

Contents

| | Page |
|---|------|
| Chairman's Introduction | 2 |
| Executive Summary | 4 |
| Background to the Survey | 5 |
| Pension Trends | |
| Survey coverage | 6 |
| Pension schemes in sample | 6 |
| Scheme take up | 6 |
| Stakeholders disappoint | 7 |
| Pension contribution levels | 7 |
| Increases in pension costs and employer responses | 9 |
| Reviews of pension arrangements | 9 |
| Employees' appreciation of pension changes | 11 |
| Principal motives for running schemes | 11 |
| Impact of FRS 17 | 12 |
| Views on Green Paper and Tax Simplification Paper | |
| Overall views | 13 |
| Pensions Tax Reform | |
| • 'A' Day | 14 |
| • Support for limits | 15 |
| • Indexing limits | 15 |
| • Scheme re-design | 16 |
| • Pensions and continuing work | 17 |
| • Compliance costs | 17 |
| Pensions Green Paper | |
| • Compulsory membership, LPI and spouses' benefits | 17 |
| • Contracting out, Section 67 and MNTs | 18 |
| • Scheme Specific Funding Requirement | 19 |
| • Support for pro-active Regulator | 20 |
| • Consultation, scheme wind up, compensation scheme | 20 |
| • State Pension, compulsory retirement and compulsion | 20 |
| • AVCs | 21 |
| Most important measures to encourage provision | 22 |
| Future reforms? | 23 |
| Appendix: | |
| Pickering Review – Responses to August 2002 survey | 24 |

Chairman's Introduction



Our latest trend report on occupational pensions makes disturbing reading.

The incidence of occupational pension provision is on the decline and the flight away from final salary arrangements has accelerated disturbingly over the last 6 months. Almost daily, we see household name businesses taking action to reduce their pension costs or forward liabilities. It is encouraging, however, that this most recent survey does report a small increase in the number of employers offering alternate defined benefit arrangements – which protect those on lower incomes, like career average schemes. Also, more employers are successfully persuading employees to increase contributions.

Our members are in the frontline advising employers and boards of trustees on what measures are needed in the short and longer term to protect both employers and members' interests. In so doing, we are cautioning – as we did during the upward track of the market – that pension investment is a long term business where decisions should be considered based on forward income streams from investments and contributions, as well as having regard to any deficit and how this might change over time.

What is clear is that employers (and members) need as much help as they can get from the Government to support occupational provision. The immense value of a sizeable employer's contribution in building a good pension cannot be under-estimated. This is why the Government's reform proposals are so important and why they must be improved upon.

What our survey shows is that whereas employers were pleasantly surprised at the innovative way pension taxes are to be simplified, they felt the Green Paper itself under-performed. The Government can do more. According to their own figures, the removal of compulsory Limited Price Indexation and spouses' benefits alone – both forced by Government on schemes after many had been established – could reduce funding costs by close to 40 per cent (see page 133 of the Green Paper). That is not to say all or even a majority of schemes want to make these savings. In fact, our survey says most wouldn't. But for those who need to make savings, or those newer firms considering offering pensions for the first time, radical measures that give the option to reduce forward liabilities are hugely important.

Better incentives too – tax or otherwise – to employers who offer an occupational scheme with a significant employer's contribution need to be very seriously considered before the Government's revised proposals, following the consultation period, are published.

I earnestly hope the Government's reforms don't end up being 'too little, too late'. Certainly, their actions now need to be both bold and brisk otherwise the scale of the move away from occupational provision might become irreversible.

Gordon Pollock

Chairman

Executive Summary: key findings

The key findings of the surveys are as follows:

Pension trends

- 29 per cent of employers have reviewed their occupational pension arrangements in the last 6 months.
- 42 per cent of employers say they are trying to reduce spending on pensions and 51 per cent are looking to reduce forward pension liabilities.
- 72 per cent of final salary pension schemes are now either closed to new entrants (63 per cent) or future accruals (9 per cent).
- Average employer contribution rates into final salary schemes have increased from 11.5 per cent last year to 13.1 per cent this year and are continuing to rise sharply.
- Contributions into occupational money purchase schemes generally are not increasing to offset the effect of deteriorating investment returns.
- Combined employer and employee contributions into final salary schemes average 17.6 per cent and are twice the average level of contributions paid into money purchase arrangements.
- Fewer than 1 per cent of employees based at firms covered by the survey have joined stakeholder schemes (46 per cent of stakeholder schemes have no members at all).

Pension tax simplification

- 68 per cent of employers say the proposals in the pension tax simplification paper will ease scheme administration.
- 69 per cent prefer 'A' Day – when the tax simplifications will be introduced - to be 6 April 2005 (although 43 per cent say 6 April 2004 is achievable)
- 69 per cent of employers support the proposed lifetime and annual contribution limits
- Employers say the lifetime limit should be £2 million + and the annual contribution limit at least £250,000
- 87 per cent say limits should be indexed to earnings (or should take account of mortality and / or annuity movements)
- 55 per cent say the lifetime limit will cause problems with senior staff / executive pension provision, with 42 per cent saying this will lead onto scheme re-designs
- 87 per cent support proposals allowing employees to draw their pension and to continue to work for the same sponsoring employer
- Only 35 per cent feel tax simplification will reduce compliance costs

