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Solvency II for Pensions – timescale slips

It became apparent last week that the timescale for the publication of a new European Union pensions directive (Institution for Occupational Retirement Provision, or IORP II – see Pensions Bulletin 2012/02) has been pushed back.

This development was effectively announced when the head of pensions and insurance at the European Commission's Directorate General – Internal Markets and Services, Karel Van Hulle, gave oral evidence to the House of Commons Select Committee on Work and Pensions.

During this exchange Mr Van Hulle said that the Commission intends to consult on the specification of the proposed quantitative impact study (QIS) into the effects of the imposition of solvency style regulation onto the private pension sector. The timescale was previously understood to be that the QIS exercise would take place during this May/June, the results would be available in September and we would see the draft IORP II directive before the end of this year.

Given that the Commission has now accepted the need to consult on the QIS this timescale has been pushed back. Selected UK pension schemes will still be required to participate in a QIS exercise, possibly later this year after consultation, but we are now unlikely to see a draft directive until 2013.

Comment

It is good news that nothing is going to be rushed out. Most schemes will not have planned for this. A new IORP directive is coming but we still do not know how onerous any new capital requirements for pension schemes in the directive will be. The consultation on the specification of the QIS will be a strong indication as to what the Commission is aiming for.

Supreme Court rules on age discrimination

Two long running age discrimination lawsuits have been ruled on by the Supreme Court.

In Seldon v Clarkson Wright and Jakes, a solicitor who was compulsorily retired from a partnership, in accordance with the terms of the partnership deed had sued on the grounds that his enforced retirement was unlawful age discrimination.

Mr Seldon lost most of the points at earlier stages of the litigation (see Pensions Bulletin 2010/33), but had continued to appeal on the point of whether or not the "legitimate aim" which is required to justify age discrimination for it to be lawful under the legislation might have been achieved by some other retirement date. The charity Age UK supported the appeal.

The Supreme Court held that the discrimination may be justified; the rationale being that the compulsory retirement policy was consistent with the need for justification to be in furtherance of a social policy aim as permitted by the relevant EU directive. Whether this particular retirement age of 65 is in furtherance of a "legitimate aim" or not though has been referred back to the Tribunal to finally decide, although the Supreme Court does seem to have given the Tribunal enough leeway to decide either way.

In the linked case of Homer v Chief Constable of West Yorkshire Police the Supreme Court ruled for Mr Homer, a police service legal adviser, who had claimed that he had been discriminated on the grounds of age in relation to promotion and pay grade. Mr Homer had effectively been demoted because he did not have a law degree, which had not previously been a criterion. When the pay grades were revamped to include the requirement for a law degree, which would take him 4 years to achieve, he was aged 62 and the retirement age was then 65. The Supreme Court held that Mr Homer had been subject to unlawful indirect age discrimination.

Comment

These cases have generated some comment in the press. They do not have that much relevance directly to the pensions field but we report it here as another building block in the developing body of law about when age discrimination, particularly in relation to retirement may be justified. HR professionals in particular will want to be up to date with these developments.

Pensions Regulator statement on scheme funding

The Pensions Regulator has issued its long-awaited statement on acceptable approaches to the scheme funding valuation process in the current economic environment. In the main, it is a confirmation that there are to be no changes to the now 7-year old scheme-specific regime delivered through the Pensions Act 2004. However, there are some interesting developments which may be of assistance to some schemes.

For further details see our News Alert issued on 27 April 2012.

UK pension obligations quantified

The Office for National Statistics (ONS) has published what is the first set of official statistics quantifying total UK pension obligations, including public and private sector workplace pensions as well as state pensions.

The details published are estimates for 2010 and have "experimental status". The expectation is that all EU countries will be required to produce what is a "supplementary table on pensions" in their national accounts for the year 2012 onwards.

Highlights from the release include:

- At the end of 2010, the total accrued-to-date pension obligations of all UK pension providers were estimated at £7.1 trillion, nearly 5 times the UK's Gross Domestic Product (GDP). This total comprised £5.0 trillion of government obligations and £2.1 trillion of private sector obligations.
- Of the £5.0 trillion pension obligations for which the UK government was responsible at end - 2010, £3.8 trillion was in respect of state pensions (263% of GDP). The latest comparable EU-level estimate (for end-2007) was 278% of GDP.
- Obligations relating to unfunded pensions for public sector employees in the UK at end-2010 were estimated at £0.9 trillion (58% of GDP). The latest comparable EU-level estimate (for end-2007) was 52% of GDP.
- Funded private sector workplace pension obligations amounted to £1.7 trillion (118% of GDP), split £0.4 trillion defined contribution and £1.3 trillion defined benefit.

