The Agenda

Last updated: 14 July 2010

HamishWilson

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.

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

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Financial and compliance issues

A Day: old IR limits, powers of amendment and refunds of surplus

The new "simplified" pensions' tax regime came into being on 6 April 2006 ("A Day") – over fours ago!

Under transitional arrangements, the old "IR limits" and, in particular, the "earnings cap", continue to apply to schemes by default until 5 April 2011, unless removed by a specific deed of amendment. This was to provide a period of grace during which employers could decide which of the old limits they wish to "hard code" into their scheme's rules in order to avoid any unintended increase in members' benefits and scheme liabilities.

The Registered Pension Schemes (Modification of the Rules of Existing Schemes) Regulations 2009, which came into force on 11 December 2009, allow schemes to remove any requirements that may have been written into their rules to obtain HMRC's approval (which can no longer be obtained) before making certain rule amendments. However, the power to make such a change is currently set to expire 5 years after A-Day, ie on 5 April 2011.

Similarly, where schemes give the trustees the power to return surplus funds to the sponsoring employer in certain circumstances, lawyers are warning that the trustees must pass an appropriately-worded resolution by 5 April 2011 if the power to return surplus is to be retained. In this case, however, the trustees must first consider whether it is in schemes members' interests to do so and give members three months' notice that they intend to pass such a resolution, so employers will need to ensure they get the ball rolling in good time (ie before the end of this year).

Whilst there is agreement that schemes will lose the ability to return surplus (if they currently have it – some do not) while they remain ongoing, legal opinion is divided, however, as to whether failure to pass a resolution would remove the ability of schemes to return surplus after all liabilities have been bought out on winding-up.

The issue arises from unintended consequences of section 251 of the Pensions Act 2004. (The intention had simply been to provide a 5-year window for schemes affected by onerous pre-A Day restrictions on the return of surplus to remove those restrictions.) Steve Webb, the new Pensions Minister, indicated in an interview published on 1 July 2010 that the DWP will look at this issue and may possibly introduce corrective primary legislation in 2011.

At first sight, it may not be obvious why trustees should want to pass a resolution to maintain the ability to return surplus to employers. However, by so doing they will remove some of the "asymmetric risk" that often concerns employers (ie the ability to seek a refund if the scheme becomes over-funded) and this may make employers more willing to agree to a tougher funding target than might otherwise have been the case.

With the transitional arrangements now having only a few months left to run, employers should check whether appropriate changes have already been made and, where not, ensure the process is started soon so that their scheme's rules can be amended and resolutions passed by 5 April 2011.

FRESH PERSPECTIVES

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ACTUARIES AND PENSION CONSULTANTS

The Agenda

Last updated: 14 July 2010

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Commutation of trivial pensions

The restrictions on when occupational and personal pensions can be commuted on the grounds of triviality have now been relaxed. The Occupational and Personal Pension Schemes (Authorised Payments) Amendment Regulations 2009 were laid before Parliament on 9 November and came into force on 1 December 2009.

Corresponding HMRC Authorised Payments regulations came into force on 1 June 2009. These regulations also make genuine benefit payment errors (eg overpayments) easier to correct.

The DWP had intended to permit Guaranteed Minimum Pensions (GMPs) to be commuted as part of a trivial pension, but it revealed in its response to the consultation on the draft amendment regulations before they were laid (issued on 7 December 2009) that the new regulations are defective. A correction has now been made through The Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2010, which came into force on 6 April 2010.

Trustees may wish to ask their scheme's administrator how many trivial pensions it will be possible to commute and what 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.

Corporate governance

A new version of the UK Corporate Governance Code was published by the Financial Reporting Council (FRC) on 28 May 2010. It applies to accounting periods beginning on or after 29 June 2010 and is intended to help company boards become effective and accountable to their shareholders. It will continue on a "comply or explain" basis.

