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SPC releases new aid to preparation for A-Day

Under the new pension taxation regime, beginning on April 6th, 2006, Scheme Administrators have three basic responsibilities when retirement benefits are paid to members:

- to establish whether a chargeable amount arises on any benefit entitlement to the member
- to account to HMRC for tax, which arises on any chargeable amount
- to provide the member with a statement within three months of retirement confirming the amount of their lifetime allowance used up by the payment of their benefits and, if a chargeable amount has crystallised, a notice confirming the level of chargeable amount which arose, and the lifetime allowance charge due on this amount (and whether or not they have accounted for the tax charge, or intend to do so in due course).

To discharge their responsibilities Scheme Administrators will be required to obtain details of members' existing entitlements to protection or to enhanced allowances.

The Scheme Administrator is jointly liable with the member for any lifetime allowance charge unless they can prove that they acted in "good faith" based on information provided by the member. Scheme Administrators will therefore require members to provide suitable declarations regarding the information they provide.

Although many scheme sponsors have yet to make changes to their schemes to accommodate the new regime, Administrators will already find that they are having to issue benefit quotations now for post A-day events, due either to the constraints of the current disclosure regulations or to member requests.

To assist Administrators in obtaining the necessary information, the SPC Administration Committee has produced two template member declaration forms. These may be downloaded via the SPC website at <http://www.spc.uk.com>. The first of these forms is the Protection and Lifetime Allowance Enhancement Statement. This form has been designed to be pre populated by the Scheme Administrator with information held on the scheme database. The second form is the Details of Benefits From Other Registered Schemes or Overseas Transfers Form, which is designed to obtain information from the member regarding other benefit crystallisation events, which have occurred, or will have occurred, before the impending event under the current scheme.

Scheme Administrators are free to use these forms in their current form or to adapt them in designing their own bespoke member declarations. ■



SPC London Evening Meetings

We have the following forthcoming SPC London evening meeting.

Date	Subject	Speaker	Venue
April 4 2006	Why we can afford to retire.	Phil Mullan (Economist and Author of "The Imaginary Time Bomb")	City Conference Centre, 80 Coleman Street, London EC2R 5BJ

If you are interested in attending this meeting, please click on the subject to obtain a booking form.

Handouts are available from the following meetings:-

Date	Subject	Speaker
October 19 2005	Learn About Money (A briefing on the Life Academy's much praised financial education package)	Stuart Royston (Chief Executive, the Life Academy)
January 25 2006	Building on the Second Report of the Pensions Commission	Professor John Hills (A member of the Pensions Commission)
February 7 2006	The new Age Discrimination Legislation: What it means for Employers	Dorothy Henderson (Head of Employment at Travers Smith)

SPC Conference 2005

SPC's 2005 Annual Conference was the most successful yet staged, with an audience of around 130 drawn from the senior ranks of the pensions world.

The conference took place at the London Stock Exchange and was arranged in partnership with FT Business.

The principal speaker was Stephen Timms, the Minister of State for Pensions Reform at the Department for Work and Pensions.

We took the opportunity to poll the audience on a wide range of important questions in the pensions world and you can see the results by clicking [here](#). ■



SPC Dinner 2005

Just before the SPC Conference the **SPC Dinner** took place on November 3rd at the Savoy Hotel, London WC2. The principal speaker was **Lawrence Churchill**, Chairman of the Pension Protection Fund. **Steve Bee** of Scottish Life responded to the toast to the guests and the final speaker was Robert Birmingham, the SPC President.

There was an excellent attendance – close to 400. ■

New additions to the SPC website

We have added the following to the SPC website (<http://www.spc.uk.com>), both in the Archive section:-

- All issues of SPC News for 2005
- Certain SPC circulars for 2005 ■

HMRC consults on new income draw-down tables

In November HMRC issued a consultation document on proposed new tables to determine annual income limits for members' and dependants' unsecured and alternatively secured pension income under the new pension taxation regime, beginning in April 2006.

SPC submitted a response, which is available by clicking [here](#). ■

The new tables have now been published. For a copy click [here](#). ■

Draft pension taxation regulations

SPC has responded to draft pension taxation regulations published by HMRC in [October](#), [November](#) and [December](#).

For a copy of the draft regulations themselves, please click [here](#). ■

HMRC gives clarification on lifetime allowance percentages

Through the SPC Money Purchase Committee, HMRC has clarified a point on lifetime allowance percentages.

It has no objection to payers of multiple annuities to one individual issuing multiple Lifetime Allowance percentage annual notices in accordance with Regulation 16 of the (at the time of preparing this issue of SPC News) draft Information Regulations. Payers can aggregate notices or not, as they see fit.

Please sponsor John Mortimer in the London Marathon 2006



The SPC Secretary, John Mortimer, is attempting the 2006 London Marathon.

He is running in support of Scope, the charity which works with children and adults with cerebral palsy and those who care for them.

He would welcome your sponsorship, which you can give by clicking [here](#). ■

SPC seeks clarification on enhanced protection and continuing life cover

We have asked HMRC to confirm our understanding of the interaction of enhanced protection and continuing life-cover (as addressed in Pension Taxation Simplification Newsletter 8), providing any clarification or corrections, where appropriate. Our understanding is as follows.

Where both the form and amount of benefit are fixed, defined and promised by the scheme, irrespective of how or whether they are funded, such provision will constitute *defined benefits*. The form must be fixed in the way the benefit is promised, e.g. it will be paid as a lump sum death benefit. The amount can be related to a multiple of salary, an amount linked to salary and service, a fixed amount or any other formula.

