



OCCUPATIONAL PENSIONS: A DIVIDED NATION

A report on the fourth major survey of UK occupational pension scheme trends in smaller firms including the results of a follow-up survey on issues raised by the 2004 Pensions Bill

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**Association of
Consulting Actuaries**

No.1 Wardrobe Place
London EC4V 5AG

Tel: 020 7248 3163

Fax: 020 7236 1889

E-Mail: acaahelp@aca.org.uk

Web Site: www.aca.org.uk

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2004 SMALLER FIRMS PENSIONS SURVEY: A DIVIDED NATION

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2004 SMALLER FIRMS PENSIONS SURVEY: A DIVIDED NATION

Chairman's Introduction

This is the fourth survey we have conducted looking at the changing face of pensions in smaller firms. This year, we have also sought views from firms in the sector on the Government's latest set of pension reforms that are currently working their way through Parliament. A number of themes strike me from this year's results.

First, the very high level of scheme reviews underscores how rapidly the pension scene could change in just a few years. The widespread closure of defined benefit arrangements to new entrants has been well reported, but there are signs in our survey that pressures to reduce costs may also be leading to reviews of defined contribution arrangements. The 'bad press' given to pensions, particularly in firms where pensions are not strongly supported, has been unhelpful in encouraging either firms or employees to take the next step in pensions.

Second, whilst the number of small (and large) firms offering defined benefit has reduced markedly, those continuing to run such schemes have increased contributions significantly to close the deficits that have emerged in the last three years or so. Many are also persuading members to increase their contributions. The worrying trend is that similar increases in contributions are not going into defined contribution schemes, where the need is just as great to cope with reduced investment returns and increased annuity costs, both of which may persist into the future.

Third, whilst there is considerable support for the concept of the Pension Protection Fund (PPF), I sense firms feel the all round effect of the *Pensions Bill* will be to add to firms' costs (not reduce them). Whilst there is a genuine desire to better protect pensions through the PPF, our respondents seem to have few illusions that the extra regulation involved will deter wider coverage, rather than encourage wider provision (the Government's view).

Only time will tell who is right in this debate, but the verdict may well shape the early reports of the new Pensions Commissioner.

Overall, the picture we see is of a 'divided nation' in pensions, with those fortunate enough to be covered by defined benefit schemes – an increasing number of public sector workers and those private sector firms able and willing to bear the costs and liabilities – enjoying greater certainty over their pension future. Set against this, is a growing number of employees of all ages taking on greater investment risk, supported by generally low levels of contributions. Worse still, we then have, through the absence (and decline) of occupational provision, a further large grouping of our citizens becoming dependent on State guarantees that deter savings but which, over the longer-term, are probably unreliable or unsustainable.

Finally, I thank all of those firms who have responded to the survey and who have given so generously of their time.

Gordon Pollock
Chairman
May 2004



Gordon Pollock

“Whilst there is a genuine desire to better protect pensions through the PPF, our respondents seem to have few illusions that the extra regulation involved will deter wider coverage, rather than encourage wider provision (the Government's view)”

Smaller Firms Pension Survey

The survey is the fourth *Smaller Firms Pensions Survey*, following those conducted in 1996, 1998 and 2001. It attracted 459 responses from firms employing 250 staff or less to a questionnaire issued in September 2003. This sector produces over half of UK business turnover and firms in this sector run the vast majority of open occupational pension schemes. A follow-up survey was conducted in March 2004 to gauge views on proposals in the *2004 Pensions Bill*. The picture gleaned from the survey is one of a divided nation in pensions, with a very wide range apparent in likely emerging pensions due to differences in scheme structure, levels of contributions and ownership of risk.

Executive Summary: key findings

The key findings of the survey are as follows:

- Group Personal Pensions (GPPs) – attracting average combined employer and employee pension contributions of 8.6 per cent – are now the prevalent type of pension arrangement in these smaller firms. 44 per cent of firms offer such arrangements, with a quarter of firms only offering a GPP.
- The survey found a very high level of scheme reviews. Within a period of 2 years, over 9 out of 10 firms will have reviewed their pension arrangements, the most marked trends being the closure of defined benefit schemes to new entrants or one or more schemes being placed in wind up. Many occupational defined contribution schemes are also subject to review.
- There is considerable interest, particularly from firms not offering pension schemes (42 per cent), in multi-employer schemes.
- Many firms have also established stakeholder schemes (37 per cent) either alongside other arrangements or as stand alone schemes, 44 per cent of which are attracting no employer contribution. Where contributions are made, average combined employer and employee contributions are just 4.8 per cent of earnings into these schemes.
- There is evidence from the survey that a few firms are marginally increasing employer contributions into defined contribution arrangements, usually by 1 per cent or less, but few employees are increasing contributions (indeed some are reducing them).
- Where defined benefit schemes are offered in smaller firms (29 per cent), only 36 per cent are now open to new members. Combined employer and employee contributions into defined benefit schemes now average 21 per cent of earnings, up by 2.1 per cent on a year ago.
- The ‘contribution gap’ – the difference between the combined employer and employee contributions into defined benefit and defined contribution schemes – has grown over the last 3 years since our last survey of the sector in 2001.
- Employer contributions into defined benefit schemes average close to three times those made by firms into defined contribution and GPP schemes and six times those into Stakeholder schemes.
- Three-quarters of defined benefit schemes have been recommended by their actuary to increase their contributions because the scheme is in deficit and over one-third have increased employee contributions, mostly by around 1 per cent of earnings. Around 1 in 10 schemes have changed their accrual rate, with a move from 60ths to 80ths being the most common change.
- Only just over a third of defined benefit schemes have changed their overall asset allocation in the

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last 2 years and fewer have changed their investment manager(s).

- Only just over a half of defined contribution schemes offer fixed interest bonds or index linked bonds as an investment choice and around 20 per cent offer no default investment option for either employer or employee contributions.
- Firms say the bad press given to pensions over the last 2 years, largely due to the effects of falling investment returns and demographic changes, has undermined the promotion of pension saving, and has undermined the perceived value of schemes or setting up a scheme.
- This bad press has largely left interest in pensions at a low level (14 per cent) in firms not offering a scheme, as against the situation in firms offering a pension scheme, where 60 per cent report greater interest.

Answering questions about the Government pension reform proposals that appear in the new *Pensions Bill* or other consultations:

- Following the publication of the *Pensions Bill* a majority of firms feel its measures will decrease occupational pension scheme coverage. Fewer than 1 in 10 firms feel the measures will improve coverage.
- Close to 9 out of 10 firms say the Bill's measures will either add to costs (49 per cent) or make no difference to costs (38 per cent) as against the Government's claims that there will be £130 million savings.
- Support for the Pension Protection Fund has grown to 8 out of 10 firms. However, 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 over £10 per head is too much.

- Firms broadly support the introduction of a flat-rate based levy in year one, with the levy ultimately being at least 50 per cent based on risk factors. Although a clear majority, fewer firms are happy that the risk factors should include the credit rating of the sponsoring firm or the scheme's investment strategy.
- Three-quarters of firms believe 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'.
- Firms are evenly divided on whether the PPF, by scaling down the initial benefits, should on introduction retrospectively cover those who have 'lost' most or all of their defined benefit pension in recent years.
- Over three-quarters of firms say the new 'knowledge and understanding' requirement placed on trustees will deter individuals from wishing to be trustees.
- 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.
- Over 8 out of 10 firms want the Government to specify a default retirement age when the EU Employment Directive comes into force in October 2006. This will make it illegal for firms to set a specific retirement age.

**Section 1
The Smaller Firms Sector**

Smaller firms - their importance

The smaller firms sector - firms employing 250 or fewer staff - is the largest part of the UK economy. It employs over half of the working population and generates over half of the UK's business turnover - some £2,200 billion per year (latest DTI figures: August 2003).

These smaller firms make up over 99% of UK enterprises - there are only 7,000 businesses including public corporations and nationalised bodies (but excluding Government) that employ over 250 staff.

The importance of pension trends in the smaller firms sector is therefore clear in terms of the coverage of employees and the potential of some of these firms to be the larger firms of the future.

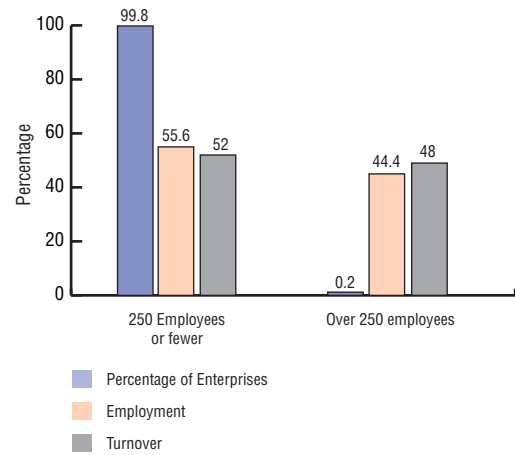
Firms responding to the Survey

This is the fourth *Smaller Firms Pensions Survey*, following up those conducted in 1996, 1998 and 2001. The survey attracted 459 responses from firms to a questionnaire issued in September 2003. The survey covers firms employing 250 people or fewer.

Of those responding to the survey:

- Just over a third employ 50 people or fewer. Those firms offering no workplace based pension scheme tend, on average, to be smaller businesses (see Table 1.1).
- The firms covered by the survey are active across a wide range of sectors, with the largest groupings being manufacturing, engineering, retail, hi-tech and business services (see Table 1.2).

