Issue 3

Exploring Group Pensions

By Mattioli Woods

Exploring Group Pensions is designed and written for those who have an active role in the administration, management and auditing of group pension arrangements

In this issue:

Wind down or a wind up?!!?
Article on enhanced transfers and the vested interest of some providers

PPF when is 100% not 100%
Simple maths calculations

Breaking the Rules
A light-hearted comment on scheme rules and policy conditions

Pension Snippets
Highlighting recent pensions news

Wind Down or a Wind Up?!!?

In a previous article we talked about gradual wind-down strategies, and in particular the use of an enhanced transfer exercise. Depending on the type of employer and the level of enhancement offered, such exercises can serve to reduce liabilities within a short time-frame, or simply transfer part of the risk that the company is taking to the members (without any immediate cost saving).

Given it would appear that around 80% of all employers have now closed their defined benefit scheme and in many cases are no longer accruing future service entitlement, it seems highly likely that a large majority of such companies will increasingly come to the conclusion that the sooner they can either wind-up or wind-down the scheme, the better. In this respect we are likely to see more demand from employers for advisers to proactively manage such wind-downs, via the use of enhanced transfer exercises etc. That said, it is very difficult for employers to obtain such advice due to the vested interest of a number of providers (who would prefer the scheme to be maintained for many years into the future, even on a paid-up basis).

Following on from the above, it has become quite apparent in the recent past that whilst some providers may initially appear to be supportive, as time goes on various 'barriers' start to materialise. By way of example, we have recently come across the following in respect of a number of major final salary providers/actuaries:

- An unusual basis being applied to a GN11 (transfer funding) report which resulted in an apparent under-funding of circa 20% (in the draft report) – this compared with a deficit of only 3% by applying the standard basis. The significance of this is that whilst a transfer exercise is perfectly feasible based on 97%, based on only 80% funding it would have been a non-starter
- A condition that all members being offered the enhanced transfer are also offered individual advice, to be funded by the company (prohibitively expensive)
- A complete refusal to provide any advice or assistance in this area due to a conflict of interest (at least they were being honest in this case!)
- An extortionate quote for providing transfer packs of £500 per member, leading to a cost of £130,000 based on the 260 deferred members in question.

The above tactics are really designed to make employers 'go away' on this issue and illustrates the very negative impact a vested interest can have.

The authors, Mattioli Woods, specialise in this area of pensions consultancy, providing a trouble-shooting service for clients and advisers throughout the UK.

Mattioli Woods
Pension Consultants

PPF

When is 100% not 100%?

The Pension Protection Fund was announced in June 2003 and came into force with effect from 6 April 2005. In the light of some high profile final salary pension scheme failures, including ASW Steel and Maersk, the Government tried to provide a level of comfort to final salary pension scheme members. Before these failures the UK Government and the FSA stated final salary schemes were 'guaranteed'.

Where a scheme's assets are transferred to the PPF there are caps on the level of cover provided and these have been widely misinterpreted. It is also the case that the Government has absolutely refused to act as guarantor to the PPF, such that if the PPF cannot afford to pay the level of benefits laid out in the regulations, then the governing board for the PPF is allowed to reduce the level of compensation as it sees fit.

The headline levels of cover offered by the PPF are 100% of benefits for retired members and 90% of benefits for members who have not yet reached normal retirement age. These levels sound quite favourable, but as in most things the devil is in the detail.

With regard to retired members, pensions already in payment are fully protected. However, the future rate of inflation protection is very likely to be lower. Specifically, under the PPF, there would be no increases paid in respect of service pre-6 April 1997 and increases in line with RPI, but capped at 2.5% in respect of service post-6 April 1997. In addition, spouses' pensions are capped at 50% and are subject to the same restrictions vis-à-vis inflation protection.

Deferred members receive less protection – only 90% of their accrued pension is protected and this is subject to an overriding limit of £26,050. The reduced pension is also subject to the same restrictions as per existing pensioners in respect of future inflation protection and spouse's cover.

Finally, and as above, these levels of cover may not stand the test of time as the governing board of the PPF is allowed to reduce the level of compensation as it sees fit (!).

With regard to the PPF generally, whilst the aim is laudable, the reality is that it may be contributing to an acceleration in the closing/winding-down of final salary pension schemes. The issue of the risk-based levy has moved much higher on recent meeting agendas, especially with an increase in the scaling factor leading to six-figure risk-based levies in some instances. At this level the effect of the levy may be to perpetuate under-funding and in turn increase the likelihood of the worst case scenario where the trustees are forced to apply for a transfer of the scheme's assets to the PPF (upon the failing of the principal employer) – this cannot be the original aim and goes to show just how poorly thought-out some changes to pension rules have been in recent times.

BREAKING THE RULES

I read with interest an article in the paper regarding a golf course in Bristol, where a law was introduced 88 years ago after nine of its club members died during the first world war. According to the official golf club rules, which were drawn up in 1919, no person of German or Austrian extraction, whether naturalised or not, should be allowed in the club-house or on the course! This restriction had been long forgotten and many Germans and Austrians have been playing on the golf course; however, not legally. After the ruling came to light, club members unanimously backed a motion to axe the rule at their last AGM and Germans and Austrians are now officially welcome on the course.

Scheme rules and contract terms are the foundation of our pension schemes. Whilst we are now in a new pensions simplified world, it is important to remember that much of the freedom and flexibility allowable within our new pensions legislation may not be allowable under the scheme rules or policy conditions.

Amending deeds and rule changes needs to be taken into consideration at all times, and it is important that scheme booklets and policy literature reflect the provisions contained in the scheme rules.