Where a scheme makes provision for a sum of money, which is not *defined benefits*, that amount will be *money purchase*. To determine whether the sum constitutes *cash balance* or *other money purchase* benefits (or both – at least at scheme level), it is necessary to consider how the provision is expressed within the scheme rules.

If the scheme will provide an amount for

the provision of death benefits and the level promised is not conditional on the proceeds of life cover (e.g. the promised sum will be paid irrespective of whether there is, or the level of, a valid contract for life insurance), the arrangement is *cash balance*.

However, if a scheme does not "promise" to make available a certain amount, instead making provision for an amount equal to (or including) the proceeds of a life cover policy, the arrangement is *other money purchase*. This is because, where the amount payable is not "promised" by the scheme but is instead dependent on payment of a certain level of insured life cover, that cover is considered simply an investment of the trustees.

Thus the proceeds of a personal pension (and section 226A) term assurance will be *other money purchase* benefits. Although the sum insured might (and probably would) have been fixed at the outset, the scheme is not making an unconditional guarantee to provide that level of benefit. If, for example, the contract becomes invalid, there might be no amount payable.

We await HMRC's response. ■

Pre-budget report makes changes to Finance Act 2004

The Chancellor's Pre-Budget report statement in December included an announcement on further changes to the new tax regime.

The main change is to remove the tax advantages for investment by SIPPs (self-

invested personal pension schemes) and their occupational equivalents (often former SSASs) in residential property and other non-traditional assets – such as fine wines and classic cars. These changes will extend to schemes

→ where the member(s) can direct which individual investments the scheme makes ("self-directed" schemes in new HMRC parlance). The objection is to specific investments selected by the individual - for example investment in a residential property unit trust will still be possible.

In addition, legislation will block arrangements which seek to "churn" tax-free lump sums - using the lump sum proceeds from one scheme to re-invest in another attracting a fresh set of tax reliefs. At the time of preparing this issue of SPC News, HMRC had just published proposals on how it intended to block "churning".

Other changes which may affect specific groups of members:

- A limited right to keep a retirement age below age 55 for those with protected rights (to retire earlier than 55) who retire and then wish to re-join the scheme or return to their old employer, subject to anti-avoidance provisions where the intention behind the device is to act as a National Insurance Contribution mitigation vehicle.
- Refinements to the definitions of pension credit members, member and employer in certain narrow circumstances.
- Refinements to the provisions for lump sum death benefits before age 75 for those taking drawdown.

There is also confirmation that the Finance Bill 2006 will include measures to:

- Fix lump sum cash in relation to a money purchase arrangement at 25% of the actual fund value, even if a scheme pension is delivered.
- Apply a further check against the Lifetime Allowance at age 75 related to change in fund value for those who select a drawdown/unsecured pension option at an earlier age and then do not purchase an annuity by 75.
- Clarify how inheritance tax will apply to choices under the new pension scheme rules, with effect from 6 April 2006. ■

Pensions Regulator's consultation on cross-border schemes

In November 2005 the Pensions Regulator published a consultation document on its approach on cross-border schemes. You can obtain a copy by clicking [here](#).

SPC made a brief response to the consultation document, essentially supporting the approach proposed by the Regulator. A copy is available by clicking [here](#). ■

Draft code of practice on reasonable periods for the purposes of the disclosure regulations

In September 2005 the Pensions Regulator published a draft code of practice on reasonable periods for the purposes of the Occupational Pensions Schemes (Disclosure of Information) Regulations 2006.

A copy is available by clicking [here](#).

SPC's response to the draft is available by clicking [here](#). ■

SPC comments on the draft disclosure regulations

We briefly summarised draft regulations, replacing the 1996 Occupational Pension Schemes Disclosure Regulations, in [SPC News No. 6 2005](#).

We made the following general comments:-

1. We are very disappointed that the opportunity has not been taken to consolidate all disclosure requirements into a single set of regulations. For example,

requirements on information to be given on transfer values or on pension sharing on divorce should be found in the same place as the general disclosure requirements. If DWP will not assist in this way, we suggest that the Pensions Regulator should be asked to produce some non-statutory guidance, which sets out all disclosure requirements in a single document.

A practical consequence of the failure to consolidate all disclosure requirements will potentially be to leave requirements outside the disclosure regulations still subject to time limits, rather than "reasonable periods". This would be unsatisfactory, so requirements outside the disclosure regulations will also need to be amended to specify fulfilment within a reasonable period. →



comments on the draft directive on portability

In October the European Commission issued a draft Directive aimed at improving the portability of pension rights. A copy is available by clicking [here](#).

The UK's negotiations on the draft are being led by DWP and we have made a submission, setting out our questions and concerns arising from the draft Directive.

For a copy of the response please click [here](#).

DWP has now issued a formal consultation document, which you can obtain by clicking [here](#), and which, at the time of preparing this issue of SPC News, we had under consideration. ■

- 2. We would like the regulations to leave it beyond doubt that the information which they set out can be provided by electronic means, for example by e-mail or through an intranet. This would be particularly helpful in the case of active members.
3. We support the government's agenda of activation, education and information. Many people need to strengthen their retirement provision

and one way of stimulating them to take action is to present them regularly with information, which enables them to assess where they currently stand, so that, if their position needs to be improved, they have the opportunity to act. This does mean, however, that the information with which they are presented should not be regarded by them as overpowering in its volume or its complexity. Otherwise, they

will not give proper attention to the information and the opportunity for them to form a better understanding of their position will be lost.

