

In *The Agenda* we summarise the state of play with the key pensions issues about which employers and trustees should be keeping themselves informed. Where appropriate, we highlight the actions that could or should be taken.

Current issues are subdivided between financial and compliance issues and HR and communication issues, although inevitably there will be a degree of overlap in some cases. We also keep one eye on what is coming over the horizon.

Our aim is to help you make your company or trustee board agendas focused on what is important to you.

We have kept *The Agenda* brief. Please contact your HamishWilson consultant, for further details.

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## Financial and compliance issues



### Abandonment, Anti-avoidance and Clearance

Abandonment occurs when a sponsoring employer seeks to avoid its pension liabilities by severing its link with a DB scheme (eg as a result of a corporate restructuring) without providing the scheme sufficient funds or assets to compensate for losing its ongoing support. If it occurs, the Pensions Regulator has the power to issue a financial support direction and/or a contribution notice against the relevant parties, depending on the circumstances.

The Regulator issued updated [guidance](#) in December 2008 on how trustees should deal with a proposal that might involve the abandonment of a DB scheme. The only significant change from the previous guidance recognises the fact that contribution notices can now be imposed on a person who has acted in good faith, but by implication did not show sufficient care.

The Regulator published [Code of Practice No 12](#) in June 2009, together with "[Guidance: Corporate transactions](#)" for employers and "[Illustrative examples: Material detriment test](#)". The Code confirms the circumstances in which the Regulator would expect to issue a contribution notice under the material detriment test (whether any actions or failures to act have had a detrimental effect on the likelihood of members receiving their benefits) to be where:

- the scheme is transferred out of the UK's jurisdictions
- the sponsoring employer is transferred out of the UK's jurisdictions or is replaced with an entity that does not fall within those jurisdictions
- the sponsoring employer's support for the scheme is removed, substantially reduced or becomes nominal
- liabilities of the scheme are transferred to another scheme or arrangement where this leads to a significant reduction of the sponsor support or funding to cover those liabilities
- the scheme is operated in such a way that creates, or is designed to create, a financial benefit for the employer or some other person and inadequate account has been taken of members' interests, including where risks to members are increased.

**Employers (in particular) should familiarise themselves with the Code if they are thinking about any of the types of restructuring covered by it.**

The [Pensions Regulator \(Miscellaneous Amendment\) Regulations 2009](#), which came into force on 6 April 2009, extend the "look back" period (the period in which the Regulator can exercise the power to issue a financial support direction) from 12 months to 24 months, with this increase being phased in over the period ending on 6 April 2010.

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## Abandonment, Anti-avoidance and Clearance (continued)

The Regulator published updated [clearance guidance](#) in December 2008 reflecting its new powers. (Seeking clearance from the Pensions Regulator is appropriate where there may be a significant weakening of the employer covenant as a result of a corporate transaction, eg where a highly-leveraged transaction occurs and/or the assets to which the scheme may currently have recourse are being removed from the employer group.)

**Employers should consider whether to apply for clearance whenever involved in a corporate deal.**

## Accounting for pensions in the credit crunch

The margin between gilt yields and bond yields ("the credit spread") has started to fall back from its credit crunch-induced peak as bond yields start to ease in response to the Bank of England's "quantitative easing". The spread stood at 2.1% pa as at 30 June 2009 compared with 2.7% pa as at 31 March 2009, but was still higher than 30 June 2008's 1.6% pa. Bond yields were about 6.2% pa as at 30 June 2009, down from 6.7% pa a year ago.

The credit spread has fallen further since the end of June and stood at just 1.5% as at 10 September 2009, with bond yields having fallen to 5.5% pa. This is a reduction of 0.7% pa since the end of June and more than 1.0% pa since last year, adding as much as 30% to companies' reported pension liabilities.

Although there has been a strong recovery in equity markets over the past few months, the FTSE 100 index has only got back to where it was at the end of September 2008.

**Finance Directors should anticipate having to report higher pension liabilities in the coming months.**

## Commutation of trivial pensions

The DWP had intended to extend with effect from 6 April 2009 the circumstances in which occupational pensions can be commuted on the grounds of triviality in line with HMRC regulations. However, HMRC's [Authorised Payments regulations](#) were not laid before Parliament until 8 May 2009 and, although they came into force on 1 June 2009, they will not relax the treatment of trivial pensions until 1 December 2009. The regulations will also make genuine benefit payment errors (eg overpayments) easier to correct.

