

Risk Sharing: information for employers considering making changes to Defined Benefit pension schemes

An information note with case studies

Sue Barbosa, March 2010

Private Pensions Policy and Regulation

Executive summary

- Following a consultation on risk sharing in private pensions during summer 2008, in December 2008, the Government gave a commitment to publicise what risk sharing options are available under current legislation.
- This note aims to build on work done by others, for example the NAPF's 2007 publication on risk sharing, *All Change*¹, by explaining some of the options available and how schemes have used them.
- The note's objective is to provide information to employers considering making changes to their defined benefit (DB) scheme – with the aim of enabling them to consider a wide range of options.
- It features case studies from five employers featuring six kinds of risk/cost sharing – cash balance/hybrid (Barclays Bank plc), career average (Morrisons), longevity adjustment factor (John Lewis), changing accrual rates and increasing normal pension age (BT), and cost sharing/cost capping (Civil Service Pension Scheme.)
- It takes employers through the kind of issues they will need to consider, for example consultation requirements.
- It is **not** intended to be a definitive, step by step 'how to' guide – employment conditions and pension scheme rules vary considerably and employers will still need to obtain their own professional advice.
- Inclusion of a case study or option should not be seen as an endorsement of or preference for any particular scheme design – employers should take advice about what options may be available to their scheme. Similarly, the note does not take a view on any matters that are properly for the Pensions Regulator, including, but not limited to, the regulation of scheme funding requirements under Part 3 of the Pensions Act 2004.

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¹ National Association of Pension Funds, 2007, *All Change! Case studies from the changing world of occupational pensions*.

Contents

Page

- Executive summary 2
- Why produce an Information Note for Employers? 4**
- Introduction 6**
 - What do we mean by risk and cost sharing? 6
 - Some common types of risk 6
- Main Types of risk sharing schemes 9**
- Consultation – something for all schemes to consider 10**
- Other considerations 10**
- Employment Contracts 11**
- Cash Balance Schemes 12**
 - What are they? 12
- Hybrid schemes 15**
 - Case Study (cash balance/hybrid): Barclays Bank plc 17
- Career Average Schemes 21**
 - Case Study: Morrisons 23
- Longevity-Adjusted DB schemes 28**
 - Case study: John Lewis..... 30
- Changing accrual rates and/or increasing normal pension age 34**
 - Case Study: BT 36
- Cap and share 40**
 - Case study: Civil Service Pension Scheme..... 42
- Conclusion 44**
- Glossary..... 45**
- Deregulatory Review Achievements 50**
- Consultation and Contracts 52**

Why produce an Information Note for Employers?

Membership of defined benefit (DB) pension schemes peaked in the late 1960s and has been in decline since then. In recent years more employers have been moving away from traditional final salary models to defined contribution (DC) schemes, for a variety of reasons including longer life expectancy and the increasing cost of providing final salary benefits.

Although the Government looks to support all types of good quality pension provision, both final salary DB and DC schemes polarise the risks towards employers and employees respectively. There may be scope for more of a middle way and for employers to consider risk-sharing models, where risks are more evenly shared between employers and employees.

Employers who have already gone down the risk or cost-sharing route tend to be paternalistic in their philosophy; when considering scheme changes they have not been happy to transfer all investment or longevity risk to their employees but have preferred to find a solution that leads to a more predictable final pension for scheme members whilst keeping firmer control over future costs.

The Government consulted on risk sharing in 2008 and looked at ways in which employers could make their DB pension provision more affordable. Responses showed there was a need for more easily accessible information for employers. **We hope that by publishing this note featuring options which others have taken, including case studies from employers who have introduced risk or cost-sharing for their schemes, we will encourage more employers to consider doing so.**

This publication aims to build on the information contained in Chapter Five of the Risk Sharing Consultation document² and on the NAPF's 2007 publication *All Change*³ which featured eight case studies of employers who had recently introduced risk sharing arrangements.

"This Information Note contains useful examples of the different arrangements available under current legislation that enable employers and pension scheme members to share some of the risks associated with operating DB schemes. It is helpful that it also contains some practical case studies showing the issues that employers need to consider when making changes to their DB scheme including the very important role that comprehensive communications plays in gaining the positive engagement of members to new pension arrangements."

David Yeandle OBE,
Head of Employment Policy,
EEF, the manufacturers' organisation

² Department for Work and Pensions, 2008, *Risk sharing consultation* (<http://www.dwp.gov.uk/docs/pensionrisksharing-consultation-june2008.pdf>)

³ National Association of Pension Funds, 2007, *All Change! Case studies from the changing world of occupational pensions.*

It features six different types of risk or cost sharing: **longevity adjusted DB**, a **hybrid** scheme, a **cash balance** scheme, a **career average** scheme, a scheme in which **increasing retirement age and increasing employee contributions** have helped to share risks, and a **cost sharing/cost capping** provision. The examples are taken from five different employers from the retail, banking, service and public sectors.

The Department for Work and Pensions would like to thank the NAPF for their help, also the Pensions Regulator, Her Majesty's Treasury and the Cabinet Office, and members of the Deregulatory Review Advisory Group.⁴

"Unions negotiate new pension arrangements every day, seeking to get the best deal possible for our members. Sometimes we find ourselves talking to employers who think that there is a simple choice between final salary defined benefit and defined contribution pensions, with nothing in between.

"This useful guide shows that this is far from the case. There are a range of options both for those who want to improve a standard DC without going to full DB, and for those trying to ensure the sustainability of defined benefits.

"No-one can pretend that pensions negotiations are ever going to be easy, but at least this clear guide can ensure that they are well-informed."

Brendan Barber
General Secretary, TUC

The Department would also like to thank Barclays, BT, John Lewis and Morrisons for agreeing to feature as case studies.

This note does not have legal status. It explains some of the options available and how schemes have used them. Inclusion of a case study or option should not be seen as an endorsement of, or preference for, any particular scheme design.

Employers' terms of employment and scheme rules vary considerably - **employers considering making changes should consult their own professional advisers such as legal advisers and actuaries.** Similarly, this note does not provide a view on operational regulatory matters which come within the responsibility of the independent Pensions Regulator – this includes, but it is not limited to the regulation of scheme funding requirements under Part 3 of the Pensions Act 2004. Among its duties, the independent Pensions Regulator is responsible for ensuring that trustees implement the 'scheme specific funding' requirements effectively: trustees must develop prudently based funding strategies for example, and where appropriate submit deficit recovery plans to the Pensions Regulator for scrutiny.

⁴ More details about the Deregulatory Review Advisory Group, including a list of members, can be found at <http://www.dwp.gov.uk/policy/pensions-reform/deregulatory-review/>

Introduction

What do we mean by risk and cost sharing?

Traditional benefit structures in occupational pension schemes polarise the risks associated with funding a scheme member's retirement:

- In a DB final salary scheme the risks fall mainly on the **employer**.
- In a DC scheme risks associated with investment returns and longevity fall on individual scheme **members**.

Risk-sharing schemes try to find a balance of shared risk somewhere between the two poles. In risk-sharing schemes, members take on some of the risk of providing the scheme benefits.

Cost-capping and cost-sharing arrangements imply that any future increases in the value of benefits past a certain level will be met by employees, rather than the employer, either through increases in employee contributions or through reductions in the generosity of the scheme (such as through increases in the scheme pension age.)

Following Government reforms, major public sector schemes have capped the employer contributions to control taxpayers' exposure to future cost pressures. For example the employer average contribution rate cap is 14 per cent for the Teachers and NHS schemes, and 20 per cent for the civil service scheme.

A brief explanation of the different kinds of financial risks can be found in the section below and in the glossary at the end of this document.

Some common types of risk

In traditional, final salary DB all **investment risk** is borne by the scheme sponsor because of the nature of the pension benefits. Once the final salary is known, the sponsor has to meet that commitment regardless of what happens to the scheme's assets. Conversely, in a pure DC scheme, all the investment risk in the accumulation phase falls on the member. After the purchase of an annuity, investment risk is borne by the annuity provider, who guarantees a stream of income.

Specific **longevity risk** after retirement is not borne directly by an individual in either DB or DC schemes (except in the decision over whether to take a lump sum. Individuals in such cases need to decide whether to take a lump sum up front when they retire to use as they wish, or have a higher pension, which may be more valuable if paid out over a long enough time period.)

In a DB scheme, which undertakes to provide a specified income stream on retirement, the sponsor will either transfer the risk to an annuity provider, or carry this

risk itself by maintaining responsibility to fund any unexpected improvements in an individual's longevity. In a DC scheme, this type of longevity risk is transferred to the annuity provider. The individual will have borne the longevity risk up to the point of annuitisation as the annuity provider will use life expectancy at that point in calculating the annuity rates offered. There are also hybrid "self annuitising" schemes which are schemes in which the member builds up DC benefits in the build up phase but a pension, in the form of an annuity, is then paid from the scheme's own resources.⁵ Thus the scheme takes on the post-retirement longevity risk as calculated when the member retires.

Inflation risk in a final salary DB scheme is currently distributed between sponsors and individuals as a result of the system of revaluation and indexation caps applied both to deferred pensions and pensions in payment. In a low inflation environment, the entire nominal cost of inflation protection falls on the sponsor; however when inflation rises above the cap, members begin to share the risk.

Discontinuity/default risk – this is the risk that accrual or payment of the pension is interrupted. For DB schemes this is typically because the sponsor defaults on the scheme's debt or becomes insolvent. In such cases there are real risks to the members' pensions, though the existence of the Pension Protection Fund mitigates much of this risk. Discontinuity risk exists in DC schemes through the possibility of the fund manager becoming insolvent in the accumulation phase or of the annuity provider becoming insolvent after the benefits have started being taken. This risk is mitigated by the existence of the Financial Services Compensation Scheme.

Regulatory risk – Since the 1970s, regulation to improve the security of members' benefits and the running of pension schemes has increased.