Changes (from what was formerly known as the Combined Code) include:

- The company's business model should be explained and the board should be responsible for determining the nature and extent of the significant risks it is willing to take – to improve risk management.
- Performance-related pay should be aligned to the long-term interests of the company and its risk policy and systems.
- All directors of FTSE 350 companies should be put forward for re-election every year – to increase accountability.
- There are new principles on the leadership of the chairman, the responsibility of the non-executive directors to provide constructive challenge, and the time commitment expected of all directors – to promote proper debate.
- There are new principles on the composition and selection of the board, including the need to appoint members on merit, against objective criteria, and with due regard for the benefits of diversity, including gender diversity – to encourage boards to be well balanced and avoid "group think"
- The chairman should hold regular development reviews with each director and FTSE 350 companies should have externally facilitated board effectiveness reviews at least every three years – to help enhance the board's performance and awareness of its strengths and weaknesses.

As institutional shareholders, trustees should familiarise themselves with the Code's requirements. They may also wish to consider whether any of the principles could be used to make their own trustee boards more effective.

Covenant assessment

The Pensions Regulator issued a statement for trustees about "Understanding employer support for DB schemes" on 9 June 2010 and followed this up by publishing "Guidance on monitoring employer support: covenant contingent assets and other security" for consultation until 7 September 2010, as well as revised guidance on internal controls (see below), on 15 June.

The statement stresses the importance of the strength of the covenant afforded by their scheme's sponsoring employer(s) whilst the draft guidance explains:

- the importance of measuring the employer's covenant

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Covenant assessment (continued)

- how to understand a group's legal structure and an employer's legal obligations
- what to consider when assessing the employer's financial position
- what to consider when valuing alternative forms of scheme security other than cash payments to the scheme
- when to appoint external covenant assessors and the process to follow in doing so and
- the importance of regular monitoring of covenant, and actions to take based on this.

In particular, the Regulator encourages trustees to establish protocols with the employer so that an agreed set of actions can be taken quickly if and when the strength of the employer's covenant falls below a certain point.

The Regulator added specific guidance for multi-employer schemes by publishing "Defined benefit multi-employer schemes and employer departures: guidance for trustees" on 1 July 2010 for consultation until 23 September 2010 (see "Employer debt regulations" below).

Trustees should familiarise themselves with the guidance and enter into discussions with their scheme's sponsoring employer(s).

Data protection

The Information Commissioner's Office (ICO) ruled in November 2009 that a trustee body was in breach of the Data Protection Act after the loss of unencrypted membership data when a laptop was stolen from its software provider.

Since 6 April 2010 the ICO has had the power to issue fines of up to £500,000 against errant "data controllers" (eg trustees). However, the ICO's own guidance on the issue of monetary penalties recognises that such penalties will only be appropriate in the most serious situations.

Trustees may wish to check whether their service-providers and advisers have adequate policies and procedures in place for protecting their members' personal data.

Employer debt regulations

The DWP published its response on 15 March 2010 to the long-awaited consultation on draft amendments to the "Employer Debt Regulations", which it had published in September 2009, and laid before Parliament The Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2010, which came into force on 6 April 2010. The new regulations introduce a "general easement" and a "de minimis easement", both of which are intended to make it easier for corporate groups to be restructured without triggering section 75 debts.

The general easement can avoid section 75 debts arising where a restructuring involves a one-to-one transfer of employees between two associated employers who participate in the same pension scheme. There are a number of conditions, including that the transfer of employees is accompanied by a transfer of corporate assets so that there is no overall weakening in the employer covenant as a result of one of the employers ceasing to participate in the scheme. More complicated restructurings involving transfers of employees between more than two employers are not catered for, although it may be possible to deal with these as a series of one-to-one transfers.

The de minimis easement has a simpler set of conditions, but is restricted to restructurings that affect no more than two members or 3% of a scheme's total membership, whichever is the greater, with total accrued pensions for members covered by the transaction being not more than £20,000 pa. One of the conditions is the scheme must be at least 100% funded on the PPF's s179 (levy valuation) basis; the PPF's figures show that 74% of all DB schemes were under-funded on this basis as at the end of May 2010, so this easement is unlikely to be of help to many employers for the time being!

