Institute and Faculty of Actuaries

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The Changing Landscape of DB Regulation

Jeanette Holland

Partner

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agenda

- Is 2015/2016 all about DC?
- DB regulatory change is alive and well
  - Overview of recent legislation
  - Some changes affecting benefits
  - Some financial aspects
  - Changes arising from Employment law
  - The European dimension

Overview of the legislation

Pensions Act 2011

- money purchase benefits – effective 24 July 2014

Pensions Act 2014

- changes to State pensions and abolition of DB contracting-out

Taxation of Pensions Act 2014

- introduces DC flexibilities announced in 2014 Budget

Pension Schemes Act 2015

- introduces new categorisation of pension schemes
- affects relationship between DB and DC (notably transfers, conversions and financial guidance)

Finance (no. 2) Bill 2015/16

- introduces tapering relief on Annual Allowance – effective from 6 April 2016

Changes affecting benefits

Pension Schemes Act 2015: three main categories of schemes

Defined benefits scheme

A full pensions promise in relation to retirement income and other benefits and a fixed normal pension age.

Shared risk scheme

A pensions promise in relation to at least some of the retirement benefits. This covers some types of cash balance scheme. The DWP hopes other scheme designs will emerge as part of its "defined ambition" initiative, such as Collective Defined Contribution Schemes.

Defined contribution scheme

No pensions promise in relation to any of the retirement benefits.

What is no longer a money purchase benefit?

- **Pensions Act 2011**
  - amended statutory definition of "money purchase benefits" from 24 July 2014
  - restricts implications of the Bridge case
  - Transitional Regulations save most past actions
- **New definition**
  - "benefits the rate or amount of which is calculated by reference to a payment or payments made by the member or by any other person in respect of the member"
  - [where] "its rate or amount is calculated solely by reference to assets which (because of the nature of the calculation) must **necessarily suffice** for the purposes of its provision to or in respect of the member."
- **Likely to affect**
  - cash balance schemes
  - internal annuitisation
  - DC benefits with DB underpins e.g. DC accounts that are contracted-out
  - Reports to TPR/PPF
  - interaction with Budget flexibilities

Pension Schemes Act 2015

Transfers and conversions from DB to DC

Transfers from unfunded DB public sector schemes to DC schemes prohibited

- Transfers from unfunded DB public sector schemes to DC schemes prohibited
- Transfer from funded DB public sector schemes to DC schemes permitted
  - extension of process to reduce cash equivalents where there is a deficit
- Transfers from DB private sector schemes to DC schemes permitted

Statutory right to transfer a "category" of benefit:

- money purchase benefits
- flexible benefits other than money purchase (e.g. cash balance)
- other benefits which are not flexible benefits (e.g. final salary/DB)

Statutory right to transfer final salary/DB

- arises following termination of accrual
- but not extended beyond present limit of 12 months before NPA

Regulator guidance on transfer payments/conversions (April 2015)

- will be reviewed in 2016 "in the light of experience"

Transfers and conversions from DB to DC (cont'd)

- Protection of "**safeguarded benefits**" (benefits other than money purchase or cash balance)
- Requirement to take "appropriate independent advice"
  - before transferring from DB to DC/converting DB benefits to DC
  - from FCA authorised financial adviser (member must provide signed confirmation from adviser)
  - although exemption if DB (CETV) transfer is less than £30,000
  - compliance failure by trustees may lead to a penalty
  - employer may have to pay for advice if employer, rather than member, initiates ("encourage, persuade or induce") a transfer
- Trustees required to go through process of checking that appropriate advice has been taken although "***it is not the trustee's role to second-guess the member's individual circumstances and choice to transfer safeguarded benefits***"
- But what is "conversion" from DB to DC?
  - internal transfer or surrender of rights within schemes
  - may need rule changes to achieve (with attendant statutory hurdles)

Abolition of DB contracting-out

Key changes at 6 April 2016 under Pensions Act 2014

- new single-tier State pension, therefore, abolition of DB contracting-out
- full National Insurance Contributions (**NICs**) become payable automatically by employer and employee

Affects all schemes contracted-out on a DB basis

- whether open or closed to accrual
- which include Guaranteed Minimum Pensions or satisfy the Reference Scheme Test
- which integrate with State provision
- raises issues for employers, trustees, administrators and actuaries
- statutory override to enable employers to make amendments to recoup increased employer NICs cost
- no statutory override for other changes e.g. integration with State provision

Consider effect on calculation of contributions and benefits

Identify where benefits or contributions integrated with State provision

Consultation requirements

Abolition of DB contracting-out (cont'd)

Auto-Enrolment Compliance

- If a DB scheme is currently using its contracted-out status to meet the auto-enrolment obligations of the employer, this will no longer be possible from 6 April 2016.
- New alternative "quality requirements" have been introduced:
  - Compliance by meeting the existing money purchase quality requirements under Section 20 of the Pensions Act 2008
  - Compliance by meeting the "cost of funding" requirements
- Employers that are currently using the RST as a basis for auto-enrolment compliance will need to ensure that they address this issue in good time and make any changes necessary to ensure continued compliance at 6 April 2016.

