

PENSION AND BENEFITS NEWSLETTER

Autumn 2009



TRUSTEES' INVESTMENT DECISIONS AT RISK OF THE 'MATERIAL DETRIMENT' TEST

Those of us who occasionally wake in the night in a hot flush thinking about the spectre of Contribution Notices usually focus on the obvious covenant-reducing acts – a highly leveraged take-over, or the payment of a chunky dividend to a Cayman Island parent. But the 'illustrative examples' recently issued by the Pensions Regulator, to compliment the finalised Material Detriment Code of Practice, raise a hitherto unexplored scenario.

The highly leveraged take-over example concerns a scheme that makes an 'inappropriate' investment decision, that, if successful, leads to profit for the sponsor (and hence the shareholders). Thus the Regulator establishes the principle that even questionable investment decisions could result in the use of the Regulator's most powerful weapon.

Contribution Notices were the dangerous spawn of the 2004 Pensions Act, but to date remain unused. One reason for this was that they could only be issued if the Regulator could prove that the principal objective of an act (or omission) was to reduce the likelihood of ultimate section 75 debt payment.

As any lawyer can tell you – proving intent is no easy job. So last year the regulatory basis was somewhat relaxed, and with effect from 14 April 2008, the Regulator has merely needed to prove that an act is 'materially detrimental' to a scheme in order to issue a Contribution Notice.

The recently issued Code of Practice sets out how the Regulator will go about assessing material detriment – with the clutch of associated illustrative examples seeking to show how the theory might be put into practice. Most of the examples are fairly bland statements of common sense, but the inclusion of an investment-related example suggests that the Regulator might be extending its tentacles into other areas of pension scheme decision-making.

Of course, the Regulator does not intimate what an 'inappropriate' investment strategy might be. It would also seem that it is the possibility that

profits from the adopted strategy could return to the sponsor that causes the raising of regulatory eyebrows, rather than the strategy itself. But it could be argued that in any scheme there is always the longer-term possibility that surplus investment returns might find their way – eventually – back to the sponsor. Investment decision-making is clearly a trustee responsibility.

So it follows that if trustees make a questionable decision, the only party to whom the Regulator could reasonably issue a Contribution Notice would be the trustees. Now trustees are not known for their deep pockets – but perhaps their indemnity insurers are. Is the Regulator lining-up an alternative funding strategy for sick and ailing pension schemes?

Until the Pensions Regulator actually dusts off its regulatory arsenal, this will all be speculation. But consideration of the question: 'will our investment strategy lead to a hard decking by the Pensions Regulator?' might just 'enliven' a few trustee meetings.

AT RETIREMENT – THE REGULATOR'S SUPPORT FOR DC TRUSTEES

In July 2009 the Pensions Regulator issued a statement entitled 'Engaged employers and informed retirement choices – key to good outcomes for members of define contribution (DC) schemes'. The Regulator is clearly wanting to improve the outcomes for forthcoming retirees who will be most affected by the current economic conditions. It is seeking to do this by putting them in a position where they can make more informed decisions at the most crucial time – at retirement.

'At retirement' – is the crucial point at which the increasing array of options needs to be fully understood by members of DC schemes to maximise income levels during retirement and often it is an area of neglect. The statement is targeting trustees, employers and their advisers to make sure standards and processes are improved.

The Regulator sees member education and communication at the heart of improving

BDO ADOPTS A SINGLE TRADING NAME

On the 1 October 2009 BDO Stoy Hayward Investment Management Limited changed its name to BDO Investment Management Limited. This is part of a global name change initiative resulting in all BDO Member Firms in 110 countries adopting standard trading names by 1 January 2010.

The name change has been made to demonstrate to our clients – the commitment that we have made to operating as a seamless integrated network that delivers respected client service and advice.



standards. It has updated its member leaflet on retirement choices which describes the range of options available to a member approaching retirement, including annuities and other alternatives. It will also be reviewing the retirement processes in a sample of schemes, as it is understood that only a third of DC schemes have reviewed their retirement processes in the last year, with some schemes never having reviewed their processes.