As their title suggests, the regulations had originally been intended to make a number of technical corrections to the existing regulations, but many of these have now been postponed pending further consideration.

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Employer debt regulations (continued)

As mentioned above under "Covenant assessment", the Regulator published "Defined benefit multi-employer schemes and employer departures: guidance for trustees" on 1 July 2010 for consultation until 23 September 2010. Although not an authoritative legal guide, the draft guidance describes the different mechanisms that can be used to prevent section 75 debts from arising when there is a corporate restructuring and the various arrangements for dealing with these if they do. Its aim is to help employers and trustees to decide what may is most appropriate in various circumstances.

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).

The Pension Protection Fund (PPF) has decided how it intends to equalise Guaranteed Minimum Pensions (GMPs) – see their consultation response issued in October 2009. However, the PPF's approach may not be a viable solution for other schemes. Indeed, the PPF recognises that where there is a possibility of a scheme in an assessment period not entering the PPF at the end of that period it would be appropriate for the rule change giving effect to equalisation to be conditional on their scheme entering the PPF.

Steve Webb, the new Pensions Minister, indicated in an interview published on 1 July 2010 that the DWP will look again at the issue of equalising GMP, but would not be drawn on whether the DWP would be issuing any guidance on what should be done. Meanwhile, a firm of independent trustees has announced it is considering taking a test case to the European court of Justice to clarify how the issue should be tackled.

Although equalising GMPs would have the effect of increasing schemes' liabilities (and, so, their deficits), the main issue for many smaller schemes will be the complexity and cost of implementation, including the cost of obtaining advice on what is expected of them.

Regulations enabling GMPs to be converted into normal scheme benefits using the concept of actuarial equivalence came into force on 6 April 2009. The obligation to equalise GMPs may create the opportunity to eliminate them through conversion, but this is unlikely to be a realistic opportunity for many schemes.

Trustees should seek advice as to whether they should equalise GMPs in their scheme and, if so, what would be the most appropriate method for achieving this. In many cases, however, they may be inclined to take a wait-and-see approach and follow the lead of schemes with greater resources.

Internal controls

There is a legal requirement under section 249A of the Pensions Act 2004 that trustees of an occupational pension scheme must establish and operate adequate internal control mechanisms. This is supported by the Pensions Regulator's Code of Practice No 9.

As part of its focus on improving scheme governance, the Regulator published revised internal controls guidance on 15 June 2010. This has been especially constructed to assist trustees of smaller schemes by making the guidance more practical and targeted, recognising that they have limited resources at their disposal.

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Internal controls (continued)

Not being exhaustive, the guidance covers seven key risks:

- a lack of knowledge and understanding
- conflicts of interest
- ineffective relations with advisers
- poor record-keeping
- deterioration in the employer's covenant
- investment risk and
- ineffective retirement processes.

The guidance is designed to help trustees to establish and operate internal controls adequate for the purpose of securing that the scheme is administered and managed in accordance with:

- the scheme rules
- the requirements of the law and
- the standard as expressed in the code.

The guidance reminds trustees that a failure to comply with the legal obligation to establish and operate adequate internal controls is a breach of law and could result in regulatory intervention.

Trustees should ensure they have established appropriate internal controls for their scheme and review these and the associated risks regularly.

PPF levies

The PPF issued a Policy Statement on 29 January 2010 regarding changes to the determination of insolvency risk for the 2011/12 risk-based levy. This reflects feedback on a consultation paper on the measurement of insolvency risk that was published by the PPF on 9 November 2009 and a review of methodology and insolvency probabilities carried out last year by Dun & Bradstreet (D&B).

Changes already made by D&B are to make increased use of interim financial statements for quoted companies and to give greater weight to changes in payment behaviour, so as to pick up sudden changes in circumstances.

