Technical Briefing

No.14

A summary of recent pensions news

Tax Simplification

Members and schemes alike are now getting to grips with HMRC's requirements for tax simplification. So far, most discussion has centred on the options and advice for members whose pension benefits currently exceed the lifetime allowance or are likely to exceed it by the time they come to retire.

The new regime has also increased benefit flexibility and allows schemes to provide pension benefits in different and innovative ways. However, many regulations were not issued until February and March 2006 and this has placed strain on schemes and their advisors to meet the new requirements in time.

It is against this backdrop that many schemes have decided to make only those changes that are needed to ensure minimum compliance with the new regulations. Decisions regarding discretionary changes to scheme design, perhaps to take advantage of phased retirement for example, have been deferred until later on.

The new regime has also fundamentally changed the ways schemes are administered with a raft of new reporting requirements that now need to be completed to ensure that aggregate benefits provided to each member fall within their Lifetime Allowance.

Pension Protection Fund ('PPF') Levy

As covered in Technical Briefing number 13, the PPF's proposals on the calculation of the risk-based and scheme-based levy have now been finalised. Each scheme's risk-based levy will be calculated according to its funding position on the PPF benefit basis and assumptions and also according to its sponsoring company's solvency risk, as assessed by Dun and Bradstreet, a credit rating agency. The scheme-based levy will be calculated as 0.014% of the value of the scheme's PFF liabilities.

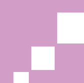
Regulator's Approach to Regulating Scheme Funding

The Pensions Regulator has finalised its proposals for regulating the way in which scheme's are to be funded under the new funding regulations (see Technical Briefing number 12 for full details). The Regulator will use two criteria to assess whether each scheme is being funded adequately.

The first criterion looks at the value placed on past-service benefits (the so-called Technical Provisions). The Regulator will compare the value placed on these liabilities to their equivalent values on a PPF basis and on an FRS17 basis (or IAS19 basis where available). Low ratios may suggest the scheme is being funded using a weak method and assumptions.

The second criterion looks at the future period over which any deficit is being cleared. The Regulator has stated it is likely to look at schemes whose recovery period is more than ten years and that it trustees to make reasonable investigations to ensure as shorter deficit recovery period as possible is agreed.

The Regulator is likely to request further information if either of these criteria is triggered and which could then lead to direct intervention in extreme cases.



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Contracting Out Rebates 2007/8 to 20012/13

The Government has set out the level of reduction in National Insurance Contributions ('NICs') applying over the five years from April 2007 for contracted out members. These differ from those recommended by the Government Actuary's Department in September last year. For salary-related contracting out, the reduction in NICs is very modest, rising from 5.1% to 5.3% of band earnings. Members who contract out on a money-purchase basis see increases of between 0.4% and 1.9% of band earnings except where the new cap level applies. This level has been lowered from 10.5% currently to 7.4% from April 2007 and is expected to dissuade many middle to older aged individuals from contracting out.

The pensions industry has criticised the new rates, arguing that the new rates are too low as they fail to reflect increased life expectancy and (for salary-related schemes) do not allow for the increased average age and therefore cost of providing contracted-out benefits to such members.

Lump Sum Death in Service only members

Section 255 of Pensions Act 2004 requires scheme to limit their activities to "retirement benefit activities". This phrase means retirement benefits and benefits that are supplementary to retirement benefits. However, as a result, schemes that provide employees with just a lump sum benefit payable on death in service contravene this requirement. The Act also provides the Pensions Regulator with the power to fine schemes that fail to comply with this section.

The DWP has issued a briefing note on this subject and the Pensions Regulator is due to issue its own interpretation. However, it is advisable for all trustees to check whether their schemes provide only a lump sum only to one or more of their members.

Changes to the Basic State Pension

The Government announced its intention to re-establish the link between the Basic State Pension and increases in national average earnings by 2012. At the same time, it is proposed that the State Pension Age will increase to 68 by 2050 to help offset the extra cost of this measure. These changes follow on from the reports issued by the Pensions Commission, headed by Adair Turner, which recommended changes to state pension provision. At this stage, further details have yet to be announced.

Transfer Values

The Government has announced it will legislate on the method and assumptions to be used for calculating the transfer values offered by pension schemes to members. Up to now, this has been governed by the Actuarial Profession through mandatory guidance. However, the profession's governing bodies proposed changes to this guidance in order that it fit in which the introduction of the PPF and new scheme funding regulations (see Technical Briefing number 07). However, the profession's membership rejected these proposals and the government then decided it would legislate directly instead.

Please contact your cprm consultant if you have any queries regarding this or other developments within the pensions industry that might affect your scheme.