The draft regulations require too much detail to be provided automatically and therefore do give rise to the risk that the information will not be properly used.

Our response is available in full by clicking [here](#). ■

SPC response to draft code of practice on internal controls

The Pensions Regulator published a consultation document on a code of practice on internal controls in September 2005. For a copy please click [here](#).

For a copy of SPC's response please click [here](#). ■

SPC in work with NISPI on cessation of contracting-out

The National Insurance Services to Pension Industry area of HMRC has started a project to create a "shared workspace", for use when pension schemes cease to contract-out and/or wind-up. The aim of the project is to speed up the interaction between NISPI and scheme administrators during the cessation process.

NISPI wishes to involve scheme administrators in the design, development and quality assurance of the shared workspace. NISPI's initial view is that the shared workspace might include the production of schedules of members and associated GMP calculations, when schemes first cease to contract out, and input documents used by scheme

administrators to advise how they propose to secure members' benefits. The aim is to have the shared workspace in use with at least one scheme administrator by April 2006 and then to extend its use generally. SPC is participating in the development of the workspace through its Administration Committee. ■

Protected rights and contracted-out rights: trivial commutation

We have written to DWP, concerning an inconsistency between the position on trivial commutation as it will be laid down under the new pension taxation regime, beginning in April 2006, and the draft Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2005, on which DWP consulted in March 2005. Since the draft regulations will override the provisions in the new pension taxation regime, we would like the miscellaneous amendments regulations to move in the direction of the new pension taxation regime.

Under the new pension taxation regime we understand that it will be possible to commute spouses' benefits at the same time as the members' benefits are commuted (this is supported by the guidance in the Registered Pension

Schemes Manual). The miscellaneous amendments regulations, as drafted, do not appear to permit trivial commutation of spouses' benefits at the same time as those of the member. This would mean that, if trivial commutation were paid for the member's benefit, an amount would need to be set aside to cover the spouse's benefit (although this could later be commuted as trivial)

Effectively this would mean revisiting regulation 4 of the draft miscellaneous amendment regulations.

Similarly it is not clear whether a spouse's GMP or s9(2B) rights can be commuted for triviality at the same time as the member's benefit (regulation 2 of the draft regulations).

This point arose when we analysed the emerging detail of the new pension

taxation regulations against relevant DWP provisions.

DWP has confirmed that it is the intention to allow all contracted out rights to be trivially commuted. This includes any benefits which would have been provided to someone other than the member. It is providing for this by the link through to HMRC trivial commutation lump sum rules in paragraphs 7 to 9 of Schedule 29 of the Finance Act 2004. The approach for trivial commutation, from April 2006, is that if the FA2004 conditions are met then the contracted out rights can be taken.

DWP does not think it needs to add anything to the draft regulations to cover this issue, which has also been raised by others. DWP proposes to clarify the matter in its formal response to the consultation on the draft regulations.

We have welcomed the confirmation that it is the intention to allow all contracted-out rights to be trivially commuted. For the avoidance of doubt, we have requested confirmation that it

is the intention to allow safeguarded rights to be trivially commuted. They were not included in the examples of contracted-out rights quoted in DWP's response.

On an allied point, there remains a problem with protected rights where they form part of a "short service refund lump sum" under the new pension taxation regime to apply from April 2006. Where the refund includes protected rights, the short service benefits cannot be completely extinguished by a refund.

Our understanding of the "short service refund lump sum" is that it must extinguish a member's total rights under the scheme, and this remains possible

where a contributions equivalent premium is paid for schemes contracted out on the reference scheme test basis. Currently, a scheme may refund the contributions whilst retaining liability for the protected rights, but we believe this option will be removed from April 2006, to comply with the new taxation regime.

However, it seems to us that schemes contracted out on the protected rights basis will require full immediate vesting by virtue of the new tax regime. We believe that this would impose an unfair administrative and funding cost on schemes simply by being contracted out on a different basis.

It would be extremely helpful, and

appears to us to be consistent with the overall intention on the treatment of protected rights, if the amount representing protected rights could also be refunded. The employer share of the protected rights could then be deemed and used as trustee reserve funds, with presumably some new notification procedure to HMRC. Alternatively, we asked whether DWP would consider allowing a premium to be paid to restore S2P rights in the same way as a CEP is now utilised. ■

DWP plans guidance on employer consultation

In October 2005 DWP issued for comment planned guidance on the Occupational and Personal Pension Schemes (Consultation by Employers) Regulations 2006 and the Pensions Act 2004 (Consultation by Employers)(Protections for Nominated Representatives) Regulations 2006.

For a copy of the draft guidance please click [here](#).

For a copy of SPC's comments on the draft guidance please click [here](#). ■

PAYE processes and age-related rebates

SPC News No. 5 2005 updated you on delays at HMRC in processing age-related rebate payments for the year ending April 5th 2005.

HMRC expected to be back on track with payment by the end of the year and has achieved this. ■

DWP issues clarification of Administration and Audited Accounts (Amendment) Regulations 2006

The above regulations addressed most of the comments we raised during consultation on the draft.

However, there still seem to be some errors and we asked DWP to comment on these.

Regulation 2(3)(d)

This substitutes "the Regulator" for "the Occupational Pensions Regulatory Authority" in regulation 2(3) of the "Audited Accounts Regulations". However, the term "the Regulator" is not defined. Rather, "the Authority" should have been substituted, being the term used within the Pensions Act 1995 to mean the Pensions Regulator.

