



# Pensions Briefing

Keeping you up to date with events in your sector.

## Welcome

Welcome to the latest of the Chantrey Vellacott DFK pensions group newsletters. Since our previous edition **The Pensions Regulator (the Regulator)** has been busy issuing guidance notes and its three year plan. Therefore, this edition highlights a few of these important documents.

Firstly, Bob Lancefield summaries some of the key points in the Regulator's three year plan which perhaps gives us some insight into their policies over that period.

Secondly, Neil Smith, pensions partner with CMS Cameron McKenna highlights some recent Regulator guidance and their potential impact upon schemes.

Lila Clarke highlights an important distinction in the switch from RPI to CPI which could have a significant impact upon an employer's reporting earnings. She then talks about an

important clarification of s75 which could mitigate or defer the liabilities of a company leaving a multi-employer scheme.

Finally, Mark Kinsella writes about recent guidance on administration records and alternative ways trustees can improve and control them.

My thanks to all these contributors, especially our guest writer, Neil. As always we hope you find these articles of interest and would welcome any constructive comments or queries you may have.



**Stephen Corral**  
Head of Pensions Group  
T: 020 7509 9182  
E: scorral@cvcdfk.com

## The Pensions Regulator – Corporate Plan

On 21 April 2011, **The Pensions Regulator (the Regulator)** unveiled its corporate plan for the next three years.

The detailed plan, which runs to forty pages, outlines the Regulator's continued focus on educating and enabling employers and the pensions sector, along with addressing risks to retirement savings and the Pension Protection Fund. The plan includes five strategic themes which are summarised below:

### 1. Improving Governance and Administration

Whilst there have been improvements in governance behaviour, a governance survey showed that there remain weaknesses in areas such as internal controls in a substantial minority of schemes surveyed. Good administration systems go hand in hand with meeting good member outcomes. The increased prevalence of defined contribution (DC) schemes and the introduction of automatic enrolment will increase the level of transactions requiring more robust scheme administration. The Regulator concludes that to secure improved standards of administration, there may need to be an increased focus on setting benchmarks and standards. To support trustees to become more demanding clients of administrators and to encourage industry coordination, the standards may seek to establish clarity about the

accountabilities of all involved, including, administrators, auditors, trustees and managers.

### 2. Reducing the risks to DB members

The whole pensions landscape is changing. Based on the Regulator's "Purple Book", in 2010 58% of schemes were closed to new members compared with 44% in 2006 and those closed to benefit accrual also show an increase from 12% to 21% over the same period. The Scheme Specific Funding regime has been in place for over five years and its principles and practice are now part of the Regulatory landscape with the result that funding risks are becoming better managed.



**Bob Lancefield**  
Audit Director  
T: 020 7509 9331  
E: rlancefield@cvcdfk.com

**The Regulator is responsible for maximising compliance as well as protecting the benefits of members.**

The Regulator intends to publish, for consultation, a revised strategy, based on its findings over the last five years, in the autumn of 2011. The Regulator believes that it needs to develop its approach to defined benefits (DB) regulation to identify where intervention is needed, reflecting that many schemes are properly engaged in the funding process and should not require the same level of scrutiny and regulatory support as when the requirements were new. The Regulator will also consider the differing approaches of schemes and whether different standards or guidance may be appropriate for schemes seeking to substantially de-risk as opposed to those where the benefit promise may not be fulfilled without taking substantial risks.

### 3. Reducing risks to DC members

Workplace pension provision has been the subject of a long-term shift from DB to DC. Between 2004 and 2009, active membership of DB schemes is estimated to have declined by 43% and DC schemes increased by 19%. As a result of workplace pension reform, it is estimated that a further five to eight million people will become new savers or saving more in DC schemes. Therefore, it is critical that the DC supply is prepared.

In January this year, the Regulator published a discussion paper aimed at developing a regulatory strategy for DC schemes. Six key areas have been identified as necessary to a good member outcome on retirement:

- Appropriate contribution decisions.
- Appropriate investment decisions.
- Efficient and effective administration.
- Protection of assets.
- Value for money.
- Appropriate decumulation decisions.

In connection with this, the areas that may need review over the next three years are considered as how to:

- Raise value for money and governance standards in small schemes and whether there is merit in encouraging a transition to larger schemes.
- Encourage pensions providers to develop products with the right characteristics to deliver good member outcomes.
- Facilitate understanding among trustees and others over long-term asset protection.