The changes for 2011/12 onwards include:

- D&B asking for appropriate evidence when employers seek changes to industry sector or geographic region
- D&B introducing a new "nationwide" attribute for businesses with branches in three or more different UK regions
- D&B proactively collecting charities' accounts from the Charity Commission's website rather than relying on non-commercial sponsors providing their accounts themselves
- D&B excluding PPF-compliant "type B" contingent assets when judging whether charges on a company's assets have a negative effect on insolvency risk
- when assessing the failure score of a subsidiary whose ultimate parent company is at substantial risk of failure, limiting the score to (at best) the score of the parent.

Given the potential sensitivity of PPF levies to D&B ratings, employers and trustees should assess how they are likely to be affected by the changes and plan mitigating action in time for next year's deadlines.

Record-keeping

As a result of a disappointing voluntary response to the "Record-keeping: good practice in measuring member data" guidance it issued in January 2009, the Pensions Regulator published record-keeping guidance on 2 June 2010.

The guidance sets targets for the completeness and accuracy of various aspects of membership data for both (DB and DC) trust-based and contract-based schemes to be achieved by December 2012.

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Record-keeping (continued)

The targets set for the existence and accuracy of "common data" (ie data that is core to all types of scheme) are:

- 100% for new data created after June 2010
- 95% for legacy data (created before June 2010) –in recognition that many schemes will have greater difficulties with older data and may inherit problems.

Trustees are expected to set scheme-specific targets for what the Regulator calls "conditional data" (which depends on scheme type, structure and scheme design) and "numerical data" (statistics relating to a scheme's membership). Trustees are also expected to obtain regular reports from their administrators on the completeness and accuracy of the membership records held and put action plans in place where data falls short of the expected standard.

Trustees and/or employers should discuss the quality of their scheme's data with their administrator or providers and agree plans for making corrective actions where necessary.

Reliance on the PPF

A test case involving the Ilford Pension Scheme (whose sponsor, the photographic firm, is in administration) has addressed whether it is appropriate for trustees to consider the PPF when making decisions. The case was taken to the High Court by Independent Trustee Services, the Scheme's trustee.

The Court ruled in November 2009 that it is inappropriate to exploit the availability of compensation from the PPF when making decisions about a scheme's future, although it also confirmed that trustees do not have a duty to take the interests of the PPF into account as it is not a scheme beneficiary.

The outcome of the case will be particularly relevant for the trustees of schemes that are less than 100% funded on the PPF's valuation measures as these are liable to enter the PPF should the scheme's sponsor become insolvent.

Trustees and employers may wish to seek advice on how the ruling affects them.

Scheme governance

The Pensions Regulator issued a statement "Good governance – keeping pensions safe" to trustees on 24 November 2009 and simultaneously launched a campaign aimed at encouraging good governance and administration and better management of scheme risks. The statement cites the Regulator's latest Governance survey, released on the same day, shows certain areas of improvement but also that gaps persist, particularly in smaller schemes.

The Regulator wants the trustees of trust-based schemes to:

- ensure all trustees meet the requirements for trustee knowledge and understanding (TKU), including those parts that have been updated recently and use the *Trustee toolkit* (or participate in other appropriate training)
- ensure adequate internal controls are in place
- know the quality of their membership records and have a concrete plan in place if improvement is required
- remember they are accountable for the services provided by advisers, administrators and others, have a formal process for their appointment, and know the activities they perform for the trustees and
- if their scheme is winding up, to complete the process within the two-year framework set by the Regulator.

Trustees should review their TKU requirements and governance procedures.

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Tax relief for high earners

The new Coalition Government announced in the Emergency Budget on 22 June 2010 (see our summary) that it intends to repeal the restrictions on tax relief for high earners that were legislated for by the previous government in the Finance Act 2010, which it believes could have unwelcome consequences for pension saving, bring significant complexity to the tax system and damage UK business and competitiveness. (The new Finance Bill enables the relevant provisions of the Finance Act 2010 to be repealed, but only before the end of this year.)

However, the Government is committed to protecting the public finances and introducing reforms that raise no less revenue and has decided to retain the current anti-forestalling arrangements.