Regulation 3(2)

The revised definition of a "wholly insured scheme" substituted within regulation 1(2) of the "Scheme Administration Regulations" includes

the words "specified insurance policies with specified insurers", but fails to define these terms. Essentially, the wording has been lifted from the draft Occupational Pension Schemes (Investment) Regulations 2005 but, unfortunately, the definitions of "specified insurance policies" and "specified insurers" have not likewise been carried across to the "Scheme Administration Regulations".

Regulation 3(4)(a)

Regulation 3(3)(g) states that, inter alia, sub-paragraph (d) of regulation 3(1) of the "Scheme Administration Regulations" is to be omitted. However, a reference to that sub-paragraph has been erroneously retained within the substituted sub-paragraph (b) of regulation 3(2) of the Scheme Administration Regulations. To correct this, "(d) to" should be replaced by

"(e)," within the substituted regulation 3(2)(b)(i).

Regulation 3(10)

Likewise, "(d)" needs to be deleted from the substituted regulation 17 of the "Scheme Administration Regulations".

Regulation 4(3)(d)

The words "in paragraph (2)(c)(i), after "(d) to (f)," insert "(h)," are meaningless, since there is no such paragraph (2)(c)(i) of regulation 3 of the "Scheme Administration Regulations". The wording actually required is "in paragraph (2)(b)(i), after "(f)," insert "(h),".

Regulation 4(8)(b)

The substituted wording in regulation 21(4) of the "Scheme Administration Regulations" now (incorrectly) implies that section 49 only requires member

→ contributions deducted from earnings to be paid over within a “reasonable period” rather than within the prescribed period of 19 days from the beginning of the next month! The substituted wording should have been “within a **prescribed** period”.

Regulation 5

This revokes, inter alia, regulation 7 of the Personal Pension Schemes (Payments by Employers) Regulations 2000, which itself revoked regulation 5A of the Personal Pension Schemes (Disclosure of Information) Regulations 1987. Presumably, the effect of this change will be to reapply regulation 5A of SI 1987/1110. This will therefore require member notification of any late payment (other than of minimum contributions) to be made within 3 months of the due date, unless the payment has already been received in the meantime. However, this appears inconsistent with new paragraph 7A of section 111A of the Pension Schemes Act 1993, introduced by section 268 of the Pensions Act 2004, which provides that notification of a missed payment date will only be required if the failure is likely to be of material significance in the exercise by the Regulatory Authority of any of their functions.

We asked DWP for its comments.

We would expect further changes in due course to (a) the “Audited Accounts Regulations”, once the “Investment Regulations” are revoked, and (b) the “Scheme Administration Regulations”, once the Occupational Pension Schemes (Scheme Funding) Regulations 2005 are finalised and in force.

DWP responded as follows.

Regulation 2(3)(d)

We will amend “the Regulator” to read “the Authority” in regulation 2(3) of the Audited Accounts Regulations in a future suitable legislative vehicle.

Regulation 3(2)

We will insert definitions of “specified insurance policies” and “specified insurers” in regulation 1(2) of the Scheme Administration Regulations in a future suitable legislative vehicle.

Regulation 3(4)(a)

We will amend regulations 3(2) of the Scheme Administration Regulations as suggested in a future suitable legislative vehicle.

Regulation 3(10)

“(d)” is scheduled to be deleted from regulation 17 of the Scheme Administration Regulations by way of regulation 5(6) of the draft Occu-

pational Pension Schemes (Exemption) Regulations 2006 currently out for public consultation.

Regulation 4(3)(d)

We will address in a future suitable legislative vehicle.

Regulation 4(8)(b)

We will address in a future suitable legislative vehicle.

Regulation 5

It is not the intention to reinstate the old regulation 5A of the Personal Pension Schemes (Disclosure of Information) Regulations 1987. We will correct the position in a future suitable legislative vehicle.

Further changes

Consequential amendments to the “Audited Accounts Regulations” and to the “Scheme Administration Regulations” are contained in Schedule 3 of the draft Occupational Pension Schemes (Scheme Funding) Regulations 2005. We do also plan to make consequential amendments to take account of changes relating to the “Investment Regulations”.

Thank you to the Society for raising these points. ■

DWP response to investment issues raised by

Under the Finance Act 2004, section 165, a scheme pension can only be an option and the member must be offered the alternative of a lifetime annuity using the open market option. If the member chooses the lifetime annuity, the Finance Act 2004 requires the trustees to follow his or her wishes. The trustees are obliged to purchase an annuity from an insurer selected by the member.

We have heard the suggestion that, potentially, there is a tension between this requirement on the trustees under the Finance legislation and the investment duties imposed on trustees by the Pensions Act 1995.

Our view is that there is no tension. It is clear that the trustees are discharging a statutory duty when buying the annuity selected by the member and that there can be no question of the trustees advising or in any way being involved in influencing the member’s choice, although the annuity could formally be regarded as an investment entered

into by the trustees. We asked DWP to comment.

We also raised what we view as a major defect in the Occupational Pension Schemes (Investment) Regulations, 2005. It was raised during consultation, but has unfortunately found its way into the final version.

Regulation 8 of the regulations provides that “wholly insured schemes” need only give a limited statement of investment principles. Wholly insured scheme is defined generally as a scheme which “has no investments other than specified qualifying insurance policies”.

The problem arises from the definition of “specified qualifying insurance policy” in regulation 1(2). This only covers policies falling within paragraph III of part II of schedule 1 to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001. Paragraph III covers “linked long-term contracts” where the life policy or annuity contract provides

benefits determined by reference to the value of funds. Importantly in this context, this excludes conventional life policies or annuities, where benefits are not linked to the performance of funds. Such contracts are covered by paragraph I of part II of schedule 1 to the 2001 Order.

