TUC

trustee network

member trustee news

Spring 2011

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photo: Getty

Shake up for State Pensions

On 6 April 2010, the State Pension Age (SPA) for women started to increase gradually from 60 to 65, to match the SPA for men. The Pensions Bill 2011 includes measures to hasten the equalisation process so that SPA is 65 for women born after 5 December 1953. The SPA would then rise so that it is 66 for both men and women born after 5 April 1954. The Government has said that it may also bring forward the timetable for increasing SPA to 68 (under current legislation, not due until 2046) but no firm plans have been announced; proposals under consideration include linking SPA to longevity changes.

There is generally no direct link between the SPA and normal pension age (NPA) in an occupational pension scheme, though employers may seek to change the scheme NPA to bring it in line with the SPA; this measure has already been proposed by

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Welcome to the Spring edition

Welcome to the spring edition of member trustee news. The new year has brought no let up in the pace of change, with another Pensions Bill on its way through parliament, and 2012 – the start of auto-enrolment – coming ever closer. The impact of auto-enrolment, with millions of members being brought into pension schemes for the first time, is likely to mean a shift of emphasis in the pensions world firmly into DC. Communicating with DC members about their pension choices will become a key issue, and the National Employment Savings Trust (NEST) has set an interesting example with its new phrasebook, available on the NEST website. Some have derided it as patronising and unnecessary but others have suggested that the terms used by NEST, e.g. "taking your retirement pot as cash" rather than "trivial commutation", should become the norm in member communications. I would be interested in your views on the NEST approach.

The Budget contained few surprises for pensions, with arrangements for the new annual allowance largely as expected. The most interesting proposal, however, is the likely shake-up of the state system including, potentially, the ending of contracting out for defined benefit schemes. Whilst some have regarded this as (yet another) nail in the DB coffin, other commentators have been more measured, pointing out that since it would mean the government providing a greater proportion of members' DB pension, it would in effect be a de-risking measure for schemes.

And finally, a date for your diary: this year's trustee network conference will be on 15 November. Pensions Minister Steve Webb has been invited and Dr Paul Woolley from the LSE will give a keynote speech. Do let us have any ideas for speakers or issues you would like to be included in a workshop session.

Fiona Draper

Member Trustee News – email version available soon

The next edition, Summer 2011, will be available by email as well as in print. So you can:

- continue to receive your copy by post
- try the emailed version (html) instead and see how you like it
- receive copies in both formats and decide later which one you want to opt for.

Please email Jennifer Mann jmann@tuc.org.uk for further details or to state your preference.

Shake up for State Pensions

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Lord Hutton for the public sector schemes.

Other wide-ranging reforms to the state pension system were flagged up by the Secretary of State to an Age UK conference in March. Iain Duncan-Smith pointed out that there are currently only one million active members in open private sector defined benefit schemes, down from five million members in the mid 1990s, and that fewer people than ever are saving in any form of scheme at all; less than half of the entire working age population is currently saving in a pension. Even those who are saving face an uncertain retirement, because contribution rates are too low, and annuity rates have fallen significantly since the late 1990s. The solution, the Secretary of State proposed, is fundamentally to simplify the state pension system to provide a stable underpin for private pension saving. Press reports have suggested that the intention will be to provide a basic state pension of £140 a week for future pensioners, but details of the proposal are not yet clear. Such a reform is an essential underpin for auto-enrolment, to remove the probability that many low-paid members who are auto-enrolled into NEST or an employer scheme will find themselves no better off than those who have opted out and rely on means-tested benefits.

Work on this issue was completed just before the Green Paper on state pensions was published, so there will be more on that in the summer edition.

photo: TUC

Responsible investment briefs

Mercer's responsible investment team have launched a major new report *Climate Change Scenarios: implications for strategic asset allocation*. The report argues that traditional asset allocation methodologies do not adequately reflect the risks from climate change, and proposes a new framework to assess the risks. The full report, and highlights from it, is available on the Mercer website at www.mercer.com/climatechange

Fund managers who do not themselves specialise in responsible investment are developing new ways of offering appropriate services to trustees. For example, State Street has developed a partnership with F&C to make the latter's ESG reporting service available to State Street's pension scheme clients. F&C head of governance and sustainable investment Karina Litvack said: "Partnering with State Street for this new service will enable their clients to be better informed on ESG issues and better placed to assess any potential ESG risks and opportunities – key factors in investment decisions today."

CPI switch good for funds – but bad news for deferred pensioners

Two articles in the same January edition of Professional Pensions neatly highlighted the impact of the switch to CPI as the basis for statutory revaluation. According to a Towers Watson survey, FTSE100 schemes will save more than

"millions will suffer big losses from the switch to CPI indexation"

£15bn as a result of the switch. The cost will be borne largely by deferred members: a study by the Pension Policy Institute (PPI) said a worker who leaves an occupational scheme at age 40 would see a 20 per cent fall in benefits at age 65 if benefits were increased by CPI rather than RPI.

