



## **PENSIONS BILL: Second Reading debate in Lords (10 June 2004)**

### **BRIEF FROM THE ASSOCIATION OF CONSULTING ACTUARIES (ACA)**

The major part of the work of ACA members is as advisers to UK pension funds of all sizes. The ACA is the largest national group of consulting actuaries in Europe.

#### **Pensions Bill: will it achieve its objectives?**

The ACA has conducted a survey of employers since the publication of the *Pensions Bill* and the results – published in May 2004 – indicate that **employers are unconvinced the *Pensions Bill* will achieve some of its key objectives.**

A summary of the main findings of this major survey is as follows:

- **Following the publication of the *Pensions Bill* a majority of firms (51%) feel its measures will decrease occupational pension scheme coverage.** Fewer than 1 in 10 firms feel the measures will improve pension coverage.
- **Close to 9 out of 10 firms say the Bill's measures will either add to costs (49%) or make no difference (38%)** as against the Government's claims that there will be £130 million savings.
- **While support for the Pension Protection Fund has grown to 8 out of 10 firms, that support will be judged by the per head levy that schemes are charged to fund the scheme.** 64 per cent of schemes say that a cost of £15 per defined benefit scheme member would be 'too much', with not far short of a half saying even £10 per head is too much.
- **Three-quarters of firms believe all public sector schemes should contribute to the levy and a broadly similar number feel that the rules should not allow the total levy to be increased by as much as 25 per cent in one year.**
- **Firms broadly support the proposed PPF benefits package, but very close to a half say that the proposed 100 per cent uncapped pension for pensioners who have reached normal retirement age is 'too high'.**
- **Over three-quarters of firms say the new 'knowledge and understanding' requirement placed on trustees will deter individuals from wishing to be trustees.**

**SEE PAGE 3 OF BRIEF FOR KEY ACA PROPOSALS ON THE PENSION PROTECTION FUND**

- **A majority of firms oppose the Government having enabling powers (as provided for in the Bill) to require trustees to provide combined benefit statements or to require employers to provide access to information and advice about pensions and saving for retirement.**

**Whilst there is a genuine desire amongst employers to better protect pensions through the Pension Protection Fund, respondents to this ACA survey seem to have few illusions that the extra regulation involved in the *Pensions Bill* will deter wider coverage, rather than encourage wider provision – the Government’s stated aim.** For further details of the survey findings go to [www.aca.org.uk](http://www.aca.org.uk) (Home / What’s New page and scroll down to 19 May 2004 links) or request a hard copy from the ACA, No.1 Wardrobe Place, London EC4V 5AG.

## **Still time to think again**

Following the Commons Stages of the Bill, the ACA has a number of key concerns that remain about the Bill as tabled. This brief concentrates on the **Pension Protection Fund**, which remains a key concern to employers and those who advise employers on their approach to pensions.

## **Pension Protection Fund and Assistance**

- Whilst it is clear the government is trying to ensure the PPF does not have the problems of the US scheme, which is now \$11 billion in deficit, there is some evidence that a number of employers are holding off taking action until the PPF is introduced. This **suggests initial claims on the PPF may be higher than anticipated.**
- It is noteworthy that the **Assistance package** announced on Friday 14 May 2004 for those who have lost some or all of their defined benefit package prior to the introduction of the PPF is much less generous in replacing lost pensions than the PPF benefits proposed in the Bill. Unless further monies, over and above the £400 million (ie. averaging £20 million pa over 20 years, albeit that monies may not be equally spread year by year), are announced or ‘obtained’, the annual average compensation payment – if 60,000 are affected – cannot be more than around £340 per annum.

**We would therefore be surprised if Members of either House feel the amount announced in the Assistance package – given the absence of real details – is sufficient to meet the problem.** For business and the pensions industry, the concern remains that after a period of time the responsibility to top-up the Government’s amount, courtesy of a later announcement, may fall upon them.

- **Given the concern the Government clearly had about the cost of the Assistance package for the 60,000, the ACA is worried that the key levels of PPF benefits are too high.** In particular, we are worried about the **cliff-edge issue**, where existing pensioners of normal scheme retirement age will receive a full pension no matter the level of pension (and this could in certain cases amount to hundreds of thousands of pounds). However, those below – even just below that age – will receive 90% of accrued pensions, but capped at probably £25,000pa. **The ACA believes the PPF level of benefits as proposed are too ambitious.**
- **We believe that the Government needs to reconsider the levels of benefit along the lines of the proposal below.** This proposal would achieve the Government’s broad objective without reducing support where it is most needed.

**The ACA proposes that:**

- **the limits for those below normal retirement age should be retained as per the Bill other than revaluation in deferment.** This should apply only in respect of pension accrued after 5 April 1997 with revaluation being from the date of entry to the PPF and capped at 2.5% per annum (revaluation to the date of entry to the PPF being under the scheme rules).
- **for existing pensioners over normal retirement age there needs to be some cap to avoid both a ‘cliff edge’ and so as not to support a situation where huge pensions are paid to retired senior executives – draining the PPF – whilst other pension scheme members close to retirement see their prospective pension capped.** We propose instead 100% of pension up to £10,000 per annum plus 75% of pension between £10,000 and £30,000 per annum, with a capped pension of £25,000 per annum.
- **the cliff edge is avoided through the same £25,000 cap and increases to immediate and deferred pensions applying in respect of the same post 5 April 1997 tranche.**
- both immediate and deferred pensioners should enter the PPF at their existing level subject to the percentage limit and the cap.