We do not believe that the exclusion from the definition of “wholly insured schemes” of schemes which invest in conventional life policies or annuities is intentional.

The simplest solution would be to amend the definition of “specified qualifying insurance policy” in regulation 1(2) so that “paragraph III of part II” reads “paragraph I or III of part II”.

DWP has confirmed that it cannot see any tension between section 165 of the Finance Act 2004 and the investment duties imposed on trustees by the Pensions Act 1995. As we suggested, section 165 provides the legislative provisions that must be complied with when making pension payments, and →

➔ DWP cannot see any obvious tension with the provisions in the Pensions Act 1995 governing trustees investment powers / duties.

DWP's response comes with the usual caveats about this being the Department's view and that it is ultimately for the Courts to interpret legislation. DWP also referred our question to HMRC to check whether it can see any tension between the two Acts.

On the definition of "specified qualifying insurance policy" in regulation 1(2) of the "Investment" Regulations 2005, DWP has confirmed that its initial view is that there does seem to be a case for amending the definition along the lines we suggested, unless further consideration of this issue were to suggest that this would not be appropriate, in which case it will contact us again. ■

Regulations issued on early leavers

The Pensions Act 2004 gives members who leave an occupational pension scheme on or after 6 April 2006 the right to a transfer value or a refund of their own contributions if all the following apply:

- They leave at least one year before normal pension age.
- They have at least three months' qualifying service.
- They have less than two years' qualifying service.

If such early leavers fail to exercise a choice within a 'reasonable' time, as specified by the trustees and notified to the member, the trustees can pay a refund. The refund will be paid less tax

of 20% up to the first £10,800 and 40% of any excess, and less the employee's part of any contributions equivalent premium to reinstate the employee into the State Second Pension. The refund can include the member contribution element of any transfer-in.

The Occupational Pension Schemes (Early Leavers: Cash Transfer Sums and Contribution Refunds) Regulations 2006 (SI 2006/33) confirms how transfer values are to be calculated, confirm that the refund may include interest or may reflect the current value of the member contributions, and specify the information that must be given to members offering the choice of a transfer or a refund. ■

A summary of the investment requirements flowing from the Pensions Act 2004

Introduction

Unless they are specifically exempted from the Pensions Act, occupational pension schemes must have a written statement of investment principles (SIP), which describes how and why the trustees have decided to invest the scheme's assets. Trustees have to seek professional advice and are liable for breaches of the duty to exercise reasonable care and skill.

The Pensions Act 2004 introduces changes to the rules on SIPs and choosing investments, and also introduces new provisions on borrowing by trustees. The changes are made to bring the UK in line with the 2003 EU Directive 'on the activities and supervision of institutions for occupational retirement provision' (the IORP Directive), which was supposed to have been implemented by Member States by September 2005.

Summary

- Unless the scheme has less than 100 members, the trustees are required to maintain a written statement of investment principles (SIP) stating their policy on a number of issues, having obtained and considered advice from an appropriately qualified and experienced person, and consulted the employer. The SIP must be reviewed at least every three years.

- For wholly-insured schemes (with 100 or more members), the SIP only has to cover the reasons for the scheme being a wholly-insured scheme.
- Trustees may delegate investment management decisions, but will be responsible for the fund manager's actions unless they have taken reasonable steps to satisfy themselves that the manager has appropriate knowledge and experience, and that the manager is acting competently and in accordance with the SIP.
- Investments must be chosen having regard for the need for diversification, the principles contained in the SIP and the 'prudent person' principle. In retaining any investment, the trustees must decide at what intervals they should get written expert advice about whether it is still satisfactory.
- Except for schemes with less than 100 members, borrowing is prohibited and, except for 'small schemes' (fewer than 12 members), there are limits on employer-related investments.

Statement of investment principles

The trustees of occupational pension schemes must ensure that a SIP is prepared and maintained. Rather than

having to review it "from time to time", and, if necessary, revise it (as originally required under the 1995 Act) the SIP must now be reviewed at least every three years, and without delay after any significant change in investment policy.

The requirement to prepare and maintain a SIP does not apply to schemes with less than 100 members (including not only active members, but also deferred and pensioner members), or to public sector schemes with a Government guarantee.

Before drawing up or revising their SIP, the trustees are required to obtain and consider written advice from a person they reasonably believe to be qualified by their ability in and practical experience of financial matters and to have the appropriate knowledge and experience of the management of investments of trust schemes. The trustees must also consult with the employer.

The SIP must be in writing, and must cover the trustees' policy for securing compliance with the requirement on choosing investments in Section 36 of the Pensions Act 1995 (see the 'Choosing investments' section below). Unless the scheme is a 'wholly-insured' scheme, the SIP must also cover the trustees' policies in relation to:

- The kinds of investment to be held. ➔

- ➔ ● The balance between the different types of investments.
- Risks, including the ways in which risks are to be measured and managed.
- The expected return on investments.
- The realisation of investments.
- The extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments.
- The exercise of the rights (including voting rights) attaching to the investments.

This list contains two differences from the requirements under the Pensions Act 1995. Firstly, the trustees must now explicitly disclose their risk management methodology, rather than simply their policy on "risk". Secondly, the 1995 Act required the SIP to cover the trustees' policy for securing compliance with the Minimum Funding Requirement; as the MFR is being abolished, and the trustees in future will have to prepare a separate statement of funding principles to set out their policy for ensuring that the new statutory funding objective is met, they will not have to include this information in the SIP.

