

FROM THE WORLD OF PENSIONS

Pensions tax regime: further consultation

The Inland Revenue has issued its second consultation paper on the simplified pensions tax regime. The document confirms the overall structure of the new tax regime outlined in the 2002 consultation paper, though with some modifications. It also adds further detail in many key areas. Key points are set out below.

- ◆ The proposed lifetime limit on tax-approved pension savings is confirmed as £1.4 million, indexed in line with prices. However, its impact is being reviewed by the National Audit Office – due to report in time for the 2004 Budget. If the impact is much greater than expected, the new tax regime may not be implemented.
- ◆ There will be a single conversion factor – 20:1 at all ages – for valuing defined benefits against the limit.
- ◆ The annual limit on tax relieviable contributions/accrual is confirmed as £200,000, indexed in line with prices. There will be some relaxations, eg in the year of retirement.
- ◆ The proposed recovery charge on funds over the lifetime limit is confirmed as 25%, with income from the excess taxed at marginal rate (giving an effective rate of 55% after higher rate income tax). The excess may be taken entirely in lump sum form.
- ◆ Transitional protection for rights accrued before A-day is being strengthened.
- ◆ There is much more detail on FURBS and UURBS.

Venables case – House of Lords judgment

The House of Lords in December 2003 gave its judgment on the latest (and final!) appeal in the *Venables* early retirement case.

To recap, Mr Venables gave up his executive directorship, drew early retirement benefits, but continued as an unpaid non-executive director. The Inland Revenue challenged this on the grounds that Mr Venables had not actually retired. This view was upheld in the Court of Appeal on the grounds that retirement, under the terms of the legislation, requires a cessation of employment, not a change in the nature of the employee's service; the court construed this situation as the latter.

However, the case was further appealed to the House of Lords. The Lords have allowed the appeal (ie found in favour of Mr Venables). Their reasoning includes the principle that 'it does not follow... that an employee who is also a director must retire from both his employment and his

office as director before he can be said to "retire" within the meaning of the trust deed.' Also, 'The fact that the taxpayer has remained in his non-pensionable occupation as a non-executive director cannot affect his right to benefit on retiring from his only pensionable occupation. But it would make no difference if he had received and continued to receive director's fees. He would still have retired from his pensionable occupation as an employee, though benefit would have to be calculated without reference to his director's fees.'

Although this ruling will generally make it harder for the Inland Revenue to tax lump sum retirement benefits in some early retirement cases, it does not by any means have a sweeping effect. Much hinged on the particulars of Mr Venables's own circumstances – not least that he was seen as being simultaneously an employee and a director prior to drawing benefits – and the particular trust deed and rules.

DWP report: changes in keeping with the Myners principles

The Department for Work and Pensions has published a report looking at the extent to which 14 occupational pension schemes have voluntarily changed their investment practices and procedures in keeping with the Myners principles.

The research is the first part of a two-stage programme designed to assess the effectiveness of the Myners principles in bringing about change in pension scheme fund investment decision-making. Results from the second stage, a large-scale quantitative survey, will be published in spring 2004.

For more information from the report see www.the-actuary.org.uk.

Pensions Update 145 – no more paper Updates

Inland Revenue Savings, Pensions and Share Schemes has issued Update 145. The sole purpose of this is to notify that it will not be issuing future Updates on paper!

The Updates are available on the Inland Revenue website at www.inlandrevenue.gov.uk/pensionschemes/updates.htm.

Outlawing disability discrimination

Under the EU Employment Framework Directive, all member states must end discrimination on the grounds of disability by 2 December 2006.

Regulations were made in July 2003 which come into force on 1 October 2004 and outlaw discrimination and harassment by employers in the provision of occupational pensions, but do not impose any requirements on trustees.