Share of businesses, employment and turnover by size of business



(Source: DTI Small and Medium-sizes Enterprise Statistics, 2002)

“The smaller firms sector - firms employing 250 or fewer staff - is the largest part of the UK economy”

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Table 1.1. Size of firms covered by survey

ALL FIRMS		Breakdown of workforce	
	Total	Permanent	Temp/Contract
Under 50 employees	37%	92%	8%
51-150	34%	89%	11%
151-250	29%	88%	12%

FIRMS WITH PENSION SCHEMES		Breakdown of workforce	
	Total	Permanent	Temp/Contract
Under 50 employees	35%	91%	9%
51-150	33%	89%	11%
151-250	32%	88%	12%

FIRMS WITH NO PENSION SCHEMES		Breakdown of workforce	
	Total	Permanent	Temp/Contract
Under 50 employees	43%	94%	6%
51-150	36%	91%	9%
151-250	21%	88%	12%

Table 1.2 Business sectors of firms responding to the survey

SECTOR		SECTOR	
Business Services	7%	Manufacturing	16%
Consumer Products	6%	Print / Publishing	2%
Food and Drink	4%	Construction	4%
Logistics / Transport	5%	Financial Services	4%
Pharmaceuticals	3%	Leisure	3%
Chemicals	4%	Oil / Mining	2%
Engineering	11%	Retail	8%
High Tech	7%	Other	14%

Section 2 Background to the Survey

The survey was conducted in the run up to the publication of the *2004 Pensions Bill*, in a period following a number of consultation documents published by the Government. These consultation papers followed from the pioneering work of Alan Pickering, who had been commissioned by the Government to come forward with simplification measures that, it was hoped, on implementation would help extend pension scheme coverage.

In the event, the steep fall in equity markets has led on to scheme deficits being reported in many schemes, followed by a number of employer insolvencies and instances where anticipated pensions have been 'lost', notably by those nearing retirement. This has re-focused the Government's agenda towards a package where 'protection' of defined benefit pensions has gained a greater imperative over simplification measures.

It is against this back-cloth that the survey was conducted and this is why a considerable part of the questionnaire (and a follow-up questionnaire produced after the publication of the *Pensions Bill*) concentrated on the proposed reform measures and how firms and schemes react to them.

The back-cloth to the survey is also one where there are a number of worrying trends apparent in this and other recent studies:

- The *General Household Survey 2002* continues to show that fewer employers are offering occupational pension schemes than in the past, with the absence of provision particularly concentrated in smaller firms.
- Despite the government's championing of Stakeholder pensions to promote provision where it has been weak hitherto (including in smaller firms), the Department for Work and Pensions' *Employers' Pension Provision Survey*

2003 shows three-quarters of the Stakeholder schemes that have been established have no active members.

- Whilst the *Employers' Pension Provision Survey 2003* does report some expansion in the number of smaller firms offering money purchase schemes, it also reports a sharp drop in the number of larger firms offering salary-related schemes and in the number of open salary-related schemes. This is echoed by the recent 2004 CBI / Mercer survey.
- The latest *Government Actuary's 2000 Survey* reports a sharp drop in the number of occupational schemes since 1995. Its findings are that the majority of defined benefit schemes - mostly smaller schemes - are closed, frozen or subject to winding up (see Table 2.1).
- The same *Government Actuary's 2000 Survey* found that since 1995 the number of active members of private occupational schemes has declined by half a million to a figure (5.7 million members) not seen since the early 1960s. However, the number of active members of public sector schemes (4.5 million) has risen by 400,000 over the period to the highest level since 1987, largely due to the increase in employment in the NHS and teaching.

This latest survey of pension trends in smaller firms follows on from the study of trends in larger firms *Pensions Reform: too little, too late?* conducted by the ACA in 2002 / 2003. These studies underscore the rapid closure of defined benefit schemes across firms of all sizes and their general replacement by lower-cost arrangements offering the likelihood of much lower emerging pensions in years to come.

Weak pension coverage in smaller firms

The *General Household Survey 2002* underscores that occupational scheme membership is at its weakest in firms employing fewer than 100 people

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Table 2.1 Scheme status: defined benefit schemes (uk private sector)

Size band (total members)	Scheme status:				
	Open	Closed	Frozen	Winding up	Total
Defined benefit					
1,000 +	946	131	54	0	1,131
	(83%)	(12%)	(5%)		
100 - 999	3,030	663	156	296	4,145
	(73%)	(16%)	(4%)	(7%)	
12 - 99	2,460	2,080	579	1,500	6,619
	(37%)	(31%)	(9%)	(23%)	
2 - 11	11,500	8,330	4,820	2,740	27,390
	(42%)	(30%)	(18%)	(10%)	
Total	17,936	11,204	5,609	4,536	39,285
	(46%)	(28%)	(14%)	(12%)	

(Source: 2000 Government Actuary's Survey)

to not much over 30 per cent. For example, only 52% of full-time men (and 60% of women) working in establishments employing 25 - 99 people are members of occupational schemes, with levels of coverage dropping well below this in firms employing fewer people.

Many employees in this smaller firms sector fail to take up membership of schemes available, including the new Stakeholder schemes. Upwards of a third of all employees in these smaller firms have no private sector pension scheme at all.

The high number of closed schemes in the smaller firms sector also explains the degree of under-provision. The most recent statistics (2000) reveal only a minority of defined benefit schemes with fewer than 100 members are open (see Table 2.1 above). This position is likely to have deteriorated some way since 2000, with the rise in scheme deficits.

What is perhaps more surprising, is that only 57 per cent of the 98,000 occupational defined contribution schemes with fewer than 100 members remain open, with some 13,000 of these either frozen or winding up.

“These studies underscore the rapid closure of defined benefit schemes across firms of all sizes and their general replacement by lower-cost arrangements offering the likelihood of much lower emerging pensions in years to come”



A famous TV sketch re-visited, what our characters might say today....

Cleese: "I look down on them (Barker and Corbett) because I have a public sector index-linked pension related to my salary and service".

Barker: "I look up to him (Cleese) because he's got a pension paid by tomorrow's taxpayers come what may, whilst my private sector employer struggles to meet the increasing cost of providing a funded pension. But I look down on him (Corbett) because my pension is much better than his".

Corbett: "I look up to him (Cleese) because he's got what I'll never 'ave. I look up to him (Barker) less 'cos his pension is a bit like mine – it could go down if shares and other things fall – but it's still better than my 'stake-burger' plan".

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Section 3 Firms operating pension arrangements

Pension arrangements run by firms

The survey found the predominant type of pension arrangement now offered by smaller firms is a Group Personal Pension.

Over the last 2 years, many firms have also introduced Stakeholder arrangements to help fill gaps in provision or as stand-alone arrangements. Most Stakeholder schemes, however, still have very few members.

There are fewer firms running trust-based defined contribution schemes than we have found in previous surveys of this sector and only 36% of defined benefit arrangements are now open to new entrants.

17% of smaller firms responding to the survey either run no pension arrangement or only offer a Stakeholder scheme with no employer contributions.

Why do firms provide employees with a pension arrangement?

The principal reason for firms offering pension arrangements is one of social responsibility to make sure employees have adequate pensions. Competition to recruit skilled staff (as a reason) comes in third. A majority of firms where the principal open arrangement is a defined benefit scheme place the second ranked answer as their first choice.

Of those firms operating schemes, the most common arrangements or combination of arrangements is as follows:

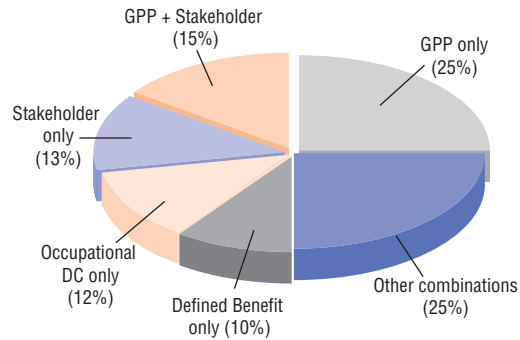


Table 3.2 Why pension schemes are provided

In ranked order
1. We consider it is our responsibility as a good employer to make adequate arrangements for our employees retirement
2. The scheme helps us build our image as a caring employer, motivating and encouraging loyalty from employees
3. The scheme helps the firm to compete in the labour market for skilled staff
4. The scheme enables us to retire employees on reasonable pensions in an orderly way to suit our business
5. The scheme has been in existence for many years and could not easily be discontinued
6. We were required to introduce a scheme under the Stakeholder rules

Table 3.1 Types of pension arrangements provided by respondents

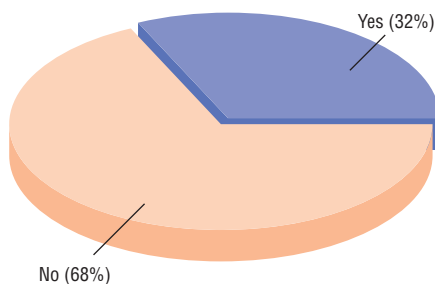
Type of pension arrangement	Yes	Open to new entrants
Defined benefit scheme	29%	36%
Occupational defined contribution scheme	24%	92%
Mixed defined benefit / defined contribution	1%	NA
Group personal pension scheme	44%	100%
Stakeholder scheme	37%	100%
Industry-wide scheme	2%	100%
Small self administered scheme	6%	100%
No scheme / no contribution to stakeholder	17%	

Pension budgets

Only a third of firms say they have a target of what they want to spend each year on pensions. Those that do, on average, set a quite low target of 7% of payroll, with many setting an even lower figure.

Given these tight budgets, it is easy to see why defined contribution schemes have become increasingly popular in the sector. Defined contribution schemes offer firms the means to meet targets of this nature by allowing them to contribute at levels that suit their budgets. This is in contrast to defined benefit schemes where, as we have seen, extra funds may be needed from time to time to reflect greater longevity, lower investment returns and increased benefit promises (often stipulated by government).

Do you set a target for pension costs?



If 'yes' average percentage of payroll is 7% (breakdown below)

Table 3.3 Cost target for pensions

Target Pension Costs (as a percentage of payroll)	Percentage of Firms
5% or under	44%
+5% - 10%	40%
+10% - 15%	11%
+15% - 20%	4%
+20%	1%

Confirming the results found elsewhere in the survey about high levels of scheme reviews, the survey found **17% of firms are trying to reduce current spending on pensions, whilst 24% are trying to reduce the cost of providing pensions that will be earned by employees in the future.**

High level of pension scheme reviews

A sizeable number of these smaller firms have reviewed their pension arrangements over the last year, and reviews are ongoing at a high level this year and into next year.

While this would be expected at a time when defined benefit schemes are often being closed to new members (and new accruals) and are being replaced by other arrangements, it seems a much wider review is in progress than this in smaller firms.