Subsequent changes in scheme bases need to be carefully documented and incorporated within any new scheme rules, especially as many schemes are updating their pension scheme rules in line with the Finance Act 2004 changes.

This in itself can create additional complications, as subsequent legislation changes may not always be reflected in scheme rules. We have already seen cases where members who thought they had a contractual right to retire at age 50 are now finding that this has not been reflected in the scheme rules. Partial transfers and unauthorised payments may be strictly prohibited by scheme rules and policy conditions. The message is simple but often overlooked – do not assume that the scheme rules will allow you to proceed just because HM Revenue & Customs' definition is met, and always ensure that scheme literature accurately reflects the scheme rules.

Mattioli Woods is one of the UK's leading and fastest growing consultancies in its area of expertise, the provision of pension and wealth management services for controlling directors, professional persons, owner-managed businesses and small to medium-sized PLCs. In particular, the practice has specialised in the application and provision of small self-administered pension schemes (SSAS) and self-invested personal pensions (SIPP), and Group Schemes.

The Pensions 'Bored'

In July this year a survey found that almost 50% of the population found the subject of pensions boring. What is more surprising is that someone had to do a survey to analyse the nation's view-point on pension schemes. The majority of people in the UK have no comprehension of how pension benefits are paid in retirement, how much money they will get from the State, how much their company pension scheme will pay, or how much a private pension will pay. Most people have a deep mistrust of pension schemes, fuelled by changing legislation and stock market crashes – none of which is the poor pension policies' fault.

For many people their pension scheme will be their second biggest asset after their home. However, they abandon their pension schemes, ignoring the paperwork sent by the insurance companies, never monitoring their pension fund, and many are still subject to old-style charging structures. Funds which may have been the right decision at the time are not now working for them and many are in 'closed' funds as a result of insurance company take-overs.

If as a nation we spent 100th of the time on our pension scheme as we do on our house, our pension affairs would be in a much better state, although for many who have watched their pension schemes plummet through no fault of their own, this warning falls on 'deaf ears'.

It is only by understanding what we have, what we can do with it and how we can utilise the pension benefits we have to create security and income in retirement, that the whole issue of pensions will become less boring and more relevant, and for that very reason, whilst we do try to look at the serious side of pensions management in 'Exploring Group Pensions', we will always try to provide you with a light-hearted view-point of our pensions industry. The next time someone tells you that pensions are boring give them a copy of 'Exploring Group Pensions', or get them to give us a call and we will try and make the subject slightly less boring for them.

NHS staff are set to retain the right to retire at 60. Under the new agreement, existing staff retain the right to a normal pension age of 60 in return for a rise in average contributions from 6% to 6.5%. New joiners from April 2008 will have a normal pension age of 65. The new agreement includes arrangements to calculate pension based on a members highest pay during the last three years. This will make it easier to take a lower paid job in the run up to retirement without adversely effecting pension. The NHS pension scheme already covers 1.3 million people

The team working on the **Financial Assistance Scheme (FAS)** Assets Review has issued a final call to trustees of final salary pension schemes, which have wound up under-funded and still have a solvent employer, to come forward. Draft regulations propose to extend FAS payments to include schemes with "compromise agreements" between trustees and solvent employers, where schemes began winding up between 1 January 1997 and 5 April 2005. This will pick up schemes where trustees have agreed to accept less money than they are owed on behalf of members to avoid forcing the employer into insolvency.

Paul Myners will head up the Personal Accounts Delivery Authority, taking up his post from 1 August 2007. The Delivery Authority will offer independent advice to Government and be responsible for setting up the new Personal Accounts from 2012.

It is proposed that **school children** between the ages of 11 and 16 will be taught about financial matters, including pension saving. However, financial education will not become compulsory.

This newsletter was written by Karena Woodall and Martin Scarrott

The PPF is launching a leaflet - 'Help! My employer has gone bust'. The leaflet explains how their compensation scheme works. The leaflet will be made available to scheme members through a variety of routes, such as the scheme trustees, the PPF website and through links with other relevant organisations, including the Citizens Advice Bureau.

KKR has reached a deal with the pension scheme trustees of Alliance Boots. Under the agreement, KKR will pay £418 million over 10 years and put aside a further £600 million as a potential safety net. The deal came the day after KKR's £11.1 billion takeover of Alliance Boots was cleared by the European Commission

Back to school Being a trustee of a pension scheme has become more onerous over the last few years. However, if you haven't already done so, it may be worth going on to the 'Trustee Tool Kit', the Pension Regulator's free on-line learning programme. Additional modules are being added to the 'tool kit' and the 'tool kit' is refreshed regularly. Even if it is just to prove to you what you know, it is a useful exercise. As a secondary point it does show that you take your trustee duties seriously and are willing to take on-line training to keep abreast of pension issues. The 'Trustee Tool Kit' can be found at http://www.trusteetoolkit.com.

A-Day strikes again Before you start panicking – no this not another attempt to overhaul our pensions system – just ironically the name to be given for 6 April 2012, the provisional date for the new Personal Pension Accounts to be introduced. Mattioli Woods will keep existing clients informed as to how the regulations affect them though our 'Exploring Group Pensions' magazine. The DWP has issued a consultation paper on the proposed changes to the Stakeholder employer designation requirements after Personal Accounts are introduced. Designation scheme requirements will be replaced by responsibilities for personal accounts; however, there will be transitional provisions where an employee has already started contributing to an existing designated Stakeholder pension scheme.

Mattioli Woods
Pension Consultants

Issue 3 was produced in September 2007

Mattioli Woods plc, MW House, 1 Penman Way, Grove Park, Enderby, Leicester LE19 1SY. Tel: 0116 240 8700 Fax: 0116 240 8701

Authorised and Regulated by the Financial Services Authority.