- Help employers in choosing a scheme which will deliver the best outcomes for its members.
- Promote effective and efficient administration.
- Help those running schemes to improve the member outcomes.
- Promote understanding of the accountability for decision making in pensions.

### 4. Preparing for 2012

Automatic enrolment is the core employer duty of the pensions reform set to commence in 2012. Phased implementation will affect larger employers first. The Regulator is responsible for maximising compliance as well as protecting the benefits of members. Using its risk based approach, the Regulator will take steps to ensure employers and their advisers have the information they need to understand their duties and make it easy for employers to register by simplifying the registration process.

The Regulator is conscious of the impact on small and micro employers and intends to communicate directly with them at least one year before their duty date and again three months before.

### 5. Better Regulation

Regulatory efficiency continues to be a key priority, since 1 January 2011 certain rule making powers have been transferred from government to EU bodies, the Regulator, together with the FSA are members of those bodies and have a shared responsibility for ensuring that new EU rules are in the best interests of UK pension scheme members. Over the next three years the Regulator will promote the better regulation agenda through the five key principles of;

- Transparency
- Accountability
- Proportionality
- Consistency
- Targeting

A copy of the corporate plan is available for download from: [www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk)

For further information please contact Bob Lancefield.





**Neil Smith**

Partner  
CMS Cameron  
McKenna LLP  
T: 020 7367 3848  
E: neil.m.smith@  
cms-cmck.com

## New guidance from the Pensions Regulator following recession impact on the pensions market

**The Pensions Regulator not only has powers to enforce the duties of employers and trustees of pension schemes, but also collects data on scheme performance and provides guidance on good practice.**

The Regulator has recently issued both some controversial new guidance and new statistics about schemes' performance during a particularly difficult period for the market. We have set out its main conclusions below.

### Incentive exercises guidance

Many companies with defined benefit schemes have undertaken or are currently considering undertaking enhanced transfer exercises in order to reduce liabilities in their schemes.

The Regulator confirmed its controversial stance on incentive exercises in December when it published its new guidance on this area.

The guidance confirmed that trustees should always start from the presumption that an incentive exercise is not in members' interests, and they should approach any exercise "cautiously and actively".

This is a stronger stance than the Regulator's previous guidance (on "inducement offers"), principally because the Regulator has indicated that it is concerned by the number of worrying practices it had encountered in this area.

The guidance sets out five general principles for employers and trustees to follow:

- Trustees should be engaged with and consulted from the start and should apply high levels of scrutiny to offers. They are responsible for protecting members' interests and ensuring the guidance is followed.
- Offers should be presented to members in a way that is clear, fair and not misleading.
- Offers should be open and transparent, so all parties involved are made aware of the reasons for the exercise and what the other parties' interests are.
- Conflicts of interest should be identified and managed, or removed. This may, for example, apply to company-appointed trustees or professionals who advise both employer and trustees.
- Independent, impartial financial advice should be promoted "in the strongest possible terms" and made available to all members. The employer should pay for it unless the member opts to use their own adviser and members should be obliged to take advice in almost all cases.

It also provides examples of information which should be given to members and warns that offers involving immediate cash incentives are likely to distort members' decision making.

In relation to the presumption, it acknowledges that some members' personal circumstances could mean it is more likely they would benefit from accepting employers' offers.



However, it states these cases are "likely to be in a minority and, very possibly, a small minority" and adds, "high quality financial advice is key to identifying those members".

Will the Regulator's stance deter companies from carrying out such exercises? Hopefully not. Our experience is that a carefully thought-out and communicated enhanced transfer exercise can both successfully mitigate funding risks of a scheme and offer good value to some of the members.

### Recovery plans

The Regulator also recently released its latest analysis of the financial state of recovery plans, based on valuations with an "as at" date between 21 September 2008 and 2009.

This was a year of "historic market lows," the Regulator said. There was a change in the estimated aggregate funding position from a surplus of £20bn on the s.179 basis in March 2008 to an estimated aggregate deficit of £192bn a year later.

Average recovery plan lengths had risen by one year, to an average 9.4 years, continuing the previous year's trend (when the increase was 1.1 years).

The proportion of schemes triggering further Regulator involvement in their recovery plans increased from 62% to 81% over the year. The greatest increases in triggering related to the technical provisions and the investment return assumption, but recovery plan length and back-end loading were also common triggers.

Although the number of clearance applications gaining approval fell in the financial year 2009-10 compared to the previous year (reflecting a fall in applications), the number of open cases and their complexity increased.