An analysis of the responses shows that this year many defined contribution arrangements are under review, with this moving onto Group Personal Pensions (GPPs) next year. Whilst reviews do not per se mean changes in scheme structure, it will be interesting to see over the period ahead whether some more fundamental reappraisal of firms' commitments to private second-tier provision is underway. Whilst the reviews may just reflect a desire to hold pension costs down to a minimum (both in terms of contributions and administration costs), there is a danger that the 'bad press' pensions have received over the last few years might cause more employers, particularly smaller firms, to abandon occupational provision on the basis that they think it has simply become too irksome.

“A sizeable number of these smaller firms have reviewed their pension arrangements over the last year, and reviews are ongoing at a high level this year and into next year”

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When was your scheme reviewed:

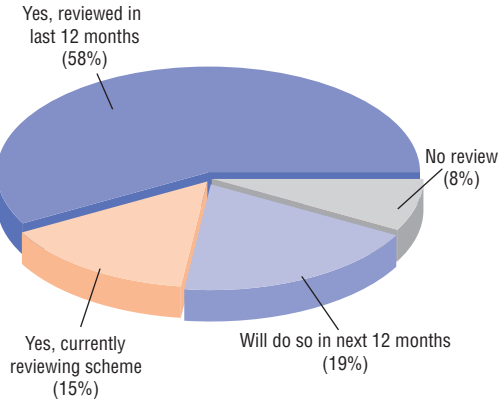
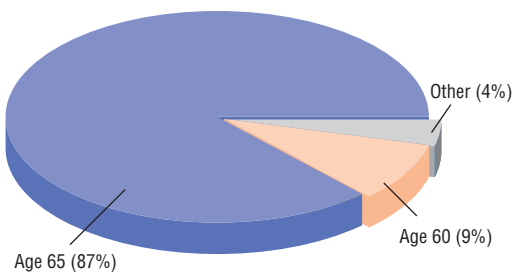


Table 3.4 Analysis of schemes currently or about to be reviewed

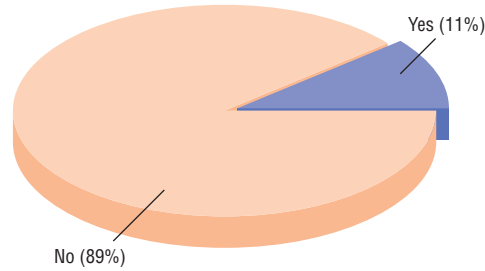
Principal scheme	Currently under review	To review next year
Defined benefit	12%	14%
Occupational DC	48%	18%
GPP	20%	49%
Stakeholder	20%	18%
Industry-Wide	-	1%

Schemes' normal retirement ages

The vast majority of schemes covered by the survey operate a normal retirement age of 65. Whereas in the past there had been pressure from members to lower the retirement age, more recently the trend has reversed with a number of schemes presently offering a lower retirement age now considering moving to age 65.



Have you or are you considering changing retirement age?



Scheme changes in the last 5 years

A further analysis of the changes taking place over the last 5 years found the two most common changes were the closure of defined benefit schemes to new entrants and firms placing one or more schemes into winding up.

Other changes are as would be expected - more employees being moved into defined contribution schemes, more firms operating flexible benefit arrangements and more members moving into contracted-in pension arrangements.

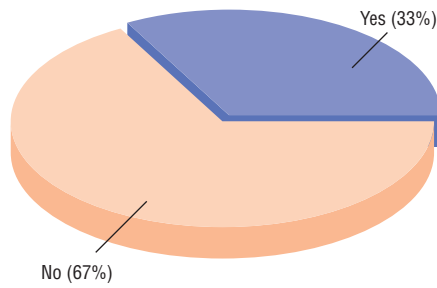
Table 3.5. Pension changes over last 5 years

	Percentage of Firms
Closed defined benefit scheme to new entrants	23%
Placed one or more schemes in wind up	11%
Moved more / all employees into defined contribution scheme(s)	8%
Contracted some / all members back into the State Second Pension	7%
Closed defined benefit scheme to future accruals	6%
Moved to more flexible benefits package with wider benefits option	5%
Set up a mixed defined benefit / defined contribution scheme	4%
Set up a career average scheme	2%
Reduced percentage of employees covered by firm's scheme(s)	2%
Introduced access to group benefits largely paid for by employees	2%

Interest shown in multi-employer schemes

Recent initiatives to encourage the development of more multi-employer schemes, offering it is hoped lower administration costs and wider investment opportunities are supported by one-third of firms (and a higher number where there is no employer sponsored scheme at present, see page 19).

Would your firm be interested in joining a multi-employer scheme?



Trends in pension contributions

Provided pension contributions into final salary and money purchase arrangements are broadly the same, there should be no great difference in the average pension outcome. However, the surveys we have conducted since 1996 have shown a significant and growing 'contribution gap' between defined benefit and defined contribution in the sector.

There continues to be a very wide range in pension contributions paid into schemes, particularly by employers. Over the last year this has widened, with average employer contributions into defined benefit schemes increasing by 1.7 per cent in terms of the percentage of individual earnings - this equates to a 12 per cent increase in average employer contributions. For many defined benefit schemes, the increases have been much higher.

Whilst there have been some small increases in employer contributions into defined contribution

arrangements over the last year, the general picture has not changed from previous surveys.

Today, firms running defined benefit arrangements - whether they are open or closed - are paying well over twice, as much into these schemes in order to secure the pension members expect.

Contributions into Group Personal Pension arrangements, that are increasingly displacing trust based defined contribution schemes, are generally lower in terms of both employer and employee contributions. The range of contributions across firms is also narrower.

The rapid rise in the number of Stakeholder pension arrangements offers a very mixed pattern in terms of contributions. Close to half of the schemes (44 per cent) receive no employer contribution whatsoever, although this is a better situation than is reported by other recent surveys. This has to be worrying in terms of what an employee contribution alone can generate in terms of a meaningful pension, particularly for the lower paid (given the State benefits currently offered). Where Stakeholders have been introduced as the sole arrangement (or are supplementing / replacing existing arrangements), some firms are contributing at higher levels, often 5 - 6 per cent of individual earnings.

The vast majority of defined contribution schemes run by firms are contracted-in to the State Second Pension, and hence members will benefit from a higher State Pension than the majority of members of defined benefit schemes, where three-quarters are contracted-out of the State Second Pension. However, the higher NI contribution paid by firms (and members) to secure this higher State pension only redresses to a small extent the wide imbalance in scheme contributions (and emerging benefits) between defined benefit and defined contribution schemes.

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A marked trend evident this year is the rise in employee contributions in over a third of the defined benefit arrangements (see page 21). Again, there is a much lower change in employee contributions into defined contribution schemes, where increased contributions are just as essential to counter the possibility of generally lower investment returns in future. Indeed, in some defined contribution schemes there is evidence that disillusionment with pension saving has caused a reduction in contributions.

Growth in 'contribution gap'

This year's survey found combined employer and employee contributions into defined benefit schemes, as a percentage of earnings, are now 11 - 12 per cent higher than those into either occupational defined contribution schemes or GPPs. This is a near doubling in the size of the 'contribution gap' since our 2001 survey, when the gap stood at between 5 - 7 per cent.

To some degree the gap is closed by the higher State Pension going to the majority of contracted-in defined contribution members. Additionally, defined benefit contributions often include the cost of life, ill-health and administration costs. These narrow the gap in contributions, but only to a limited degree.

"There has been a near doubling in the size of the 'contribution gap' since our 2001 survey"

Table 3.6 Average level of firms' contributions currently paid into their pension schemes

(As a percentage of an individual's total earnings. Some schemes ignore around the first £4,000 of salary, some only pay on basic salary. Figures adjusted accordingly.)

	Average Employer's contribution		
	Current year	Last year	Longer-term*
Defined benefit scheme	15.5%	13.8%	14.0%
Occupational DC scheme	5.8%	5.7%	N/a
Stakeholder scheme +	5.2%	5.0%	N/a
Stakeholder scheme	2.4%	2.2%	N/a

*ie when any surplus / deficit has gone + average excluding schemes with 'nil' contributions

Table 3.7 Average level of employee contributions

	Average Employee contribution		
	Current year	Last year	Longer-term
Defined benefit scheme	5.5%	5.1%	5.5%
Occupational DC scheme	4.1%	4.1%	N/a
Stakeholder scheme +	3.4%	3.3%	N/a
Stakeholder scheme	2.4%	2.4%	N/a

Table 3.8 Average combined employer and employee contributions

	Average Combined Employer & Employee contributions		
	Current year	Last year	Longer-term
Defined benefit scheme	21.0%	18.9%	19.5%
Occupational DC scheme	9.9%	9.8%	N/a
Stakeholder scheme +	8.6%	8.3%	N/a
Stakeholder scheme	4.8%	4.6%	N/a

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The 'contribution gap' is widening between defined benefit and defined contribution schemes

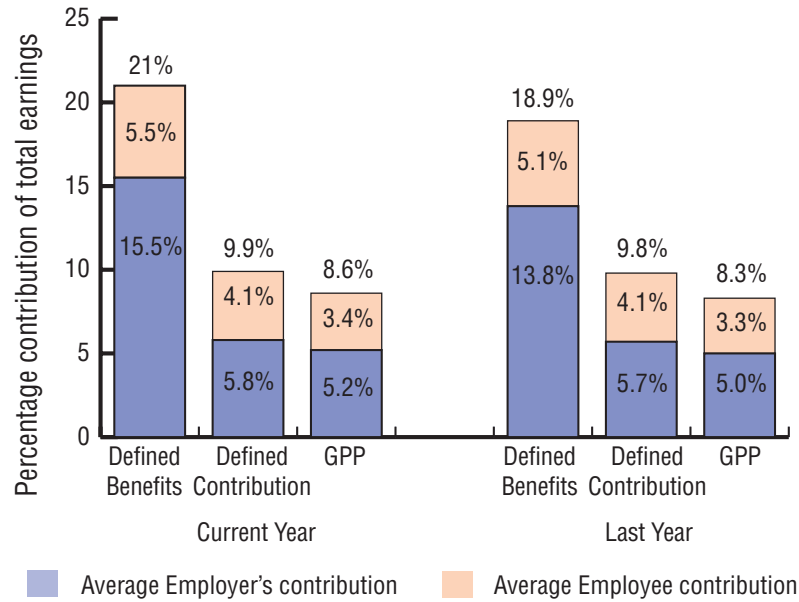


Table 3.9 Firms with pension schemes: current range of employer contributions

Contribution as % of earnings	Percentage			
	Defined Benefit	Occupational Defined Contribution	GPP	Stakeholder
0%	1%	2%	3%	44%
Up to 3%	2%	2%	19%	28%
Over 3 - 6%	9%	52%	49%	23%
Over 6 - 9%	7%	20%	23%	3%
Over 9 - 12%	22%	17%	6%	2%
Over 12 - 15%	13%	4%	-	-
Over 15 - 18%	18%	2%	-	-
Over 18%	28%	1%	-	-

Table 3.10 Firms with pension schemes: current range of employee contributions

Contribution as % of earnings	Percentage			
	Defined Benefit	Occupational Defined Contribution	GPP	Stakeholder
0%	7%	10%	3%	18%
Up to 2%	2%	4%	9%	30%
Over 2 - 4%	13%	38%	49%	30%
Over 4 - 6%	50%	40%	33%	16%
Over 6 - 8%	21%	4%	5%	6%
Over 8%	7%	4%	1%	-

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Issues influencing thinking on pensions in the longer term

Looking to the longer-term, firms see the 'performance of investment markets' as their principal concern, influencing how they will approach pensions into the future.