The DWP issued [draft amending regulations](#) on 19 August 2009 for consultation until 29 September, which are intended to align its regulations with those of HMRC.

**Trustees may wish to ask their scheme's administrator how many members' pensions it will be possible to commute and what administrative cost savings would be achieved. They should also seek legal advice as to whether rule amendments are required before they can take advantage of the relaxations.**

## "Debt on employer" regulations

Rosie Winterton, then Minister of State for Pensions, announced in November 2008 the Government is considering making changes to the "debt on employer" regulations under s75 of the Pensions Act 1995. The intention is to relieve some of the constraints on corporate restructuring for companies participating in multi-employer schemes.

New regulations had come into force on 6 April 2008, but these have been heavily criticised. The DWP was aiming to hold a full public consultation in February 2009 and to introduce changes from October 2009, but the consultation is still awaited!

**Any employer who participates in a multi-employer scheme should seek legal and actuarial advice about the consequences of a corporate restructuring or ceasing future benefit accrual before taking action.**

## Equalisation issues

The provisions of many schemes had to be amended following the European Court of Justice's "Barber" ruling of 17 May 1990 in order to achieve equality of benefits between men and women. More recently, schemes will have had to remove any age-based discrimination (except where exempt). Various recent Court cases have highlighted the importance of ensuring that any changes that have been made are both lawful and made appropriately in accordance with the requirements of the scheme's trust deed and rules.

However, the judgment in the recent Court case involving Foster Wheeler suggests that pragmatic solutions can be accepted by trustees where benefits have not been equalised appropriately to date.

**Trustees and employers may wish to check the validity of any changes made to their schemes, especially where it was intended to level down benefits in respect of service after the date of change.**

The Pension Protection Fund (PPF) issued a [consultation paper](#) in April 2008 setting out how it intends to require schemes that have entered an assessment period to equalise benefits relating to Guaranteed Minimum Pensions (GMPs). The PPF's Board of is reviewing the responses and has indicated there is a lot to consider and discuss with stakeholders before it reaches a definite decision. It was aiming to publish its proposal for GMP equalisation early in 2009, but nothing has emerged yet.

The PPF's approach to GMP equalisation may not be a viable solution for other schemes. Even so, **trustees should monitor developments given the Pensions Act 1995 placed an obligation on them to equalise benefits.**

Regulations enabling GMPs to be converted into normal scheme benefits using the concept of actuarial equivalence came into force on 6 April 2009.

In our opinion, converting GMPs is likely to be a non-starter unless the sex-equality issues surrounding GMPs are clarified. See our [press release](#) for further explanation.

## Member-nominated trustees (MNTs)

With limited exceptions, all schemes should have established and implemented arrangements under which members can nominate and select at least one-third of their trustees (and this may rise to one-half in future). The arrangements should be reviewed every three to five years. See our [In Focus](#) for further details.

[Amending regulations](#), which came into effect on 6 April 2009, clarify that independent trustee companies performing a professional function are not required to appoint member-nominated directors where they sit as a scheme's trustee alongside a general trustee company (ie where the directors perform a similar role to lay trustees).

**Trustees should check when they next need to review their MNT arrangements.**

## Notifiable events

[Amending regulations](#), which came into effect on 6 April 2009, simplify the "notifiable events" framework (see our [In Focus](#)) by removing the requirement to notify the Regulator about:

- two or more changes in the holders of any key scheme post within the previous 12 months
- any change in the employer's credit rating, or the employer ceasing to have a credit rating and
- two or more changes in the holders of any key employer posts within the previous 12 months.

**Trustees and employers should ensure they are familiar with the remaining notification requirements.**

## Pension sharing on divorce

The Pensions Act 2008 abolished "safeguarded rights" (ie contracted-out rights created under a pension sharing order on divorce) from 6 April 2009.

**Amending regulations**, which came into effect on 6 April 2009, enable pension credit benefit members to have the same choices as other occupational pension scheme members on when and how to draw their pension (bringing those choices into line with those currently existing with personal pensions).