Whether scheme performance will improve next year remains to be seen, but in April the Regulator expressed the hope, in its Corporate Plan for the next three years, that increasingly fewer schemes will require its assistance in the valuation and recovery plan process in 2011. It added, however, that the effects of the downturn remain "pervasive on both sponsors and schemes".



**Lila Clarke**  
Pensions Manager  
T: 020 7509 9175  
E: lclarke@cvsdfk.com

## Is the potential change from RPI to CPI for pension increases good news for your accounting profits?

The government has announced that its future pension increases will be based on the change in the Consumer Price Index (CPI) rather than the Retail Price Index (RPI). CPI is estimated to be, on average, 0.7% lower than RPI. Occupational schemes following the government's lead should therefore benefit from a reduction in the value of their long term liabilities.

Therefore, the main accounting question is how is that reduction reflected in a reporting employer's financial statements under FRS 17?

The accounting standards board have considered this and issued guidance to be followed with immediate effect. In essence, it hinges on how pension increases are defined in the scheme's trust deed and rules or, expected by reference to past action or public statement.

### Is the rate of increase defined as RPI or any other rate?

The rate of increase may be written into the scheme's trust deed or rules or, expected by virtue of past practice or public statement. If this is the case, the change represents a change to the benefit structure and hence should be treated as a past service credit to the profit and loss account, and recognised in the accounting period that the change is agreed.

### Is the method to be used in calculating increases not specifically defined?

In this case the use of RPI in previous periods may be taken as the most appropriate assumption at the time therefore, any change to the rates applied becomes a change in assumption and the resultant credit is to be taken to the Statement of Total Recognised Gains and Losses.

Whilst we can advise on the accounting implications, the decision in respect of the above may well require the advice of the scheme actuary.

Further to our article in our winter 2010 briefing, the treasury have announced that a working party has been set up to examine the calculation of CPI, in particular the inclusion of housing costs, which may reduce the long term difference compared to RPI.

For further information please contact Lila Clarke.

## Multi-employer schemes and employer departures

Where employers leave either a multi-employer scheme or cease to be involved with a scheme through ceasing to employ active members, insolvency or scheme wind-up, a statutory obligation for that employer to pay its share of the scheme's liabilities, known as the "section 75 debt" arises.

The section 75 debt is calculated on the buy-out basis, the most expensive option. Whilst trustees are obliged to request that employers pay this debt in full, legislation does allow a number of options to defer or reallocate the liability.

The Pensions Regulator issued updated guidance in November 2010 covering the six prescribed ways of modifying or removing a section 75 debt. The headings for these are:

- The restructuring test
- Scheme apportionment arrangement
- Withdrawal arrangements
- The de-minimis restructuring test
- Approved withdrawal arrangements
- Regulated apportionment arrangements.

In all cases a number of detailed conditions must be met.

The full details can be found on the regulators website, [www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk).

For further information please contact Lila Clarke.



## Scheme Administration Initiative

**In April 2011 the Pensions Regulator issued a statement for trustees as part of its focus on administration issues in pension schemes.**

The statement comes as a result of extensive consultations with the Institute of Chartered Accountants of Scotland (ICAS) and England and Wales (ICAEW), and sets out what trustees should expect of their statutory auditors in relation to record-keeping, including:

- That trustees are ultimately accountable for scheme records and for the associated internal controls, even if the day to day running of the records are delegated to administrators.
- The necessity of risk assessment processes which consider risks associated with member records.
- That trustees are responsible for ensuring that their member records meet the targets recommended by the Regulator in 2010 - that 100% of new data and 95% of legacy data should be accurately completed by December 2012.

The basis of the statement is to clarify that trustees are accountable for member data and that they take separate steps to ensure the quality, accuracy and risks of their member data rather than rely on their schemes statutory audit information. The Regulator emphasises in the statement that there is no statutory obligation for auditors to consider controls or risks, other than those associated with the financial transaction reports in the financial statements.

The Regulator has also published a guide for trustees to assist them in discussions with their administrator to ensure that data records are up to date, accurate and appropriately maintained.

The guide follows research undertaken by the Regulator that uncovered that, in particular for the smaller schemes

that it spoke to, 20% with 12-99 members never meet with their administrators to review their records, compared with 10% of schemes with 100-999 members. A total of 39% of schemes with 12-99 members were unaware of the Regulator's record-keeping guidance, compared with 23% of schemes with 100-999 members.