Pensions Green Paper

- 93 per cent of employers say the Green Paper proposals will be ineffective in encouraging greater occupational pensions provision
- 27 per cent of employers say the Green Paper has prompted them to bring forward a review of their current pension arrangements
- 56 per cent say occupational scheme coverage will increase if employers are permitted the option to make their scheme compulsory
- Only around 25 per cent of employers feel the removal of requirements to offer Limited Price Indexation and spouses' benefits will extend provision
- Only 26 per cent of employers feel the proposals to simplify contracted out benefits and to reduce complexity are sufficient easements (67 per cent favour abolishing contracting out if rebates are not improved)
- 69 per cent of employers support the replacement of the Minimum Funding Requirement with a Scheme Specific Funding Requirement
- 76 per cent support a more pro-active Pension Regulator to replace Opra
- Employers are split down the middle on support for statutory backed employee consultations prior to scheme changes and the Section 67 proposals to allow schemes to modify (with limits) accrued rights without member consent
- 84 per cent of employers support a fairer distribution of assets on scheme wind up
- 53 per cent support a compensation fund to be funded by all pension scheme in the event of an insolvent employer's scheme being unable to meet accrued benefits
- 95 per cent of employers believe the Government should not exclude simplifying the State scheme from its reform measures
- 91 per cent of employers say within a few years the new Pensions Commission will recommend greater compulsion
- 71 per cent of employers agree with the Government's decision not to raise the State Pension Age
- 66 per cent say schemes should no longer be required to offer AVCs
- Employers say increased tax incentives for individuals; incentives to employers offering occupational pensions and more compulsion are the three most important policy priorities to boost private occupational provision.

The survey results point to a 'widening gap' between those employees fortunate enough to be offered occupational arrangements and the increasing number that are not, coupled with a growing gap in contributions to fund pensions for those remaining in final salary schemes as opposed to those in money purchase arrangements.

The survey also reveals a rapid acceleration in scheme changes over the last 6 months, most particularly the closure of final salary arrangements to new entrants.

Whilst the survey reveals strong support for the tax simplification proposals put forward by the Government, the wider Green Paper proposals are likely to be ineffective in addressing the UK occupational pensions crisis.

Background to the surveys

In the Summer of 2002, ahead of the Government's Green Paper on pensions, the ACA undertook a survey on occupational pension trends across employers of all sizes. As part of the survey, employers were invited to comment on the Pickering pension simplification proposals submitted to Government in the Summer of 2002. Then, in February 2003, following the publication of the Green Paper and Tax Simplification Paper, the ACA conducted a follow up survey to gauge reactions to the two papers.

The surveys have been undertaken at a time when there is mounting evidence of a serious and accelerating decline in occupational pension provision. This is evidenced as follows:

- The *2001 General Household Survey* notes that 'the proportion of men working full time who were in an employer's pension scheme decreased from 64 per cent in 1989 to 54 per cent in 2001, reflecting the decline (from 79 per cent in 1989 to 71 per cent in 2001) in the proportion of employees who were offered a pension scheme by their employer'.
- The preliminary results of the Government Actuary's report on *Occupational Pension Schemes 2000* notes that 'since the number of employees in the private sector has grown since 1995, the fall in the number of members of private sector occupational schemes (to 5.7 million from 6.2 million in 1995 and 8.1 million in 1967) represents a significant fall in the proportion of private sector employees who are members of such schemes'.
- The same Government Actuary's preliminary study showed that of the 105,000 private sector occupational schemes registered on the *Pension Schemes Registry* database, only 62,100 schemes are open.
- Since both the *2001 General Household and 2000 Government Actuary's* study collected their data, growing numbers of employers have announced final salary pension scheme closures to new entrants (and in some cases an end to future accruals), and – due to the sharp reduction in Stock market investments – a rapid increase in reports of scheme deficits and members adversely affected by deficits on wind up.
- The Government's 2002 Green Paper *Simplicity, security and choice* states that 'perhaps 3 million people are seriously under-saving (or planning to retire too soon). Depending on their expectations of retirement and circumstances, a further group of between 5 and 10 million people may want to consider saving more or working longer'.

Pension Trends

Survey coverage

The initial survey, conducted in August and September 2002, attracted responses from 336 firms, selected on a random basis, employing 1.8 million people. Employers responding to the survey ranged from those with under 10 employees through to those employing upwards of 50,000 staff. 208 firms responded to the follow up survey conducted in February 2003.

Pension schemes in sample

The spread of types of schemes offered by employers in the sample is wide ranging. Whilst 76 per cent of employers run final salary arrangements, **well over half of these schemes are now closed to new members or future accruals.**

Whilst on the face of it the number of employers offering stakeholder arrangements appears encouraging, in fact – due to very low take up rates - fewer than 1 per cent of employees in the sample are at present covered by the stakeholder schemes that have been established. However, it could be argued, these are still early days for many stakeholder arrangements.

| Percentage of employers running following types of schemes | | | | | |
|--|-----------------------------|-----------------------|-----------------|-------------------------|-------------|
| Final salary | Occupational Money purchase | Industry wide schemes | Hybrid/ Mixture | Group Personal Pensions | Stakeholder |
| 76% | 41% | 4% | 12% | 19% | 28% |

(Figures exceed 100 per cent as many firms offer more than one type of scheme)

Occupational scheme take up

Take up of occupational arrangements varies very widely across the employers covered by the survey. On average, 72 per cent of employees are members of occupational schemes covered by the survey. This is a higher percentage than across the economy as a whole, where only 54 per cent of men and 58 per cent of women working full-time belong to employers' schemes.

