

Funding Code of Practice and 2014 Budget

The Occupational Pensioners' Alliance 2014 AGM

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8 May 2014

Agenda

The Pensions Regulator's draft code of practice

- Recap of the existing regulations and guidance
- Reasons for changing the current code of practice
- Expected timescales and key principles in the draft code
- Regulator tools for intervention in funding valuations
- Towers Watson's thoughts on the draft code

2014 Budget announcements

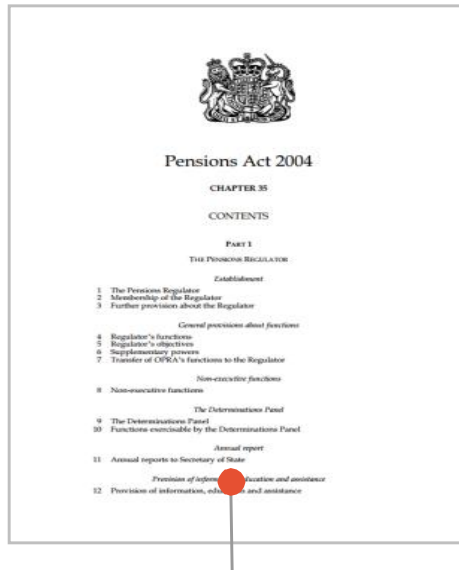
- Pension headlines from the 2014 Budget
- Potential affect to members
- When changes will take effect

Code of practice

Regulating defined benefit schemes

The existing position

Pensions Act 2004 (UK legislation)



Establishes
scheme-specific
funding regime

Scheme Funding Regulations (UK legislation)



Further detail
of scheme-specific
funding requirements

Code of Practice: Funding defined benefits (The Pensions Regulator)



Practical guidelines
for meeting the legislative
requirements

The Regulator also issues guidance on specific topics including:

- How the Pensions Regulator will regulate the funding of defined benefits (May 2006)
- Understanding employer support for DB schemes (June 2010)
- DB Annual funding statement 2013 (May 2013)

Consultation on the regulation of DB schemes

Why?

The key drivers for change are:

- To take into account the **new statutory objective**
‘in relation to the exercise of its functions under Part 3 only, to minimise any adverse impact on the sustainable growth of an employer’
- To **reflect experience** over the last eight years, a better understanding of risk and changing circumstances
- To re-ensure the framework and approach **remain fit-for-purpose** over the coming years

The Pensions Regulator’s other objectives in relation to DB schemes are:

- to protect the benefits of members of occupational pension schemes
- to promote, and to improve understanding of the good administration of work-based pension schemes
- to reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund (PPF)

A new regulatory approach

When?

- **2 December 2013**

Consultation period on the revised Code of Practice opens – Pensions Regulator (tPR) issues 4 documents:

- **Consultation document: Regulating defined benefit pension schemes**
- **Draft code of practice 3: Funding defined benefits (76 pages)**
- **Draft defined benefit regulatory strategy (16 pages)**
- **Draft defined benefit funding policy (60 pages)**