⁵ These schemes would appear to be affected by the recent Court of Appeal judgment in *Houldsworth & Anor v. Bridge Trustees & Anor* (the Imperial Home Décor Pension Scheme). The Government is considering the issues further and seeking leave to appeal the judgment.

Table 1 summarises risk in the traditional UK pensions landscape:

	DB schemes	DC schemes
Longevity risk	Employer bears risk as benefits are guaranteed – has to provide additional funding to meet increasing liabilities when life expectancy of members increases	Individual bears longevity risk through exposure to annuity prices, which increase with increasing life expectancy
Investment risk	Employer bears risk as benefits are guaranteed – has to provide additional funding if investment performance falls short of expectation	Individual bears investment risk. Lower than expected investment growth results in a lower than expected pension (and vice versa)
Inflation risk	Sponsor (below cap)/ member (above cap)	Member (non-indexed)/ Annuity provider (indexed)
Discontinuity/ Default risk	Member/ the Pension Protection Fund	Member/ Financial Services Compensation Scheme
Regulatory risk	Sponsor, possibly member	Employer, for some Trust based DC schemes or the member for other DC arrangements

Main Types of risk sharing schemes

There are various types of risk-sharing schemes:

- **Cash Balance Schemes** – the employer guarantees a pension pot to scheme members, payable at normal pension age, with which they can purchase an annuity.
- **Hybrid** - a scheme with more than one section or element, for example DC with a DB underpin. Here employer and employee contributions go into a DC pot, but the employer provides a low level of DB benefits as an underpin. This means that, at normal pension age, the member gets either the invested money purchase value of the pot, or the DB pension, whichever is higher. The way that this type of scheme is regulated is that if the value of the accrued benefits fall below the DB floor, the scheme must be funded to the level of the DB underpin. Costs may be higher because each pot must be held separately and two separate calculations must be carried out each year in respect of the same pot, so as to check whether the scheme has met funding requirements.
- **Career Average Schemes** – a percentage of salary, usually revalued annually, is allocated to the employee's pension pot. Final benefits are paid from the scheme as under traditional DB.
- **Longevity Adjusted DB schemes** - this is where schemes can adjust benefits to take account of changes in longevity, **for future accruals only**. In such cases, provisions would be written into the scheme rules that if longevity increases to a specified level, the scheme's benefits would be adjusted **for that tranche of benefits accrued after the date of change** to take account of the fact that they will be paid for longer than originally anticipated.
- **Changing accrual rates for future accrual and/or increasing normal pension age** – subject to scheme rules employers may choose, in respect of benefits accruing after the date of the change, to reduce future accrual rates (eg from 1/60ths to 1/80ths), and/or to increase normal pension age, (eg from 62 to 65). This means that scheme benefits would be “tranching” with rights accruing from the date of change being payable at a later normal pension age than rights accrued up to the date of change.
- **Self annuitising hybrid schemes**⁶ – benefits are money purchase in the build-up phase but the annuity is normally provided by the scheme rather than secured with an insurance company. However, the member retains the right to an open market option – the option, at retirement, to purchase an annuity with an insurance company of the member's choice, which enables consumers to shop around for the best annuity rates available on the open market.

⁶ These schemes would appear to be affected by the recent Court of Appeal judgment in *Houldsworth & Anor v. Bridge Trustees & Anor* (the Imperial Home Décor Pension Scheme). The Government is considering the issues further and seeking leave to appeal the judgment.

Consultation – something for all schemes to consider

You will need to consult your employees before introducing any risk-sharing changes.

The relevant regulations are **SI 2006/349 “The Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations”**. These oblige employers to consult with prospective and active pension scheme members or their representatives before making significant changes to future pension arrangements and provide protection for employees in connection with consultations carried out under the requirement.

All employers we spoke to emphasised the importance of communications both during the formal consultation period and after the changes had been introduced. Although the case study employers are big employers with large schemes who created websites and put on roadshows explaining the changes, the lessons are still valid for small/medium sized employers with smaller pension schemes.

More detail on consultation is found in [Annex B](#).

Other considerations

Restrictions in scheme rules

Remember, trustees need to act in the best interests of **all** scheme members and beneficiaries, not just active members, when looking at changes that you as the employer want to make. There may be restrictions relating to the amendment power in the scheme rules. It is very important to act in accordance with its provisions. For example, the rules may contain restrictions along the lines that an amendment must not:

- “vary or affect any benefits already secured by past contributions in respect of any Member without his consent in writing”
- “reduce ... the accrued pension of any employed member”.

These kinds of restriction are quite common in scheme rules.

Section 67 of Pensions Act 1995

Notwithstanding any specific restrictions in scheme rules, schemes need to consider the requirements of sections 67 to 67I of the Pensions Act 1995, the aim of which is to protect the value of pension benefits promised under scheme rules. The legislation limits the right to make amendments to the scheme that would or might be detrimental to an individual's accrued or 'subsisting' rights (detrimental modifications).

It is possible to make changes to members' accrued pension rights, but only where:

- the affected member consents to the change; or
- in the case of certain changes, if the member does not consent,
 - the change does not involve converting any DB (eg, Final Salary) pension rights into DC (eg Money Purchase) rights, and
 - the total actuarial value of the member's subsisting rights at the point of change is maintained, ie any rights removed or reduced are replaced by something of actuarially equivalent value.

In both cases, there must be a power in scheme rules to make the change, the trustees must approve the change and members must be notified appropriately about the changes.

Employment Contracts

In most cases, employees will have contractual rights to be a member of a pension scheme. These may be in the employment contract, collective agreements, scheme rules, membership booklets or pension membership forms or may arise by custom and practice or the shared understanding between employer and employee.

It will be important for employers to check that there is a right to increase employee contributions or to cease future accruals in the pension scheme.

If you are considering making changes to employee's contracts and their terms of employment, it is important to consult professional advisers.

Further detail is at [Annex B](#).

The note will now give further details, including case studies, on all of these risk sharing options.

Cash Balance Schemes

What are they?

Cash balance schemes are a risk-sharing scheme in which an employer guarantees a pension pot to scheme members, payable at normal pension age, with which they can purchase an annuity. The simplest way to understand a cash balance scheme from a member perspective is to imagine a DC scheme in which the investment return is guaranteed and the value of the pot cannot fall.

Normally the employers guarantee a percentage of salary each year to be paid into the scheme. This can be indexed to protect accruals from inflation and, in addition, benefit from a discretionary notional “investment” return, as shown in Figure 1 on page 13.

This constitutes risk sharing as the employer takes on pre-retirement investment risk while the member takes on the longevity risk and interest rate risk at retirement. The employer still has to fund a certain level of benefit.

The differentiating factor in a cash balance scheme – compared with a straightforward DC scheme - is that the revaluation of the account does not depend on market conditions alone and is subject to some kind of guarantee.

If the sponsor actually pays 10 per cent contributions but the assets backing the pension promise do not keep pace with the revaluation, then a deficit will arise which the sponsor will need to meet. Equally, if the assets deliver more than the revaluation then the cost to the sponsor will be less than the 10 per cent credited, since part of the credit will, in effect, arise from investment returns. The revaluation of the account may be guaranteed under the plan rules, or it may be subject to discretion – which will increase the funding flexibility for the sponsor.

Cash balance schemes usually have a normal pension age at which benefits from the cash pot are realisable through the purchase of an annuity. Therefore, in some types of scheme, the value of the cash pot may be actuarially reduced if a member transfers out of the scheme before normal pension age or retires early.

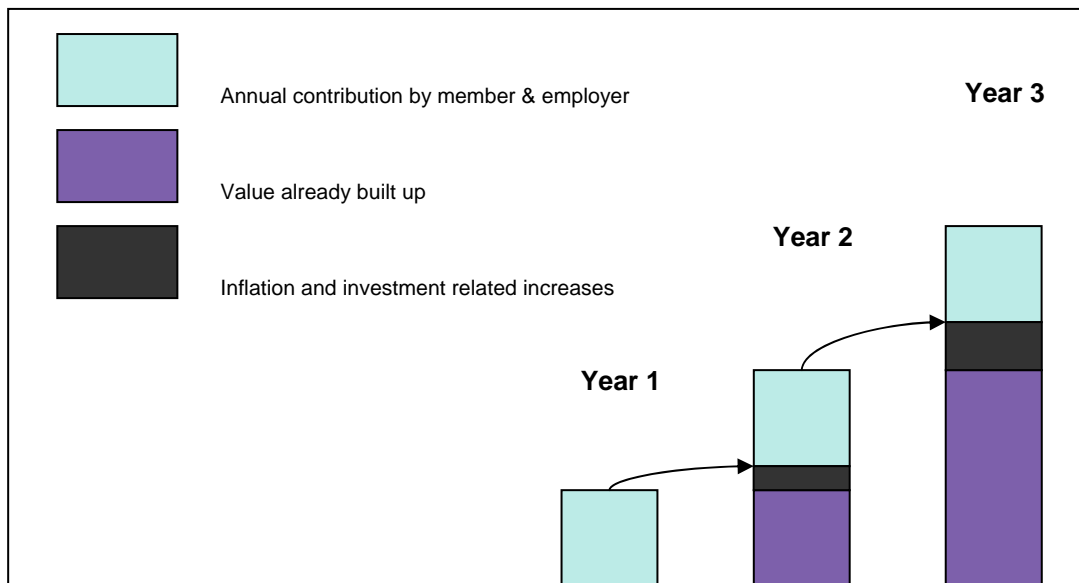


Figure 1 – cash balance schemes

What's in it for the employer?

- Liabilities are predictable on an ongoing basis.
- Although the employer takes on the pre-retirement investment risk, he may also benefit from higher than expected returns on investments.