After further thought, the government has decided that occupational pension scheme trustees must make 'reasonable adjustments' where to do otherwise could result in indirect discrimination. So in November the Disability Discrimination Act 1995 (Pensions) Regulations 2003 were made, also coming into force on 1 October 2004, which:

- ◆ prohibit trustees from discriminating against or harassing a disabled person. Schemes will be treated as though they had an overriding non-discrimination rule giving trustees power to make necessary amendments to scheme rules where they otherwise do not have the power. The non-discrimination rule applies only to benefits that will accrue after 1 October 2004 (though this restriction does not apply to the provision of information about benefits accrued before this date);
- ◆ require trustees to make reasonable adjustments where a provision, criteria or practice, including a scheme rule or any physical feature of premises occupied by the trustees, places a disabled person at a substantial disadvantage compared to someone who is not disabled; and
- ◆ allow claims against the trustees to be brought before an employment tribunal by an active or deferred scheme member in addition to the existing route of complaint to the pensions ombudsman.

It is clearly going to be important, but not necessarily easy, to distinguish disability for the purposes of the non-discrimination requirements from general ill-health and incapacity.

Opra publishes Bulletin 29

The contents of Bulletin 29 include

- ◆ whistleblowing gets the green light – a look at Opra's revised guidelines for statutory whistleblowers;
- ◆ a word from the Auditing Practices Board – Richard Fleck, APB chairman, considers the new Opra Note 1;
- ◆ red, green, or amber...? – case studies from Opra's whistleblowing workshops;
- ◆ it's criminal – Opra's first prosecution for fraudulent evasion.

Visit the Opra website to read more, at www.opra.gov.uk.

 GORDON SHARP

Black hole partly filled

The combined pension deficit at top 100 UK companies has halved owing to the rise in equity markets last year, according to Hewitt Bacon & Woodrow, the pensions consultants. The firm estimates that the gap in pension funds at FTSE 100 companies has been reduced to under £50bn (€72bn), from a high of £100bn when markets were at their lowest point in March last year.

Raj Mody, principal consultant at Hewitt Bacon & Woodrow, said: 'At last there is a sliver of good news for pension schemes.' However, Mr Mody warned that schemes could still dramatically reverse, due to their heavy reliance on returns from equities. He said pension trustees faced the decision of whether to sell equities in favour of bonds to reduce their risk, or to continue to invest in equities in the hope of further strong gains.

According to the WM Company, pension funds took the opportunity thanks to the strength of UK equities during the year to switch money into UK bonds. This suggests that schemes are keen to increase their exposure to fixed income in order to better match liabilities but have a market timing overlay. The WM Company said UK pension funds achieved an average return of 16.8%, the first positive performance since 1999.

In contrast, the pension funding black hole in the US has continued to grow throughout 2003 despite sharp increases in global equity markets, according to the latest research from Standard & Poor's. Pension under-funding among companies in the S&P 500 grew from \$212bn (£120bn) in 2002 to a record \$259bn in 2003 – an increase of over 22%.

Despite the S&P 500 index gaining more than 25% in the year, pension schemes managed to boost their assets by \$112bn – or 12% – to \$1.1 trillion from \$951bn at the end of 2002. However, pension obligations have soared to an estimated \$1.3 trillion, up \$160bn from the end of 2002.

Standard Life capital base

A tougher regulatory stance from the Financial Services Authority (FSA) could force Standard Life, Europe's largest mutually owned life insurer, into the arms of a trade buyer, according to independent analyst Ned Cazalet.

Standard Life recently started discussions with the FSA to determine how it needs to comply with the new solvency regime, due to be introduced in March. It

is understood that the talks were initiated by Standard Life and rival life insurers are likely to be holding similar discussions in the months ahead.

The FSA said in a statement: 'The FSA confirms that it is in discussion with Standard Life about the calculation of its realistic balance sheet. There has been a high level of engagement between the company and the FSA which is close to a conclusion.' It has been reported that the FSA's estimate of Standard Life's core capital has fallen from £6bn to £2.5bn.

Stop press Just as we went to press, Standard Life and the FSA announced 'agreement' on the outcome of their discussions which appeared to require an additional capital infusion of £750m. To market surprise, the company confirmed the immediate resignation of chief executive Iain Lumsden and that it would undertake a wide-ranging review of strategy, including a review of its mutual status. The rating agencies immediately downgraded Standard Life, which will add to the cost of its intended capital-raising.