The PPI also found annual retirement income for an occupational scheme member would be 2 per cent less annually one decade after retirement and 4 per cent less per year at age 85 if a scheme switches to CPI. (See PPI Briefing Note 57 from **www.pensionspolicyinstitute.org.uk** for more on this.)

The TUC welcomed Pensions Minister Steve Webb's announcement that he did not intend to change the law to make it easy for schemes to end RPI indexation where their rules require it, and that schemes should have to consult members about changes to indexation, but pointed out that "this small piece of good news should not obscure the big losses that millions will suffer from the switch to CPI indexation."

Fair Deal consultation

The Treasury has launched a review of the Fair Deal policy that protects pensions for staff transferring out of the public sector (and therefore keeps alive DB pension provision for many low-paid staff in the private sector). Commenting on the launch Brendan Barber said:

"The Fair Deal on pensions provides an essential safeguard for staff where public services are transferred to private sector providers. Removing it would allow private contractors to boost profit margins by slashing staff pensions. We've already seen the damage caused by the race to the bottom in pension provision across the private sector. Adding public sector workers to this will lead to greater poverty and more dependence on state benefits." The consultation runs until 15 June.

AUNTY'S ANNUITY

Remember me? Josh? The guy who did some nifty footwork to fix his 70 year old Aunty Ivy up with a pension without leaving me with an open-ended commitment if the old girl lives for ever? Well, I'm pleased to report that Aunty is still going strong, so I've no regrets yet about the pension deal!

Indeed, Aunty bowled me a real googly the other day. Phoned me up and said that as she wasn't getting any younger she thought that it was time she started to draw her pension. Well, there I was taking care of her because I thought she only had her State pension when all the time she was sitting on another arrangement! So, round I scooted to her flat to find out what it was all about.

I knew Aunty had worked part time as a secretary all her life, but it turns out that her employer for all those years was an insurance company and one which specialised in pension provision. True to its own principles, it had obliged employees to contribute to a pension scheme. Aunty worked all the way through until she was 63 but for some reason did not draw her pension when she retired. Now she thought that it was about time she started to use her savings so she'd phoned the insurance company, the Farnborough Reliable Equity Deposit (bit of a mouthful, so I'll call them FRED!), to ask them to give her the money. But they had refused and said she had to buy something called an annuity. That threw Aunty into bit of a spin and so she called me.

Trouble is I didn't know what an annuity was, other than an almost being an anagram of Aunty! But I do now, and it isn't simple! And there must be lots of Aunty Ivy's (and Uncle Ernest's) around who find themselves pitched into the same jungle without much of a guide.

First thing I found was that an annuity at its simplest is an investment which will pay a guaranteed income – a pension – for the lifetime of the purchaser. They get more complicated than that, but that's it in a nutshell. When the purchaser dies the income ceases and anything remaining of the original investment remains with the annuity supplier. Clearly the size of the guaranteed income depends on how much money you have to invest, but it also depends on a number of other factors and, especially on how old you are. So the income Aunty will get from her savings will be greater because she is starting to draw it at age 70 than it would have been had she bought the annuity when she was 63.

"at its simplest an annuity is an investment which will pay a guaranteed income – a pension"

I spoke to my mate Tony. In return for a drink or two, Tony put me wise to something he called the 'OMO'. He explained that OMO stands for Open Market Option and that this was something Aunty should explore.

FRED have now written to Aunty telling her that her investment with them of £43,000 entitles her to buy from them an annuity worth £2,500 a year. But Aunty is actually free to take her money and buy an annuity from any firm prepared to sell her one – that is the Open Market Option – and very often it is possible to get better rates from someone other than the firm with whom you have been investing, although obviously you want to buy your annuity from a well established and reputable provider. That's exactly the case with Aunty; I did some research and found that another insurance firm would pay her an annuity of £2,900 pa. That's about 14 per cent more than is on offer from FRED. The amazing thing is, about two thirds of people do not even explore the OMO – I guess they may not know about it: yet another reason why people should always get some good advice. Tony also pointed me in the direction of a great website – buying Tony a drink is always a good investment! He said the website for the Financial Services Authority (FSA) provided comparisons of the annuity rates currently being offered by different companies. It's a great site and using their interactive facility to find the best deal flags up other issues Aunty needs at least to consider before buying her annuity. For example, does she want her annuity income to be flat rate for the rest of her life or would she prefer to build in some protection against inflation? Seems like a good idea to me, although if she opts to do so her initial income from the annuity will be reduced.