### What should Trustees and Administrators be doing?

#### Trustees should:

- Contact their administrator and ensure that they assess any risk that poor or deficient member records has on the scheme.
- Discuss with their administrator and their auditor the extent that the risks are tested and the controls that are in place to manage data.
- Ensure that they have full reassurance on member records, via regular re-testing and/or commissioning tests from third parties other than their administrator.

Administrators should be carrying out regular reviews of their data and reporting the findings to the Trustees and they should consider more periodic reviews to be carried out on some or all of their records by an external supplier, who should also be able to provide constructive feedback on areas of improvement. We believe that data mining offers a best value solution for the review process.

### How can data mining help?

The use of data mining software and forensic testing techniques allows for the complete testing of all members' data be it held on single and/or multiple databases. Data mining can be the most cost effective solution for administrators and trustees because it allows for 100% testing at relatively low cost. It also means that the administrators and trustees can demonstrate full compliance with the administrative, governance and stewardship responsibilities as set out by the Regulator.

#### Data mining can be used for:

- one off data cleansing and regular housekeeping checks of members data;
- accuracy, consistency and completeness checks of all electronic data held for scheme members;
- matching of electronic data held on its members to a myriad of external publically held databases and records both in the UK and abroad;
- forensic testing for 'gone aways';
- matching members records to current death related registry data;
- fraud investigations;
- electronic testing and matching of members data held in multiple relational databases.



**Mark Kinsella**  
Internal Audit Partner  
T: 0118 952 4700  
E: mkinsella@cvsdfk.com



### How long does it take?

Depending upon the size of the record database and the checks to be carried out the process typically takes between four to seven days for a standard review of internally held and maintained databases including the production of a report. An initial meeting is held to help us understand the structure of your data, the number of records to be reviewed, the checks to be performed and any DPA requirements. Where the scope of the review includes the testing of data held in more than one database, external database and the testing for 'gone aways' and death registry data then this will take longer. Much of the work can be done off site so there is very little disruption to day to day business.

### How can we help?

Chantrey Vellacott DFK has extensive experience of reviewing records and member databases ranging from 100 up to 20 million records. We believe the use of forensic data mining software provides an innovative and cost effective solution to both administrators and trustees of schemes who want independent assurance as to the integrity of scheme member records.

The Pension Regulator's Statement:

<http://www.thepensionsregulator.gov.uk/docs/auditors-statement-feb-2011.pdf>

The Pension Regulator's Guide to keeping member records up to date: <http://www.thepensionsregulator.gov.uk/docs/record-keeping-prompt-sheet-feb-2011.pdf>

For further information please contact Mark Kinsella.

## Our services to pension schemes include:

**Audit** - We currently provide a cost-effective, value-added, fully compliant, tailored and timely audits to over 150 pension schemes, both large and small, under the umbrella of 'painless compliance' – giving total assurance and saving the time of key personnel.

**Data mining/cleansing** - We can review pension schemes administration data to ensure its accuracy and cross check to public records.

**Internal controls reviews** - We can provide trustees with a review of the effectiveness of the controls currently in place with their investment manager.

**Employer covenant reviews** - We can provide trustees with an independent assessment of the financial position of an employer and of the risk that the employer may be unable to meet its obligations to the pension scheme. We have performed over 40 covenant reviews over the last three years which have been well received by pension trustees for their clarity and added value. We are recognised for providing a quality service at a reasonable cost.

**Tax** - We can provide advice to organisations on their corporate tax and income tax on any overall employee benefits package that it provides.

**Trustee training** - We have solid experience of providing financial training to trustees.

## Who to Contact

For further information or advice, please contact the author of the relevant article, your usual Chantrey Vellacott DFK partner or one of the following:

### Birmingham

Suk Aulak  
0121 454 4141  
saulak@cvdfk.com

### Croydon

Richard Willis  
020 8633 9378  
rwillis@cvdfk.com

### Northampton

Chris Hindle  
01604 639257  
chindle@cvdfk.com

### Brighton & Hove

Ken Touhey  
01273 421200  
ktouhey@cvdfk.com

### Leicester

Elliot Harris  
0116 247 1393  
eharris@cvdfk.com

### Reading

Ian B Johnson  
0118 952 4700  
ibjohnson@cvdfk.com

### Colchester

Dawn Lay-Flurrie  
01206 549303  
dlay-flurrie@cvdfk.com

### London

Stephen Corrall  
020 7509 9182  
scorrall@cvdfk.com

### Stevenage

Mark Stevens  
01438 741147  
mstevens@cvdfk.com

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