Whilst over half the schemes covered by the survey have a take up rate of over 80 per cent, over a quarter of schemes are only reporting take up rates of under 60 per cent of employees, which – in pension coverage terms – is disappointing:

| Occupational scheme take up | |
|---|-----|
| Over 90 per cent of employees | 42% |
| Over 80 per cent, but under 90 per cent | 9% |
| Over 60 per cent, but under 80 per cent | 21% |
| Over 40 per cent, but under 60 per cent | 11% |
| Under 40 per cent | 17% |

Stakeholder take up disappoints

Since their introduction, 41 per cent of employers said they were required to offer some of their staff access to stakeholder arrangements. However, of these:

- **46 per cent of employers say no employees have joined the stakeholder schemes** that they have offered access to.
- **only 19 per cent of the stakeholder schemes established have more than 5 per cent of employees in membership.** These are all companies employing fewer than 1000 people, the majority employing fewer than 100.
- **only 31 per cent of employers are paying an employer's contribution into stakeholder arrangements,** and these are generally only at modest levels (see 'pension contribution levels' for levels of contribution).

Close to 30 per cent of employers said they gained exemption from stakeholder requirements by reducing the age of access to existing occupational schemes or by otherwise extending eligibility to join.

Pension contribution levels

Contribution levels into final salary arrangements are climbing steeply as more employers see deficits appearing in the near or longer-term, as a result of depressed investment markets coupled with factors such as greater longevity.

Average contribution rates by employers into final salary schemes have climbed from 11.5 per cent last year to 13.1 per cent this year. A further increase in average employer contributions to 15.1 per cent is expected over the longer-term.

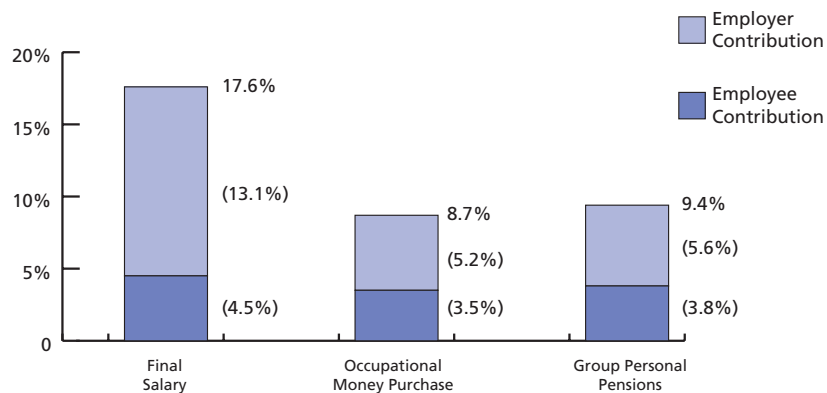
The need for these sharp increases in employer contributions is undoubtedly fuelling the swing away from final salary arrangements. Data collected in the 2003 survey also found more schemes are increasing employee contributions to 'share the pain' of increased funding costs.

Given the much lower investment returns being achieved, together with the improvements in mortality, it is worrying – in terms of the pension benefits emerging – that contributions into the range of money purchase arrangements generally are not rising to reflect these changed circumstances. As we have reported in previous surveys, the emerging pensions offered by money purchase arrangements at these average levels of contributions are likely – increasingly - to disappoint members.

| Average employer contributions into | | | |
|-------------------------------------|-----------|--------------|--------------------|
| | Last year | Current year | Long-term expected |
| Final salary schemes | 11.5% | 13.1% | 15.1% |
| Occupational money purchase | 5.1% | 5.2% | 5.4% |
| Group personal pensions | 5.6% | 5.6% | 6.2% |
| Stakeholders (where contrib.) | 5.0% | 5.2% | 5.5% |
| Stakeholders (across all schemes) | 1.6% | 1.6% | 1.7% |

| Average employee contributions into | | |
|-------------------------------------|-----------|--------------|
| | Last year | Current year |
| Final salary schemes | 4.3% | 4.5% |
| Occupational money purchase | 3.4% | 3.5% |
| Group personal pensions | 3.6% | 3.8% |
| Stakeholders | 3.3% | 3.5% |

Current year contribution levels by schemes (average)



| Average combined employer and employee contributions into | | | |
|---|-----------|--------------|--------------------|
| | Last year | Current year | Long-term expected |
| Final salary schemes | 15.8% | 17.6% | 19.6% |
| Occupational money purchase | 8.5% | 8.7% | 8.9% |
| Group personal pensions | 9.2% | 9.4% | 10.0% |
| Stakeholders (where employer con) | 8.3% | 8.7% | 9.0% |

Increases in pension costs and employers' responses

Over the last 5 years, some three-quarters of all employers say increases in pension scheme administration and contribution costs have grown at a faster rate than other business overheads. This rises to 94 per cent amongst companies offering final salary arrangements.

The three 'most important' contributory reasons for these scheme cost increases cited by employers are:

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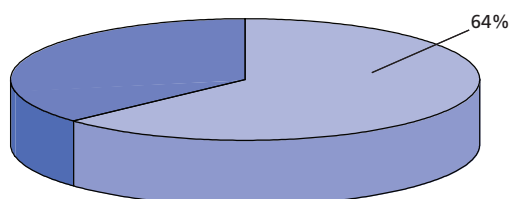
1. Lower real investment returns
2. Greater longevity
- 3 Tax changes (ACT)

Significantly,

- **42 per cent of employers say they are trying to reduce spending on pensions**
- **51 per cent are looking to reduce forward pension liabilities**
- **18 per cent of employers say they set a target on what they want to spend on pensions.** Expressed as a percentage of payroll the median level these employers are setting is 13 per cent (but with a range stretching between 5 per cent and 25 per cent).