Issues to consider

- The Government's view is that cash balance schemes should be subject to DB scheme regulation because the employer guarantees a specific sum for each year of service.⁷ This means:
 - deferred members' benefits should be revalued at the same rate as those of active members;
 - the scheme funding requirements should still apply;
 - the Pension Protection levy is still payable, as members should receive compensation from the PPF in the event of a sponsoring employer becoming insolvent;
 - at retirement, cash balance scheme members are required to buy annuities which contain statutory pension increases (mandatory indexation). **It is worth noting, however, that DWP plans to review this requirement in the future.**
- If a cash balance scheme is contracted out, it will need to comply with the relevant contracting-out requirements.

⁷ These schemes would appear to be affected by the recent Court of Appeal judgment in *Houldsworth & Anor v. Bridge Trustees & Anor* (the Imperial Home Décor Pension Scheme). The Government is considering the issues further and seeking leave to appeal the judgment.

What's in it for the employee?

- Employees tend to find the benefits easy to understand.
- Members do not bear all the investment risk, as they would in a pure DC scheme, as the value of past accruals is guaranteed in cash terms and investment returns are smoothed due to the sponsor guarantee⁸ (though, in some schemes, they also do not reap the full benefits of high investment returns).

Issues to consider

- Employees take on post-retirement longevity risk in cash balance schemes as annuity rates available at the point of retirement will dictate the level of income they can get for their money.

Legal issues

There have been suggestions that some cash balance schemes are discriminatory on the grounds of age because:

- the cost of funding the pension earned for a younger employee is less than for an older employee earning the same salary; and
- a younger member with the same accrual period will get greater benefit from the interest applied up to retirement age than a comparable older member who has less time, and therefore less interest applied, to retirement age, on the same accumulated "pot".

Depending on the detail behind the design of such schemes, in the Government's view, it is probable that the practice of making equal contributions to a cash balance scheme would not be discriminatory. **However, scheme trustees should seek their own legal advice on this point.**

What kind of employers have introduced them?

Barclays have the largest cash balance scheme in the UK, *Afterwork*, with 31,000 employees.

Other employers with cash balance schemes include Diageo and the Royal Society for the Protection of Birds.

⁸ These schemes would appear to be affected by the recent Court of Appeal judgment in *Houldsworth & Anor v Bridge Trustees & Anor* (the Imperial Home Décor Pension Scheme). The Government is considering the issues further and seeking leave to appeal the judgment.

Hybrid schemes

There are a range of possibilities for hybrid schemes including schemes incorporating both DB and DC elements. **They provide a clear approach to risk sharing, with one section where the employee takes all the risk and one where the employer takes all the risk.** The following are a few options (NB this list is not exhaustive.)

Combination Hybrid: Schemes where money purchase and DB benefits accrue simultaneously and the member's eventual pension at retirement may comprise both DB and DC elements in the proportions set out in the rules of the scheme.

Sequential hybrid: benefits based on service where active members accrue DC benefits for a certain number of years' service and DB benefits thereafter. These are single schemes which have more than one part or section; one provides for a money purchase benefit the other a DB benefit.

Capped DB: where a salary limit is placed on the DB component of the scheme. Employees earning above this either have the option of paying contributions on the difference into a DC fund or, alternatively, may not have access to the DB scheme at all and only have access to DC benefits.

DB and money purchase underpin schemes which provide the better of a DB or money purchase benefit.

Self annuitising hybrid schemes – the annuity is provided by the scheme rather than secured with an insurance company, although the member retains the right to an open market option.

What's in it for the employer?

- For employers, risks reduced will depend on the specific hybrid model employed, although whatever one is used it is likely that there will be a reduction in **investment** and **longevity** risks compared to a final salary DB scheme.

Issues to consider

- It is possible that scheme administration will be more complex.
- Communicating to members will also be more complex.
- Hybrid schemes, if contracted out, will need to comply with the relevant contracting-out requirements.

What's in it for the employee?

- Again, how the risks are shared will depend on the specific hybrid. In general, the employer will take more risk in one section of the scheme (ie one part of the pension), so the employee only has to take greater risks in the other part.

Issues to consider

- Employees will be exposed to some additional investment risk but will still be sharing them with the employer, rather than taking on both investment and longevity risk as they would in a pure DC scheme.

Prevalence of hybrid schemes

At present, it seems that around three per cent of occupational schemes are hybrid.⁹ Classification tends to be difficult because of various ways of classifying hybrid schemes. Despite the added administrative complexity, it seems likely that more and more employers will consider using such models in future.

⁹ tPR *Annual Report and Accounts 2008-2009* states there were 53,697 DC, 6,634 DB and 1,973 hybrids which means that 3.2% of schemes were hybrid.

Case Study (cash balance/hybrid): Barclays Bank plc

What led you to introduce a risk sharing scheme?

Barclays introduced a DC scheme for new employees in 1998. Following a period of global stock market volatility this led to some members of the scheme retiring on smaller pensions than they had been expecting. Although the scheme had only been in operation for a few years, the business was conscious of the effect stock market uncertainty could have on employee pension savings into the future.

As a result, Barclays reviewed its pension provision to see if there was a way of providing employees with more certainty over their retirement savings while continuing to offer pension provision that met the needs of its overall compensation package.

After considering various options, including increasing contributions to the existing DC scheme, Barclays decided on a hybrid cash balance arrangement called Afterwork, which is still in place today.

In Afterwork, the risks are shared. The employer takes on more of the investment risk while employees maintain the longevity risk through purchasing an annuity at the point of retirement.

Barclays was unusual in that it moved away from a pure DC scheme to a hybrid cash balance scheme, effectively a 'halfway house' between a defined benefit and a defined contribution scheme.

How the scheme works

Afterwork is made of two parts: the Credit Account, which provides a guaranteed sum at normal retirement, and the Investment Account which provides employees with the opportunity to increase their retirement savings. On retirement members purchase an annuity with the combined sums.

Employees are automatically enrolled into the Afterwork Credit Account if they are aged 25 or over when they join Barclays or when they reach that age. Employees under 25 are also eligible to join.

The Credit Account:

In return for an employee contribution of 3% of Pensionable Salary each month, Barclays contributes a total credit of 20% of the employee's Pensionable Salary each month (subject to an internal earnings cap) into the Credit Account. The benefits in the Credit Account build up as a cash sum

and are inflation protected for RPI to a maximum of 5% per annum. In addition, a discretionary investment-related increase can also be provided of up to an additional 2% per annum. This means that the benefits built up in the credit account are not subject to the volatility of investment and can provide a degree of certainty.

Barclays guarantees the value of the Credit Account will not go down in value if taken at Normal Pension Age, which is usually 60. This means that the benefits employees build up in the Credit Account are not subject to investment performance and can provide a degree of certainty.

Example: An employee works for three years, earning £20,000 each year. She contributes £600 a year and in return receives annual credits worth £4,000. Assuming that inflation stands at 2%, her cash balance pot will be £4,000 after year one, £8,080 after year two and £12,241 after year three, payable in full from Normal Pension Age.

The Investment Account:

While the Credit Account provides a guaranteed sum, the Investment Account allows employees to increase their retirement savings further. This is a defined contribution account which has a minimum employee contribution of 1% with the maximum set in line with HM Revenue and Customs limits for those opting to pay into it. Barclays matches these optional additional contributions up to 3% of an employee's Pensionable Salary each month.

What issues did Barclays encounter?

There were no major problems in setting up Afterwork. Barclays worked with all of the relevant parties, for example the Trustees, to establish the new arrangement. Afterwork is contracted in to the State Second Pension - as was the former scheme so no contracting-out issues arose.

A key consideration for Barclays was that the legislation covered DB and DC schemes, but did not provide clear regulations for hybrid schemes. The business found that administering a pension arrangement that did not clearly fit within the regulations created additional administrative and legal costs.

How much professional advice was required?

Barclays has a professional in-house pensions team which engaged external advisors appropriately throughout the development and implementation of Afterwork. Smaller organisations with limited in-house resources may need to seek more external advice about how to make changes to their pension scheme.

How did Barclays consult employees before making the change? Were there any issues with the trade unions?

Introducing Afterwork was a significant change affecting a large number of employees. Barclays has a 'partnership' relationship with the union that represents many of its UK employees, and it was recognised that the proposed Afterwork scheme had advantages for existing DC members and new employees.

Barclays invested time and resources in communicating with pension scheme members. The biggest challenge was helping employees understand that Afterwork is a hybrid scheme. This added another layer of complexity when explaining how it works. Barclays believes that employers need to be aware of the challenges of communicating pensions information, particularly on hybrid schemes, and be prepared to invest time and resources into doing this effectively. Barclays produced a range of new literature, including Afterwork booklets, as well as a campaign with roadshows, posters and benefit calculators. One of the attractions of DC schemes from a communication perspective is that they can be easier to explain.

How long did it take to implement Afterwork?

From start to finish, the project took approximately two years. The original design was agreed in 2002 and the scheme launched in October 2003. The take-up rate of the Afterwork Credit Account is currently about 97% of eligible members.

Have any changes been made to Afterwork?

Barclays has made some amendments to benefit design as a result of legislative changes. These have increased flexibility for Afterwork members, for example introducing lump sum death-in-service benefits, salary sacrifice and flexible retirement.

As employees increasingly accessed information online, Barclays also launched a pensions website.

As part of its commitment to effective pensions communications, Barclays regularly updates all the relevant booklets, guides and forms, making them available through a variety of channels.

Benefit statements have also been redesigned to inform employees who have not joined Afterwork or the scheme's Investment Account about the benefits they are missing out on.

Afterwork ensures colleagues have a good foundation of retirement savings,

with the flexibility of being able to increase those savings in a way that suits them.

Has Barclays conducted any formal evaluation of the changes?

Barclays reviews the benefit design of Afterwork on a regular basis. No significant changes have been considered necessary to date.

What is the main piece of advice Barclays would give to employers considering risk sharing schemes?

Employers need to be mindful of the regulatory environment around hybrid schemes. It is particularly important to be aware that DWP believes that hybrid and cash balance schemes should be treated as DB schemes in legislation, although we and other employers are encouraging government to consider them in their own right when legislative and regulatory changes are being made.

Offering cash balance and hybrid arrangements can have significant benefits for both employees and employers.