The Government believes its objectives might be met better by an alternative approach involving reform of existing allowances, principally by reducing the annual allowance for pension saving. Provisional analysis suggests the annual allowance would have to be reduced from its current level of £255,000 to somewhere in the range £30,000 to £45,000. In DB schemes, this could catch employees at (say) middle-manager level who are given a promotional pay rise, particularly if they have long service.

Before making any firm decisions, the Government wishes to consult with the pensions industry to determine the best design for the new regime.

As widely feared, the Emergency Budget also confirmed that Employer Funded Retirement Benefit Schemes (EFRBSs) fall within the scope of the anti-avoidance measures that were announced in March's Budget. These measures tackle the use of trusts and other vehicles to reward employees in ways that avoid, defer or delay the payment of income tax and National Insurance Contributions by employees and directors or to avoid restrictions on pensions tax relief.

We are delighted the Government intends to scrap the idea of restricting the rate at which high earners obtain tax relief on their (and their employer's) pension contributions; the system that was due to come into force in April 2011 broke the concept of not being taxed on the same income twice and would not have provided high earners (particularly those with incomes in excess of £180,000 pa) with any incentive to use pension schemes as a vehicle for saving for their retirement. Even a much reduced annual allowance would encourage all tax-paying earners to make at least some pension provision and keep pension schemes in favour in company boardrooms, but will mean many more employees and employers will be affected.

Employers should thus start gearing up for the administrative implications and review whether they should be making changes to their pension provision for higher earners and/or long-serving employees.

Transfer incentive exercises

In the statement for trustees issued on 9 June 2010 about "Understanding employer support for DB schemes", the Pensions Regulator said he would be issuing revised guidance on transfer incentives and other situations in which members are asked to consider substituting or converting their benefits. The revised guidance was published in draft for consultation on 13 July 2010; the consultation runs until 5 October 2010.

The revised guidance reveals a more challenging, but less prescriptive approach, based on five key principles:

- An offer should be made in a clear, fair and not misleading way, to enable members to understand the implications and make decisions that are right for them.
- The offer should be open and transparent so that all parties involved in the process are made aware of the reasons for the exercise and the interests of the other parties.
- Conflicts of interest should be identified and appropriately managed in a transparent manner, and where necessary removed.
- Trustees should be consulted and engaged from the start of the process, with any concerns arising through the exercise alleviated before progressing.
- Fully independent and impartial financial advice should be made accessible to all members and promoted in the strongest possible terms; in almost all circumstances, the structure of the offer should require that members take financial advice.

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Transfer incentive exercises (continued)

The Regulator suggests that, if the employer has any concerns about the scheme members' ability to understand the structure and implications of the offer, then it should pay for independent financial advice and require that members take advantage of this advice before making a decision. Each member should be able to choose whether he or she takes advice from any appointed adviser, or takes advice from one of his or her own choosing.

Trustees should, above all, ensure they are comfortable that the selection, remuneration and broader commercial interests of the adviser are aligned with members' interests. Employers and trustees must ensure that the adviser selected for the task has appropriate qualifications and demonstrable expertise in advising members on the specific area of pensions.

The Regulator states that trustees should start from the presumption that such exercises and transfers are not in the members' interests, and should therefore approach any exercise cautiously and actively. He also finds it difficult to see how an offer involving cash incentives would lead to sound decisions being made.

Trustees should familiarise themselves with the revised guidance. Employers should carefully consider whether the potential benefits to them of trying to incentivise members either to transfer out or convert the form of their pension benefits outweigh the cost of ensuring such an exercise complies with the new guidance.

Winding up

The Pensions Regulator expects that trustees of schemes that are winding up should be able to complete at least the key activities within 2 years.

To help schemes achieve these targets, the Regulator issued revised winding-up guidance on 2 June 2010, along with the recording-keeping guidance – see above. (The Regulator blames historically poor standards of data for the delays often experienced when trying to wind up pension schemes.)

Trustees should familiarise themselves with the guidance if their scheme is about to be wound up.

HR and communication issues

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.

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 Government announced in the Emergency Budget on 22 June 2010 (see our summary) that it will consult shortly on how quickly to phase out the default retirement age (currently 65) from April 2011.