More is likely to have emerged by the time this reaches our readers, but the shock developments appeared to owe much to actuarial issues. Reading between the lines of the statements from Standard Life and the FSA, there appeared to have been disagreement in three areas:

- ◆ the quality or verifiability of the company's asset share calculations;
- ◆ the interaction of the manner in which prospective benefits were illustrated by the company and the determination of

balance sheet liabilities;

- ◆ the economic or financial assumptions underlying the calculation of provisions for guarantees.

Some actuaries may be disturbed that issues fundamental to actuarial management have been debated and 'resolved' apparently without any involvement on the part of the profession collectively.

2003 – not the worst of years?

According to Swiss Re's preliminary estimates, 20,000 people worldwide were killed by natural and man-made catastrophes in 2003. Overall financial losses from catastrophes amounted to an estimated \$65bn (£35bn). Property insurers across the globe had to contend with losses of some \$17bn.

Five insured losses in excess of \$1bn in North America and none in Europe or Asia – this is the preliminary conclusion drawn for 2003 by Swiss Re's latest *sigma*. Although, at \$17bn, losses were higher than in the previous year, 2003 is still no record year in a long-term comparison. *sigma*'s records indicate that there were a high number of fatalities: almost 20,000 people lost their lives in the just under 350 catastrophes registered. More than 2,200 people perished in the earthquake in Algeria in May, while nearly 1,400 died in India's heatwave.

Also new on the Swiss Re website is *sigma* research showing that, while financial market turbulence continued to

Obesity discovered to be hereditary!

The founder of a programme in the US to improve parent fitness found that 20% of the initial replies were from parents and attorneys wanting to sue doctors for the obesity and overweight suffered by children.

In letters sent to the American College of Obstetrics & Gynecology, American Society of Reproductive Medicine, and the American Academy of Family Physicians, Dr Applebaum, a Chicago-based physician and attorney, fitness expert, and author, informed them of his experience. 'Of the initial respondents, a full one-fifth were more interested in my law degree than my medical degree and fitness credentials. They felt betrayed by their own physicians who did not warn them of the effects their overweight could (and in some cases allegedly did) have on their children. In short, they

wanted to sue. Apparently the message of parental obesity and overweight and their effects on children is not getting through. These people seem to think that it was never given. So did the attorneys who also made contact.'

Studies prove that the number one predictor of childhood weight problems is parental unfit. If one parent is unfit, a child has a 40% chance of developing weight problems, and if both parents are unfit, a child has an 80%–90% chance of developing weight problems. According to the US Center for Disease Control, a majority of adults of reproductive age are unfit, ie overweight or obese. This places the number of potential plaintiffs in the tens of millions. The implications for malpractice insurance reserves have yet to be assessed!

plague the insurance markets in 2002, some signs of recovery were evident in the most important markets: the non-life insurance sector grew at a record-breaking rate, and the life sector posted minor improvement. Visit www.swissre.com.

Swiss Re obtains \$400 million of mortality risk coverage

Swiss Re has successfully sponsored its first-ever insurance-linked security relating to life insurance risk, and has obtained \$400m (£220m) of coverage from institutional investors.

As part of the transaction, Swiss Re entered into a financial arrangement with Vita Capital Ltd to provide up to \$400m of payments to Swiss Re in certain extreme mortality risk scenarios. In turn, to fund potential payments under this arrangement, Vita Capital issued \$400m of principal at-risk variable rate notes.

The structure of the Vita Capital risk coverage is based on a combined mortality index similar to other index-based insurance-linked securities. The mortality index measures annual general population mortality in five select countries by applying predetermined weights to publicly reported mortality data from each country. The principal of the Vita Capital notes will be at risk if, during any single calendar year in the risk coverage period, the combined mortality index exceeds 130% of its baseline 2002 level. The bond matures on 1 January 2007.