Career Average Schemes

What is a career average scheme?

It is a type of DB scheme where benefits accrue based on the member's salary in each year rather than on their final salary. Where the earnings each year are subject to revaluation, these plans are often referred to as CARE – Career Average Revalued Earnings schemes – or Indexed Pension schemes.

A career average scheme may yield a lower income at retirement than a final salary scheme, especially for members who reach their earnings peak shortly before normal pension age. However, employees will have the knowledge that the employer will continue to provide some guaranteed benefits and for some employees, for example those on flat salaries or those who are phasing their withdrawal from the labour market, it may be a positive change.

What kind of employers have career average schemes?

Nearly 12 per cent of active members of DB schemes are in career average schemes¹⁰. Companies with career average schemes include Morrisons (our featured case study), BT (the increasing normal pension age/contribution rate case study), the BBC, Tesco, the Co-operative Group, Mothercare, Nationwide and Unilever. In the public sector, the Civil Service introduced a career average pension scheme on 30 July 2007 for new entrants.

What's in it for employers?

- For employers, providing a career average scheme is likely to achieve a reduction in the overall **cost** compared to a final salary scheme, (provided they do not increase accrual rates)
- Employers **reduce their exposure to salary risk** as accruals are based on earnings in each year.

Issues to consider

- Career average schemes are subject to the same legislative framework as final salary schemes and, if contracted out, they must still comply with the contracting-out requirements. For example, whilst the Reference Scheme Test (RST) looks at qualifying earnings (earnings between the Lower Earnings Limit and the Upper Accrual Point) in the last three years of service, a CARE scheme is not precluded from meeting the RST so long as an actuary can certify that the benefits it provides are broadly equivalent to or better than benefits provided under the RST.

¹⁰ Source: *Occupational Pension Schemes Survey 2008*

- They also continue to bear the major risks associated with pension provision – investment, longevity, corporate finance and regulatory risks remain.

What's in it for employees?

- Career average schemes may provide close to final salary benefits for people with flat salary progression.
- Career average schemes may also be a positive change over final salary schemes for those who are phasing their withdrawal from the labour market.

Issues to consider

- Employees' salary progression may be significantly greater than benefit revaluation.

Case Study: Morrisons

What was the main driver for introducing risk sharing?

Wm Morrison Supermarkets Plc had initiated a review of its final salary pension schemes in order to put the schemes on a sounder footing, eliminate the pension deficit and manage the level of risk to the balance sheet. Two pension schemes were involved: The Wm Morrison 1967 Pension Scheme and the Safeway Pension Scheme.

Both schemes were closed to new members so the review was looking at legacy arrangements. At the time of the last review the schemes had £2 billion liabilities and Morrisons had a market capitalisation of £8 billion. There were around 12,000 active members and 40,000 pensioners/deferred members spread across both schemes; and combining the two schemes would make it one of the larger DB schemes in the UK's private sector. The pension scheme is Morrisons' largest unsecured creditor.

The main risks to the schemes were **investment** and **longevity**. The outcome of the review was that a number of changes were agreed between Morrisons and the Trustees of each of the two schemes:

- A move away from equities into long dated bonds as a basis for the funding strategy ;
- An agreed funding position based on longevity which was considered to be prudent in comparison to other schemes at the time – Morrisons used the long cohort before the Pensions Regulator advised schemes in general to use this;
- Selection of a more 'stable' model than final salary in order to control liabilities – the decision was made to move to CARE.
- Additional contributions of £200 million to fund the deficit. In 2009, Morrisons published accounts show a surplus of pension assets over liabilities of around £50 million.

In summary, the main aims of the changes were to make the schemes affordable for the long term, and to make them more secure for members.

What were the alternatives?

Technically, 'everything' was on the table, but the main options considered and eliminated were:

- increasing the normal pension age (generally age 65)
- increasing employee contributions

To help select the correct option Morrisons were guided by several principles when considering their changes:

- the Company did not want to impact members' net pay adversely;
- 'Lifestyles' – most members focused mainly on when they would retire, rather than thinking about how much their pension would be;
- any change that was introduced should affect all members proportionately across the five different benefit structures within the two schemes: a single 'shop floor to top floor' principle.

How does your risk sharing arrangement work?

Morrisons introduced a Career Average Revalued Earnings (CARE) scheme in October 2009. An outline of how CARE works for an active member is that each year, active members earn a pension benefit based on an accrual rate of 1.5% of their qualifying salary, with part years counting proportionately. This benefit will be determined on 5th April each year. This accrued pension is adjusted each year in line with the Retail Price Index up to the date that the member retires.

What kind of issues did you encounter?

Agreement of the trustees of both schemes was an important step but with two schemes that have completely different trust deeds this was a process that could not be rushed. In agreeing in principle, the main concern of the trustees was to understand the Company's business case, understand who were the 'winners' and 'losers' and ensure that the proposed changes were effectively communicated through the consultation process. Following the completion of consultation the amendment deeds to both schemes were signed off in September 2009.

The implementation of new payroll systems at the same time as the conversion of the pension administration systems from final salary basis to CARE meant that the selection of a conversion date was not straightforward. Certain dates created additional complexities as the pension administration cycle differed from the payroll cycle. With a major payroll implementation in progress the availability and priority of IT resources also had to be considered. This resulted in a date of October being chosen – some four months after the completion of consultation.

The schemes remained contracted-out.

How did you communicate the changes to scheme members?

Communication was key to the success of the pension consultation. The proposed changes needed to be communicated to approximately 52,000

active, deferred and pensioner members across two pension schemes with five separate benefit structures and 500 locations throughout the UK. A strong Trade Union presence (USDAW and Unite) added to the complexities for communicating the proposed changes. As the majority of members had no access to a workplace computer, online access to information was not a viable option.

How much professional advice was required?

The project required a significant amount of external resource from pension consultants, the schemes' actuaries and legal advisers.

What kind of member consultation did you do before making the change?

The Company had worked in conjunction with the trustees throughout the review. As a result, the trustees had agreed to the changes in principle subject to the outcome of consultation.

Launch of Consultation

- The formal pension consultation began in February 2009 and lasted 100 days rather than the legal minimum of 60 days.
- At the start of consultation, each active member received an information pack including:
 - A Personalised Illustration to show individual impact of the proposed changes
 - A Proposals Booklet for each of the five sections of the two pension schemes to clearly explain the proposed changes
 - A Feedback Form and freepost envelope to encourage members to become involved in the consultation
- Additionally, over 500 HR Managers were fully briefed to provide 'on-site' support. All active members were invited to view a DVD providing further information at workplace meetings.
- A helpline operated by pensions professionals was available Monday to Friday 6am-8pm and Saturday 9am-1pm.
- A dedicated e-mail account was also provided.
- Letters were sent to the deferred members to advise them of proposed improvements to commutation rates.
- Letters were also sent to pensioner members to provide them with reassurance that the proposals had no impact on them.
- Morrisons had agreed upfront with each trade union negotiating body that there would be four or five meetings during the consultation process. The unions, UNITE and USDAW, were invited to contribute to the consultation

documents before they were launched and copies of member consultation documents were circulated to union representatives.

- Each trade union meeting was chaired by the Group HR Director, who took a “this will take as long as it needs approach” to negotiations. Morrisons tried to be as open and honest as possible about its plans.

Consultation Update

- At the beginning of May 2009, all active members were provided with a 'Consultation Update' booklet which included a summary of the 'Frequently Asked Questions' from the feedback forms, helpline and e-mail.
- 98% of members had taken the opportunity to view the first DVD – as feedback had shown that this had helped members to understand the proposals an individual copy of an 'Update DVD' was provided to all active members (subtitled versions and large print transcripts were also available).
- As the consultation process had raised awareness of pensions in general amongst the membership, an A-Z guide, “Pensions – the Essentials,” was also provided to all active members.

During the consultation, 660 calls and emails were made to the helpline, and 600 feedback forms were returned. Out of the responses very few significant amendments were proposed or objections received, with many members expressing their support for the proposed changes and recognising that the Company had taken action to protect the future of the schemes so as to continue to provide members with a defined benefit on retirement.

All members who returned a feedback form either received an individual response, were invited to attend a face-to-face meeting or were contacted by an Independent Financial Adviser.

End of Consultation

- Following the end of consultation, individual letters were sent to all active, deferred and pensioner members to advise them of the outcome and to confirm that the proposed changes would be implemented.
- The communication aspect of the pension change exercise was recognised as exemplary by the pensions industry, and won the award for 'Best DB Communications' at the Professional Pensions Awards in September 2009.

Were there any issues with the Trade Unions?

- No significant issues arose with the Trade Unions. The union negotiating bodies had the opportunity to contribute to the consultation process and participate fully in the consultation process with a resulting understanding and acceptance of the proposals.
- Both unions' pensions technical officers gave the business case a robust

challenge but they were generally supportive of the proposals. Both believed CARE to be a fairer benefit structure than 'pure' final salary, in the context of Morrisons workforce.

What benefits have there been to the scheme?

- Morrisons have retained a defined benefit variant with quality benefits – an effective retention tool. The exercise revealed the workforce's lack of understanding on retirement planning – this issue is now firmly on the employee communications agenda.
- The funding deficits with both schemes were effectively eliminated as shown in the Company's published balance sheet, giving its members additional security for the future.

Have you done any formal evaluation of the changes?

Because the changes only started in October 2009, no formal evaluation has been conducted yet.

What is the main piece of advice you would give to an employer considering introducing risk sharing?

Morrisons identified four key pieces of advice:

- 1) Understand your audience.
- 2) Plan the logistics of your communications in terms of "what does it mean for me?"
- 3) Make your communications as open, honest and personalised as possible.
- 4) Ensure the support of key operational management and the Trustees.

Longevity-Adjusted DB schemes

Increasing longevity means pensions are often in payment for longer than expected, increasing the scheme's liabilities and consequently the cost to the employer. For a DB pension, the Pensions Regulator has estimated that each year of extra life expectancy increases the liabilities of DB pension funds by about 0.5 per cent, year on year.¹¹ Therefore, some employers are looking for ways to share the risk of increasing longevity with members.