Employers should start to prepare for the removal of the default retirement age.

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Employer consultation

The Occupational and Personal Pension Schemes (Miscellaneous Amendment) Regulations 2010, which came into force on 6 April 2010, have added a new item to the list of benefit changes that require prior consultation with members. From 6 April 2010 employers must consult on an intention "to change what elements of pay constitute pensionable earnings, or to change the proportion of or limit the amount of any element of pay that forms part of pensionable earnings, for or in respect of members or members of a particular description".

The DWP's original proposal was limited to such changes being made in a scheme's rules, but the final regulations were widened so that employers are required to consult where they intend unilaterally to change which elements of pay constitute pensionable earnings, and where changes are made to the proportion of any element of pay that is to be 'pensionable', or where there are limits put on the amount of any element of pay that is pensionable. (This had always been something of a loophole.)

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

Statutory money purchase illustrations (SMPIs)

The Board of Actuarial Standards issued a consultation paper in March 2010 on changes to technical memorandum TM1: Statutory Illustrations of Money Purchase Benefits. The deadline for commenting was 4 June 2010.

The proposed changes include:

- updating the mortality tables (and allowance for future improvements in longevity) and the adjustment made to index-linked gilt yields to derive the discount rate used for estimating the cost of buying an annuity at retirement
- showing separately the pension projected to be derived from members' existing pension pots and from future contributions.

The consultation also raises the possibility of doing more to highlight the significant uncertainties surrounding money purchase illustrations and/or to harmonise with projections produced under the Financial Services Authority's rules.

BAS intends the changes to take effect for SMPIs with effective dates on or after 6 April 2011.

Trustees should monitor the consultation and ensure their administrators make appropriate changes to future SMPIs.

On the horizon

Accounting standards

The IASB's January 2009 Update indicates that the Board has tentatively decided to work towards two exposure drafts amending IAS19.

The first exposure draft, which was published on 29 April 2010, deals, 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).

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Accounting standards (continued)

In the first of the exposure drafts, "Defined Benefit Plans (Proposed amendments to IAS19)", the Board proposes that companies should:

- recognise immediately in the balance sheet all estimated changes in the cost of providing defined benefits and all changes in the value of plan assets, effectively removing the option of using the "corridor method", which allowed gains and losses within 10% of the larger of the assets and liabilities to be carried forward and those outside the "10% corridor" to be spread;
- use a new presentation approach that would clearly distinguish between different components of the cost of these benefits; and
- disclose clearer information about the risks arising from defined benefit plans.

In particular, the Board wishes to do away with the separate expected rate of return on plan assets and intends instead that DB scheme sponsors should account in finance costs for interest at the discount rate on the net liability or net asset, as appropriate.

The Board also proposes that the value of a DB scheme's liabilities should include a reserve for future administration costs. This is likely to have a proportionately larger effect on smaller pension schemes where economies of scale are not easy to obtain.

Removal of the corridor method would have a significant one-off adverse effect on many balance sheets currently protected from substantial unrecognised losses and add volatility in the longer term, while reserving for expenses will have a negative long-term effect on balance sheets. Replacement of the expected return on plan assets by the discount rate is likely to increase pension costs; some have suggested this would lead to a move away from investment in equities, which in pure accounting terms will become largely "unrewarded".

Employers may wish to quantify the effect of any proposed changes on their accounts.

Disclosure regulations

The DWP published a consultation on 6 January 2010 on proposed amending regulations and its response to an earlier consultation about changes to the current Disclosure Regulations as part of its Deregulatory Review. The latest consultation ran until 1 March 2010.

The DWP says there is little appetite for a wholesale move away from prescription and has decided to drop the idea of introducing an overarching disclosure principle that would have allowed trustees greater freedom to do what they consider to be appropriate for their scheme and its members. In particular, the DWP has decided not to replace specified time limits with "within a reasonable period" backed up with a new Code of Practice.