Given the costs that could fall on the reducing number of defined benefit schemes, **the ACA feels Members should press the government to pause to reconsider the levels of benefits when starting the scheme given the uncertain nature of the claims experience at its outset.** Should high claims not materialise, benefits could be gradually improved (rather than choked off as provided for in the Bill).

## Scheme specific funding

Our understanding is that the Government intends that:

- the scheme specific funding requirement will be based on a prudent expected return on the fund's assets and will not be related to the high cost of buying out the benefits with an insurance company.
- the trustees and the employer will be able to agree on a reasonable recovery period over which any deficit can be made good.

**The ACA calls for the government to confirm the above position, by amendment to the Bill or by regulation, so that companies can plan their future financing.**

**The ACA proposes that, in order to protect the PPF, the scheme specific funding requirement should be subject to a minimum of the PPF liabilities valued on a basis close to the cost of purchasing the liabilities with an insurance company.**

## Risk related levy

The government has said the levy to pay for the PPF will be flat rate (not risk-related in the first year), but that when a risk-related element is added, this will form at least 50% of the total levy. The ACA welcomes the concept of a risk-related levy, but is concerned that the detail of how this will work is being left to the PPF to determine at some later date. We believe that more progress could be made in this area ahead of the PPF starting-up and that a risk-related premium structure should form part of the initial levy structure.

**The ACA calls on Members to seek an assurance from the Minister that much greater detail on how the risk-related levy will be determined is made available to Members and those paying the levy at the earliest possible opportunity.** It is also important that this risk-related levy is implemented as soon as possible and that well-run schemes are not exposed to a high general levy for a number of years.

We anticipate that a major part of the risk related levy will be calculated by reference to the level of underfunding of the PPF liabilities valued on a basis close to the cost of purchasing those liabilities from an insurance company. If this figure were not available initially, the **under-funding could be calculated by reference to the MFR coverage at the last valuation for the first few years.**

## **Anti-avoidance measures and financial support provisions for associated employers**

Members should be aware that the **anti-avoidance measures** introduced in the final committee stage of the Pensions Bill could have far-reaching and significant impacts.

**The ACA believes that the proposal that any employer within a group of associated employers be compelled to make up (or otherwise 'underwrite') some or all of a scheme shortfall should be restricted to the scheme shortfall up to PPF level benefits and not the full scheme shortfall.**

Such a provision would protect the PPF as well as being a balance. For example, the employer may never have participated in the scheme or it may not be possible to exercise this debt against the employer if it is a non European company in the group.

**With the aim that this debt will not be necessary in the future, the suggestion above that the debt is limited to the shortfall up to PPF benefits is consistent with the ACA call for scheme specific funding to be underpinned by a minimum funding test based on the cost of the PPF benefits and for the risk related levy to be introduced from April 2005.**

**The ACA is also concerned that the late introduction of these 'anti-avoidance' clauses into the Bill, targeted at 'unscrupulous employers' – elements of which are back-dated to 11 June 2003 based on the Secretary of State's statement of that date – are highly dangerous as the detail will come in regulations after the Bill is passed.** The regulations could, therefore, impact on a wider range of employers.

**The ACA believes such important provisions – which may have an impact on company borrowings and forward investment – should be in primary legislation and not introduced through last minute clauses and back-door regulations.**

## **The New Pension Regulator**

The ACA genuinely welcomes the concept of a pro-active regulator that operates a light touch regime for the vast majority of well-run schemes.

There are concerns, however, that the responsibility of the New Regulator to take actions to minimise calls on the PPF could lead to an invasive regulator, calling for detailed information from sponsoring employers well beyond that presently sought.

**If the additional requirements placed on the New Regulator manifest themselves in widespread additional paperwork sought from large and small employers alike, this will lead to a further acceleration in scheme closures to future accrual.**

**The ACA recommends to Members that an additional objective is added to the New Regulator's principal objectives, namely to promote occupational pension provision by reducing the day to day regulatory requirements falling on well-run schemes and their sponsoring employers.**

## **Overall impact of the Pensions Bill**

- The Government has a stated objective of moving to a situation where pensions are provided on a 60 / 40 basis by the private sector / State, as opposed to the 40 / 60 basis broadly at present.

**Members might consider asking the Minister what measures in the *Pensions Bill* will actively encourage greater private pension provision?**

**As the ACA survey (see page 1) reports very clearly, employers – encouraged by the Government's initial adoption of the 'simplification agenda' are now totally under-whelmed by another piece of legislation that will add further 'protections' and costs, with virtually no important measures included that will actually encourage occupational provision.**

**Had Parliament not placed so many additional cost burdens on pension schemes in the last 20 years it is probably the case that the need for a Pension Protection Fund would have been unnecessary.**

**Indeed, the expectations of many employers and those active in the pensions industry are that – just as with the *1995 Pensions Act* – this latest Bill in its current form, when enacted, will once again turn more employers away from providing 'good' pension arrangements.**

**Is this really what Parliament wants?**

**Brief produced by the Association of Consulting Actuaries (ACA)**

No.1 Wardrobe Place, London EC4V 5AG Tel: 020 7248 3163

Email: [acahelp@aca.org.uk](mailto:acahelp@aca.org.uk)

Web: [www.aca.org.uk](http://www.aca.org.uk)

8 June 2004