One option by which employers may choose to do this is by increasing normal pension age (see next section), while others may consider a longevity adjustment factor.

What is a longevity adjustment factor?

It's a way for the employer to share some of the longevity risk with members. The John Lewis Partnership has introduced one which reduces the rate of pension at retirement to take into account the greater number of years it will be payable. Further details are in the case study on page 30.

What's in it for the employer?

- Reduced liabilities and costs for increases in longevity

Issues to consider

- Will be affected by restrictions on the modification of accrued rights so will only apply to rights accrued after the change to the schemes rules

What's in it for employees?

- They are still accruing a defined benefit pension

Issues to consider

- They will not know exactly how their pension will be calculated until shortly before retirement

Legal issues

Sections 67 to 67I of the Pensions Act 1995 need to be considered. Section 67 covers the modification of accrued rights (ie rights built up to date.) It should not, however, place restrictions on changes which only affect rights which have not yet been accrued. The Occupational Pension Schemes (Modification of Schemes) Regulations 2006 (SI 2006/759) are also useful reference material.

¹¹ <http://www.aegonglobalpensions.com/Documents./AGP/Newsletters/Q2%202009/De-risking%20pensions%20in%20the%20UK.pdf>

DWP believes that section 67 should not prevent schemes from drafting rules in such a way that benefits in respect of future service may be changed, provided accruals in relation to past periods of service are unaffected. Some schemes, eg BAE and John Lewis, have already introduced changes which increase normal pension age in respect of future service only.

If the scheme does not have the power to make changes to scheme benefits, then the modification will not be able to proceed unless a way can be found to amend the scheme rules concerned. **The trustees and the employer would need to take legal advice on this.**

Case study: John Lewis

John Lewis Partnership had been thinking about making some changes to their pension scheme to maintain its sustainability into the future. With a long tradition of caring for their employees (who are partners in the business), the Partnership wanted to preserve a good quality defined benefit pension scheme, but had to acknowledge the importance of managing costs, especially with rising longevity.

The DB section has around 87,000 members (including deferred and pensioner members). A DC section operates for new staff and an open DB final salary section exists for more established staff and is available to new staff after three years' service. The scheme is Trust based and about 25 full and part-time staff are employed to manage the scheme. In addition there are professional trustees and other specialist advisers. Normal pension age is 60 in respect of Pensionable Service accrued before 30 July 2006, and varies between 60 and 65 for Pensionable Service after this date in respect of Partners who were in Pensionable Service on 29 July 2006. Entrants after 29 July 2006 have a normal pension age of 65 for all Pensionable Service. The accrual rate is at 1/60th per annum and the scheme is contracted in to the State Second Pension.

There is a single LEAF (Life Expectancy Adjustment Factor) calculated each year by John Lewis's scheme actuary, taking into account life expectancy, pension increases and the interest that the pension fund earns on its investment. These factors, once combined, give the cost of providing £1,000 a year of pension for a 65 year old. LEAF is then calculated as:

LEAF = The cost per £1000 of pension in 2007 divided by the cost per £1000 of pension at retirement.

John Lewis Partnership introduced its changes for pensions earned from 1 October 2008. Any pension earned before that date is **not** affected by LEAF and is paid in full.

The first LEAF was calculated as 1, and this is the number which applied to retirements before 1 April 2009 (ie LEAF did not affect these Partners at all.) The first change to LEAF was calculated as **0.992**. The annual change to the LEAF factor cannot be greater than or less than 1% of the previous year's factor.

The LEAF is phased in for partners who retire between 1 April 2009 and 31 March 2010. If partners retired shortly after March 2009 the LEAF would be close to 1, and if they retired shortly before 1 April 2010, it would be close to 0.992.

The LEAF for April 2010 was calculated and announced about a year before (and would be allowed for in all pension estimates.) John Lewis do not know by how much life expectancy will increase, and so are unable to estimate what LEAF will be in future years.

A simplified explanation is below. It is based on a member who joins the DB scheme in October 2008, and retires aged 65 in 2018 with a pension which would (without LEAF) be £1000 per year. For this example, it is assumed that population statistics for two selected years show that a 65 year old is then living for the number of years shown below:

Year	Further years of life expectancy at 65 = anticipated years in retirement	Age at death
2007	18	83
2018	20	85

JLP would (without LEAF) have expected to pay total pension of £18,000 (ie 18 years x £1,000). However, by the time the member retires at 65, in 2018, the cost has gone up to £20,000 (ie 20 years x £1,000). If JLP wanted to keep the cost at 2007 levels, they would therefore have to reduce the pension to 18/20 (= 0.9), ie to £900 a year, such that 20 x £900 is again £18,000. LEAF would then be **0.9**.

However, the trend for increasing life expectancy is likely to affect all ages, including those over 65, and if this member lives to 90, the actual cost, even with LEAF will be 25 x £900, ie £22,500. The Partnership will bear the extra cost relating to further increases in life expectancy for retired members, which is why they refer to LEAF as a sharing of the life-expectancy risk.

NB: Nothing affects accruals before 1 October 2008. Where an employee’s pensionable service straddles that date, their pension would be calculated by aggregating the “pre-change” pension and the “post-change-with LEAF” pension, for example:

Callum joined the Partnership at age 30. He is now 40 (1 October 2008) and has completed 10 years’ service. He will retire in 25 years’ time at age 65. Callum’s pensionable pay is £10,500 a year. Assume LEAF would be 0.8728 at retirement.

To calculate Callum’s pension:

- (a) Pension earned to 30 Sep 2008: $(£10,500 \times 10 \text{ years}) \div 60 = £1,750$
- (b) Pension earned from 1 Oct 2008: $(£10,500 \times 25 \text{ years}) \div 60 \times 0.8728 = £3,818$

Therefore, Callum’s Partnership pension would be £5,568 a year (£1,750 + £3,818)

What other possibilities did you consider?

The employer thought about asking partners to pay contributions (the scheme is currently non-contributory), or they could have increased the normal pension age further or cut the accrual rate going forward. However JLP were keen on the idea of risk sharing, and of promoting the value of pensions generally and the discipline of pension saving. They also made other changes at the same time – introducing a new DC scheme and reducing the waiting period to join the DB scheme from five to three years. Before the changes were made to the pension scheme, a working group of 12 people from across the Partnership had met around a dozen times to discuss the benefit changes.

To mitigate member uncertainty, a year's lead-in time is given, therefore it will be two years from the date the LEAF is calculated before the factor is fully applied; also the LEAF cannot increase or decrease by more than 1% in any given year.

Professional advice

Both John Lewis Partnership as the employer and the pension scheme trustees obtained a combination of professional and in-house advice.

Communicating with scheme members

The whole process of introducing the changes probably took 18 months from inception to implementation.

John Lewis is a Partnership with the business held in trust on behalf of its 70,000 Partners. It operates a 'parliament' type system of elected representatives (known as Partnership Councillors) who make sure the business is truly being run in the best interest of the Partners.

Each Partnership Councillor was trained by the pensions department to give presentations to their 'constituents' over a 3-4 month period, before the Council voted on the proposal. There were also articles in the in-house journal, 'the Gazette' and many letters were published on the proposed changes. At the end of the process they produced a leaflet, 'Pensions for Partners' which had clear information and worked examples.

Benefits to the scheme

It is maybe a little early to tell; however scheme administration is marginally more complex. John Lewis Partnership plan to evaluate the changes in April 2010.

A key piece of advice you'd offer to others?

- Start communication with your employees early
- Manage employees' expectations and take them with you.

Changing accrual rates and/or increasing normal pension age

Schemes can change accrual rates **for future accruals providing scheme rules/contractual arrangements permit**, for example from 1/60ths to 1/80ths. They can also raise the **normal pension age for future service** for groups of employees (usually those with more than five years to go to reach the previous expected normal pension age).

What's in it for employers?

- Makes it easier to control costs
- Still providing a valued DB pension to their employees – will assist in recruitment and retention

Issues to consider

- Some parts of the workforce may be on more advantageous accrual terms than others (usually newer employees) and this could raise 'two-tier workforce' issues.
- Administrative issues – do you let employees take pension with actuarial reduction at age 62 (if that was the former normal pension age) or do you perhaps ask them to work till 65 and offer an enhancement to compensate for benefits deferred until age 65? This will, of course, depend what is possible under scheme rules.

What's in it for employees?

- Employees are still receiving a valuable DB pension; this will help with their retirement planning.

Issues to consider

- Employees may have to work longer to receive their benefits if normal pension age changes
- Employees may have to work longer to receive a similar level of pension income if accrual rates are changed.

Legal issues

Schemes would need to consider the requirements of sections 67 to 67I of the Pensions Act 1995, whose aim is to protect the value of pension benefits promised under scheme rules. The legislation limits the right to make amendments to the scheme that would or might be detrimental to an individual's accrued or 'subsisting' rights.

Current legislation

It is possible to make changes to members' accrued pension rights, but only where:

- the affected member consents to the change; or

- in the case of certain changes, if the member does not consent,
 - the change does not involve converting any DB (eg Final Salary) pension rights into DC (eg Money Purchase) rights, and
 - the total actuarial value of the member's subsisting rights at the point of change is maintained, ie any rights removed or reduced are replaced by something of actuarially equivalent value.

In both cases, there must be a power in scheme rules to make the change, the trustees must approve the change and members must be notified appropriately about the changes.

Raising normal pension age

Although raising normal pension age might at first glance appear to be a future change as it only takes effect when the member retires, it is caught by section 67 because it would affect the value of the subsisting rights at the date the rule change takes effect.

This is because the "before and after" actuarial equivalence test is based on the cash equivalent transfer value, and increasing pension age reduces the transfer value for a given period of service because the benefit derived from the service will be payable later and over a shorter period.