Following this is 'the impact of legislation on benefits and funding costs'. Whilst there was some optimism post-Pickering that legislation would ease burdens, there has been growing alarm since the Government's 11 June 2003 announcement that the ultimate impact of the 2004 Pensions Bill might mean additional costs (through reforms like the Pension Protection Fund) that outweigh the savings made from the simplification measures thus far announced.

Looking further down the list, there are clearly concerns that the absence of success to date in re-invigorating occupational pensions may at some time lead onto a further raft of pensions reform, with greater compulsion as a possible proposal.

A factor that may be influencing the offer of particular types of pensions to employees is the perceived 'low' need to improve pension arrangements to compete for staff.

Table 3.11 Issues influencing longer-term pension thinking

In ranked order
1. Performance of investment markets
2. The impact of legislation on benefits and funding costs
3. Further pension reforms introducing, for example, compulsory employer contributions
4. Increasing burden on management time due to greater scheme complexity
5. Impact of accounting requirements
6. The increasing public profile of pensions will lead to more costly / complex pension related communications with employees
7. Competition for staff will lead to a need to improve my firm's pension arrangements

Pensions: the impact of a 'bad press'

The last few years have been difficult for pensions and pension providers. Alongside longer-term demographic changes, falling investment returns and the consequent effects in terms of more sizeable scheme deficits, 'lost' pensions and reductions in individual pension pots has meant much bad press for pensions. The questionnaire explored the effect on scheme members.

Whilst this back-cloth has undoubtedly awakened greater interest in pensions where pension arrangements are offered, the negative side of poor pension returns and worries about security of pensions have countered the benefits that might have been hoped for from an awakening of interest. More than half the firms said that the bad climate for pensions had undermined both the promotion of pensions and the perceived value of their scheme(s). This is particularly worrying in a defined contribution world where higher pension contributions are particularly needed to build more meaningful pensions than are going to be delivered at current contribution rates.

"More than half the firms said that the bad climate for pensions had undermined the promotion of pensions and the perceived value of their scheme(s)"

Table 3.12 Impact of 'bad press' for pensions: firms with schemes

(percentages in brackets are responses to similar question of firms offering no pension scheme)

	With scheme	No scheme
Has awakened greater interest in pensions and your pension scheme	60%	(14%)
Has undermined promotion of pension saving	57%	(72%)
Has undermined perceived value of your scheme	52%	(33%)
Interest in pensions and the pension schemes has remained low	28%	(49%)
There has been very little noticeable change in attitudes to pensions	16%	(12%)
Employees have sought better non-pension benefits	9%	(14%)

**Section 4
Firms that do not offer a pension scheme or make an Employer's contribution to a Stakeholder Scheme**

Why do firms not offer pensions?

This year, we looked again at why many firms do not provide a pension scheme or pay any contribution into a Stakeholder scheme (which many are now required to offer access to).

By some way, the principal reason given was (as in previous years) cost - employer pension contributions simply cannot be afforded, says this grouping of firms. At face value, this answer makes any wider extension of private pensions into smaller firms an immense problem. It requires that government challenge smaller firms, perhaps threatening employment or employment growth. Unless extra pension saving is achieved voluntarily or by extra compulsion, many people working in smaller businesses will have very small private pensions over and above State benefits at retirement.

Given the size of the smaller firms sector not offering pension schemes, the importance of addressing non provision is of key importance if any government is to extend private pension coverage beyond present (inadequate) levels.

It certainly appears that at present there is little competitive pressure to offer a pension arrangement that employers contribute to.

More compulsion opposed

Very few firms in this sector would support any additional compulsion, even if this was phased in over a number of years. If this did occur, the extra costs involved would be spread, but with customers and employees working in the sector likely to meet much of the extra cost involved.

“Unless extra pension saving is achieved voluntarily or by extra compulsion, many people working in smaller businesses will have very small private pensions over and above State benefits at retirement”

Table 4.1 Reasons why firms do not provide a pension scheme and / or an employer's contribution to a stakeholder scheme.

In ranked order
1. Cost - cannot afford employer contributions
2. There are insufficient competitive pressures to justify scheme
3. Employees prefer non pension benefits
4. Scheme inappropriate due to staff turnover
5. Cost - have had to withdraw employer contributions
6. State pension arrangements are adequate
7. We have fewer than 5 staff and do not need to offer stakeholder scheme

If your firm was required by legislation to pay minimum employer pension contributions for all employees over and above current NI contributions, perhaps phased in over a number of years, how would your firm react?

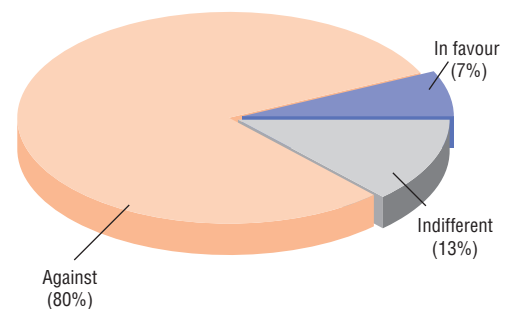


Table 4.2 If greater compulsion went ahead, how would your firm meet the cost?

	Yes
Firm would meet cost (ie. owner / shareholders)	8%
Customers would have to meet cost (ie. increased prices)	12%
Staff would have to meet cost (ie. reduced salaries)	38%
Combination of all three answers above	42%

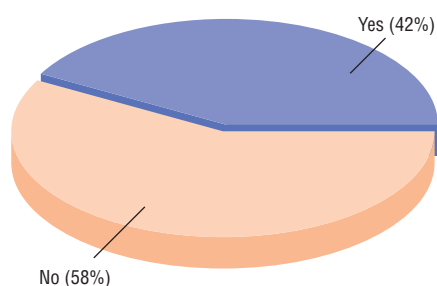
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Strong interest in multi-employer schemes

Interestingly, quite a high number of these firms are interested in the multi-employer scheme concept.

Perhaps this is an avenue where further developments could assist in extending pension coverage, particularly if there are government incentives provided.

Would your firm be interested in joining a multi-employer scheme?



Impact of 'bad press'

There are interesting contrasts with the replies made by firms offering pension arrangements (see page 14). Considerably more firms in this non provision / non contribution category say the bad pensions climate has undermined the promotion of pension saving and far fewer felt that the 'bad press' had awakened greater interest in pensions.

The fact that interest in pensions remains apparently so low in these firms must mean there is little pressure from employees on management to offer arrangements. If this is the case, there is a clear problem for any government in encouraging wider pension provision through voluntary processes.

Table 4.3 Impact of 'bad press' for pensions: firms with no schemes

(percentages in brackets are responses to similar questions of firms offering one or more pension schemes)

	No scheme	With scheme
Has awakened greater interest in pensions	14%	(60%)
Has undermined promotion of pension saving	72%	(57%)
Has undermined perceived value of setting up pension scheme at firm	33%	(52%)
Interest in pensions has remained low	49%	(28%)
There has been very little noticeable change in attitudes to pensions	12%	(16%)
Employees have sought better non-pension benefits	14%	(9%)



A famous TV sketch re-visited, what our characters might say today....

Cleese: "I look down on him (Barker) because I will retire at 60 on a two-thirds of final salary pension. He'll have to work to age 65. I look down on him (Corbett) even more as he may have to work until he's over 70 before he retires".

Barker: "I look up to him (Cleese) because to afford my pension, my employer has asked me to pay more and retire later, his employer is only asking that of new entrants. I look down on him (Corbett) because his employer only offers a Stakeholder scheme, with no contribution".

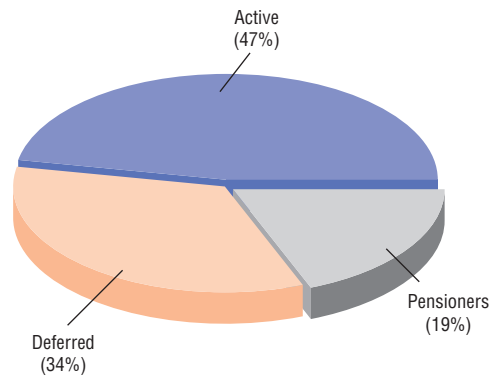
Corbett: "I look up to him (Cleese) 'cos he gets even more out of the government than I do. I look up to him (Barker) less 'cos he's having to pay more into 'is pension. I know my place. I will rely on the government for my pension".

**Section 5
Firms operating a Defined Benefit Scheme**

Given the major changes in occupational pension provision, which have particularly focused on the closure of defined benefit schemes mainly to new members, the questionnaire explored how the general trends have impacted on smaller firms. Additionally, it looked at how those firms with defined benefit schemes are reacting to Government proposals to offer greater protection to defined benefit members, which have come alongside measures designed to simplify rules, in the *2004 Pensions Bill*. Views were tested both before and after the Bill's publication.

Only just over a third of the defined benefit schemes in smaller firms are open to new members, with just over three-quarters open to future accruals. Given the cost pressures on smaller businesses, this is probably an encouraging picture and compares well with what is occurring in larger businesses.