For wholly-insured schemes, instead of covering the above list, the SIP must cover the reasons for the scheme being a wholly-insured scheme.

What is a wholly-insured scheme?

A wholly insured scheme is one which only has investments (other than cash on deposit, and investments from AVCs) in 'specified qualifying insurance policies'.

Unfortunately, the definition of such policies is flawed. Firstly, the definition only covers unit-linked policies, which provide benefits by reference to the value of funds. This means that schemes providing death in service benefits through a group life assurance policy and/or buying annuities via the scheme (as opposed to in the member's name) would not be wholly-insured. Secondly, the definition of insurance policy specifically excludes policies for the management of pension funds and appears also to exclude with profit policies.

We do not believe that these provisions represent a policy intention and have asked DWP to urgently correct them.

Choosing investments

Under Section 36 of the Pensions Act 1995, as amended by the 2004 Act,

the trustees (and any fund manager to whom the trustees have delegated responsibility for investments) must have regard to the need for diversification of investments, as appropriate to the scheme.

Before making new investments, the trustees need to obtain and consider proper advice as to whether the investment is satisfactory. This advice must be made, or later confirmed, in writing. Where they retain any investment, the trustees must decide how often to obtain advice, and then obtain and consider it. In deciding whether an investment is satisfactory, the trustees must have regard to the need for diversification, the principles contained in the SIP, and the 'prudent person' principle as required by the IORP Directive. This requires trustees to:

- Invest the scheme assets in the best interests of the members and beneficiaries or, if there is a potential conflict of interest, in the sole interest of the members and beneficiaries.
- Invest in a way calculated to ensure the security, quality, liquidity and profitability of the portfolio as a whole.
- Invest predominantly on regulated markets (includes any market which is properly regulated, and certain investments in collective investment schemes). Those assets not in a regulated market must be kept to a prudent level.
- Have regard to the appropriate diversification of investments so as to avoid excessive reliance on any particular asset, issuer or group of undertakings. Investments in assets issued by the same issuer must not expose the scheme to excessive risk concentration.
- Ensure that any investments in derivatives should contribute to a reduction of risks or should facilitate efficient portfolio management.

Delegation of investment decisions

The trustees will be responsible for their scheme's investment policy and are under an obligation to exercise care and skill in the performance of investment functions or its delegation. This obligation cannot be excluded or restricted by any instrument or agreement (such as the scheme rules) so that, for example, there can be no requirement for employer consent in investment decisions.

Although trustees are allowed to delegate investment management decisions, they will continue to remain

responsible for the manager's actions unless they can demonstrate that the manager has appropriate knowledge and experience, and that the manager is acting competently and in accordance with the statement of investment principles.

Exemptions

Other than the overriding requirement for the trustees (and any fund manager to whom any discretion has been delegated) to consider the need for investments to be diversified, the provisions on choosing investments do not apply to schemes with less than 100 members.

Borrowing by trustees

Trustees are prohibited from borrowing or from acting as guarantors, although borrowing on a temporary basis to provide liquidity for the scheme is permitted.

This restriction does not apply to schemes with less than 100 members, but the trustees in exercising their powers of investment, and any fund manager to whom any discretion has been delegated, must consider the need for investments to be diversified, as appropriate to the particular circumstances.

Under the Finance Act 2004, schemes may borrow up to 50% of the value of the scheme assets at the date the loan is taken out. Any borrowing above this limit will be treated as an unauthorised payment. Before 6 April 2006, small self-administered schemes can borrow up to 45% of the net assets plus three times the annual contribution, and self-invested personal pensions can borrow up to 75% of the property value or development costs.

Employer-related investments

No more than 5% of the scheme's assets may be invested in employer-related investments, and none of the assets may at any time be invested in an employer-related loan.

Where a scheme with more than one employer is divided into two or more separate sections, the self-investment provisions apply to each section of the scheme as if it were a scheme in its own right.

Where there is a scheme with more than one employer, but the employers are not connected or associated (for example, an industry-wide scheme), up to 5% of the scheme assets may be invested in each participating employer as long as no more than 20% of the assets in total are invested in employer-related investments.

➔ 'Small schemes' are exempt from these restrictions. A 'small scheme' is one with fewer than 12 members where:

- All the members are trustees and either the rules require that the member trustees make decisions unanimously, or the scheme has a registered independent trustee.
- All the members are directors of a

company which is the sole trustee of the scheme and either the rules require that the members make decisions unanimously, or one of the directors of the company is a registered independent trustee.

Timetable

The new rules came into force on 30 December 2005. The Pensions Regulator

has said that, where the scheme does not already have a SIP, it would normally expect the trustees to ensure a SIP is in place within two months. If this does not happen, the trustees would be considered in breach of the regulations. However, a report should only be made to the Regulator if this is considered to be a material breach. ■

Information from PPF on contingent assets and S.179 valuations

The Pension Protection Fund (PPF) has published guidance and documentation on contingent assets, as well as setting out its approach to rolling forward section 179 valuations.

Contingent Assets

PPF has published updated versions of its guidance on the types of contingent assets it is prepared to take into account in the calculation of the risk based levy and the process trustees must follow to get those assets certified. Trustees and employers who want to take advantage of this must have sent certification to PPF by the 31 March 2006 deadline for the assets to be taken into account for the 2006-07 levy year. Although at the time of preparing this issue of SPC News the treatment of contingent assets was not definite pending PPF's final determination on the calculation of the levy in late February 2006, and the coming into effect of the associated regulations, PPF has said it does not expect to make any further changes to the standard documentation or certificates.