Reviews of pension arrangements

Rising pension scheme costs have prompted high levels of scheme reviews.

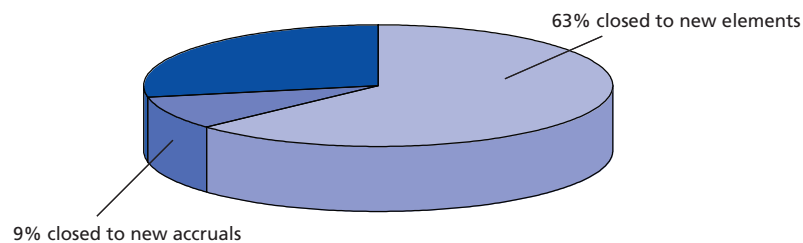


During the last 18 months, 64 per cent of employers had reviewed their arrangements.

| Review of Pension arrangements | |
|--------------------------------|-----|
| In last 6 months | 29% |
| In previous 12 months | 35% |

Alarming, given the results of reviews reported elsewhere in the survey, **29 per cent of employers have reviewed their scheme in the last 6 months**, with many making significant changes.

Over the last 5 years, employers have made significant changes to their pension arrangements as below. The most significant change is the closure of final salary schemes to new entrants.



Well over half the schemes – 63 per cent - in the sample have been closed to new entrants or to future accruals and some 17 per cent have taken this decision in the last 6 months alone.

| Changes in pension arrangements | Over 5 years to Aug 2002 | In last 6 months | Total |
|---|--------------------------|------------------|-------|
| Closed final salary scheme to new entrants | 46% | 17% | 63% |
| Closed final salary scheme to future accruals | 9% | - | 9% |
| Moved more employees onto money purchase schemes | 14% | 8% | 22% |
| Set up a mixed money purchase / final salary scheme | 9% | 2% | 11% |
| Set up a career average scheme | 1% | 3% | 4% |
| Reduced percentage of employees covered by pensions | 5% | 2% | 7% |
| Placed one or more schemes into wind up | 8% | 3% | 11% |
| Moved to more flexible benefits | 9% | 5% | 14% |
| Increased member contributions | - | 6% | 6% |

(Figures exceed 100 per cent as more than one answer possible)

It is not difficult to foresee – particularly if investment conditions fail to improve markedly – a situation within two years where only around 15 per cent of final salary schemes will still be open to new members. Whilst this will still leave many millions of employees in final salary schemes, new employees will – at best – be joining mixed or money purchase arrangements, with these generally attracting much lower pension contributions (and, hence, lower emerging benefits).

Also, as employees move on from one firm to another, there will be a steady erosion in the number of employees covered by final salary arrangements.

Only 47 per cent of employers said they consulted with employees ahead of the scheme changes they have made.

Employees' appreciation of pension changes

Over two-thirds of employers feel that their employees have fully appreciated the significance of major changes in scheme arrangements over the last few years:

| Employers' perception of employees appreciation of pension changes | |
|--|-----|
| Yes, fully appreciate | 68% |
| No | 19% |
| Don't know | 13% |

That said, close to one-third of employers (31 per cent) who have changed their overall pension package are concerned that employees will come back to the company in years to come to say that they did not appreciate the impact of the changes made, possibly seeking financial redress

Principal motives for running an occupational pension scheme

Given the rapid change in the pension package being offered to staff – certainly new entrants – the survey examined why firms say they offer a pension scheme. By far the most important reason given for offering a pension scheme is that it is seen as an important part of the overall benefits package. Of secondary importance is its ability to assist in the recruitment process or retention.

| Principal motives for running pension scheme | |
|--|--|
| 1 | Important part of overall benefits package |
| 2 | Recruitment |
| 3 | Retention |
| 4 | Safeguard loyal employees' incomes in retirement |
| 5 | Inertia |

A quite high percentage – 19 per cent – say that their motives for offering a pension scheme have changed over the last few years.

| Most important factors in changing motives | |
|--|----------------------------------|
| 1 | Costs – increased contributions |
| 2 | Changes in business structure |
| 3 | Continued complexity of pensions |

Other typical factors influencing change that were reported by respondents were:

- Ease of recruiting without pensions package
- Cost, mobility and flexibility has influenced change
- Impact of MFR
- Risk of equity mismatch
- Competitors have reduced pension offering
- The total benefits package is what is important for recruitment.
- Retention by cash / shares more important
- Low level of perceived benefit by employees, particularly lower paid

Impact of FRS 17

Around one-third of employers say that the prospect of the introduction of the new pension scheme accounting standard (FRS 17) has caused them to review their pension arrangements.

In part, this may reflect the fact that already so many schemes have taken action to restrict the cost of final salary arrangements. Also, the full impact of FRS 17 is only beginning to have its affect.