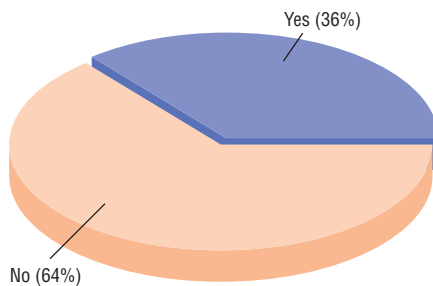
Distribution of membership of schemes



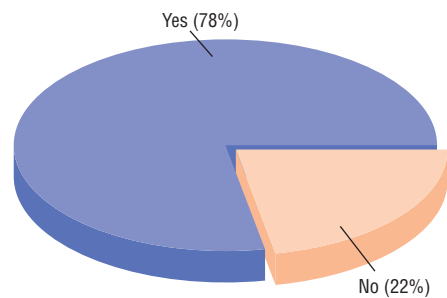
Defined Benefit: what's left?

Is the main defined benefit scheme:

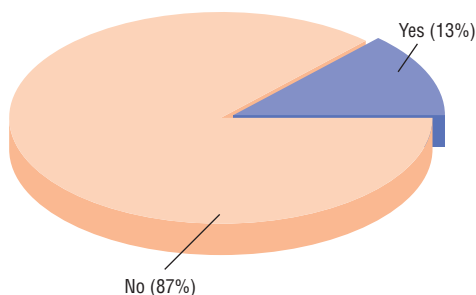
Open to new members



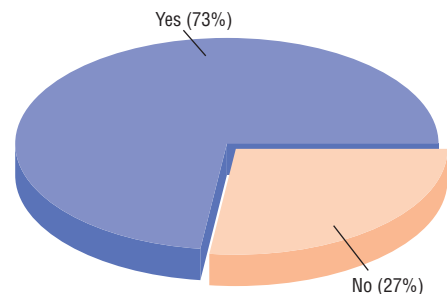
Open to future accruals



In the process of winding-up



Contracted out of S2P



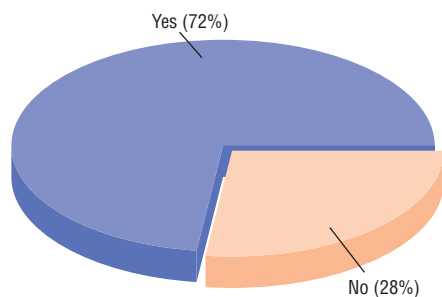
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Scheme deficits

Whilst a number of firms noted they were awaiting a report on their scheme's funding position, close to three-quarters have been advised that their scheme is in deficit and have been advised to increase contributions.

Where they were in deficit, 15 per cent reported that the funding level was below 75 per cent.

Have you been advised by the actuary to your scheme that it is in deficit?



Those in deficit: average funding level as a percentage of liabilities - 80 per cent (by bands below)

Funding Level	Percentage of firms in deficit
+95%	15%
85% - 95%	39%
75% - 85%	31%
Below 75%	15%

If in deficit, have your actuaries recommended you increase contributions?

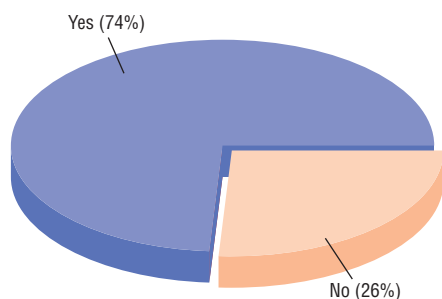


Table 5.1 Schemes in deficit: average funding level as a percentage of liabilities

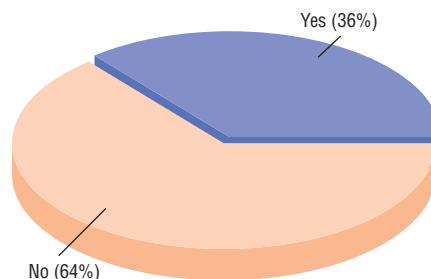
The varying position of schemes means there has been a wide range of changes to employer contributions. A quarter of affected schemes said they had or were increasing employer contributions by over 5 per cent of individual earnings - as a percentage increase in employer contributions, this often amounts to well over 25 per cent.

Table 5.2 Schemes in deficit: changes in employer contribution rate

Employer contribution rate increases	Percentage of firms
+ 5% of earnings	28%
+3% - 5%	56%
0 - 3%	16%

In addition to extra employer contributions, over a third of schemes report an increase in employee contributions. Generally this is of the order of 1 per cent of earnings, but 17 per cent of schemes report an increase of over 2 per cent. Undoubtedly, where employee contributions are increasing this is helpful in sharing the cost of meeting an expensive benefit, and it may also reflect a better appreciation by employees of the value of the benefit.

Is there / will there be any increase in employee contributions?



"In addition to extra employer contributions, over a third of defined benefit schemes report an increase in employee contributions"

Table 5.3 Schemes in deficit: where employee contribution has changed

Employee contribution rate increases	Percentage of firms
+ 2% of earnings	17%
+1% - 2%	48%
0 - 1%	35%

Supporting increased contributions, a small number of defined benefit schemes have also decreased their longer-term costs by reducing the accrual rate. Typically this means, for a new starter, 20 years of service will accrue a pension equivalent to a quarter of final salary as opposed to a third of final salary.

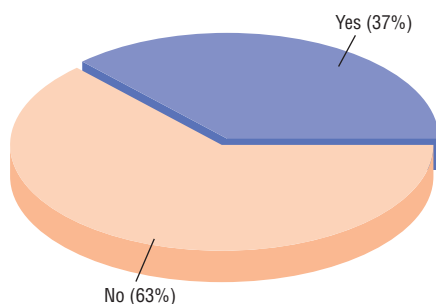
Table 5.4 Changes in the accrual rate of benefits in the last year or so

Moved from 60ths to 80ths	8%
Moved from 60ths to between 60ths and 80ths	2%
Moved from better than 60ths to 60ths	1%

Investment issues

Over a third of defined benefit schemes have changed the overall asset allocation of their fund over the last two years. It is perhaps surprising that not more have reported such a change. In the main, schemes have increased their holding of bonds at the expense of equities.

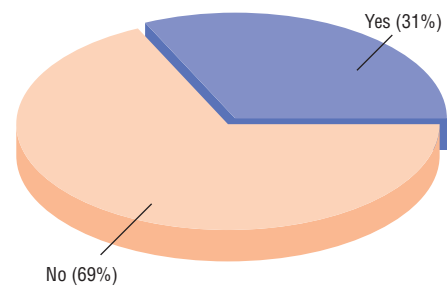
Have you changed the overall asset allocation of your fund over the last 2 years?



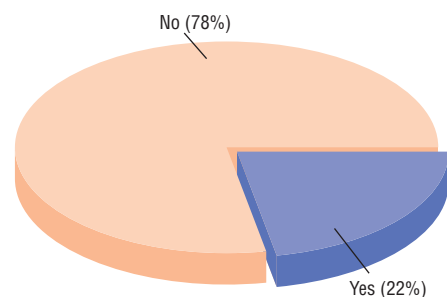
At a time when investment performance is of particular importance it is also surprising that only just over one fifth of schemes have changed their fund manager(s) over the same period.

Under a third of schemes said that trustees had taken any positive action resulting from the Government's response to Myrers. In part, this might reflect the different pressures on smaller schemes to change, but it might also reflect a reality that such schemes and their trustees do not have the same amount of time to consider such non-core issues. Others will feel they already comply with the principles.

Have the trustees of your scheme taken any positive action resulting from the 10 principles set out in the Government's response to the Myrers review of institutional investment in the UK?



Have you changed your fund manager(s) in the last 2 years?



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Section 6 Firms operating a Defined Contribution Scheme or contributing to a Stakeholder Scheme

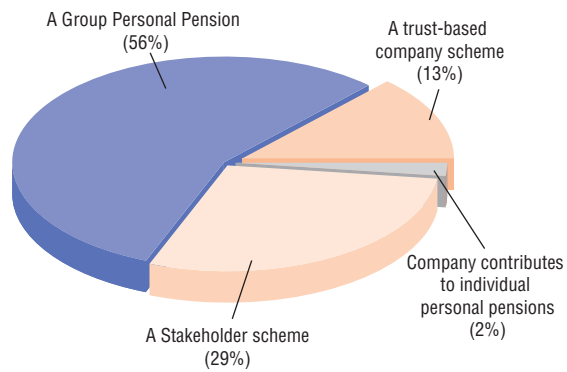
In the smaller firms sector, the majority of defined contribution schemes are now Group Personal Pensions (GPPs). This position has changed quite markedly from previous surveys.

Status of schemes

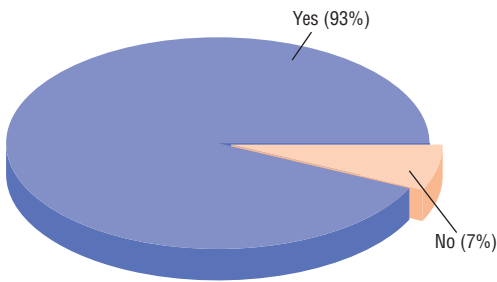
In the main, those firms running defined contribution schemes have had a more settled period, albeit some have only been recently established to receive members from closed defined benefit arrangements.

In contrast to most defined benefit schemes, the majority of defined contribution arrangements are open to new members and future accruals. Where they are not, it is most likely due to a new defined contribution scheme (perhaps a GPP or Stakeholder) being introduced.