- **7 February 2014**

Close of consultation period

- **June 2014**

Revised code and 2014 Annual Funding Statement expected

- **July 2014**

Revised code anticipated to be in force

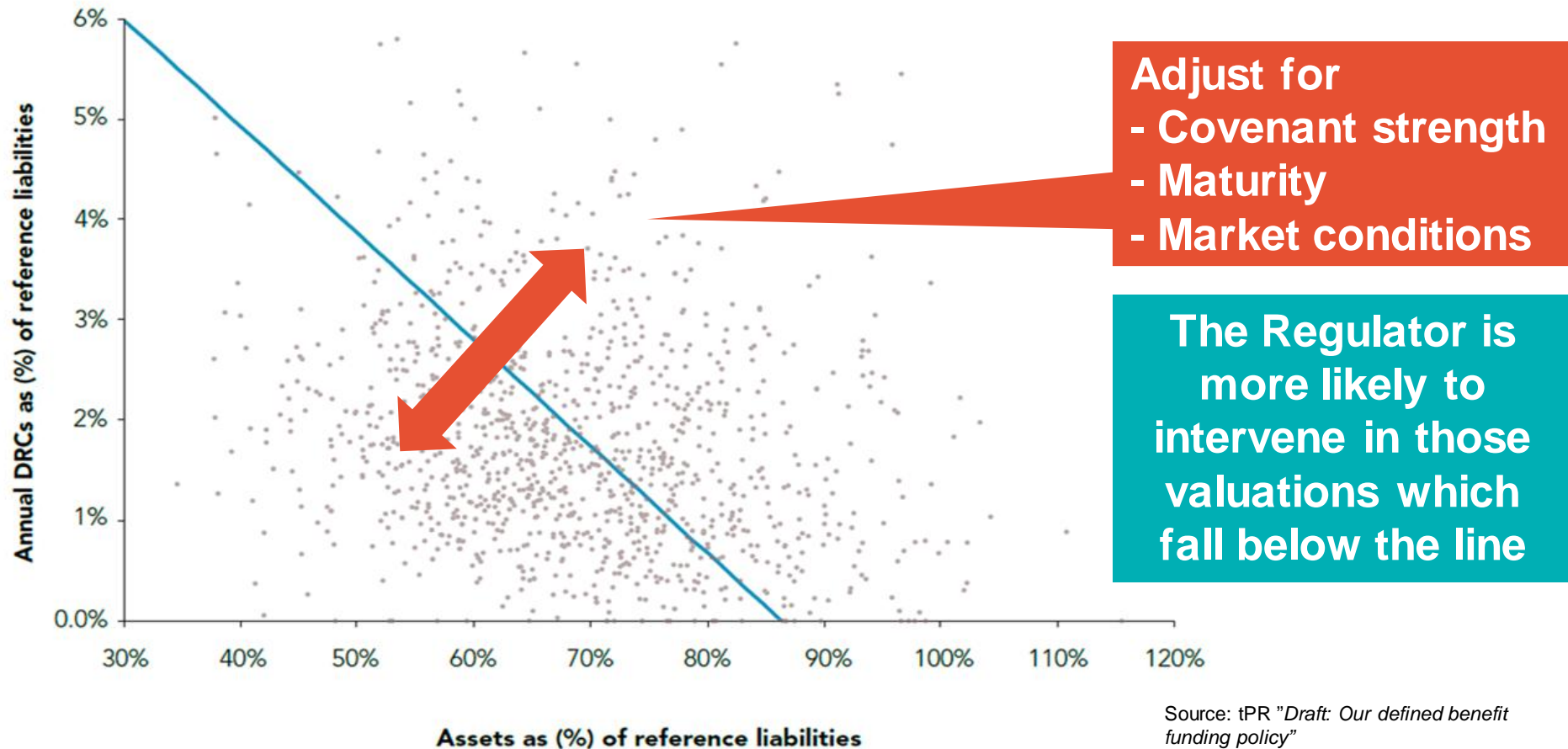
Key funding principles

How?

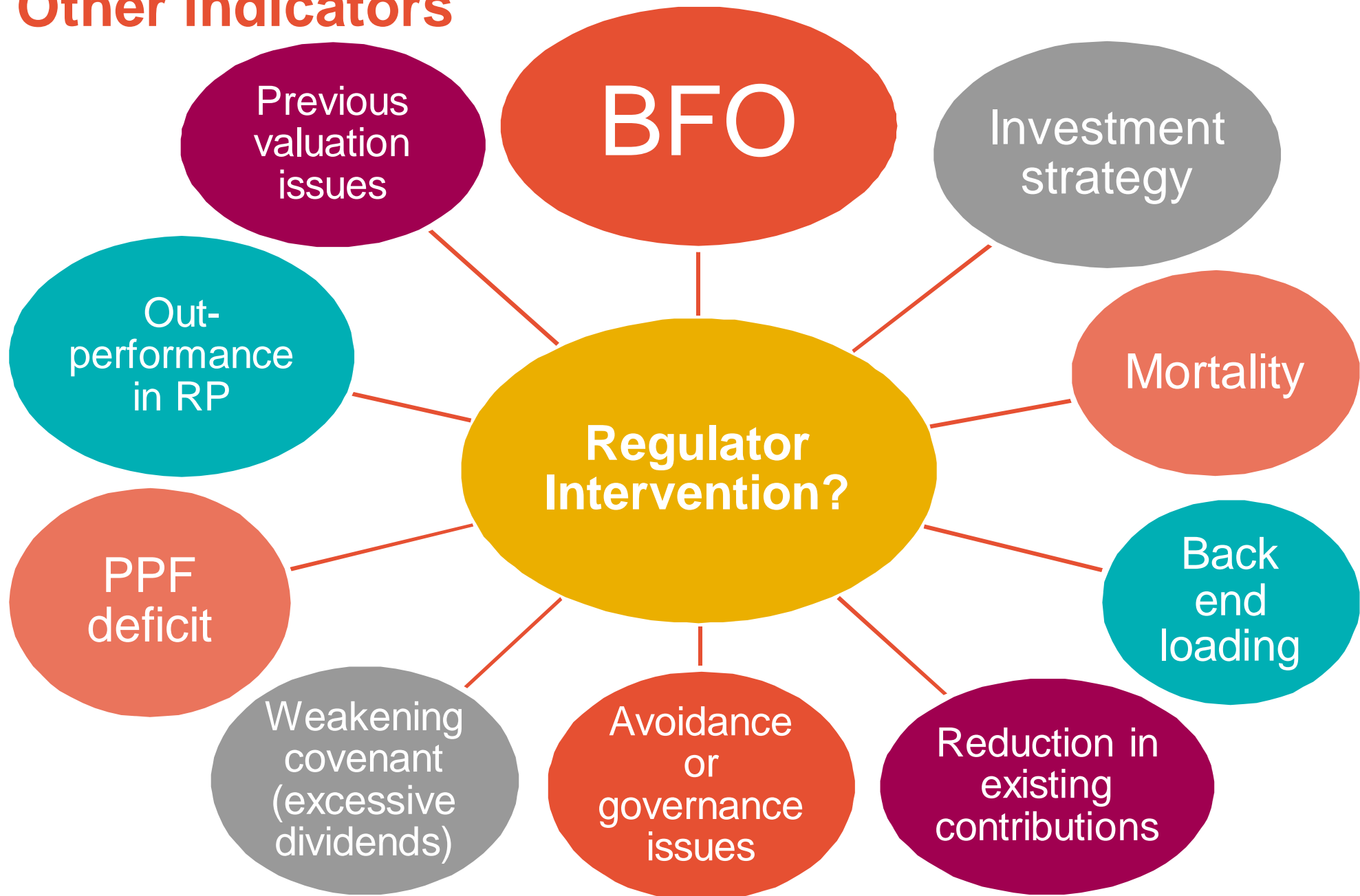
- **Working collaboratively:** Trustees and employers should work together in an open and transparent manner to reach funding solutions that recognise the needs of the scheme and the employer's plans for sustainable growth
- **Managing risk:** Integrate the management of employer covenant, investment and funding risks; identifying, assessing, monitoring and mitigating those risks effectively – including setting clear triggers for action
- **Taking risk:** Be confident that the employer is able to mitigate likely adverse outcomes
- **Taking a long-term view:** Employer covenant, funding and investment targets
- **Proportionality:** According to scheme's size, complexity and circumstances
- **Balance:** Act in the interests of members and consider the needs of the employer. Ensure that their decisions do not: 1. compromise the needs of the scheme; 2. unreasonably impact on the employer's sustainable growth plans and its long term ability to support the scheme, or 3. involve taking excessive or unnecessary risks
- **Fair treatment:** Scheme is treated fairly amongst competing demands on the employer
- **Reaching funding targets:** Any funding shortfall eliminated as quickly as the employer can reasonably afford
- **Well governed**