It also wants improved employer engagement but at the same time not increasing the regulatory burden on businesses – that aside from the current economic conditions, will be preparing themselves for Personal Account and auto-enrolment.

For trustees of DC schemes, it only seems sensible that as great effort has been put into deciding upon the best investment strategies and default options for members, a similar level of diligence is exercised when agreeing how best to buy an income with the accumulated funds and in so doing making sure its on the best terms and right for the member.

Whilst the statement does not deal with members of Group Personal Pension arrangements, the same issues arise. Seeking financial advice will ensure individuals will get the best terms and the right type of annuity but often the cost of obtaining financial advice can outweigh the benefits particularly for those with small pension funds. With the Regulator's increased interest on member outcomes at retirement, employers and their advisers should look again at their retirement processes and pre-retirement literature as we expect to hear more from the Regulator later in 2009.

WELLNESS IN THE CURRENT ECONOMIC CLIMATE

Wellness benefits – are these necessary?

In the current economic climate, wellness benefits may be considered low priority for many employers, and in some cases employers may take the opportunity to remove them from the benefit programme. With limited budgets employers will want to make cut backs and are focusing on other areas of employee spend. However, ignoring the value of wellness benefits could be to the detriment of the business.

At a time of pay freezes employers should be looking for innovative ways of enhancing the benefit programme without increasing costs. Introducing some simple but carefully communicated 'wellness initiatives' can be effective in improving morale and giving employees access to valuable medical information and treatment.

At the same time employers can build on this by providing access to support and treatments to help manage employees' wellbeing; this in turn helps to manage absence and the consequential cost to the business.

What can a wellness programme look like?

There are many approaches to developing wellness programmes but typically they will consider both preventative and management measures to raise awareness and reduce absence. Concurrent to this, employers may provide insured benefits to fund required medical expenses such as medical insurance for more serious conditions.

Taking a proactive approach to preventative measures will have a positive effect on the subsequent claims incidence against these insured benefits thus managing the cost of future premiums.

The hidden cost of absence

Along with the cost of insurance cover, employee absence costs need to be considered. These are quite often overlooked and the full impact on both direct and indirect costs should be fully considered. Absence currently costs employers an average of £692 per employee and 7.4 working days for every member of staff per year (source: CIPD Absence Management Annual Survey Report 2009).

In many cases this is a hidden cost to the business. Steps can be taken to understand and evaluate the cost by looking for improvements to absence recording, monitoring and line managers training. These are steps that can reduce absence costs and secure a positive return on investment.

Employee Assistance Programmes

In the current downturn, employees need the valuable support provided by employee assistance programmes (EAP). These provide access to advice on health matters by phone or in some cases face-to-face counselling. Many income protection insurers are recognising the positive effective they can have on absence and are offering these as add-on benefits at little or no cost.

In many cases sick employees are going into work as they are too scared to take the time off for fear of losing their jobs. At the same time concerns over job insecurity are causing an increase in anxiety and stress related conditions.

Employers need to exercise their duty of care to ensure adequate stress management support is provided and this is where an EAP can help.

As well as the potential for wellness to improve employee morale and manage absence costs to the business, a healthy and motivated workplace is a productive one – critical to any business in these uncertain times.

ABOUT BDO

BDO Investment Management Limited provides independent financial advice to private clients and corporations. It is part of BDO the UK Member Firm of BDO International, the world's fifth-largest accountancy network, with more than 1,000 offices in over 100 countries*.

DISCOVER MORE BY CONTACTING US:

Mark Howlett
Director
mark.howlett@bdo.co.uk
020 7893 2327

LONDON
nick.rudd@bdo.co.uk

LEEDS
steven.banks@bdo.co.uk

GLASGOW
alastair.mcquiston@bdo.co.uk

MANCHESTER
paul.mills@bdo.co.uk

BIRMINGHAM
andy.mcgowan@bdo.co.uk

SOUTHERN REGION
mark.wooldridge@bdo.co.uk

EASTERN REGION
sharon.thorpe@bdo.co.uk

BDO Investment Management Ltd
55 Baker Street
London W1U 7EU

Telephone
+44 (0)20 7486 5888

Facsimile
+44 (0)20 7487 3686