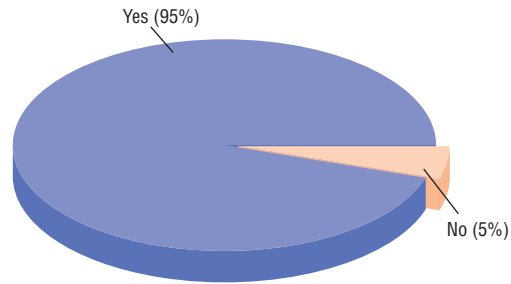
Is the main scheme



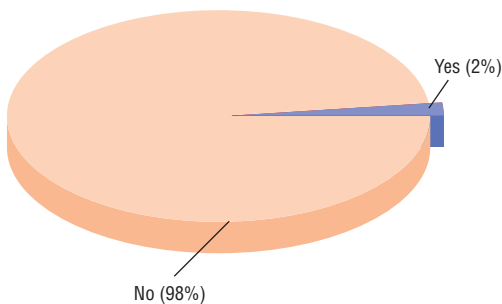
Is the main defined contribution scheme: Open to new members



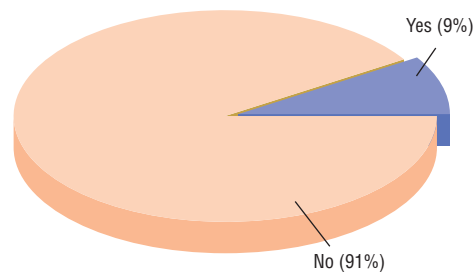
Open to future accruals



In process of winding-up



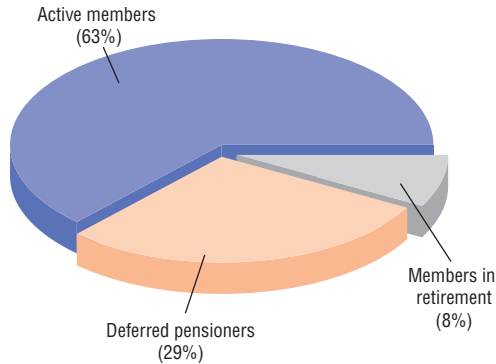
Contracted out of S2P



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The occupational defined contribution schemes reporting to the survey are much less mature than the defined benefit arrangements.

Distribution of membership of occupational defined contribution schemes



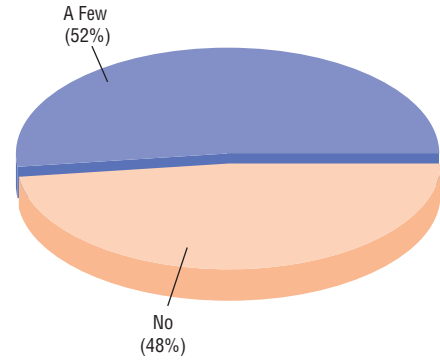
In contrast to the defined benefit sector, only a small number of employers have increased contributions to offset falls in equity markets and to reflect reductions in investment returns and increases in annuity costs. More have recommended to employees that they increase their contributions, but generally only a few have responded positively, with another group responding by reducing their contributions.

Investment choices

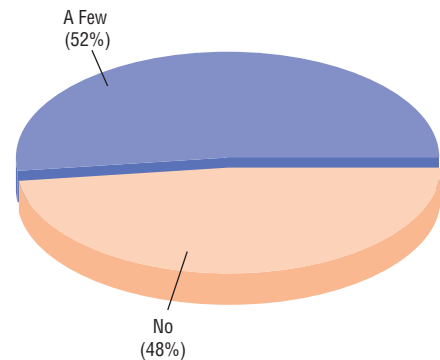
The majority of defined contribution schemes offer a quite wide range of investment choices. However, at a time when more members should be locked into some proportion of investment in bonds, it is worrying that only just over a half of schemes offer such an option.

Firms offering defined contribution: during the last 2 years many employees' defined contribution funds or 'pots' have declined considerably in size. Has this:

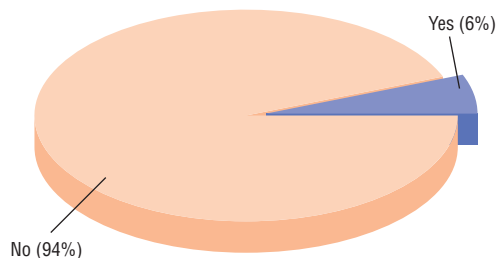
Has the fall in equity markets and lower returns caused employees to increase their contributions:



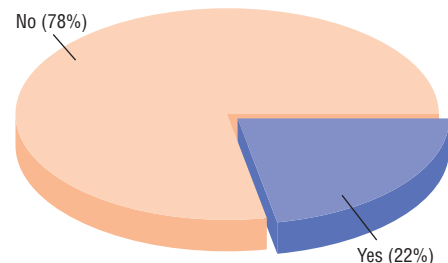
Or has it caused employees to reduce their contributions:



Prompted the firm to increase employer contributions



Prompted the firm to recommend that employees increase their own contributions

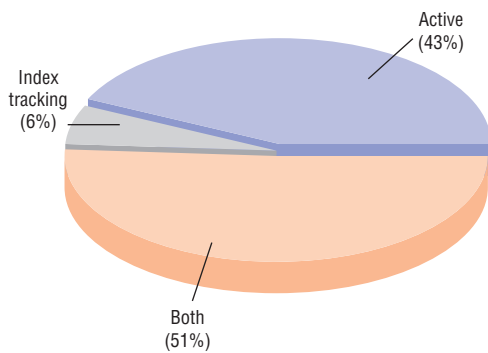


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Table 6.1 Which of the following investment choices does the scheme offer?

UK equity	86%	Cash / deposit	68%
Overseas equity	69%	With profits	73%
Global (UK & Overseas) equity	75%	Mixed managed fund	89%
Fixed interest bonds	59%	Life-style	63%
Index linked bonds	57%		

Are investment choices?

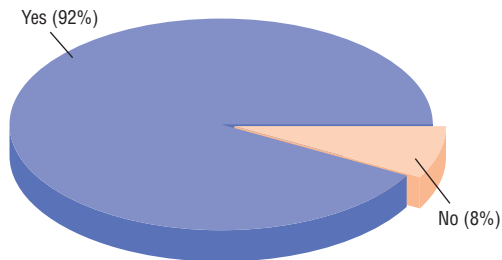


Around 1 in 10 members have no choice over the destination of their contributions or those of their employer. Of those that do have a choice, only 1 in 5 are offered a default investment.

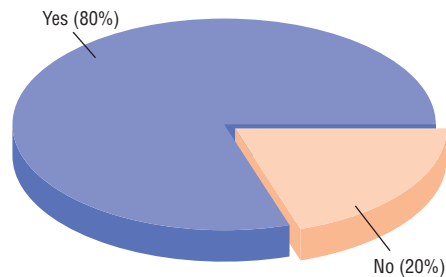
Only a few firms and trustee boards are apparently concerned that they might in future be blamed for poor investment performance. This may well prove to be optimistic - only time will tell.

Do individuals have choice over where contributions are invested for:

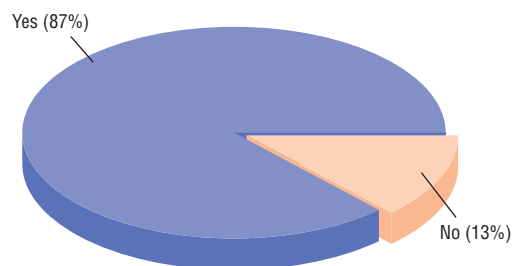
Member contributions:



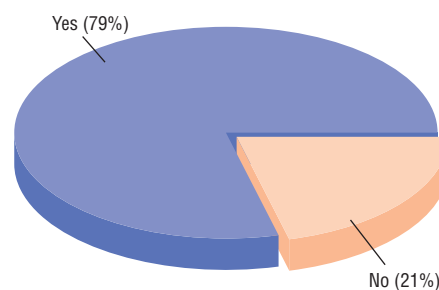
If 'Yes' is a default investment offered:



Company contributions:

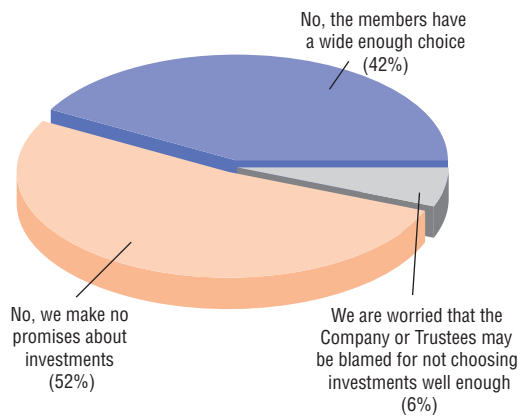


If 'Yes' is a default investment offered:



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The choice of investments in a defined contribution scheme has a more direct effect on retirement benefits than under a defined benefits scheme. Does that make the Company or Trustees feel exposed to possible criticism if the investment arrangements are unsuccessful?



“In contrast to the defined benefit sector, only a small number of employers have increased contributions into defined contribution schemes to offset falls in equity markets and to reflect reductions in investment returns and increases in annuity costs”



A famous TV sketch re-visited, what our characters might say today...

Cleese: “I look down on them (Barker / Corbett) because I will have a comfortable retirement with no financial worries”.

Barker: “I look up to him (Cleese) because he’s got a more secure pension than me. I look down on him (Corbett) because he’s got a poor pension and I will have to pay higher taxes in retirement to pay for his State benefits”.

Corbett: “I look up to them (Cleese / Barker) ‘cos they’ll keep me in my retirement. I know my place - I may have now’t but I don’t ‘ave to worry about stocks and shares and lifetime allowances!”.

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Section 7 Pension Reforms

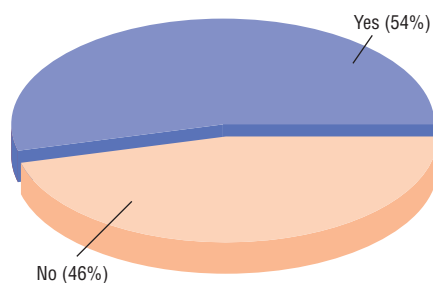
We looked at firms' reactions to the proposed Government reforms to pensions in September 2003, following the June 11 announcements mapping out the likely contents of the then forthcoming *Pensions Bill*. Following the publication of the Bill, we then re-surveyed in March 2004 to assess whether views had changed on key issues over the six-month period. We also explored views on specific contents of the Bill. The analysis below indicates the timing of the questions and, where available, changes in the situation over the six-month period.