The DWP has, however, decided there is some scope for amending the requirements relating to Statutory Money Purchase Illustrations (SMPIs) with effect from 1 October 2010. This would enable schemes to provide shorter and simpler SMPI statements once the Board of Actuarial Standards has completed its ongoing review of its guidance (Technical Memorandum: TM1) – see above.
Schemes are also to be allowed to use electronic communications as their default method of communication if they so wish, provided members can opt out and receive hard copy communications if that is what they prefer.

Trustees may wish to consider whether they would like to amend their SMPI statements and/or whether it would be appropriate for them to make (greater) use of communicating by e-mail, intranet or internet.

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Limited price indexation and statutory revaluation

In a written ministerial statement given on 8 July 2010, Steve Webb, the new Pensions Minister, indicated that the DWP intends to use the Consumer Prices Index (CPI) instead of the Retail Prices Index (RPI) in future as the basis for statutory orders that affect limited price indexation (LPI), statutory revaluations in deferment and increases to guaranteed minimum pensions accrued between 6 April 1988 and 5 April 1997. This extends the use of the CPI to private sector pensions, following the announcement made in the Emergency Budget on 22 June 2010 that the CPI is to be the basis for future increases to public sector pensions.

The statement included the line "Using CPI will mean making some small changes to primary legislation to ensure we can apply it fully in every circumstance". This has generally been interpreted as meaning the Government will put overriding legislation in place that will enable schemes to use the CPI in future even where their rules explicitly refer to the RPI. Draft legislation will be put before Parliament at the earliest opportunity.

The DWP issued a follow-up statement on 12 July 2010 to clarify how the transition from the RPI to the CPI will work. The CPI will only be used to measure inflation over periods ending on and after 30 September 2010; the RPI will still be used for all past measures of inflation. For example, the revaluations applicable to an existing deferred pensioner will be based on a combination of the RPI up to 30 September 2009 and CPI from 1 October 2009.

Employers should check whether the changes will apply to their scheme(s) automatically or whether they will need to liaise with the trustees over an amending deed if the rules refer explicitly to the RPI. Trustees may need to review how they use investments to hedge out inflation risks and seek new financial instruments that are based on the CPI rather than the RPI.

Personal Accounts and automatic enrolment

Personal Accounts and the requirement for workers to be automatically enrolled into a "qualifying pension scheme" are scheduled to be phased in from October 2012 (see below).

As announced on 7 January 2010, the Personal Accounts Scheme is to be given the official name of the National Employment Savings Trust (NEST). NEST Corporation came into being on 5 July 2010 to take over from Personal Accounts Delivery Authority (PADA), which has served its purpose.

The Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010 were made on 11 March 2010, but do not come into force until 1 October 2012. Despite criticism at the consultation stage, they reaffirm the DWP's policy decision that an individual cannot opt out of scheme membership until they are a scheme member; the opt-out right is a right to opt out of scheme membership, not a right to opt out of automatic enrolment.

The requirements for automatic enrolment are to be phased in over a five-year period starting in October 2012, broadly starting with the largest of employers and ending up with small and micro employers (those with fewer than 50 employees). During this period, the minimum contribution requirements for DC schemes will start at a nominal 2% level. The minimum contributions required will be increased over the period to October 2017, when the full requirements of the Pensions Act 2008 will be met, ie an aggregate of at least 8% of "qualifying earnings" (including tax relief on members' contributions), of which at least 3% must be paid by the employer.

The new Coalition Government, however, has announced that it will be reviewing NEST and the automatic enrolment requirements, so watch this space!

Despite the uncertainties created by the new Government's review, employers should start thinking about the impact the introduction of NEST and automatic enrolment will have on them and the design of their pension arrangements.

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PPF levies

The PPF published a consultation paper on longer-term changes to the pension protection levy in November 2008. The principles received broad support, but much of the detail was criticised. The PPF's July 2009 consultation update announced the PPF would think again and delay implementing any changes until 2012/13 at the earliest.

The areas for reconsideration 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 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.

Given the potential sensitivity of PPF levies to D&B ratings, employers and trustees should continue to monitor developments and assess how they are likely to be affected when more details are known.

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