Transfer value analysis assumptions – FSA issues new rules and guidance

The Financial Services Authority (FSA) has issued new rules and guidance, effective from 1 May 2012, that must be followed by FSA regulated advisers when advising on pension transfers from defined benefit schemes, following consultation (see Pensions Bulletin 2012/09).

The changes comprise:

- Updated mortality tables operating on a gender neutral basis. These are effectively the same as used in Statutory Money Purchase Illustrations (SMPIs) sent each year to those with defined contribution (DC) benefits.
- New rules distinguishing inflationary pension increases bounded by maxima and minima (ie "caps" and "collars"), based for the time being on the Retail Prices Index (RPI).

- A 12 month rolling annuity interest rate (AIR) between the annual standard reviews of the AIR, so that advisers are using the most up-to-date rate in their assessments.
- New guidance requiring advisers to use growth rates that take into account the likely returns on the DC fund assets.

No change is permitted yet to take account of revaluation and indexation in line with the Consumer Prices Index (CPI). The FSA is to consult separately on the assumptions to use as part of its review of projection rates and in the meantime such benefits need to continue to be valued by reference to the RPI.

The guidance also now states that when giving a recommendation, the transfer of various risks must be highlighted to the individual and when formulating the recommendation it is insufficient to rely only on the transfer analysis producing a rate of return that may replicate the defined benefits being given up.

Comment

The update, which has been implemented very quickly, is broadly in line with the FSA's proposals but also reflects the feedback it has received. The changes to the assumptions and methodology appear reasonable and taken together with the messages around suitability make it harder for advisers to recommend transfers as being in the best interest of the individual.

The move to a rolling average for the annuity interest rate is a direct result of feedback received by the FSA. The intention is to reduce the difference between the rate used by pension schemes to calculate transfer values and the rate used by financial advisers when advising on such matters.

Auto-enrolment – CARE schemes anomaly to be fixed

The Department for Work and Pensions has launched a consultation on proposals to slightly adjust the auto-enrolment quality requirements for career average revalued earnings (CARE) schemes, following concern that some CARE schemes might not qualify under current rules.

Currently CARE schemes can be used for auto-enrolment purposes but they need to provide for accrued rights to be revalued by at least a minimum rate while the individual's pensionable service continues. Such revaluation can be on a guaranteed or funded discretionary basis, but not on a mixture of both. Draft regulations now propose to also permit guaranteed revaluation below the minimum, so long as there is a discretionary power to revalue at or above the minimum rate which is funded for and reflected in the scheme's statement of funding principles.

Auto-enrolment – new website launched for employee communications materials

The Pensions Regulator and the Department for Work and Pensions have launched a new website to offer employers materials to help them communicate with their employees throughout the automatic enrolment process.

Amongst the documents currently available is a 15 page guide answering many frequently asked questions and some initial communication material.

PPF to bring member services in-house

The Pension Protection Fund (PPF) has announced its intention to bring its member services in-house, particularly the customer services operation that makes compensation payments to members.

These services have been outsourced to administration services provider Capita Hartshead during what the PPF calls its "formative years". The PPF says that it believes it is now big enough to bring the services in-house, in line with the practice among many FTSE 100 companies. The PPF is now actively seeking tenders to provide a suitable IT system once the contract with Capita expires in the summer of 2014.

New research reveals pensions shortfalls

The Pensions Policy Institute (PPI) has published a research report which suggests that only 40% of people currently between 50 and State Pension Age can expect to achieve sufficient income after State Pension Age to maintain their standard of living, and then only if they continue to work right up until State Pension Age.

Worryingly, 45% of people currently between 50 and State Pension Age can only expect to achieve sufficient income after State Pension Age to maintain their standard of living, if they continue to work and save right up to and 11 years beyond State Pension Age.

INSIGHT CLARITY ADVICE

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