Overall views on pensions reform

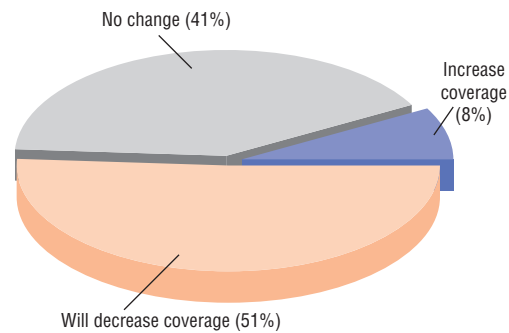
In September 2003, following the 11 June Government announcement on the path ahead of pension reform and simplification - including the proposal for a Pension Protection Fund - a small majority of firms said they broadly supported the approach being taken in promoting occupational pensions.

However, by March 2004, the position appears to have changed quite markedly, with the majority saying the measures in the *Pensions Bill* will decrease occupational pension scheme coverage, with just 8 per cent saying the measures will improve the position.

Overall, do you feel the Government's stated policy of promoting occupational pensions is moving in the correct direction? (September 2003)



Taken in the round, from what you have read about the Pensions Bill, do you feel the measures therein will increase occupational pension scheme coverage across more businesses and within individual businesses? (March 2004)

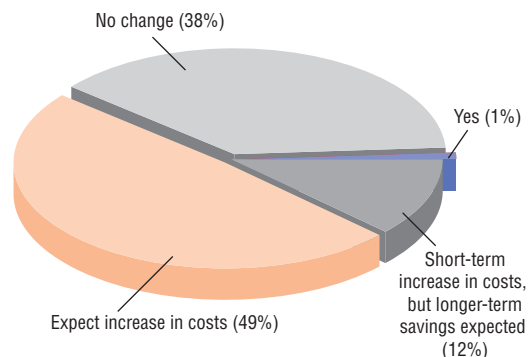


Savings from the Pensions Bill challenged

Firms are skeptical of the Government's regulatory assessment suggests overall that there will be £130 million savings flowing from the Bill's measures. The Government says these savings will come from removing the minimum funding requirement (allowing schemes to 'save' by investing more heavily in equities) and simplification measures. These, the Government says, will more than offset the £300 million pa costs of the PPF.

Firms disagree. Half expect their costs to rise and, in total, 9 out of 10 expect no reduction in costs.

The Government says the overall savings to employers from the measures in the Pensions Bill will be £130 million. Do you anticipate your firm will make savings from the total package of measures? (March 2004)

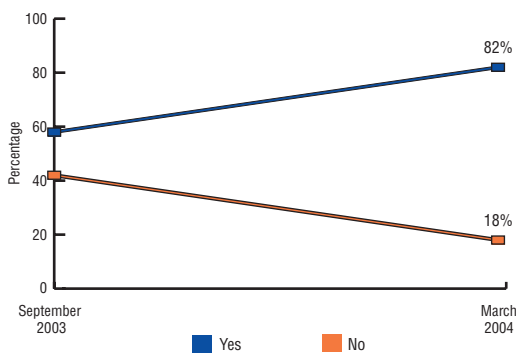


"The majority say the measures in the Pensions Bill will decrease occupational pension scheme coverage, with just 8 per cent saying they will improve the position"

Pension Protection Fund

Encouragingly for the Government, a clear majority of firms offering defined benefit schemes are in favour of the proposed Pension Protection Fund (PPF), one of its key new proposals in the *Pensions Bill*. The importance of offering greater security to defined benefit scheme members was mentioned by many firms. Support for the PPF has grown since the publication of the *Pensions Bill*.

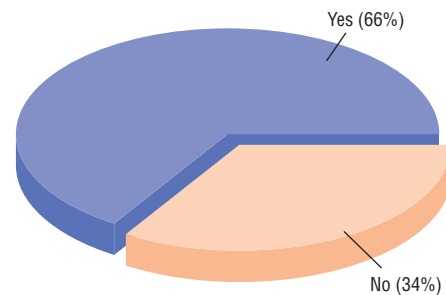
The Government has announced the establishment of a Pension Protection Fund (PPF) from April 2005 or 2006. Do you agree with its establishment?



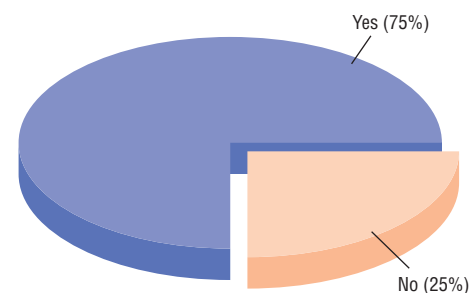
Two-thirds of firms believe that the PPF should be funded by a levy collected from defined benefit schemes, but three-quarters believe the levy should be collected from all defined benefit schemes, including public sector schemes, many of which are presently excluded from paying the levy under the terms of the Bill. The Bill says the levy is to be collected from only those schemes whose members are eligible for benefits from the PPF. Most public sector schemes are underwritten by the taxpayer through a Crown guarantee and therefore will not have access to the PPF. Arguably, however, given this 'gold plated protection' from the taxpayer such schemes might reasonably be asked to contribute a proportion of the levy (perhaps, the non risk related element) to assist in keeping the costs of

the PPF down for those schemes who do not enjoy such protection by the taxpayer.

Do you agree that the PPF should be funded by a levy on defined benefit schemes? (March 2004)



Do you believe that the levy should also be paid by public sector defined benefit schemes? (March 2004)



Support for the PPF is not given unconditionally. If the levy per head per year exceeds £15, a clear majority will be unhappy as they will regard this cost as 'too much'. Indeed, a levy of £10 per head per annum will be considered too much by over 40 per cent of firms.

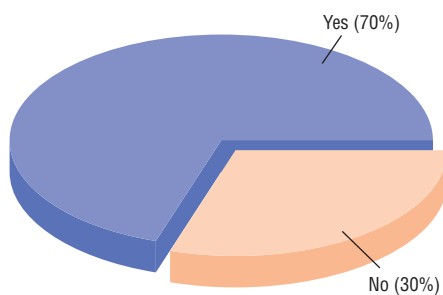
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Table 7.1 What annual per member levy would you regard as 'too much' for the protection offered? (September 2003)

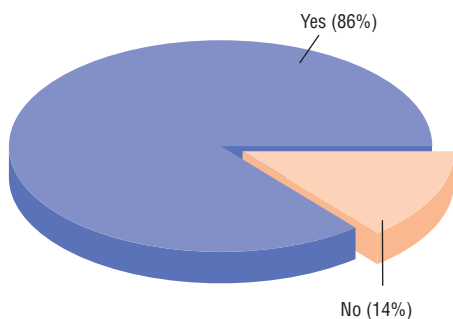
Levy per member per annum	Band that is 'too much'
Up to £5	29%
£6 - £10	12%
£11 - £15	23%
£16 - £20	10%
£21 - £25	9%
£26 - £30	6%
£31 - £35	6%
£36 +	5%

Firms generally support the Government's short and longer-term approach to the levy in terms of a flat-rate to start with, but at least half thereafter being risk related.

Do you agree with the fact that, in its first year, the PPF will only collect a levy based on scheme factors such as numbers of members and the balance between active and retired members? (March 2004)



Do you agree that, in principle, at least 50% of the levy should ultimately be based on risk factors such as funding level and investment strategy? (March 2004)

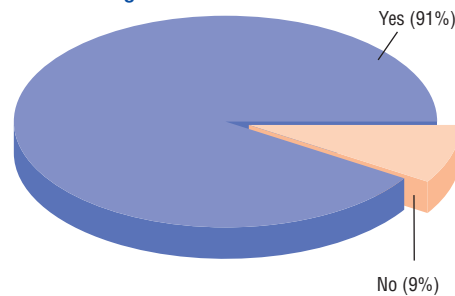


Whilst 9 out of 10 firms support 'scheme funding levels' as one of the risk factors to be used in determining the levy, a quarter oppose the risk factors being extended to cover the credit rating of the sponsoring employer and the scheme's investment strategy.

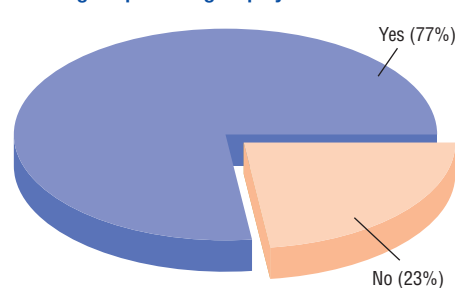
Over a third of firms are concerned that these credit ratings will be used by other organisations to gauge their overall creditworthiness, presumably in an adverse direction. It would be unfortunate indeed if the intrusive impact of finding the most complete way of measuring risk led onto more firms abandoning defined benefit provision for new and existing members.

The risk factors to be considered in determining the levy are likely to be the scheme's funding level, credit-rating of the sponsoring employer and the scheme's investment strategy. Do you agree with these factors being used? (March 2004)

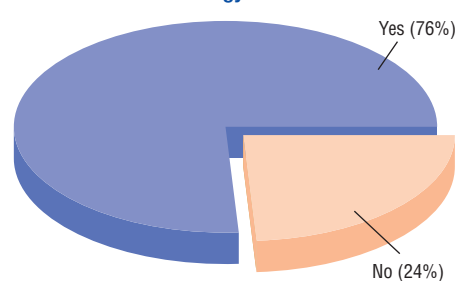
Scheme's funding level



Credit rating of sponsoring employer



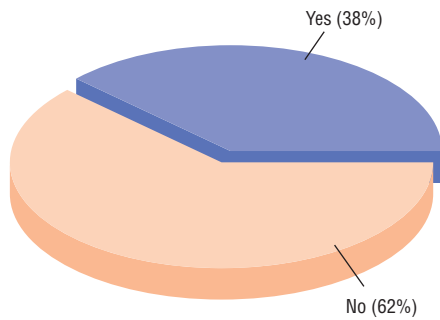
Scheme's investment strategy



"Support for the PPF is not given unconditionally. If the levy per head per year exceeds £15, a clear majority will be unhappy as they will regard this cost as 'too much'"

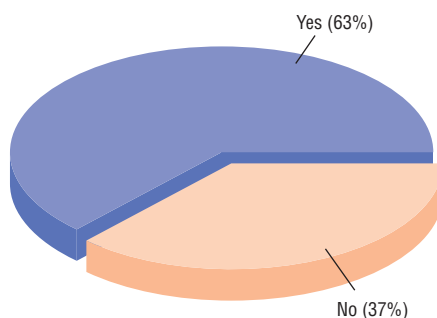
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Are you at all fearful now or in the future that the outcome of the risk factors being used to assess your PPF levy may be used by other organisations to gauge your firm's creditworthiness? (March 2004)



Close to two-thirds of firms support a simpler levy for smaller firms, but there are concerns amongst some larger firms that this will further tilt the playing field against well-run arrangements as they envisage the bulk of claims will be from smaller arrangements.

