

pension trustee bulletin

A briefing for occupational pension scheme trustees and their advisers

Spring 2010

Good governance

The Pension Regulator (TPR) has launched the first salvo in a new campaign to improve scheme governance and administration (called 'keeping pensions safe'). In the revised draft guidance on internal controls, the TPR have accepted that, despite all their efforts, smaller schemes have not adopted processes to deliver improved risk management. As a result, the campaign is particularly targeted to these smaller schemes.

To coincide with the start of the campaign, the publishing of the latest survey on governance shows that there are still a large number of schemes with gaps in their processes and behaviours. Unsurprisingly, it is those with more significant resources, the larger schemes, that are associated with higher levels of governance activity. TPR is happy to note that most schemes appear to have a risk register in place but less than half of schemes are very confident that they have adequate internal controls.

From the broad scope of the risk-based approach in the original guidance, TPR is proposing much more explicit demands of trustees including a tough requirement to 'comply or explain'. Therefore, smaller schemes with resources already under strain as a result of the economic downturn will be put under further pressure by TPR in order to comply promptly.

A minor concession allows smaller schemes to have 'less formalised controls than more complex larger schemes but, regardless of size, key risk areas will still need to be adequately controlled'. Unfortunately for trustees, the 'key risks' identified by TPR cover all aspects of a scheme's operations so, in essence, this concession will only help those schemes with a simple structure and straightforward processes.

The guidance focuses on seven risks of which the first relates to skills of those involved with schemes and the remainder relate to processes.

1. Deficient trustee knowledge and understanding
2. Conflicts of interest
3. Ineffective relations with advisers
4. Poor record keeping
5. The worsening of the employer covenant
6. Investment risk
7. Deficient retirement processes.

The guidance also sets out why TPR considers each of these as important, what behaviours they expect trustees to adopt and what control procedures it expects to see implemented.

Guidance has recently been issued to provide:

- a revised code and scope guidance for trustee knowledge and understanding
- provision of an e-learning module on risk management.

Over the next few months, the development of the 'keeping pensions safe' campaign will also result in:

- new guidance on record keeping
- updated guidance on the winding-up of pension schemes.

The Financial Reporting of Pensions

A joint report by a number of European accounting standard setting bodies and led by the UK Accounting Standards Board (ASB) has been published providing redeliberations on the financial reporting of pension schemes. This follows their original discussion paper in January 2008.

The report covers reporting of pension schemes in employer's accounts and those of pension schemes. The main recommendation of the ASB (the other European bodies do not express a view) in respect of pension scheme accounts are:

1. The discount rate used to calculate scheme liabilities should be the risk-free rate.

Our view: As the risk-free rate is lower than that AAA corporate bond rate currently used, using the risk-free rate could significantly increase the value of the scheme liabilities and, hence, the FR.S17/IAS19 deficit in employer accounts.

2. Pension scheme accounts should recognise the liability to pay future benefits with a more detailed study of potential costs being undertaken.



Our view: Significant additional costs will be incurred where the employer and pension scheme accounting periods are not co-terminous. In this case, the cost of obtaining the liability calculations for the pension scheme would be in the order of that incurred by the employer in their annual FRS17/LAS19 calculations. However, even where the periods are co-terminous, the scheme trustees may need to incur actuarial costs to ensure that the calculations carried out for the employer are suitable to be used by the scheme in their accounts. In particular, this may occur where the actuary engaged by the employer has not been engaged by the trustees for the same purpose.

3. The liability should be calculated on the same basis for both the employer's and the related pension schemes accounts.

Our view: It would seem sensible to calculate the liability for the employer's and related scheme's accounts on the same basis as, in effect this represents the same liability that happens to be reported in two sets of accounts.

4. By a majority vote, the employer covenant should be recognised as an asset in the pension scheme accounts with the preferred alternative being narrative disclosure of how the difference between the scheme assets and liabilities will be funded.

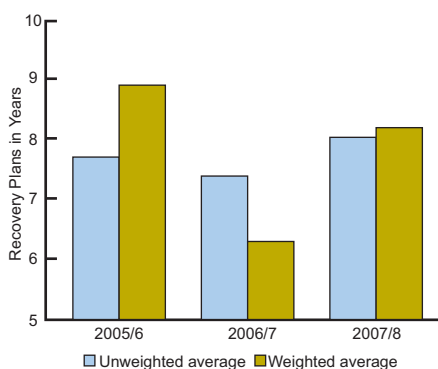
Our view: There may be significant difficulties in calculating the value of the employer covenant. Indeed, the ASB recognises this problem, including having to assess the employer's creditworthiness which may lead to considerable uncertainty in the amount recognised.

Scheme Funding

The TPR survey of recovery plans submitted for clearance to them over the past three years shows two major trends.

Recovery plans

As expected, the worsening economic situation has resulted in the length of recovery plans increasing as shown below. The longest plans are around 15 years with only 12% of schemes having plans longer than 10 years. The unweighted average has increased by almost a year between the latest two periods and, we would expect this trend to have accelerated since September 2008 with employers trying to extend recovery periods.

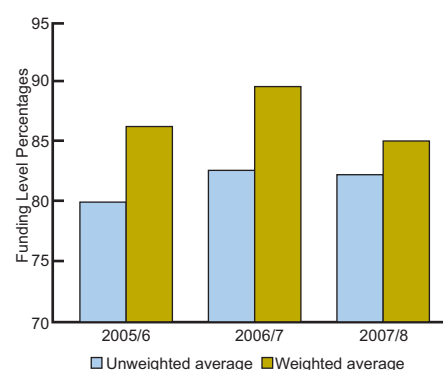


Note: Periods run from 1 October to 30 September. The weighted average is weighted against technical provisions.

Funding levels

Schemes that file a recovery plan, by definition have funding levels below 100% so, such schemes are not included in the population surveyed. However, we can look at the trend of funding levels in the survey as these will reflect movements in schemes as a whole.

As can be seen in the following graph, funding levels have worsened in 2007/8. This appears to be due to the impact of adverse market conditions leading to lower asset values, although it should be noted that these results predate the market activity in late 2008 and 2009 which would depress the funding levels even further.



Note: the weighted average is weighted by size of scheme which would indicate that larger schemes, on average, have better funding levels and perform calculations on a more prudent basis than smaller schemes.

Pension Protection Fund (PPF) Levy

The PPF confirmed in December 2009 that, as announced in June, the levy for 2010/11 has been set at £720m; being an indexed to earnings, inflationary increase from the £700m for 2009/10. As a result, schemes with unchanged circumstances should expect a small increase in the levy next year.

Pension scheme financial benchmarking survey 2009

Smith & Williamson provide advice and support to more than 200 pension schemes. Our annual pension benchmarking survey, of defined benefit pension schemes, provides valuable financial analysis for trustees and scheme advisors across the UK.

If you would like to participate in the 2009 survey, and receive a copy of the report to be published in April, please contact Matthew Maneely using the details below.

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