**Trustees of schemes that grant pension credits should review whether they need to make changes to their scheme's administrative procedures.**

## PPF levies

The PPF's new Chief Executive, Alan Rubenstein, announced in June 2009 that the total amount the PPF intends to collect in pension protection levies in 2010/11 will be frozen in real terms and so will be £700m, indexed to national average earnings. However, until the levy scaling factors for 2010/11 are announced later this year, it will not be possible for trustees and/or employers to make informed decisions about the merit of taking action to reduce their scheme's 2010/11 levy, eg by paying and certifying deficit-reduction contributions.

**Trustees and employers should consider levy-reduction actions once the levy scaling factors have been announced.**

## Revaluation of deferred pensions

The Pensions Act 2008 has reduced the statutory rate of revaluation of deferred pensions for service after 6 April 2009. Statutory revaluations remain geared to price inflation, but the cap has been reduced from 5% pa to 2.5% pa for benefits accrued after 5 April 2009. The change thus only affects members who become early leavers on or after 6 April 2009.

A reduction in the cap could be expected to reduce the cost of future benefit provision, particularly if the rate of price inflation is expected often to be above 2.5% pa. However, it would create another tranche of benefit, adding to administrative and communication complexities.

**Amending regulations**, which came into effect on 6 April 2009, give trustees the overriding power (subject to employer consent) to amend their scheme's revaluation provisions by resolution where the rules would otherwise have prohibited such a change.

The DWP's policy department reportedly said in February 2009 that any rule amendment required to lower the revaluation cap would not be a "listed change" under the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006 and so would not trigger the need for employers to consult with their employees. The Pensions Regulator has also reportedly clarified that enforcement action will not be taken against employers who do not consult on such a change.

**If they have not already done so, employers should decide whether to take the opportunity to reduce the cost of benefit provision and their exposure to high rates of inflation and ask their lawyers to check what their scheme's rules say about revaluations and to advise what actions (including obtaining trustee agreement) will be required to reach the desired position.**

## Risk alert

The Pensions Regulator issued a statement "[Alert to risks in the economic downturn](#)" in April 2009 to all those involved in the running of pension schemes to alert them to potential risks and to encourage trustees to contact the Regulator if they are worried.

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## Risk alert (continued)

The statement looks at:

- the risk of dishonesty and fraud (eg members being encouraged to access their pension savings through “trust-busting” or “pension liberation” activities) and
- behaviours that unacceptably increase risks to members’ benefits, the PPF and all levy-paying schemes, such as the avoidance of employer debt, inappropriate transfers for individuals from under-funded schemes that would not subsequently have the resources or adequate employer support, as well as employer-related self-investment and poor practice associated with transfer incentive exercises.

It also reminds trustees, employers and advisers of their whistle-blowing duties.

**Trustees should familiarise themselves with the alert and keep an eye out for any suspicious activity.**

## Scheme-specific funding regime

The Regulator issued a [Statement to trustees about current financial pressures](#) in October 2008.

For DB schemes, the Regulator indicates it is important trustees keep the employer’s covenant under review and consider whether their review processes are adequate. Where an employer believes an existing recovery plan is at serious risk of jeopardising its future that will be a matter for discussion with the trustees. Trustee boards will wish to consider carefully any proposal for change taking into account among other things plans for payments to other creditors and dividends to shareholders. Where a recovery plan is revised, the Regulator must be informed.

The Regulator issued a [statement to employers sponsoring DB pension schemes](#) in February 2009, which:

- recognises that current economic conditions are of real concern to employers
- reassures employers that the scheme funding regime is flexible enough to cope with the economic downturn
- confirms there is potential to renegotiate previously-agreed plans to repair pension deficits where the sponsoring company is under pressure
- suggests trustees should be in a position to understand what is reasonably affordable for their sponsor, but all unsecured creditors must be treated equitably and the pension scheme not disadvantaged and
- confirms the Regulator will continue to seek outcomes that are in the best interests of the scheme and sponsor.

The Regulator adds that recovery plans should not be amended to enable the sponsor to continue to pay dividends and that, where there are short-term concerns over affordability, back-end loading a recovery plan may be more appropriate than extending its length.

**As indicated by the Regulator, trustees should continue to focus on making sound decisions in the long-term interests of scheme members, which includes not jeopardising the sponsor’s future viability.**

We are now into the second round of scheme-specific funding valuations. Our impression is trustees won the first round on points, supported by legislative pressure for prudence and greater trustee knowledge and understanding. An important factor in many cases was employers did not obtain independent advice (effectively yielding the initiative to the trustees who are the primary focus of the scheme actuary’s advice).