The main changes from the previous drafts are:

- PPF's standard documents now provide for the value of the asset to be reduced, and/or different contingent assets to be substituted, in some circumstances;
- the guidance is more detailed;
- the standard documentation includes security over land in Scotland and Northern Ireland as well as England and Wales.

Section 179 valuations

The PPF has also published its methodology for rolling forward section 179 valuation results to 31 March 2006. The main elements are:

- liabilities will be rolled forward at a rate 'reasonably' consistent with section 179 assumptions and not adjusted for future accrual or benefit payments;
- assets will be increased in line with certain stock market indices but not adjusted for contributions or benefit payments. ■

Internal dispute resolution changes postponed

The Pensions Act 2004 changes to the internal dispute resolution (IDR) procedures, which were due to come into force in April 2006, will not now be enacted in their proposed form. Instead new changes are to be drafted, and it is unknown when they will come into force.

DWP has now accepted, following consultation on the draft IDR regulations and draft Code of Practice, that the changes as drafted might not achieve the government's intended policy of simplifying procedures or increasing flexibility, but could in fact place additional burdens on schemes.

In particular there was concern, raised by SPC, that a potential unintended

impact of the changes as drafted could be to disallow a two stage dispute resolution procedure (despite a scheme wishing to retain that) and impose a one stage process. Acknowledging again that this was never the intention, DWP has confirmed that, when the law is eventually changed, schemes will be allowed to retain their existing two stage procedure.

DWP will not now bring into force the relevant Pensions Act 2004 section as drafted. Instead it will amend the Pensions Act 1995 section 50 (the current dispute provision) to achieve the stated policy intention. This will require new primary legislation. ■

The new scheme funding regime

The Government has published regulations, and the Pensions Regulator has published a Code of Practice, setting out how the new scheme funding regime is expected to operate. Trustees will have to carry out valuations using the new scheme funding regime where the valuation has an effective date on or after 22 September 2005.

The new regime requires trustees to consult and, in most cases, reach agreement with the sponsoring employer on all the significant steps in the valuation process. This includes setting the method and assumptions for calculating the assets needed by the scheme to meet benefits as they fall due (known as the 'technical provisions'), the period over which any shortfall in the assets against the technical provisions is to be met and the content of the schedule of contributions.

The responsibility for achieving a satisfactory conclusion to the valuation process rests with the trustees, and the Code indicates the strategies and behaviours TPR expects the trustees to demonstrate in achieving this. In particular, trustees are expected to establish and monitor an Action Plan, covering the whole process and to have procedures to manage conflicts of interest that could emerge during the course of the valuation.

The Regulator expects the outcome from the scheme funding process to be improved security for members. It expects that, in many cases, the assumptions used for scheme funding valuations will be stronger than those used currently and the period over which shortfalls are corrected will be shorter. Where the information submitted to it suggests that this outcome is unlikely to be achieved, the Regulator will review the procedures trustees have used to develop their funding policy.

In October 2005, the Regulator published a further document, 'How the Pensions Regulator will regulate the funding of defined benefits', for a consultation period that closed on 26 January. For a copy, please click [here](#). For a copy of SPC's response to that document, please click [here](#) and [here](#).

For an in depth summary of the scheme funding regime, click [here](#). ■

PPF has published the levy calculation for 2006/7

The board of the Pension Protection Fund (PPF) has published its final consultation document on its approach to calculating the levies it needs to raise in 2006/7. The consultation, which ended on 26 January 2006, is required by legislation and is expected to be a formality. A copy of the consultation document is available by clicking [here](#). The proposals are not expected to be changed materially.

The main features are:

- The total levy the PPF expects to raise in 2006/7 is £575 million.
- The levy comprises a scheme based levy (SBL) and a risk based levy (RBL) and the SBL will represent 20% of the total raised. The formula for the SBL is therefore
 $.014\% \times \text{the scheme's PPF liabilities}$.
- The formula for the RBL is
 $\text{Underfunding risk} \times \text{insolvency risk} \times 0.8 \times \text{scaling factor}$.
- For schemes less than 104% funded on the PPF basis, "underfunding risk" is the difference between 105% of

the scheme's PPF liabilities and the value of the scheme's assets.

- For schemes with funding levels greater than 104% of their PPF liabilities "underfunding risk" is:
 - > PPF funding level between 104 and 111% - 0.75% of PPF liabilities
 - > PPF funding level between 111 and 118% - 0.50% of PPF liabilities
 - > PPF funding level between 118 and 125% - 0.25% of PPF liabilities
 - > PPF funding level over 125% - 0% of PPF liabilities

This means schemes more than 125% funded against their PPF liabilities will not have to pay any risk based levy.

- There will be 100 insolvency risk bands, based on the ratings given by Dun & Bradstreet. Insolvency probabilities range from 0.074% in the most secure band (which is 100) and 33.8% in the weakest category (band 1). However, the maximum insolvency probability used in the calculation will be 15%, so the formula for the companies in the bottom three bands is effectively capped.

- The scaling factor is 0.53.
- There is also a cap on the total levy that will be charged to any one scheme of 0.5% of the scheme's PPF liabilities.

The PPF has said that it will permit certain contingent assets to be taken into account in calculating the size of the underfunding risk. Previously it was only considering doing this for the 2007/8 levy period. The types of contingent assets it will allow are parent company guarantees to the scheme, charges on company assets, and certain letters of credit and bank guarantees. The PPF has published standard documentation for each type and it will expect trustees to certify that the assets for which they are seeking credit are legally valid and established in the standard form.