It's not relevant to Aunty, but it is also possible to opt to buy an annuity which will continue to be paid to your partner after you die. Again, of course, there is a cost in terms of a reduction in the annual payment. Finally, and this is one Aunty may wish to think about, you can also do what is referred to as guaranteeing your annuity for a certain period. What this means is that your annuity will continue to be paid for an agreed minimum period, usually five years, even if you die before the end of the period. Another issue that doesn't apply to Aunty is something called an "impaired annuity". If you are suffering from one or more of a list of illnesses which in general are

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EIGHT BIG ISSUES FOR AUNTY

Issue/Question	Comment
1 Should I seek help from an Independent Financial Advisor (IFA)?	Almost invariably the answer should be 'yes'.
2 When should I buy my annuity and start taking my pension?	This is something to consider whenever you stop contributing to a pension arrangement. The earliest age at which you are allowed to take a pension is 55 and pensions activated after age 75 may be subject to some restrictions. If you cease contributing before age 55, perhaps because of a job change, you may wish to consider transferring your pension pot into any new arrangement to which you start contributing.
3 Should I take a cash lump sum?	This will depend on individual needs and circumstances.
4 Should I accept what my pension scheme offers or look at the Open Market Option?	It is definitely worth looking at the Open Market Option. Although it requires a little more work, which your IFA can do for you, there is nothing to lose by looking at the options, and there may be a substantial amount to gain.
5 Do I want to protect my pension, at least to some extent, against inflation?	Another one which will depend largely on individual circumstances. With life expectancy increasing, inflation could have a sizable impact on a fixed income, although as we get older we often tend to spend less unless we start to incur costs for care.
6 Do I want an annuity which will continue to be paid to my partner after my death, and if so, at what rate?	Clearly one to consider if you have a partner, taking account of any other pensions and income they may have in their own right.
7 Alternatively, do I want to ensure that my pension is paid for a guaranteed period even if I die soon after it starts?	This will depend on individual needs and circumstances.
8 Do I qualify for an 'impaired annuity'?	If you have an illness it may well be worth asking your medical practitioner and your IFA about this.

Round-up from the Regulator

The Pensions Regulator (tPR) has issued final guidance on "incentive exercises" such as offers of enhanced transfer values to persuade members to take their benefits out of the pension scheme. The guidance has generally been welcomed as balanced and proportionate. tPR makes clear that: "Trustees should start from the presumption that such exercises and transfers are not in most members' interests, and they should therefore approach any exercise cautiously and actively." There will be a minority of members whose circumstances mean it is more likely they will benefit from accepting such an offer; good financial advice is key to identifying these members.

David Norgrove, tPR chair, said: "Offers involving cash incentives are likely to result in less objective decision-making. It can be extremely difficult for a member to weigh up whether giving up a DB pension promise in exchange for a cash transfer into a DC scheme will be in their interests in the long-term. Given the gravity of the decision, the difficult financial equation, and potential for detriment if they get the decision wrong, we believe our stance is reasonable and proportionate."

Independent advice should be made accessible to all members, and they should be under no pressure to make a decision to accept the offer.

The Regulator has continued its work programme on DC schemes with the publication of a discussion document, *Enabling Good Member Outcomes in Work-Based Pension Provision***.**

The discussion paper identifies six elements that it believes are important for achieving good outcomes for savers, and explores the ability of the different segments of the DC market to provide these elements in the pension products they offer. These elements are:

- appropriate decisions with regards to pension contributions
- appropriate investment decisions
- efficient and effective administration of DC schemes
- protection of scheme assets
- value for money
- appropriate decisions on converting private pension savings into a retirement income.

Chief executive Bill Galvin said:

"This paper marks the start of a dialogue with the industry and stakeholders over what good DC pensions look like and how we can support the market in delivering good outcomes for members. It is important now that we ensure our regulatory approach supports the government's workplace pension reforms and is designed to deal with current and future challenges as the market develops." Comments from all those involved with DC provision including trustees, need to be in by 22 April.

The Regulator has also continued to focus on scheme administration, launching a new education drive highlighting the importance of

"...poor administration and record-keeping can undermine good outcomes for members."

administration in enabling good outcomes from pensions saving. June Mulroy, executive director with responsibility for DC, governance and administration issues, said:

"Retirement savers rightly expect their pension to be accurate and to reflect their contributions. But poor administration and record-keeping can undermine good outcomes for members. To inspire confidence in saving, we expect trustees and their administrators to place an unwavering focus on standards, and understand their respective responsibilities."

As part of this new education drive, tPR has published a statement for trustees detailing what trustees should (and, as important, shouldn't) expect from their auditors in respect of member data, and a 'prompt sheet' for trustees setting out the questions they should be asking of their administrators.