Changing normal pension age in respect of accrued rights is still possible provided:

- 1) the member consents (and it must be individual consent), or
- 2) the total actuarial value of the member's subsisting rights at the point of change is maintained. This is unattractive if the purpose of the change is to share financial risk between employer and member.

Schemes can, of course, change normal pension age in respect of future service, but having different tranches of pension payable from different dates raises issues for both the member and the employer.

Capping pensionable pay

Some employers with final salary DB schemes have opted to cap pensionable pay. For example, an employer might decide that only the first one per cent of each pay increase will increase the pensionable pay used to calculate the pension on retirement and any further element of a pay award will not be pensionable.

This can have a significant effect on a final salary pension, which is why **it was decided to make this a 'listed change' for the purposes of the Consultation by Employer Regulations¹². The change will come into effect on 6 April 2010.**

¹² S.I. 2010/499 amended regulation 8 of the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendments) Regulations 2006.

Case Study: BT

Why did BT introduce the following changes?

- increased normal pension age from 60 to 65
- increased employee contributions
- switched to CARE
- reduced accrual rates
- ceasing to contract out of S2P

BT's principal DB pension scheme had around 340,000 members, of which about 180,000 were pensioner members and 100,000 were deferred members. So the changes would mainly be affecting 60,000 active members of the scheme.

- Main drivers were **sustainability** – ensuring the scheme was in a position to remain open into the future and not have to close to future accrual whilst remaining defined benefit.
- Wanted to move to a **career average scheme for future service** to increase affordability for BT, but benefits built up to 31 March 2009 would still be linked to final salary.
- **Fairness** – 'high fliers' receiving higher rate tax relief would pay higher contributions towards their pension than lower paid employees who receive tax relief at the basic rate of income tax. Career average also good for those who do not experience much pay growth in the years leading up to retirement. It was also a key objective of the review to be fair to different generations. New employees since April 2001 had joined a DC scheme. Making the DB scheme more sustainable and affordable created the opportunity to improve the benefits for many DC scheme members.
- **Flexibility** – if employees did not want to join the new arrangements and pay the attendant higher contributions they were offered the choice of building up benefits based on 1/90ths pension and 3/90ths lump sum accrual rate. (This option is offered annually but it is an irrevocable option once exercised.) There is also the option to surrender guaranteed pension increases in exchange for a higher initial pension.

What was the scheme like before?

The BT Pension Scheme had different sections. In broad terms, pre-privatisation members had fully indexed pensions in deferment and retirement based on a 1/80ths with a 3/80ths lump sum accrual rate. Post privatisation members received Limited Price Indexation (LPI) capped at five per cent based on a 1/60th accrual rate with a commutation option.

Employees contributed 6% of their salary. After the change, members' contributions were linked to earnings and the value of the underlying benefits

accruing. Contribution increases were phased in over two years and will now range from 6% up to 8½% from 2010.

The changes mean that contribution levels are now linked more closely to overall benefits. Members can select a lower value benefit in exchange for reduced contributions.

What does the scheme look like now?

It has ceased to contract out of the State Second Pension. Employees build up State Second Pension alongside their BT pension. When the State Second Pension becomes payable, the BT pension is reduced by an equivalent amount. The employee pension contributions paid by employees are reduced by the higher employee NI contributions paid by members. Overall employees' take-home pay is slightly reduced as the higher NI contributions do not qualify for tax relief in the way that private pensions do.

Employees receive the same overall benefit as before but from two sources. This arrangement reduces risk to the scheme as it transfers longevity risk for part of the member's retirement income from BT to the state, and makes the scheme less volatile and more sustainable. Whilst this introduces an element of political risk into the scheme as a future government might make changes to the State Second Pension or contracting-out régime, BT has introduced a review mechanism into the Scheme to deal with such an eventuality.

Other flexibilities were introduced. Employees can now surrender pre-1997 indexation rights in return a higher initial non-indexed pension which in turn can be commuted for a higher commencement lump sum. Thus, an indexed pension (say of £10,000 a year) could be converted to, say, a partially indexed pension of, say, £13,000 per year of which £7,000 is indexed and the other £6,000 is not (ie it can decline in real terms.) The latter option is proving very popular with employees, because they want to have extra cash in their 'young elderly' years and employees expect they would be well into their 80s before the effects of inflation on non-indexed pension would become an issue.

Employees can also build up extra AVCs, or take a larger proportion as a lump sum.

What kind of communications did you do?

A website was built as part of the review process, containing modellers so that employees could work out the effect of the changes on them personally. Graphs were included to show the effects of normal pension age changes: for example a 30 year old might need to work an additional three years to get the pension they had been expecting; whereas a 59 year old would only need to work an extra eight weeks.

The timetable of the project ran as follows:

- **May 2008** – BT announced its Pension Review to its employees
- **Summer 2008** – As well as discussions with the unions and trustees, BT issued regular newsletters featuring different proposals (for example career average one issue, Normal Retirement Age the next).
- **October 2008** – reached agreement with unions
- **Mid November 2008** – Started formal 60 day consultation period. Issued comprehensive consultation pack to members.
- **January 2009** – created feedback loop for members – an email address and a helpline.
- **February 2009** – employer produced a feedback report, featuring adverse and favourable feedback, then issued an action report to members.
- **April 2009** – changes came into force.

Any issues with trust deed or rules? Did BT take any professional advice?

BT's trust deed was probably slightly more restrictive than the average private sector one, given that it caters for a small group of former civil servants who have to consent individually to changes, which can never be worse than what they would expect under the old scheme. However this was a small, ring-fenced group.

Trustees had to consent to changes to the scheme and also have a primary role in setting the contribution rates. The Trustee Board was made up of four union (member) nominated directors, two employer representatives and three independents including the Chairman, so its composition is perhaps a little unusual. The trustees are well versed on pensions and investment issues. BT has no powers to wind up the scheme.

The Trustees took their own legal advice and came to the view that it was in the long term interest of the scheme to have a strong employer with a good covenant. They understood the rationale for the proposed changes and accepted the need for them as long as past service benefits were protected, there was good communication with employees and that the unions were supportive.

The employer did obtain professional advice from lawyers and other company advisers such as actuaries and this was a costly and drawn out process. With around 340,000 members, Actuaries had advised that if members lived one year longer on average that would increase liabilities by over £1 bn. Significant analysis was undertaken on mortality issues as well as the impact of lower investment returns and interest rates going forward and the cost increases which may arise from greater regulation.

The contracting-in changes were complex and were breaking new ground. As a result both the trustee and employer sought advice from Counsel; the total cost to develop these proposals along was estimated to cost BT in the region of £300,000 in legal fees.

What evaluation has been done?

BT has started to collect statistics on how many employees have opted to commute part of their pension or take part of it without indexation. Approximately 50 per cent of newly retired pensioners elect this option. It is proving popular so far, although the changes took some time to bed down in members' minds. Take up is expected to vary as RPI trends change. In the first year of launch, inflation has been very low (even negative).

Making so many far reaching changes at one time resulted in a major overhaul of pension administration processes and systems. Virtually every process required amendment. It is fair to say that scheme administration became a bit more complex; the opportunity was taken to modernise a number of systems and processes. However, communicating scheme benefits doesn't get any easier. The changes meant that retirement letters now have about seven different options for the member to choose!

The investment in administration systems does mean however that members can 'self serve' by accessing a dedicated website and modelling systems so that they can model the effect of retiring at various ages as well as carrying out various other administration tasks themselves.

Cap and share

The Government's Pre-Budget Report 2009 explained that cap and share reforms to Teachers, Local Government, NHS and Civil Service pensions schemes will cap the average contribution to pensions made by employers, thereby limiting the liability of the taxpayer as pensions become more valuable, for example because people are living longer. The intention is to ensure that schemes are affordable and taxpayers in general are protected from additional costs.

Cap and share is also an important step in ensuring that public service scheme members recognise the value of their pensions and that further reforms will be needed to ensure these are sustainable.

However, the Government has made clear that this announcement has not changed its commitment to continue to provide good quality public service pensions. The Pre-Budget Report was not announcing a new policy on cap and share but reflecting the Government's decision to allow for these reforms in the fiscal arithmetic. Bodies as diverse as the TUC and CBI had already noted that cap and share provisions apply widely across the public sector.

The Teachers, NHS, Civil Service and Local Government Pension Schemes, which cover around 90 per cent of public service employment, are all committed to implementing cap and share. At their next scheme valuations (between now and 2012) average employer contribution rates will be capped at approximately their current level, the exact level of the cap varying between schemes.

If those scheme valuations show increasing cost pressures, increases up to the level of the cap will generally be shared (50/50) between employers and employees, with costs above the cap being picked up by employees.

This complements and builds on the Government's other reforms to public service pensions since 1997, such as higher retirement ages and reduced ill-health benefits, agreed before and after the Public Services Forum agreement in 2005 on handling proposed increases in pension age for the NHS, teachers and civil service pension schemes.

Taking cap and share forward

The Pre-Budget Report did not change the processes for handling cap and share going forward. The UK Government departments and the Devolved Administrations responsible for the individual pension schemes will continue to lead discussions with representative bodies and their workforces and the cap and share provisions will be determined on a scheme by scheme basis. That process will include, for instance, deciding how higher paid members would pay a greater contribution towards the costs of their pensions, as also announced at Pre-Budget Report.

Scheme members' share of cost increases could be met by:

- increasing employee contributions, so providing more cash income;
- reducing employee benefits, so payments made from the scheme will be lower, particularly in the long-term.

Capping employers' exposure should therefore have short, medium and long-term benefits for schemes. Scheme members will be involved in deciding how to meet their share of cost pressures – probably through a combination of contribution and benefit changes that could include higher pension ages.

Case study: Civil Service Pension Scheme

Individual public service pension schemes have slightly different mandates for the application of “cap and share”. This reflects, among other things, the timing of valuations.