Impact of FRS 17 in causing pension arrangement reviews

| Impact of FRS 17 in causing pension arrangement reviews | |
|---|-----|
| Yes, of itself | 16% |
| Yes, on top of other extra costs in recent years | 17% |
| No | 67% |

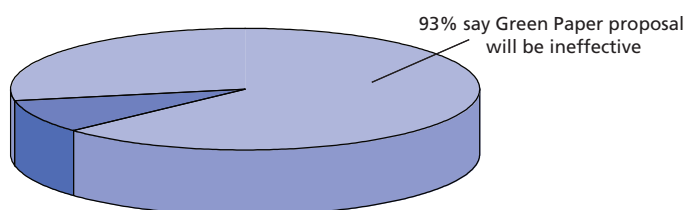
Views on the Pensions Green Paper and Tax Simplification Paper

Following the publication of the Pensions Green Paper *Simplicity, Security and Choice* and the Tax Simplification Paper *Simplifying the taxation of pensions: increasing choice and flexibility for all* in December 2002, the ACA undertook a follow up survey of employers who responded to the August 2002 survey to ascertain reactions to the proposals.

Overall Views

Vast majority of employers say Green Paper proposals will not be effective in encouraging greater occupational pension provision

The vast majority of employers – 93 per cent – feel that the Green Paper proposals overall will be ineffective in encouraging greater occupational pension provision.



This must be of concern as extending occupational provision is a key aspect of what the Government is seeking to achieve by its proposals. The results suggest that following the consultation exercise, the Government will need to come forward with a much more ambitious set of proposals to engage employers in the promotion of occupational arrangements. This is particularly the case given the flight from occupational arrangements over the recent past.

| Will Green Paper proposals encourage more occupational pension provision? | |
|---|-----|
| Yes | 7% |
| No | 93% |

More worrying still, is that **27 per cent of employers say the Green Paper has itself prompted them to bring forward a review of their current pension arrangements**. Here, the proposed requirement for employee consultations ahead of scheme changes may already be having an impact.

Pension Tax simplification proposals will be helpful in easing administration, but not in encouraging greater occupational provision

Generally, the response to the more radical tax simplification measures proposed in the December paper has been much more positive than reactions to the Pensions Green Paper itself. This is reflected in the survey responses, with over two-thirds of employers saying the tax simplification proposals will ease administration. However, it is still not felt that these tax changes will be successful in encouraging greater occupational provision.

| Overall impact of Tax Simplification proposals | |
|--|-----|
| Will ease administration | 68% |
| Will not ease administration | 32% |
| Will encourage occupational provision | 15% |
| Will not encourage occupational provision | 85% |

Pension Tax reforms

The survey examined in greater detail a number of the key tax simplification proposals outlined in *Simplifying the taxation of pensions: increasing choice and flexibility for all*.

'A' Day: Employers favour 6 April 2005

The tax paper asks for views on what date should be chosen for 'A' Day – the date when the simplified tax regime is to be effective from. The Government is clearly keen on April 2004, but concerns have been expressed from a number of sources as to whether this can be achieved due to the likely legislative timetable and pressures upon insurance companies in terms of administration load.

Overall employers favour 6 April 2005 as the implementation date, but with a sizeable minority indicating 6 April 2004 as achievable.

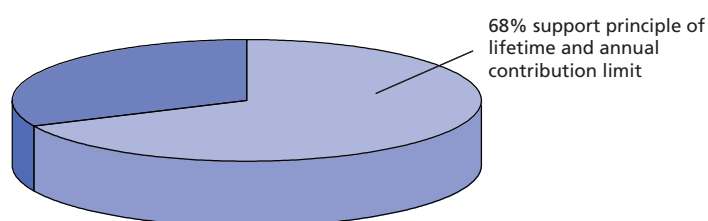
| Is 6 April 2004 achievable for 'A' Day? | |
|---|-----|
| Yes | 43% |
| No | 57% |
| Is 6 April 2005 preferred? | |
| Yes | 69% |
| No | 31% |

Support for limits, but employers favour £2m + lifetime limit and annual contribution limit for tax relief of at least £250,000

The innovative proposals in the Government's tax paper to sweep away technical restrictions on contributions in favour of a lifetime limit and annual limit have generally met with considerable support. However, on reflection, it is clear many employers believe the Government has under-estimated the number of individuals who will be affected by the limits. Therefore, whilst the principle of limits is widely agreed, the survey found a strong call for both higher lifetime and annual contribution limits.

Some 30 per cent of employers favour no annual limit, believing – presumably – that a lifetime limit alone would suffice.

Other respondents took the other view, saying that there should only be a limit on annual contributions as the lifetime limit might be breached inadvertently solely by a few good years of investment performance, an area quite beyond the control of the individual saver.



| Support for the £1.4m lifetime and £200,000 annual contribution limits | | |
|--|-------------|---------------|
| Support | | 7% |
| Do not Support | | 93% |
| | Mean | Median |
| Annual contribution limit should be | £310,000 | £250,000 |
| Lifetime limit should be | £2.25m | £2m |

Indexing of limits

A key issue for firms is the method of indexation of any limits, particularly if the Government holds to the limits proposed in the paper. If indexation were to be linked to prices alone, employers would be up in arms as, inevitably, over just a short period of time many more individuals would be caught by the limits (the earnings cap provides a precedent). The favoured index would be limits linked to average earnings, or some method that takes into account mortality improvements and / or annuity rate movements.

| Any lifetime and annual limits should be indexed to | |
|---|-----|
| Prices | 2% |
| Earnings | 87% |
| Annuity rate movements | 22% |
| Mortality improvements | 54% |

(More than one answer possible)

Lifetime limit will cause problems and scheme re-designs for many firms

Despite the general welcome given to the proposals, **55 per cent of firms say that the lifetime limit will cause problems in pension provision**, particularly in respect of remuneration for senior staff and executives.