Swiss Re Capital Markets Corporation structured the Vita Capital securities and acted as the sole bookrunner in the distribution to institutional investors according to Rule 144A. The Vita Capital

securities were rated A+ by Standard & Poor's and A3 by Moody's Investor Service. Investors will be paid a quarterly coupon rate of USD three-month Libor plus a spread of 135 basis points for the principal at risk.

Claims set to rise

A new report from independent market analyst Datamonitor finds that personal injury claims costs increased by over 30% between 2001 and 2003, to an estimated £7bn, and are set to increase at over 15% a year during the next five years. The number of personal injury claims made in the year ending March 2003 increased by 2.6%. While this refutes the notion that the UK is gripped by a US-style compensation culture, personal injury claims costs are the main concern for insurance companies, as claims inflation across all lines of business is having a severe impact on the ability of insurers to achieve underwriting profitability. 'Advances in medical science, legal and legislative reforms, and increasing damages all look set to continue and add to the personal injury cost for insurers' commented Vicki Summerhays, author of the report.

Mercer acquires KPMG Switzerland

Mercer Human Resource Consulting, a unit of Marsh & McLennan Inc, has announced that it has entered into a definitive agreement with the shareholders of KPMG Benefit Consulting to acquire its consulting business in Switzerland. Terms of the agreement, which will add 24 employees to Mercer's Swiss team, were not disclosed. Earlier Mercer had

acquired the benefit consulting operations of KPMG in Germany.

Prudential outsources

Capita has secured a £100m, ten-year business process outsourcing (BPO) contract with life and pensions giant Prudential and St James's Place International, one of Prudential's customers. The contract is a significant boost for Capita after a slow-down in its win rate following a strong start to the year.

Under the terms of the deal, Capita will buy the share capital and assets of Prudential's Dublin-based services company, Prudential Europe Management Services, for an undisclosed amount and will take on the end-to-end life and pension policy administration services provided by Prudential Europe.

Capita expects to generate revenues of £17m from the contract in its first year and will employ 260 Prudential staff as part of the deal.

Ethics for auditors

The Auditing Practices Board (APB) is issuing for public comment five exposure drafts of proposed ethical standards (ESs) on the integrity, objectivity, and independence of auditors.

The standards will establish basic principles and essential procedures with which auditors will be required to comply in any audit of financial statements. When finalised, these standards will replace the existing guidance for auditors, issued by the auditors' professional bodies. The five proposed standards cover:

- ◆ integrity, objectivity and independence;
- ◆ financial, business, employment, and personal relationships;
- ◆ long association with the audit engagement;
- ◆ fees, economic dependence, remuneration, and evaluation policies, litigation, gifts, and hospitality;
- ◆ non-audit services provided to audit clients.

Important new features include the roles of the audit firm's 'ethics partner', the requirement for an 'independent partner' where the audit client is a listed company or other public interest entity, and the interaction with the Higgs code of corporate governance. The changes are likely to require a considerable shift in the cultures of major auditing firms – for example appraising auditor performance on business development with audit clients will be prohibited.

Spreadsheet risks and control

Most actuaries tend to work on the mitigation end of risk management; Louise Pryor is one of the few to concentrate on risk control. She has just released an Excel add-in that is intended to reduce the risks of end-user software development. 'About 80% of spreadsheets contain significant errors,' says Louise, 'although many actuaries do much better than that by putting a lot of effort into checking and reviewing.' She says that her new product, XLSior, helps to streamline the process and give you a greater comfort level for less effort. XLSior is intended to support best practice during spreadsheet

development and maintenance, and should help prevent errors such as the restatement of \$70m we saw for Provident Financial in March and the recent \$1.2 billion for Fannie Mae.

Meanwhile the European Spreadsheet Risk Interest Group is dedicated to increasing awareness of spreadsheet errors among academia and industry and to promoting research regarding the extent and nature of the problem, methods of prevention and detection of errors, and methods of limiting damage.

Find out more at www.eusprig.org.