The Civil Service scheme operates a system whereby employers pay contributions at one of 4 different rates depending on the scheme member’s salary. Cap and share operates by reference to the average employer contribution which is currently 18.9% of pensionable pay. The scheme rules have been amended to set out, in detail, how cap and share will work. This includes both the mechanics of the calculations and also the timetable for getting from the “as at” date of the valuation through to the implementation date 24 months later. The first valuation subject to cap and share is the one taking place as at 31 March 2010, for implementation from 1 April 2012.

The basic rule is that “shareable” cost pressures will be shared 50:50 between employees and employers subject to the average employer contribution not going above the cap (20% in this case). Most costs are shareable but some are specifically excluded in the scheme rules (for instance, those resulting from changes in financial assumptions set by the Treasury). If costs go up at this valuation, Civil Service employer contributions will increase. The employee share of the cost increase could be met by a mix of contribution increases and by benefit changes for future service. If costs go down, the scheme rules provide that savings will be held in reserve and will not be passed back to employers or employees (this would be reviewed in the event that a large surplus were to build up).

Simplified Example:

Currently, employee contributions are 3.5% and average employer contributions are 18.9% of pay, making total contributions of 22.4%

Suppose valuation shows total cost of 25% - i.e. an increase of 2.6%, all attributable to “shareable” costs.

In the absence of the cap, employees and employers would both be responsible for 1.3%. But, in practice, the employer contribution would rise by 1.1% to 20%, the maximum permitted.

The employee share is then $1.3\% + 0.2\% = 1.5\%$. One option would be for employee contributions to rise from 3.5% to 5% of pay. But other options – involving benefit reductions for future service – would also be considered.

The cap and share timetable for Civil Service pensions envisages production of the initial valuation report within nine months of the valuation date. In the event of a cost

increase, the scheme rules require the Minister for the Cabinet Office to pass the report to the Governance Group (a mix of employer and trade union representatives with a scheme governance role) to ask for options for handling the share of cost pressures falling to active scheme members. The Minister will consider the Governance Group's views in coming to his or her own decision on what approach to take and will then consult with the Council of Civil Service Unions (as required by the Superannuation Act 1972) before making changes to the scheme rules. The intention is to provide scheme members with at least three months' notice of changes.

Cabinet Office asked all employers to issue a notice to all staff in 2008 when the "cap and share" rules were introduced. Despite the issue being reiterated subsequently in other communications, it is probably fair to say that many scheme members may not realise that, from April 2012, they may be paying more for their pension and/or having benefits reduced for future service. In the event that the 2010 valuation identifies significant cost pressures then a concerted communication effort will be required throughout 2011 to engage both trades unions and staff in a constructive dialogue.

Conclusion

We acknowledge that we live in a changing world which sees a growing trend of DB scheme closures and that, in future, more employers will provide DC benefits. The recent economic challenges have perhaps accelerated the trend towards DC.

The private pensions landscape will also be changing as a result of Government reforms, due to be introduced from 2012. Under the reforms, employers will be required to automatically enrol all eligible jobholders into a workplace pension arrangement that meets certain quality criteria and, for the first time, make a minimum contribution to that arrangement. There will be a substantial expansion in the pensions market as a result of the reforms, with millions of new savers in workplace pensions.

Final salary DB and DC schemes polarise risk. We hope that this note has given employers a better idea of what risk-sharing options may be available to them, and what issues individual employers faced when making a change. Inclusion of a case study or option in this note should not be seen as an endorsement of, or preference for, any particular scheme design. Employers are reminded that all schemes and employers differ and that they should seek advice from their lawyers, actuaries and other professional advisors when considering their own circumstances.

Glossary

Accumulation – during the investment phase of a DC fund, when a member is contributing, this is known as the ‘accumulation’ phase. Most funds are usually invested in a combination of equities and bonds.

Annuity – a pension payable for life.

Commutation –conversion of part of pension into a lump sum payment. This is only permissible if in accordance with requirements under the Finance Acts.

Contracted out – an arrangement where a person receives pension benefits from an occupational or personal pension rather than the additional State Pension (currently State Second Pension, formerly the State Earnings-Related Pension Scheme.)

Employees can contract out by joining a contracted-out

- occupational pension scheme – which can contract out on either a defined benefit or defined contribution basis; or
- personal pension or stakeholder pension, also known as an “appropriate scheme”. This term is used to describe a personal pension scheme or stakeholder pension scheme that its members can use to contract out. Individuals might choose these types of pensions if their employer does not run an occupational pension scheme, or if their employer does offer one, but they decide not to join it.

If an individual decides to contract out, they will not normally build up additional State Pension, but they are compensated for this. The way they are compensated depends on the type of scheme they are in:

- if they are in a contracted-out occupational pension scheme, both they and their employer pay a reduced rate of National Insurance contributions.
- if they are in a contracted-out personal or stakeholder pension scheme, they pay full rate National Insurance contributions but the Government pays part of those contributions into their pension scheme.

If an occupational scheme contracts out on a defined benefit basis, it must provide benefits that equal or better the **Reference Scheme Test** (see below). Both the employer and employee pay a lower rate of National Insurance contributions.

If an occupational scheme contracts out on a defined contribution basis, the employer and employee pay lower rate National Insurance contributions but also have to pay a certain level of contributions (“minimum payments”) into the occupational scheme. An age-related rebate of National Insurance is also paid into the scheme by HMRC.

Contracting out of the additional State Pension on a defined contribution basis is to be abolished from 6 April 2012. From this date individuals will no longer be able to contract out of the additional State Pension through:

- a personal or stakeholder pension; or
- an occupational pension scheme which is contracted out on a defined contribution basis.

If an individual is contracted-out through one of these schemes on 6 April 2012, they will automatically be brought back into the additional State Pension and will begin to build up entitlement from this date.

Contracted in – a scheme or person who has not contracted out of the additional State Pension and is therefore building up benefits in the State Second Pension.

Defined benefit – a member's fund is defined by a particular promise, for example benefits are calculated by reference to an employee's final salary. Also referred to as a salary-related pension.

Defined contribution – also known as 'money purchase' – the final benefits payable are the direct product of the contributions paid by the member or employer into an individual fund and the subsequent investment performance.

Deferred pension – when a member leaves a pension scheme before reaching the scheme's normal retirement age, their pension rights are preserved in the scheme until they do reach that age. This deferred pension is then revalued (see "revaluation", below) and put into payment. A deferred pension is held in the scheme in the same way whether the person has left the sponsoring employer or not.

Detrimental modification is a modification which on taking effect would or might change the nature of the subsisting rights of a member or survivor of a member of the scheme.

Final Salary – a defined benefit pension scheme that gives individuals a pension based on the number of years of pensionable service, the accrual rate and final earnings as defined by the scheme. What is used to determine "final salary" will be defined in scheme rules but may be, for example, the best year in the last five or the average of the three years prior to leaving.

Guaranteed Minimum Pension (GMP) – a particular requirement for some contracted-out schemes was that they needed to provide a guaranteed minimum pension. This requirement exists in respect of benefits built up in a scheme contracted out on a salary-related basis at any time between 1978 and 1997. See also Reference Scheme Test.

Income drawdown – an arrangement which permits the pension fund to remain invested with the pension provider whilst allowing the member to draw down an income from the fund within prescribed limits.

Indexation – this term is used to refer to increases to a pension in payment. Indexation increases are normally awarded annually by a pension scheme to account wholly or partially for increases in the general level of prices from year to year. Indexation protects the real value of the pension against inflation over the period of a member's retirement.

Limited Price Indexation (LPI) – legislation requires defined benefit occupational pension schemes to increase pensions in payment annually, as a minimum, in line with the increase in the general level of prices subject to an upper limit or 'cap'. This is termed 'Limited Price Indexation'. The legislation applies only to pension built up from 6 April 1997 onwards. The 'cap' is set at 5 per cent per annum for pension rights built up between 6 April 1997 and 5 April 2005. Pension based on service from 6 April 2005 onwards is subject to a lower cap of 2.5 per cent per annum.

Money purchase – see defined contribution

Normal pension age - also referred to as normal retirement age. This is the age under pension scheme rules at which the member would be entitled to benefits without any reduction being applied to those benefits (apart from any special provision for early retirement on grounds such as ill health or redundancy). Some schemes may, in certain circumstances, pay benefits from an earlier date but subject to an actuarial adjustment to take account that the pension will be paid for longer.

Pensionable Pay – the elements of an employee's pay (eg basic pay, overtime) on which pension entitlement is calculated. This is normally defined in the scheme rules. See also **final salary**.

Revaluation – A deferred pension (see above) is required to be revalued when the member reaches normal retirement age, to account for inflation over the period since leaving the scheme. The legislation requires (as a minimum) an increase in the deferred pension in line with the rate of inflation over the relevant period, or at 5 per cent per annum (cumulative) over the whole period, whichever is the lesser. The 5 per cent per annum 'cap' was reduced to 2.5 per cent per annum in respect of pension based on service carried out from 6 April 2009 onwards.

Reference Scheme Test (RST) - The RST was introduced from 6 April 1997 as a minimum benchmark for salary related schemes to meet if they wished to contract out of the State additional Pension. The test replaced the previous contracting-out requirement to provide Guaranteed Minimum Pensions (which existed from 1978 to 1997.) In order for a scheme to meet the RST it is required to provide benefits that are broadly equivalent to, or are better than, those specified in the RST for at least 90

per cent of the scheme membership. Specifically the RST requires that the scheme meets the following minimum requirements which are set out in primary legislation:

- commences at normal pension age of 65 and pension is paid for life
- has pension accrual at the rate of $1/80^{\text{th}}$ of qualifying earnings in the last three years of service multiplied by the number of years of service
- defines qualifying earnings as 90 per cent of earnings between the Lower Earnings Level and Upper Accrual Point.
- provides for a survivor benefit to a spouse or a civil partner of a half.