Typical comments from respondents were:

- Uncapped executives already beyond £1.4m will want an alternative for future
- People will be promoted out of tax effective savings vehicles
- Difficulty in tracking value of retained benefits for senior staff
- All senior employees will need tax advice
- One large employer said they would need to revisit pensions of 10 per cent of staff
- Fundamental benefits review of middle earners upwards will be needed

As a result of these kinds of issues, **42 per cent of employers say that they anticipate the tax changes will lead onto scheme re-designs**. Typical comments from employers as to why re-design is likely are as follows:

- Will need to review senior executives packages and will hasten total move from defined benefit schemes
- Need to review Senior executive packages
- Proposals better fit defined contribution arrangements and hence will encourage trend away from defined benefit
- Complete change for senior staff
- Will review basis of scheme – presently defined benefit

Close to half the firms felt that they were likely to respond to the new limits by agreeing higher salary levels for those affected.

| What actions are employers likely to take for individuals affected by the tax relief limits? | |
|--|-----|
| None | 27% |
| Extra salary | 49% |
| Non-tax approved pension | 23% |
| Same pension (but with over limit subject to recovery charge) | 14% |

(More than 1 answer possible)

Some 28 per cent of employers added that they would expect the tax proposals to affect their ability to retain key staff.

In the shorter-term there is a concern that there will be an increase in those seeking to retire early. In the longer term, employers expressed worries that they would have to offer alternatives to pensions where further contributions were blocked off by limits.

Recruitment policies too would be affected if firms found that they were unable to offer usual pension benefits to key senior staff who have already reached the limits. A move to more cash based remuneration and share options seems inevitable, commented many employers.

Support for drawing pension whilst continuing working and later age for drawing pension

Employers express support for two other proposals in the tax simplification paper:

- **87 per cent of employers support the proposed reform, whereby employees will be able to draw a pension from a scheme and continue to work for the sponsoring employers.**
- **55 per cent support the later age (55 years old) from which pension benefits can be drawn**, this to be introduced in 2010. Only a third favour this being introduced over a longer phased time-scale.

Minority see savings in compliance costs through tax reforms

Perhaps surprisingly, **only 35 per cent of employers feel the tax simplification measures will reduce compliance costs.**

This minority says that savings, on average, of up to 10 per cent of administration costs could be achieved.

Pensions Green Paper reforms

Employers were asked a wide range of questions based on the main proposals in the Pensions Green Paper *Simplicity, Security and Choice*.

Compulsory membership and removal of Limited Price Indexation and Spouses benefits

The Green Paper says that the Government is minded to allow employers the option to make their schemes compulsory (subject to certain opt out rights), but they remain unconvinced that schemes should be given the option to remove Limited Price Indexation (LPI) for future service and spouses' benefits. These proposals featured in the Pickering report proposed in 2002. The latter two proposals might reduce scheme costs by up to 40 per cent.

Rather curiously, the Government has requested 'evidence' that the removal of LPI and spouses benefits will extend pension scheme coverage. Without offering employers the freedom to test what would happen, the only evidence available is from the period when

LPI and spouses' benefits were not required. As occupational scheme coverage was much higher then, this historic evidence seems to support the Pickering case.

However, the view of employers looking to the future is different. **Whilst a clear majority feel making schemes compulsory will help extend pension coverage, three-quarters say that the removal of LPI and spouses benefits will not.**

| Would occupational scheme coverage and contributions increase if | Yes | No |
|---|-----|-----|
| • employers are allowed to make their scheme compulsory? | 56% | 44% |
| • Limited Price Indexation (LPI) of accrued benefits is no longer required? | 26% | 74% |
| • the requirement to offer spouses benefits is removed? | 24% | 76% |

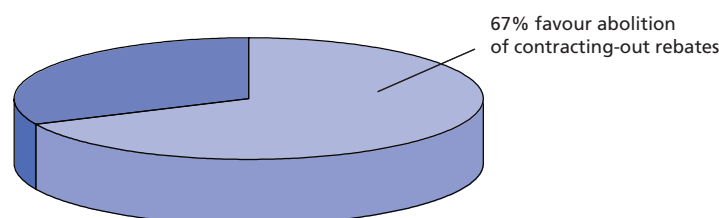
If the requirements to provide LPI and spouse's benefits were removed, **only 31 per cent of firms said they would consider removing these benefits from their schemes.**

It seems perverse in an environment where employers have been critical of the extra costs forced upon them by past Governments – Limited Price Indexation and spouses benefits (for contracted-out schemes) being cases in point, that they should seem so unenthusiastic to be given the option of significantly reducing forward scheme costs.

It has to be questioned, however, whether these results would be different if the employers responding to the survey were generally not already running a scheme offering LPI or spouses' benefits.

Contracting-out, Section 67 and Member Nominated Trustees

Contracting-out: the Government feels the proposals it has made in the Green Paper to simplify the structure of contracted-out benefits and to reduce complexity for both past and future service will greatly simplify administration and could reduce funding pressures. **Only 26 per cent of employers agree with the Government.** Indeed, **67 per cent of employers say that if contracting-out rebates are not improved, they would prefer to see contracting-out abolished.**



Section 67 reform: here the Government's proposals are more popular. **49 per cent of employers support the proposals allowing schemes to modify accrued rights without member consent** (with no individual change exceeding a percentage limit of 5 per cent and with compensation given equivalent to this amount).