Regulator intervention – BFO

- Balanced Funding Outcome indicator (BFO) is at the centre of the new regulatory approach to funding (already in use)
- **Scheme-specific** and is defined in terms of the **expected deficit contributions** that will be paid to the scheme over the **‘medium’ term**



Other indicators



TW's thoughts on the draft code

- Principles based and so **should be shorter**
- The integration of the Regulator's **new objective** appears reasonable from a trustee perspective but employers may ask for stronger wording
- Overall thrust for a **collaborative approach**
- Greater guidance required on interpreting '**sustainable growth**'
- Greater guidance required on **measuring sponsor covenant** over medium and longer term
- Increased focus on **understanding of risks** and taking an **integrated** approach
- **Practicalities** of contingency planning and flexible risk management
- **Unintended funding impacts** if the BFO is used as the primary risk indicator with pressure to level up or down to the BFO

Questions



2014 Budget

Impacts and considerations for pension schemes

Budget 2014 – pensions headlines

Radical changes to the rules for DC pensions

“From April 2015, no-one will have to buy an annuity”

After 25% tax free lump sum, can withdraw all remaining amounts taxable at the member’s marginal rate

Free DC guidance for retirees

From April 2015, all DC retirees offered free and impartial **face-to-face guidance** on their options at retirement

Restrictions on DB transfers?

The Government is consulting on **restricting transfers from DB to DC** due to concerns about the impact on the economy

Minimum retirement age to increase to 57

Proposal to **increase the minimum pension age**, reaching 57 by 2028, and maintain it ten years below State Pension Age

Trivial commutation limit increased

Trivial commutation value for benefits in all registered pension schemes increased from £18,000 to £30,000

Small lump sums payable for benefits in a scheme valued at no more than £10,000 (increased from £2,000)

Potential member implications

Defined Contribution scheme members

- DC savings are now much more attractive
- May need to change investment strategy
- Postpone retirement until 2015?
- Members are less likely to buy an annuity

Defined Benefit scheme members

- DC flexibility in retirement may be in some DB members' best interests
- May only be a short 'window' for members to transfer from DB to DC environment
- How will AVCs be affected?
- I only have a small pension – can I cash it in?
- Communications to members?

Face-to-face guidance



- Who will provide this?
- What will be covered?
- Further advice?

The end of DB transfers?

- Removal of transfer option from public service DB
- The decision is more finely balanced in relation to private sector DB schemes
- A range of alternatives is being considered

What next for DB to DC transfers?

The government is open to options including:

1. The **removal of the right** for DB members to transfer to DC, except in exceptional circumstances
2. DB transfers to DC allowed, but transferred funds are **ring-fenced** and subject to the existing DC tax framework
3. DB transfers to DC allowed, but a **cap placed on the amount** that people can transfer from DB to DC each year
4. DB transfers to DC allowed, but any transfer to a DC scheme must be **approved by the DB scheme trustees**
5. Leaving in place the **existing flexibility** to transfer from DB to DC (but only if it is clear that this would not create significant risks for the UK economy)

Timeline for implementation



- **19 March 2014**

Budget speech and beginning of consultation

- **27 March 2014**

Initial changes come into effect (trivial commutation/small lump sums)

- **11 June 2014**

Closing date for the consultation

- **Before 22 July 2014**

Government response (before summer recess)

- **April 2015**

New changes take effect

Questions



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