“Risk” types:

- **Investment risk** – the risk that a scheme or individual’s assets will be adversely affected by fluctuations in the market value of the assets in which the pension fund is invested.
- **Longevity risk** – the risk that either an individual or a group of people will live longer than expected
- **Inflation risk** – concerns the real value of the pension received and the real cost of providing it.
- **Discontinuity/default risk** – the risk that accrual or payment of the pension is interrupted
- **Regulatory risk** – given the complex nature of pensions and associated informational barriers a degree of regulation is unavoidable

Stakeholder pension – a type of personal or occupational pension scheme that has to meet certain Government standards to ensure they are flexible and have a limit on annual management charges.

State Second Pension – From 6 April 2002, the State Second Pension reformed the State Earnings-Related Pension Scheme (SERPS) pension to provide a more generous additional State Pension. People earning more than £5,044 a year but less than £14,100 (in 2010/11 terms) will be treated for State Second Pension purposes as if they had earned £14,100. Qualifying carers and certain long-term sick or disabled people will also be treated as if they had earned £14,100 in a qualifying year.

Unlike SERPS, which had a uniform accrual rate on earnings between the annual National Insurance Lower and Upper Earnings Limits, the accrual rate for State Second Pension is based on cumulative earnings bands. For people who are opted-out of the state scheme, State Second Pension top-ups ensure that they are no worse off than they would have been if they had stayed in the state scheme.

The additional pension is can be a combination of both SERPS and State Second Pension and is paid with the basic State Pension at State Pension age, although it can be paid on its own if there is no basic State Pension payable.

Statutory override – introduced by the Miscellaneous Amendment Regulations 2009 (SI 2009/615), this enables employers who have schemes with restrictive scheme rules to amend them to take advantage of changes to the indexation and revaluation caps, *provided the trustees agree*.

Deregulatory Review Achievements

The aim of the deregulatory review is to make the private pensions regulatory framework simpler and less burdensome for employers and pension providers through a rolling review programme.

- In **May 2006**, proposals for a rolling deregulatory review were published in the pensions reform white paper.
- The review's aim was to make the private pensions regulatory framework simpler and less burdensome whilst continuing to provide adequate protection for scheme members.
- In **July 2006** an advisory Group was set up to obtain external stakeholders' views. It has representatives from the CBI, the TUC, Unite, a trustee representative, and the major pension industry bodies as well as DWP, HMRC, Treasury, the Pensions Regulator and the PPF.
- In **December 2006**, the Government announced the appointment of two external reviewers, Ed Sweeney (at that time Joint Deputy General Secretary of Amicus and now Chair of ACAS) and Chris Lewin (formerly Head of UK Pensions at Unilever).
- In **March 2007** the reviewers published a consultation paper before publishing their final report on **25 July 2007**.
- In **October 2007** the Government response was published. The response outlined a number of proposals and sought views. The response to the consultation was published on **5 December 2007**.
- Risk sharing was a major theme of the original Lewin and Sweeney Report. Therefore the Government consulted on risk sharing in June 2008 and published its response on **11 December 2008**. The conclusion was that, on balance, we should not proceed with industry ideas on conditional indexation but to examine other ideas instead, including whether collective defined contribution might provide a valuable additional option to employers.

Major achievements so far:

- Changes to **revaluation** in the 2008 Pensions Act which have potential savings for employers of £250 million a year in the longer term;
- A **statutory override** from April 2009 which enables schemes with restrictive scheme rules to take advantage of the revaluation cap, and earlier changes to indexation, provided trustees agree;

- In-depth study of whether collective defined contribution schemes could work in a UK context was published in December 2009 (the conclusion was they could not);¹³
- **Guaranteed Minimum Pensions** (GMPs) ceased to accrue in 1997 but past rights still existed. Pensions Act 2007 legislated for conversion and regulations came into force in April 2009. These changes allow schemes to convert GMP rights into scheme benefits offering the actuarial equivalent value in exchange. This will allow for easier administration and make it easier for scheme members to move their rights into another pension product if they wish. Potential savings of £6m per annum, depending on take-up.
- The **abolition of DC Contracting Out** was legislated for in the Pensions Acts 2007 and 2008 and will be implemented in April 2012.
- From October 2008 **contracted-out protected rights** can now be held in Self Invested Personal Pension Schemes (SIPPS).
- **Employer Debt 'period of grace'** regulations allowing a 12 month period of grace before the triggering of a cessation event were enacted in April 2008.
- **Pensions on Divorce** – 2008 Pensions Act repealed legislative requirements on pension sharing which apply to safeguarded rights and on pension credit benefit.
- **Trustee Knowledge and Understanding** – work required by the Lewin/Sweeney report to combat misconceptions about the TKU requirements is now complete. We have worked closely with the Pensions Regulator to ensure individual trustees understand how the law applies and provide access to resources to help them fulfil their duties.
- Changes to the **Employer Debt** rules which introduce easements in certain corporate restructurings with savings estimated at being up to £49m a year will come into force on 6 April 2010.

Current and future work programme

- The current work programme includes regulations simplifying **Disclosure**, planned for October 2010, which enable greater use of e-communications (potential savings of £27 million a year).
- The Government also considers there may be some merit in allowing more flexibility under the section 75 employer debt rules – for example, allowing multiple transactions in wholly owned associated companies - where guarantees are put in place to stand behind the debt. It intends to explore this further with stakeholders, but any new proposals will need to be robustly tested and member protection will have to be maintained.

¹³ Department for Work and Pensions, 2009, [Collective Defined Contribution Schemes. An assessment of whether and how collective defined contribution schemes might operate in the UK](http://www.dwp.gov.uk/docs/collective-defined-contribution-schemes-dec09.pdf)
<http://www.dwp.gov.uk/docs/collective-defined-contribution-schemes-dec09.pdf>

Consultation and Contracts

Further detail on consultation requirements

The legislation applies to sponsoring employers in Great Britain who offer occupational pension schemes or personal pension schemes where direct payment arrangements exist and who have 50 or more employees.

The changes that trigger consultation in respect of occupational pension schemes are contained in regulation 8, and in personal pension schemes are in regulation 9, and are known in the Regulations as “listed changes”.

Schemes need to consult their members or members’ representatives for a period of at least 60 days. **This applies only to future pension provision and not to any modifications under the subsisting rights provisions** to rights already built up in a scheme (section 67 of the Pensions Act 1995, as modified by section 262 of the Pension Act 2004). Active and prospective members must be consulted, but not retired and deferred members of pension schemes.

There are some schemes which are excluded:

- Public service pension schemes
- Small occupational pension schemes
- Schemes with fewer than two members
- Employer Financed Retirement Benefit Schemes (EFRBS)
- Schemes with their main administration outside the EU that are not tax registered.

The relevant occupational pension scheme changes are as follows (Regulation 8 (1)):

- a) an increase in the normal pension age
- b) Closure of the pension scheme to some or all new members (but active members will remain in the pension scheme)
- c) Stopping future accruals in the pension scheme to some or all members
- d) Removing the employer’s liability to make contributions to the scheme
- e) Introducing contributions for some or all pension scheme members where there had not previously been a member contribution
- f) Increasing member contributions in some or all cases
- g) The changes listed in paragraphs (2) and (3).

Paragraph (2) A change that applies to occupational pension schemes that provide money purchase benefits is to reduce the employer contribution to the scheme in respect of some or all members.

Paragraph (3). Changes that apply to occupational pension schemes which are not money purchase schemes are:

- a) Changing the scheme to provide some or all money purchase benefits;
- b) Changing the basis for determining future accruals (for example from final salary to career average or from final salary to a hybrid scheme);
- c) Modification of the rate of future accrual of benefits to some or all members, with employer agreement under section 229 (2) of the Pensions Act 2004;
- d) Making any other reduction in the rate of future accrual of benefits to some or all members.

NB: Regulations which come into force in April 2010 will make changing pensionable earnings a listed change.

Consultation process

The information needs to be given in writing and provided before the consultation commences. It must include details of the proposed change, its effects on the scheme and the scheme member, together with any background information. It must also indicate the date that the proposal would take effect.

How the written information is passed to affected members and their representatives is not detailed in the Regulations. The employer should use a method that fulfils his obligation to ensure the widest possible coverage of all those affected (regulation 15(1)).

In DWP's view any media which only reaches some of the relevant parties is not acceptable on its own. For example: email when not all relevant parties have access or will be able to access their account; or simply placing information on a staff notice board in anticipation that all relevant parties will read it is not sufficient.

To ensure the widest coverage an employer is likely to have to send written information to relevant parties in the workplace and separately to those who, for whatever reason, are not attending work during the whole or part of a period of consultation.

If the employer is considering some different changes which might achieve a similar outcome it is advisable to consult explicitly on the range of potential changes at the same time.

DWP employer guidance is at the following link:

<http://www.dwp.gov.uk/docs/occ-personal-pens-schemes-regs06.pdf>

Pensions Regulator's role

The Pensions Regulator is the body that regulates work-based pension arrangements. Regulation 19 confers a limited scope for the Regulator to waive or relax an employer's statutory consultation obligation. Employers may apply to the Regulator for the obligation to be waived or relaxed. An application should set out reasons why delay in making a change to the pension scheme in accordance with regulations 8 or 9 by the minimum period of 60 days that is required for consultation would be damaging to scheme members' interests. For example: it could be demonstrated that the delay would adversely impact the company's ability to remain solvent.

The Pensions Act 2004 enables the Regulator to take action where it appears that an employer has failed to comply with the Consultation by Employers Regulations. Regulation 18 provides for certain remedies when the regulations have been breached. The Regulator may issue an improvement notice under section 13 of the Pensions Act 2004 or ultimately impose a penalty sanction of up to £50,000 for companies and up to £5,000 in respect of individuals, where appropriate, to be paid within 28 days.

Further information about the Pensions Regulator can be found on its website at <http://www.thepensionsregulator.gov.uk>

Further detail on requirements relating to contracts of employment

Employers need to consider whether there is a contractual right to make the changes?

- Have clauses relating to pensions been properly incorporated into employment contracts?
- Are clauses specific/wide enough to cope with the change proposed?