Those looking for greater freedom to modify and rationalise schemes wanted the limit raised from the 5 per cent proposed to – on average – 15 per cent.

Member-nominated trustees: the government is proposing an end to the popular employer's 'opt out' to be replaced by less prescriptive rules but a requirement for all schemes to have at least one-third of trustees selected by members. If the employer's opt out is abolished (whereby many schemes do not have one-third MNTs), **76 per cent of employers feel they would not have difficulty in 'recruiting' the required number of member-nominated trustees.**

Those that did foresee difficulties, typically commented:

- Obligations on trustees are unreasonable
- Fragmented membership over many sites makes MNT election process very difficult
- Recruitment of trustees will get more difficult because of growing trusteeship obligations

Scheme Specific Funding Requirement

69 per cent of employers welcome the replacement of the Minimum Funding Requirement (MFR) by a Scheme Specific Funding Requirement, which the Government says will be more flexible and offer greater transparency to members. Only 6 per cent oppose the move, with 25 per cent saying 'don't know'. The 'don't know' category is unsurprising given the current lack of flesh around the bones of the Scheme Specific Funding Requirement.

Typical comments on the change were:

- Scheme specific requirement can take account of scheme's asset liability model
- More representative method of calculating accrued benefits and costs
- MFR outdated and not appropriate
- Better than MFR, but needs minimum solvency level based on accrued benefits without pension increases
- Value of employers covenant vary as do investment strategies
- Welcome flexibility but concerned at variety of approaches that will be adopted

Support for a more pro-active regulator

Opra has been criticised in some quarters as a 'tick box' regulator, largely due to the remit it has been given. **76 per cent of employers support the Government's proposal for a more pro-active regulator than Opra.**

This 'New Kind of Regulator' is likely to focus on protecting scheme members, particularly where there is a perceived high risk of fraud, bad governance or maladministration.

Consultation, scheme wind up and compensation scheme

Employee consultation prior to changes in pension arrangements: the Green Paper proposes making consultation with employees a requirement prior to changes in pension arrangements. **Employers are split down the middle on this proposal with 49 per cent supporting statutory consultations and 51 per cent against.**

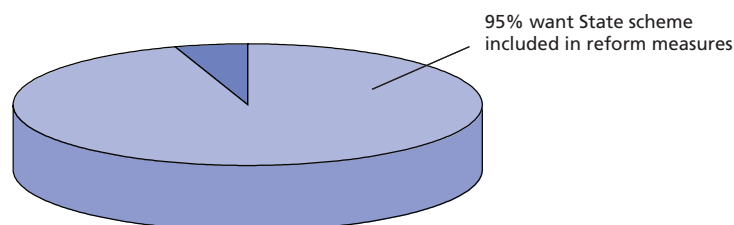
Fairer distribution of scheme assets on wind-up: Even though it might reduce pensioner benefits (and this was the major concern), **84 per cent of employers support a fairer distribution of scheme assets on wind up.**

Compensation scheme: 53 per cent of employers support a compensation scheme funded by all pension schemes to provide members with some extra security in the event that their employer is insolvent and the scheme is unable to meet accrued benefits.

Those opposed to such a scheme typically comment:

- Why pay for those that deliberately under-fund?
- Good schemes penalised
- Government should act as safety net
- Prefer compulsory insurance scheme
- A minimum solvency level based on accrued benefits without pension increases would be better
- Additional cost may reduce funding

State Pension, compulsory retirement and compulsion



State Pension reform: 95 per cent of employers do not believe the Government should exclude simplifying the State Pension Scheme from its pension reform measures.

The State Pension structure, albeit reformed recently with the introduction of the State second pension (S2P), the minimum income guarantee and pension credit remains a mess upon which to build a private pension on top. The State scheme remains highly complex, riddled with means testing and it is in need of massive simplification if it is to be understood by a wider public.

State Pension Age: 71 per cent of employers agree with the Government's decision not to raise the State Pension Age on the grounds that this will hurt those most dependent on it.

Compulsory retirement age: there is a 50:50 split amongst employers as to whether they foresee problems if the Government decrees that compulsory retirement ages are unlawful.

Those respondents foreseeing problems, typically comment:

- Bottleneck on younger employment
- Coupled with employment laws, an unnecessary burden
- Will reduce ability to manage the business
- Will cause retirement chaos
- Many will hang on for redundancy
- Extra complexity with death benefits
- Will lead to more discrimination against older workers
- Stifle succession and enterprise

Pensions Commission: the Government has set up a Pensions Commission to report to them on how voluntary pension savings is developing (and hence any need for greater compulsion). **91 per cent of employers say that within a few years, the Commission will recommend greater compulsion.**

AVCs

As members will be able to be, simultaneously, a member of a personal pension and an occupational scheme **66 per cent of employers say there should no longer be a requirement for an occupational scheme to offer an AVC option.**

Most important measures needed to encourage more private occupational pension provision

Employers say the reforms that are needed to encourage more private occupational pension provision are in priority order:

| What is needed to encourage more private occupational pension provision | |
|---|---|
| 1 | Greater tax incentives for individuals |
| 2 | Encouragement / incentives to employers offering company pensions |
| 3 | More compulsion |
| 4 | Less government interference / more simplification |
| 5 | Earlier education |
| 6 | Compulsory membership |

Other important measures sought by employers responding to the survey are:

- Simplification of State schemes
- Simplified pension tax measures
- Reform that does not disengage boardroom from interest in employees' pensions
- Consistent political backcloth for pensions
- Better tax treatment for pensions than other savings
- Beef up contracting out rebates
- Abolish contracting out
- Improve Government pensions safety net

Future reforms?