Recent financial turmoil means the second round will be tougher and pensions more critical, possibly being the knock-out blow for some employers. In such circumstances employers are taking a serious risk if they get into the ring without a good team of seconds (both actuarial and legal) in their corner.

**Employers should ensure they have access to independent advice if they are to avoid having one hand tied behind their backs when sparring with the trustees.**

## Tax relief for high earners

It was announced in the Budget on 22 April 2009 that tax relief on pension contributions is to be restricted for those with incomes above £150,000 pa from 6 April 2011. This will follow hard on the heels of the introduction of a new rate of income tax of 50% that will apply on income in excess of £150,000 pa from 6 April 2010.

From 6 April 2011, the value of pensions' tax relief applying to income in excess of £150,000 pa will be tapered down (from 50%) so that for those on incomes above £180,000 pa tax relief will be at the rate of 20%, the same as for basic rate income taxpayers.

The restriction on tax relief will apply not only to an individual's own pension contributions but also to any contributions made on their behalf by their employer or any other party. This means that employer contributions paid in respect of high earners will no longer be tax-exempt as far as the employee is concerned.

It will be easy to quantify contributions made to DC pension arrangements, but not so easy in DB schemes. The Government will thus consult on the implementation of the restriction of tax relief and, in particular, how employer contributions to DB schemes should be valued.

Employers will continue to receive full relief from corporation tax on their pension contributions.

Of more immediate impact, anti-forestalling measures were set out for preventing high earners from maximising their pension contributions over the next couple of years in order to take advantage of full tax relief while it is still available.

The Finance Act 2009, which received Royal Assent on 21 July 2009, creates a new tax charge of 20% that will apply until 5 April 2011 to high earners who "increase their pension savings on or after 22 April 2009 over and above their normal pattern of regular pension savings", but only if their total pension savings exceed £20,000 in that year.

A minor concession was made on 3 July 2009 that would allow people (eg the self-employed) without a regular (at least quarterly) pattern of pension saving to obtain full tax relief on the first £30,000 of their pension savings (or on the average of their last three years' pension contributions, if this is smaller).

HMRC published some [Questions and Answers](#) on the anti-forestalling measures on 10 July 2009.

**Employers should urgently review their pension provision in respect of high earners and take particular care when making changes to their pension arrangements.**

## Trustee knowledge & understanding (TKU)

The Regulator announced in October 2008 it had refreshed its TKU framework to ensure it remains relevant and also published drafts of a revised [Code of Practice](#) and scope guidance (for DB and DC schemes) for consultation. The new [Code of Practice](#) was published on 17 July 2009 and is currently before Parliament for approval.

The revised code of practice sets out practical guidance for trustees in relation to the TKU regime, while the scope guidance provides a checklist of the topic areas of which trustees need to have knowledge and understanding.

**Trustees should familiarise themselves with the new Code of Practice and scope guidance and keep their training needs under regular review.**

## HR and communication issues



### A-Day

In his Pre-Budget Report of 24 November 2008, the Chancellor of the Exchequer, Alistair Darling, announced that the Lifetime Allowance will be frozen at £1.8 million from the 2010/11 tax year until 2015/16. Likewise, the Annual Allowance will be frozen at £255,000.

Under transitional arrangements, the old "IR limits" and, in particular, the "earnings cap", continue to apply to schemes by default until 5 April 2011.

HMRC announced in February 2009 that the notional earnings cap for 2009/10 will be £123,600.

**To maintain the old limits to avoid an unintended increase in members' benefits (and scheme liabilities) employers need to ensure their scheme's rules are amended by 5 April 2011.**

### Age discrimination

The pensions-related aspects of The Employment Equality (Age) Regulations 2006 ("the Age Regulations") came into force on 1 December 2006. With certain exceptions, it is now unlawful for employers, or trustees of occupational pension schemes, to discriminate on the grounds of age when exercising their scheme functions in respect of periods of pensionable service on or after 1 December 2006.

