Finance & Resources Committee 18 September 2007

Pensions update

Executive summary and recommendations

1. Introduction

2. Decision

The Committee is requested to note the document. No decision is required.

3. Background information

Employee Presentations

Barnett Waddingham visited HPC premises on 23 August and gave a presentation to new members of the Friends Provident pensions scheme. Employees who have not yet joined the pension scheme, but may be interested in doing so at some point in the future were also invited to the presentation.

A second presentation was then given separately to HPC Flexiplan 1 (Capita) pension scheme members, and their transfer value amounts from Capita discussed on a one-to-one basis after the meeting. Mark Futcher of Barnett Waddingham outlined the options open to Capita members in terms of transferring their Capita funds to the new Friends Provident scheme. Most employees are now going away to seek independent financial advice before taking a decision on whether to transfer their funds, however, five employees have already applied to transfer their funds.

Employer Meetings

The new independent trustee of the Flexiplan scheme, Entrust Pension Recovery Ltd, "Entrust" invited scheme employers to a meeting on 29 August to explain the scheme's current position and consider employer views on the future of the scheme. Mr Nigel Hacking, Actuarial Consultant and Partner of Barnett Waddingham LLP attended the meeting on HPC's behalf. Mr Hacking's full report is outlined in Appendix One.

At the Employer's meeting, it became clear that the transfer value may vary from the full fund transfer quoted by Capita relating to each individual member's Pension Capital Account because of several factors :

– some share of the current scheme surplus would need to be added to the transfer value and
– the trustee advised that the transfer value may be reduced as the transfer values only need to be set at a level that would produce the Pension Capital account with 2/4% p.a. interest at retirement.

Mr Hacking advised that the trustee is entitled to stall the quoting and paying of transfer values until they move to a new transfer value basis, which could take up to 6 months.

Barnett Waddingham Investments LLP, "BW" separately advised HPC that the transfer value process involves three stages, once (BW) receive the completed forms from those Flexiplan members wanting their values transferred :

- Send the Capita forms for completion to Friends Provident and wait for their return
- Forward the completed Capita forms along with the completed forms for the nominated scheme to Capita
- Wait for Capita to return the forms to Friends Provident along with payment for the fund transfer value.

BW advised HPC that in light of the feedback from Mr Hacking about the transfer value uncertainty, that BW will complete only stage one of the above process pending further details on the transfer value being received (from the trustee) in order to avoid any members losing out by transferring out of the Capita plan prematurely. Furthermore, BW advised that because of the latest trustee information, further work also needs to be done in how to provide a comprehensive assessment of the situation in a presentation to members.

4. Resource implications

Nil

5. Financial implications

Approx £1k+VAT cost of attendance of N.Hacking at the Employer's Group Meeting

6. Background papers

Nil

7. Appendices

- Report on the Capita Flexiplan Employer's Group Meeting

8. Date of paper

6th September 2007

APPENDIX ONE

Email received from Nigel Hacking, dated 29th August 2007, bold emphasis added.

Re: Employer consultation meeting - 29 August 2007

Simon,

Feedback from today's meeting:

1. A new trustee company - entrust - has been appointed in place of the Capita trustee company (although Capita remain responsible for the administration services and the actuarial and consultancy advice to the trustee). Entrust seem professional and good progress seems to have been made.

2. A quotation has been obtained from Legal and General for buying annuities for all current pensions in payment, and this shows that there would be sufficient assets remaining, after buying these annuities, to cover the Pension Capital accounts for all the non-pensioner members with a surplus of GBP 5.4m to GBP 10.9m. This is a significant improvement over the position as at the 31 March 2005 actuarial valuation, when there was a deficit of GBP 3.7m (as was presented at the November 2006 meeting).

3. Also a quotation has been obtained from L&G for buying out the Pension Capital accounts with the guaranteed 2%/4% p.a. future investment returns and this shows a surplus of GBP 19.7m. The surplus is increased because L&G actually need less than the current value of the Pension Capital accounts because they assume that they can achieve an investment return higher than the 2%/4% p.a. This means that there is no "section 75" debt - this is a major turnaround compared to the position as at 31 March 2005 when the actuary indicated a section 75 debt of some GBP 9.5m (as was presented at the November 2006 meeting). Hence, the trustee could hand over to L&G all the defined liabilities (i.e. the pensions in payment and the liability for the Pension Capital accounts together with the guaranteed 2%/4% p.a. future investment returns) and still have GBP 19.7m left over as surplus!