If pension reforms fail to check the decline or extend voluntary private provision, employers were given a number of options to consider as to how the Government should respond.

Views expressed were as follows:

- **55 per cent of employers would support, over a number of years, higher State pension contributions and pensions to set a higher base above which private pensions are built,**
- **76 per cent would support the introduction, over a number of years, of minimum compulsory private pension contributions (say 4 per cent) over and above existing NI contributions from employees and the self employed,**
- **66 per cent would support the introduction, over a number of years, of minimum employer contributions (say 5 per cent of earnings) into employer sponsored schemes covering all employees**

The danger in the Government setting either minimum employee or employer contributions is that these minimums can easily become the maximums, with both employers and employees moving towards these levels.

It is likely that minimum contributions set by Government could over the longer-term, at best, increase the numbers receiving some small private pension above their State pension, whilst, at worst, lowering general private pensions for a large grouping of employees at all income levels.

Appendix: Pickering Review

The Pickering proposals put to the Government in 2002 advocated a raft of pension reforms that were designed to encourage more employers to retain or offer occupational arrangements into the future. In the ACA survey conducted over the Summer of 2002 we asked respondents to comment on the proposals. The feedback received has now been superseded by feedback on the Green Paper and Tax Simplification Paper published in December 2002, but we include the results of the Summer 2002 survey in this appendix as they underscore the reforms employers and schemes are looking for in the final Government proposals to be published later in 2003.

When asked to rank in order of importance those Pickering proposals that were most important, employers identified the order of importance as below.

The most popular measure would demand a major shift in government policy away from prescription and in favour of a broader brush approach to legislation and regulation.

Whilst recent governments have paid lip-service to this philosophy, the track-record of pension legislation and regulation over recent years shows that the change in mind-set required has not occurred as yet (although the tax simplification proposals do represent – at this stage – a welcome advance).

It is interesting that the protection of benefits of individuals nearing retirement has come out second in the employers' list of Pickering priorities. This reflects current concerns where some active members of schemes – especially those close to retirement - are experiencing sizeable reductions in anticipated benefits on retirement, due to deficits on wind up.

| Companies' 'Top Ten' Pickering proposals | |
|--|--|
| 1 | Statutory requirements should focus on the objective to be achieved rather than the process needed to achieve it |
| 2 | Move to the priority order due to come into effect in 2007, including a separate category to protect the benefits of individuals nearing retirement |
| 3 | A new consolidated Pensions Act (consolidating or repealing all existing DWP private pension legislation) should be passed |
| 4 | Allow schemes to transfer small amounts of accrued pensions into a 'safe harbour' product, where the member does not object or make a transfer within, say, 6 months |
| 5 | Allow liabilities on wind-up to be discharged to a stakeholder or money purchase vehicle provided the member does not object |
| 6 | Option to convert accrued Guaranteed Minimum Pensions (GMPs) to the new accrual rate test (1/100th of all earnings between the Lower Earnings Level (LEL) and the Upper Earnings Level (UEL)) or to Protected Rights |
| 7 | Remove the restriction on the date at which contracted-out rights are payable |
| 8 | Replacement of the certification / consent requirements of s67 to allow for scheme modifications where the overall replacement of benefits are expected (but not guaranteed) to be of equal value |
| 9 | A New Kind of Regulator (replacing Opra) should be established that gives advice to professionals and government as well as regulating the sector |
| 10 | Information for new or prospective members of occupational pension schemes should be very basic – setting out a few key features |

On the other hand, the five most unpopular Pickering proposals were as follows.

| Companies' least favoured Pickering proposals | |
|---|--|
| 1 | No requirement to provide survivors' benefits as a precondition for contracting out |
| 2 | Give priority to indexation of pensions in payment at the point a scheme goes into wind-up over increases to deferred members when they reach pension age |
| 3 | No requirement in the future for Limited Price Indexation (LPI) increases of pensions in payment |
| 4 | Minimum standard for contracting-out: accrual rate to be 1/100th of all earnings rather than 1/80th of earnings between the Lower and Upper Earnings Limit |
| 5 | No requirement to provide Limited Price Indexation (LPI) as a precondition for contracting out |

In all cases, more employers opposed these recommendations than supported them. These elements of the Pickering package generally were seen as the most contentious when the proposals were first published, but certain of them offer the opportunity to reduce markedly the costs of running a defined benefit type scheme into the future.

Given that certain of these proposals on, for example, Limited Price Indexation (LPI) and spouses benefits were seeking only to give schemes the option to change for the future, it is perhaps surprising that a majority of employers were opposed to such flexibility.

Overall, employers said that if the Pickering proposals were implemented:

- **22 per cent of employers offering salary related schemes would be encouraged to retain their existing scheme**, although 74 per cent said implementation would make 'no difference'.
- **Only 4 per cent said implementation of the Pickering proposals would cause them to extend occupational scheme coverage** to more employees.
- **22 per cent of employers would consider making membership of their scheme compulsory**, although 52 per cent say they would not take this course.
- **28 per cent would replace guaranteed pension increases with, in the majority of cases, discretionary increases**, although 43 per cent would not take this course.
- **Only 10 per cent of schemes said they would take advantage of the Pickering proposal to remove spouses' pensions**, whilst 65 per cent would not.

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