However, uncertainty remains as to what constitutes a discriminatory practice. In early 2008, different outcomes in a couple of employment tribunal cases that addressed whether compulsory retirement at the age of 65 could be objectively justified illustrated the importance placed on individual circumstances.

**If they have not already done so, employers should check for discriminatory practices in their schemes (eg age-related accrual rates) and take action to minimise their exposure to equalisation costs.**

The European Court of Justice (ECJ) started hearing the "Heyday" case in July 2008. Heyday, part of Age Concern, is challenging the UK Government's decision to allow employers to compulsorily retire employees when they reach the age of 65. Heyday claims this runs contrary to the European Union's Directive 2000/78/EC which requires equal treatment in employment and occupation.

The Advocate General opined in September 2008 that it was appropriate for the UK Government to specify an age at which employees can be retired compulsorily, provided it is objectively and reasonably justified. The ECJ's formal ruling, given on 5 March 2009, confirmed this view.

It is now for the High Court to decide whether having a default retirement age of 65 is objectively and reasonably justified. The Court started to hear the case on 15 July 2009.

Meanwhile, the new Minister for Pensions and the Ageing Society, Angela Eagle, announced on 13 July 2009 that the Government would bring forward its review of the default retirement age of 65 to 2010 from 2011.

**Employers should continue to monitor developments, with the retention of a default retirement age of 65 looking increasingly unlikely.**

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## DC communications

The Pensions Regulator issued a statement "[Engaged employers and informed retirement choices – key to good outcomes for members of defined contribution \(DC\) pensions](#)" on 22 July 2009.

In relation to trust-based DC schemes, the statement stresses it is important for trustees to ensure that members are able to make informed choices and so must be aware of their options, including the open-market option of buying their annuity from the provider of their choice. It adds that the Regulator will be reviewing the retirement processes and literature of a sample of schemes and, where there are short-comings, will expect the trustees to make improvements, using its enforcement powers if necessary.

The statement also encourages employers to engage more with their DC schemes, whether trust-based or contract-based. It adds that the Regulator has previously produced guidance "[Voluntary employer engagement in work place contract-based pension schemes](#)" for employers and will be working with the FSA to clarify the extent to which employers can provide information and support to their employees.

The Regulator has also published a guide "[Making your retirement choices](#)" for members of DC schemes.

**Trustees and employers should review their communication materials.**

## Employer consultation

Since 6 April 2008, employers with at least 50 employees have been required to consult before making certain changes to future benefit accrual or DC contributions payable under an occupational (or personal) pension scheme. [Amending regulations](#), which came into effect on 6 April 2009, give the Pensions Regulator the power to impose civil penalties on employers who fail to comply without reasonable excuse.

The DWP issued updated [guidance](#) for employers in April 2009.

**Employers should factor in the consultation requirements when planning any benefit changes.**

## Statutory money purchase illustrations (SMPIs)

Following a fast-track consultation, the Board for Actuarial Standards (BAS) published [version 1.3 of Technical Memorandum 1: Statutory Money Purchase Illustrations \(TM1\)](#) in January 2009 to reflect recent changes in legislation. The amendments will mean that, from no later than 1 September 2009, SMPIs will reflect the forthcoming abolition of money purchase contracting out and the changed method of calculating contracting-out rebates of National Insurance Contributions.

**Trustees should ensure the SMPIs prepared for their scheme comply with version 1.3 of TM1.**

BAS will be carrying out a wider ranging review of TM1 over 2009.

## On the horizon



## Accounting standards

The Accounting Standards Board (ASB) issued a consultation paper "[Policy Proposal: the future of UK GAAP](#)" on 11 August 2009, setting out proposals for the reporting requirements of UK and Irish entities.

The ASB is proposing a three-tiered approach to entities' reporting whilst converging UK (generally-accepted accounting principles GAAP) with the International Financial Reporting Standard (IFRS), the three tiers being:

- Tier 1 – publicly-accountable entities who would apply IFRS as adopted by the European Union
- Tier 2 – all other UK entities (other than "small entities") who could apply the IFRS for Small and Medium-sized Entities (SMEs)
- Tier 3 – small entities who could continue to apply the Financial Reporting Standard for Smaller entities (FRSSE).

The convergence with IFRS will only have a minor effect on FRS17, the UK's standard for reporting pension costs, as this is already very similar to IAS19, the international standard.