Summer Finance Bill 2015

- Tapered annual allowance
  - will apply to individuals whose income, including the value of their total pension input amount, is over £150,000
  - for every £2 over £150,000 income, annual allowance will be reduced by £1
- Tax on lump sum death benefits
- Further tax changes envisaged in high-profile consultation: *Strengthening the incentive to save: a consultation on pensions tax relief*
  - aim of the consultation is to look at how individuals can be better encouraged to save adequately for their retirement
  - policy considerations surround the consultation - "*If people are to take responsibility for their retirement, it is important that the support on offer from the government is simple and transparent, and that complexity does not undermine the incentive for individuals to save*"
  - responses due by 30 September 2015

Further changes affecting benefits

Equalisation /conversion of guaranteed minimum pensions	work on this is "ongoing" (HMRC bulletin: July 2014)
Preservation	to be restructured, but final salary method to continue as default method for final salary schemes
Same sex marriages	application to pre-5 December 2005 accruals awaits outcome of Innospec appeal (outcome of 29 July hearing expected)
Disclosure to members	new requirements to accommodate the budget flexibilities

The financial aspects

The financial aspects

Statutory debt (Section 75)

- DWP considering whether further relaxations are appropriate
  - Response to lobbying by charity and not-for-profit sector
- Focus is on schemes for non-associated employers and industry-wide schemes
  - necessary because existing statutory mechanisms (e.g. flexible apportionment) may not be workable in this context
  - possible elimination of debt trigger when employer ceases employing active members
- Possible relevance of Baptist Church case
  - will the Pensions Regulator and PPF give comfort to trustees who choose not to call in a triggered debt?
  - on what basis may trustees decline to call in the debt?
- Some regulatory uncertainty has been addressed in the courts
  - Merchant Navy Ratings case and the definition of an active member

The financial aspects

DB Funding Code

- Revised Code of Practice (number 3) in force from 29 June 2014
  - Reflects the Pensions Regulator’s new statutory objective “to minimise any adverse impact on the sustainable growth of an employer”
  - Intended to promote a “reasonable balance” between the need to pay benefits and the needs of the employer
    - “managing” risk (as opposed to “mitigating” risk) through “integrated risk management”
    - eliminating deficits over an “appropriate period” rather than as quickly as employer can afford
  - Encourages “open dialogue and collaborative working between trustees and employers”
- New TPR Guidance “Assessing and monitoring the employer covenant” – August 2015
  - addressed primarily to Trustees
  - not restricted to valuation e.g. could be relevant when agreeing a flexible apportionment arrangement

The financial aspects

PPF levy calculations

- Now administered by Experian
- Changes basis of measuring insolvency risk: PPF-specific measure of insolvency risk
- Designed to be more transparent, enabling schemes to check their data and scores via web portal
- Changes to initial consultation proposals include
  - amending entry conditions for the "large and complex" assessment
  - capturing full-time equivalent employee members
  - excluding immaterial mortgages from "highly predictive" "mortgage age" condition
    - aggregate charges not exceeding 0.5% of total assets
    - employers with investment grade credit rating
    - refinancing on equal or better terms
- FAQs provide limited guidance re certification requirements for last-man-standing schemes

Changes arising from Employment law

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Shared parental leave

- Applies to children due from 5 April 2015
  - mothers may convert up to 50 weeks of maternity leave into shared parental leave
- Any period of paid shared parental leave must be treated in accordance with the "normal employment requirement"
  - for benefit accrual: treat as if receiving normal remuneration for the period of absence
  - for employee contributions: member contributes by reference to contractual remuneration or shared parental pay actually received

Changes arising from Employment law

Holiday pay

- Bear Scotland v Fulton (EAT) decision in November 2014
- 4 weeks' statutory holiday pay to include
  - non-guaranteed overtime (which employer need not offer but employee must accept)
  - certain travel allowances
- Possible pensions implications
  - whether this will affect current and historical calculation of pensionable pay and contributions will depend upon drafting of rules
    - e.g. does definition of pensionable pay include holiday pay?
  - whether this affects the calculation of qualifying earnings and basic pay for auto-enrolment purpose

The European dimension

The European dimension | IORPS update

- IORPS II proposal draft published: March 2014
- Likely implementation date for Member States: 31 December 2016
- A package of harmonisation measures
  - improving scheme governance structures and provision of information to members
  - promoting cross-border pension provision in the single market
  - encouraging long-term investment policies
- Proposed requirement for scheme trustees to have "professional qualifications" now dropped (November 2014) – allowing lay trustees to continue
- 28 July 2015: draft report by European Committee on Economic and Monetary Affairs on IORPS II published with a number of interesting recommendations

Any Questions?

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