of benefits under a defined benefit scheme. So it's possible that gender-specific actuarial factors may not be allowable in the future. While we don't believe you have to take any action now, this isn't legal advice and we recommend that you consult your lawyers about how the ruling could affect your scheme.

Effect on annuities

It's also likely the ruling will affect the buying of annuities. If trustees buy an annuity to match a member liability or to wind up a scheme, then the cost may be higher than in the past, although it's not yet clear what the full impact on annuity pricing will be.

This ruling won't become effective in the UK until legislation is put in place. We don't yet know the detail of how the UK government will implement the ruling, but once we have more information about this, we'll let you know any impact on defined benefit schemes.

Please get in touch with your usual AEGON Trustee Solutions contact if you'd like to discuss this topic further.

Kenny Tindall

Head of ATS Development

Please note – this communication isn't for private customers and shouldn't be given out to, or relied on by, them.