The ASB also has no immediate plans to amend the Statement of Recommended Practice (SORP) that applies to pensions schemes' own accounts.

The ASB is seeking to receive comments on its proposals by 1 February 2010.

The International Accounting Standard's Board (IASB) and the US's Financial Accounting Standards Board launched a consultation in October 2008 under a joint project on proposed enhancements to the [presentation of financial statements](#) with the objective of converging standards; this ended on 14 April 2009.

The IASB's [January 2009 Update](#) indicates that the Board has tentatively decided to work towards two exposure drafts amending IAS19. The first will deal, amongst other things, with the recognition and presentation of changes in the defined benefit obligation and plan assets. The second will deal with contribution-based promises (see [News](#) for an explanation of these).

For the first of the exposure drafts, the Board has tentatively decided entities should:

- disaggregate changes in the defined benefit obligation and in plan assets into employment, financing and remeasurement components, and recognise the components in the income statement
- disclose the employment and financing components either in the income statement or in the notes, and present the remeasurement component in the income statement.

However, the Board announced on 5 August 2009 that it had decided at its meeting on 21 and 22 July to publish an urgent exposure draft regarding discount rates in countries (such as Australia or South Africa) where there is no deep market in high-quality corporate bonds. This is currently expected to be published in the second half of August, with comments required by 30 September 2009.

**Employers may wish to have the effect of any proposed changes on their accounts quantified.**

## Personal Accounts

Personal Accounts are scheduled to be introduced in 2012. (The Personal Accounts Delivery Authority (PADA) says its working assumption is the onset of employer duties and, hence, Personal Accounts will be in October 2012.)

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## Personal Accounts (continued)

Draft regulations detailing employers' duties as regards automatic enrolment were published on 12 March 2009 for consultation until 3 June 2009. (See [our response](#).)

Two further consultations on draft regulations are planned for spring and autumn 2009, which are to cover:

- spring – the constitution and rules of the Personal Accounts Scheme
- autumn – the remaining elements of employers' duties (including re-enrolment and opt ins, the phasing-in of certain duties, qualifying schemes criteria and certification) and employment safeguards and elements of the compliance regime, including information to be passed to the Pensions Regulator, sanctions and penalties.

**Employers should start thinking about the impact the introduction of Personal Accounts will have on them and the design of their pension arrangements.**

The DWP and PADA jointly published a [consultation paper](#) on 28 April 2009 regarding the operation and rules of the Personal Accounts Scheme. The consultation ran until 20 July 2009.

PADA issued a discussion paper "[Building personal accounts: designing an investment approach](#)" on 7 May 2009 to support consultation. The consultation was closed on 10 September 2009.

## PPF levies

The PPF published a [consultation paper](#) on longer-term changes to the pension protection levy in November 2008 with a view to changing the levy formula from 2011/12 onwards. Although the principles received broad support, much of the detail was criticised. As a result, the PPF published a [consultation update](#) on 30 July 2009 in which it announced it would think again and delay implementing any changes until 2012/13 at the earliest.

The objective of the additional work, which will involve stakeholders within the pensions industry, will be to assist in developing an improved proposal. The areas for consideration could include:

- The principles of a new levy formula that charges for unexpected risk (such as the higher level of claims that can arise in adverse economic conditions)
- What the balance should be between short-term (expected) and long-term (unexpected) risk
- Options for the measurement of long-term insolvency risk
- The use of the PPF's long-term risk model in the development of proposals
- Options for the measurement of investment risk, particularly in relation to the more sophisticated investment strategies.

A new levy formula would affect how the aggregate levy is shared between levy-paying schemes. The PPF's Board is also interested in changing its approach to collecting levies so that levies are higher in aggregate when the economy is strong and employers can afford to pay more and lower when times are tough.

**Employers and trustees should monitor developments.**

## Risk sharing

The DWP issued a [consultation paper](#) in June 2008. The paper looked at two different risk-sharing approaches:

- Conditional indexation schemes – DB schemes with pension increases dependent on the funding level.
- Collective defined contribution schemes – schemes that are DC from the employer's perspective, but with a DB target and pooling across members to share out certain risks.

The DWP issued its [consultation response](#) in December 2008 and indicated it will be carrying out further work to explore the concept of Collective DC, but not Conditional Indexation. (See our [press release](#) for our views on this.)