All the documents referred to above can be found on the website **www.thepensionsregulator.gov.uk**

The Pensions Regulator

Support grows for UK **stewardship code**

photo: TUC

At the TUC Trustee Network Conference in November

Over 115 asset managers have now registered their support for the UK Stewardship Code, together with 24 asset owners including the USS and the BBC, Railways and BT schemes and a number of local government pension funds. The NAPF have published a short guide, UK Stewardship Code: guidance for investors, which is available from the NAPF website. A number of advisers have also signed up, including Aon Hewitt, Hymans Robertson and Mercer. Assistance from advisers on ESG or stewardship issues can include, for example, screening fund managers on their ESG credentials as part of a manager selection, or assistance in implementing a governance overlay service.

However, research from FairPensions has found that the quality of fund manager statements is highly variable. For example, many compliance statements do not refer to management of environmental and social risks, even in the wake of the Gulf of Mexico oil spill which should have removed all doubt as to the financial relevance of environmental and social issues. This suggests that when the FRC revises the code it should flag up the importance of monitoring and managing environmental, social and governance considerations to safeguard clients' assets.

The research also found that visibility of meaningful information on stewardship activities such as voting and engagement continues to be disappointingly poor for individual members of pension schemes; the FRC should consider if a standardised form of voting disclosure would raise standards.

Further information on the FairPensions research can be found on their website, **www.fairpensions.org.uk**

“many compliance statements do not refer to management of environmental and social risks”

Pensions Bill 2011

In addition to the measures on State Pension Age (see page 1), this year’s Pensions Bill includes measures to simplify auto-enrolment following the review last year. Of particular relevance to trustees of DC schemes, the Bill includes provisions to make it easier for existing DC schemes to be used for auto-enrolment without having to make complex changes to definitions of pensionable pay. In schemes where all elements of pay are pensionable, it is likely that a minimum contribution level of 7 per cent (with at least 3 per cent coming from the employer) will qualify as an appropriate scheme. Higher levels of contributions will be needed where pensionable pay is less than members’ gross earnings.

The Bill also includes provisions relating to the switch to CPI, by removing references to RPI from the legislation governing revaluation of deferred benefits and indexation of pensions in payment. Other provisions in the Bill will prevent a “CPI underpin” for schemes whose rules require RPI increases.

New actuarial standard on transformations is published

The Financial Reporting Council's Board for Actuarial Standards (BAS) has published its standard for actuarial work on "transformations" – in pension terms, bulk transfer of members without consent (e.g. scheme mergers); modification of member benefits; and transfer of liabilities to an insurer. The new standard will help trustees and other decision-makers to understand the potential effects on beneficiaries. It requires actuaries to analyse the impact of the proposed transformation by adopting assumptions which place proper emphasis on the interests of all parties, and to indicate how that impact might change under different scenarios.

"It requires actuaries to analyse the impact of the proposed transformation by adopting assumptions that place proper emphasis on the interests of all parties"

Commenting on the new standard, Jim Sutcliffe, Chairman of the BAS, said:

"Legislation places an important responsibility on trustees and courts to consider how proposed transformations might affect a wide range of beneficiaries. The complexity of the analysis required means that they will rely heavily on actuarial work. We have laid out principles that we believe will help ensure that the work is not only of a high quality, but conveys clearly the uncertainties and risks associated with the proposed transformation." Copies of the transformations standard can be downloaded from the BAS's website at **www.frc.org.uk/bas/publications/pub2467.html.**

Unisex factors?

The European Court of Justice decided on 1 March that gender-based insurance premiums are contrary to the general principle of equal treatment for men and women, and insurers will not be able to base premiums on gender after 21 December 2012. The ruling was broadly welcomed by the TUC; Assistant General Secretary Kay Carberry said:

"Women who are looking to take out an annuity to provide a pension will gain from this ruling. Women tend to have much smaller pension pots as they earn and save less over the course of their careers, so this will end the extra discrimination in the annuity market."

However, it is unclear what difference the ruling will make in practice, as increasingly insurers are using much more sophisticated measures to calculate life expectancy.

The ruling did not directly apply to occupational pension schemes, and it is unclear at present if gender based actuarial factors will continue to be permitted. More on this in the next issue…

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demonstrably life shortening, then you can get an "impaired annuity" which will pay you a significantly higher annual income than a standard annuity. You'd probably need some sort of certification from your doctor to satisfy the annuity provider that you weren't just trying it on, but it could prove well worthwhile. Smokers also can get better terms.

Aunty should have the last word on this story. I took her through all the points in my table (pages 4-5) and asked her what she wanted to do. And guess what, she said it was none of my business and that she would speak to an IFA!

Useful websites:

- **www.fsa.gov.uk/tables** - FSA comparative tables on pension annuities
- **www.moneymadeclear.fsa.gov.uk** - FSA guides
- **www.pensionsadvisoryservice.org.uk** The Pensions Advisory Service (PAS) has developed an online annuity planner for pension scheme members to provide them with information on annuities
- **www.unbiased.co.uk** - finding an independent financial adviser