Timing

The PPF will ask DWP to legislate so that the last date for trustees to submit section 179 valuations will be 31 March 2008, with the intention that no scheme valuations will have to be done out of cycle. The option of projecting forward from the MFR results will remain into the 2007/8 PPF year.

Section 179 valuation certificates, contingent asset certificates and scheme structure forms (for multi employer schemes) will need to be submitted to PPF by 31 March 2006 too be taken into account for the 2006/7 levy year. "Deficit reduction contributions" can be notified electronically to the PPF by as late as 7 April 2006, so that trustees can get credit for contributions paid during March.

SPC submitted some brief comments on some of the detail of the consultation document. For a copy, please click [here](#). ■

Update on FSA consultation paper 179

FSA Consultation Paper 179 concerns guidance on pensions related activities and has been in draft form for well over a year.

FSA has delayed finalising the guidance in order to take full account of various changes in the regulatory regime directly affecting the establishment, operation and promotion of pension schemes and the implications of the

EU Insurance Mediation Directive.

Towards the end of last year FSA sent us a revised draft version of consultation paper 179, designed to present the guidance in a more straightforward format.

FSA now hopes to finalise the guidance in its new question and answer format during the first quarter of this year. ■

FSA consults on stand-alone term insurance

In its final quarterly consultation document of 2005, FSA included proposals to allow stand-alone pension term assurance to be sold under its insurance conduct of business rules, as well as its main conduct of business rules.

The questions which it raised, and our answers, are set out below.

Question 11: Do you agree that we

should allow standalone pension term assurance to be sold under ICOB under an enhanced regime and COB?

We are concerned that FSA proposes to allow pension term assurance to be sold under ICOB. We believe that most ICOB advisers wishing to sell this product will have very limited understanding of pension schemes and associated tax rules. The main issues will be annual

allowance, lifetime allowance and eligibility rules. We do not believe that these issues can simply be 'learned' in isolation by an ICOB adviser, without understanding the basis of how they are calculated or what their future impact might be.

Question 12: Do you agree with the proposed amendments to ICOB to give effect to this? ➔

Whilst the implementation of ICOB 4.3.9 seeks to put ICOB suitability rules on a similar standing to COB, we are not convinced that, once the appropriate information is to hand, ICOB Advisers will have sufficient knowledge to make an assessment of its impact. For instance, there are different factors for calculating notional annual contributions under defined benefit schemes, benefits which began before A-day and the

amount of lifetime allowance accounted for by a scheme pension under a defined benefit arrangement – all of which may be relevant in providing a suitable recommendation. We question whether it is reasonable to expect that ICOB advisers will grasp these issues when they are already proving reasonably complex for experienced pension professionals.

We would add that an additional risk, which has not been noted in the consultation paper, is for those members who may become ineligible for tax relief at some time after they have concluded the contract. In this instance they will need to be aware that they may not qualify for the amount of tax relief required to fund their original combined pension and term assurance contract. ■

response to proposed changes to the eligibility rules for establishing a pension scheme

SPC submitted a detailed response to the Treasury's consultation document proposing changes to the eligibility rules for establishing a pension scheme.

For a copy of the response click [here](#).

A copy of the consultation document is at <http://www.spc.uk.com/docs/MPC131.pdf>. ■

Civil partnerships

The Civil Partnership Act took effect on December 5th, 2005. The SPC Legislation Committee considered the question of whether scheme rules needed to be amended by December 5th, to provide for civil partners to receive a 50% GMP. If an amendment was required and was not made by December 5th, would the scheme lose its contracted-out status?

DWP has indicated that its aim is to ensure that, after 5 December 2005, where a member of a contracted-out defined benefit scheme dies after entering into a civil partnership, that scheme will pay the surviving civil partner a pension based on the contracted-out rights, which is analogous to that to which a widower is currently entitled.

DWP's view is that it is up to the individual schemes to decide whether they need to actually re-write their scheme rules and, if so, what changes are needed. It is also the scheme that has to decide how and when the changes are to be made.

DWP has addressed the proposition that a scheme might have to surrender its certificate if by 5th December it had not succeeded in changing its scheme rules (assuming that such a change was necessary to ensure civil partners were covered by the survivor rules at, for

instance, section 17 of the 1993 Act) because it had ceased to be compliant with section 9(2A)(b) of the Act.

DWP indicates that, while this might be the theoretical position, it would not expect a scheme to send its certificate back if the only reason the rules had not been changed was an administrative one. Neither will NICO be contacting each scheme to ask whether they have made the changes to their scheme rules and demanding the certificate is surrendered if the change has not been made. ■

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SPC is the representative body for the providers of advice and services needed to establish and operate occupational and personal pension schemes and related benefit provision. Our Members include accounting firms, solicitors, life offices, investment houses, investment performance measurers, consultants and actuaries, independent trustees and external pension administrators. Slightly more than half the Members are consultants and actuaries. SPC is the only body to focus on the whole range of pension related functions across the whole range of non-State provision, through such a wide spread of providers of advice and services. We have no remit to represent any particular type of provision.

The overwhelming majority of the 500 largest UK pension funds use the services of one or more of SPC's Members. Many thousands of individuals and smaller funds also do so. SPC's growing membership collectively employ some 14,000 people providing pension-related advice and services.

SPC's fundamental aims are:

- (a) to draw upon the knowledge and experience of Members, so as to contribute to legislation and other general developments affecting pensions and related benefits, and
- (b) to provide Members with services useful to their business.