4. The position will have worsened a bit since the L&G quotations were obtained due to recent falls in stock markets. However, they indicated at today's meeting that the deterioration would only be of the order of GBP 1m - in part because the trustee switched GBP 6.1m of assets from equities into gilts/bonds before the recent market falls.

5. The trustee's plan is to go ahead with the insurance buyouts (they will obtain quotations from other insurers as well as L&G in order to test the market) and in the process allocate the GBP 19.7m surplus to the members (i.e. to the non-pensioners and to those pensioners who have retired since July 2006 when the target benefit was withdrawn).

6. The benefits for future contributions will then be on a simple money purchase basis either provided under the Flexiplan trust or a new Capita pension scheme (in which case the Flexiplan scheme will be wound up). The vast majority of the meeting (90% or more from a show of hands) wanted nothing further to do with Capita and so will presumably set up their own pension plans for future contributions and push for the complete winding-up of the Flexiplan.

7. Some lawyers present (not the legal advisers to the trustee) said that there was a very small risk that a section 75 debt could arise in the future if the Flexiplan trust continued - so even though all of the defined liabilities would be bought out with an insurance company, there is apparently a risk that the scheme could be viewed as not a simple money purchase scheme and a section 75 debt may arise on employers ceasing to participate in the future. They emphasised that this is a small risk, but even so the lawyers view was that the safest route would be to wind-up the Flexiplan now, when it is

known that there is no section 75 debt. The trustee noted these views - and we will hear more on this issue in due course.

8. The trustee said that they are still quoting individual member transfer values equal to the full value of a member's Pension Capital account. However the trustee mentioned that they are reviewing this practice shortly (no timescale was indicated). The advisers present said that the transfer values only need be set at a level that would produce the Pension Capital account with 2%/4% p.a. interest at retirement. If the method of calculating transfer values is changed to this level, then on average transfer values would be reduced to around 75% of a member's Pension Capital account (for the same reasons as given in 3. above). However, this will vary substantially by age: members close to retirement would have transfer values of much more than 75% of the Pension Capital account, whereas younger members would have transfer values much less than 75%. If they do reduce transfer values to this lower level, the trustee will also need to decide what share (if any) of the GBP 19.7m surplus to add to transfer values. This surplus is equivalent to approximately 40% of the Pension Capital accounts and so if it is all allocated to members, then the older members may receive transfer values that are higher than their Pension Capital account, but younger members may still end up with less than the value of the Pension Capital account. This is going to take many weeks/months to resolve and it is unclear what they are going to do in the meantime - but as I say they did indicate that the current policy is to pay the full Pension Capital account as the transfer value.

My conclusions from the above are:

a) You definitely did the right thing in setting up your own plan as soon as possible (it seems most, if not all, of the other employers will be doing the same thing - they will have no choice if the Flexiplan is wound-up)

b) There is no need to carry on paying contributions for the one or two individuals who have remained in the Flexiplan, i.e. the worry about triggering a section 75 debt has gone away. I recommend that you run this past Sackers to make sure that you correctly cease your participation at the current time - this may be important just in case a section 75 debt issue arises in the future (see 7 above), since the debt is assessed as at the date your participation ceased and we know there is no debt at the current time.

c) The decision around the timing for individual members to transfer out of the Flexiplan is complicated! The trustee may stall the quoting/paying of transfer values until they move to the new transfer value basis, in which case the members will have no choice other than to wait (there is a 3 month statutory timescale for quoting transfer values and then a further 3 months to pay) - but they would then need to make sure that the transfer value includes their fair share of the surplus. Alternatively, if members can now transfer out their full Pension Capital account, this may be a bad deal for the older members, but may be a good deal for the younger members (see comments in 8 above) - as a rough rule of thumb, I estimate that anyone under age 40 is likely to be better off taking the full Pension Capital account as a transfer value, rather than waiting for a share of the surplus being added to a reduced transfer value. In the light of this new information received at today's meeting, I think we need to consider this issue very carefully and think what to say to the members. Again, it may be worth running this issue past Sackers also.

I am out of the office at meetings over most of the coming week or so, but if you have any queries please send me an email and I will try & get back to you within a day or two.

Regards,

Nigel.

Nigel Hacking
Fellow of the Institute of Actuaries
Partner, on behalf of Barnett Waddingham LLP
Chalfont Court, Hill Avenue, Amersham, Bucks HP6 5BB
Tel: +44 (0)1494 788100
Fax: +44 (0) 1494 788800
www.barnett-waddingham.co.uk