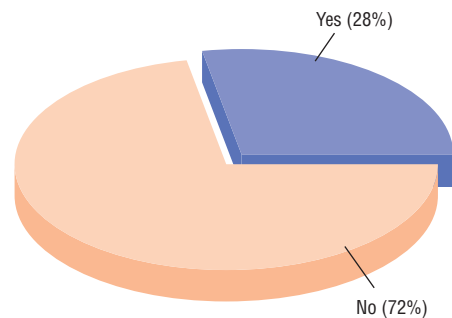
Smaller employers (perhaps those with 100 staff or fewer) may be offered a simpler levy (perhaps without the risk factors). Do you agree with such a concession? (March 2004)



Close to 3 out of 4 firms feel the powers given to the PPF to increase the levy by up to 25 per cent in one year (presumably to meet a series of claims or one or two large claims in a short period) is too high.

Certainly for many mid-sized and large companies, an increase of this scale would be a significant un-budgeted increase in costs.

The total levy charged will not be able to be increased by more than 25% from one year to the next? Do you think this is a reasonable cap? (March 2004)



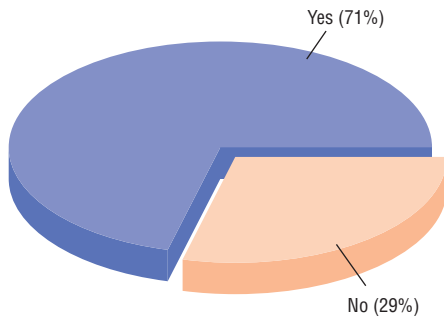
Firms generally support a PPF that offers less generous benefits than those typically offered by a defined benefit scheme.

Of the measures to achieve this aim, which will help to reduce the cost of the PPF and the levy, firms are generally supportive of the benefits package proposed by the Government. That said, the uncapped 100 per cent of pensions for those who have reached normal retirement age is judged to be 'too high' by almost half of the firms, whereas the benefits due to those below retirement age (capped at £25,000pa) are judged 'too low' by over a quarter of firms.

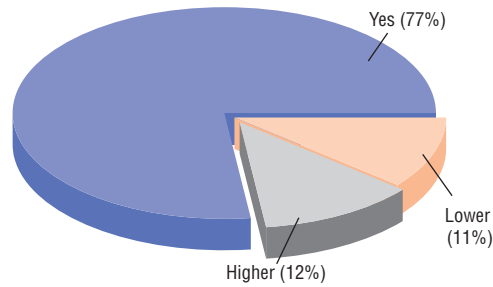
Whilst the indexation provisions will hold down pensioner benefits from the PPF into the future, it may be anomalous that the scheme will be seen at some stage to pay an uncapped pension of perhaps several hundreds of thousands of pounds (or more) per annum to a retired executive, whilst a 64 year old long-serving staff member might be capped at £25,000pa, when his anticipated pension might have been many thousands of pounds more.

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On establishment, do you think PPF benefits should be restricted compared to the benefits that would have been paid by a typical defined benefit scheme? (September 2003)

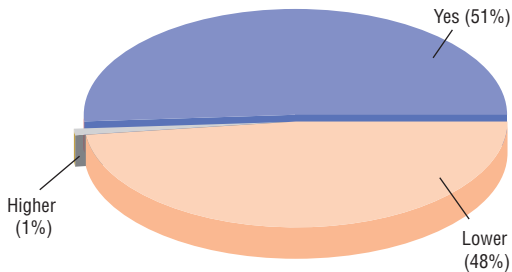


Indexation for any pension accrued after April 1997 will be increased in payment in line with RPI (capped at 2.5% per annum)?

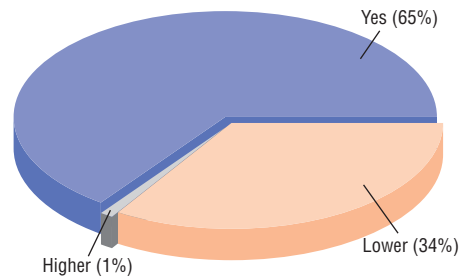


Following a scheme entering the PPF, do you think the PPF should pay the following benefits (March 2004):

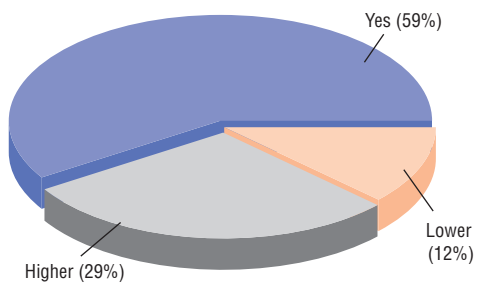
100% of pensions in payment with no limit for those who have reached the scheme's Normal Retirement Age?



Deferred pensions will be revalued in line with RPI (capped at 5% per annum)?

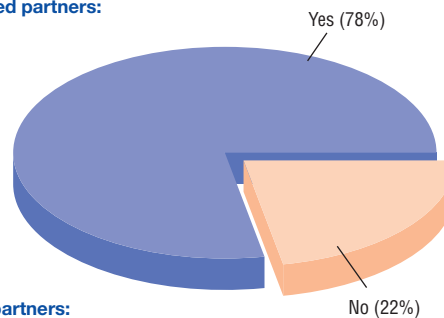


90% of the accrued pensions of others (including pensions in payment for those who have not yet reached the scheme's Normal Retirement Age) but subject to a flat ceiling of £25,000 per annum regardless of service or salary?

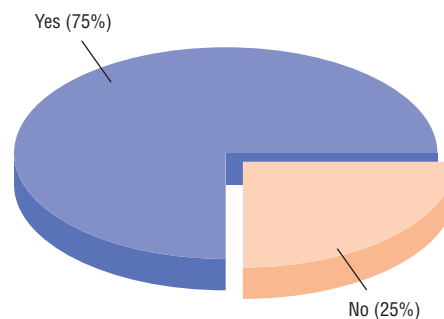


Survivors' benefits for married and civil partners?

Married partners:

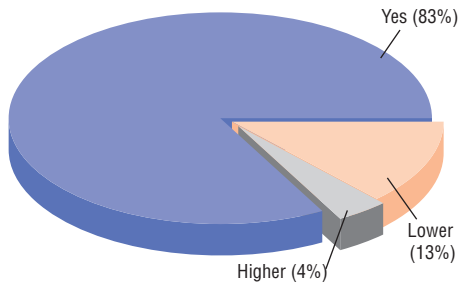


Civil partners:



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Spouse's death after retirement pension based on 50% of the member's direct entitlement?

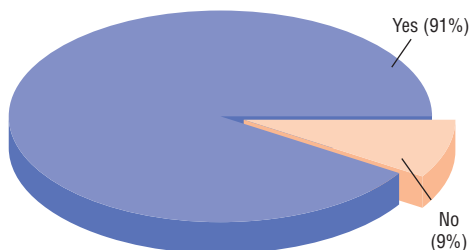


Firms generally support the safety valves in the Bill that will enable the PPF board to reduce costs falling on a scheme because of overly generous decisions made by trustees in the period running up to their demise and where the overall costs of benefits look likely to run ahead of income.

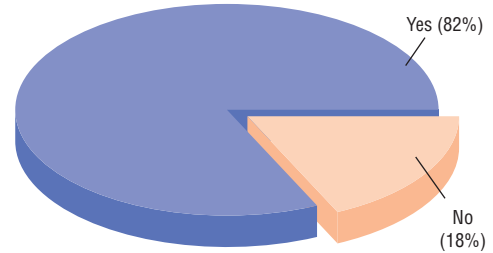
Pension scheme members need to be aware that the protection being offered by the PPF can be cut back in these circumstances and it is wrong for the Government to give the impression (as some press notices have) that full protection of pensions is offered by this package.

The PPF board will be able to disregard scheme rule changes and discretionary changes made to the scheme in the previous 3 years that would have the effect of increasing the liabilities it is required to meet.

Do you agree with the power to disregard recent rule / discretionary changes? (March 2004)



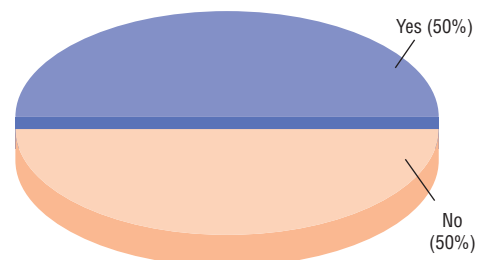
Do you agree with the power to reduce / suspend benefit increases? (March 2004)



Most likely in a situation where the PPF deficit is rising sharply, the PPF board will also have a discretionary power to reduce or suspend the rate of increases paid, both in deferment and in payment.

There is a great deal of genuine sympathy about the present situation where probably something like 60,000 pension scheme members have 'lost' most if not all of their anticipated pensions, due to their scheme being considerably in deficit at the time of their employer's insolvency. At the time of writing, the Government has ruled out these members from benefiting from the PPF, but has left open the door for some kind of compensation package. It is likely this compensation will be assessed nearer the time of the PPF launch so as to better quantify the maximum cost.

Would you support a move to scale down the initial PPF benefits to members if this allowed the PPF to offer benefits retrospectively to those scheme members (possibly around 60,000) who have 'lost' most or all their pension entitlement in recent years? (March 2004)



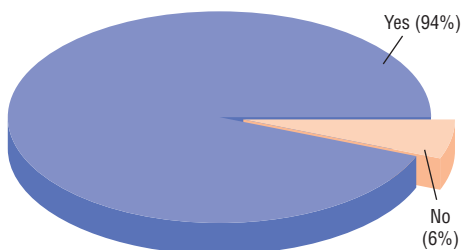
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Firms are evenly divided on supporting measures that would scale down initial PPF benefits if this enabled those who have lost some or all of their pensions in recent years to draw PPF levels of benefit.

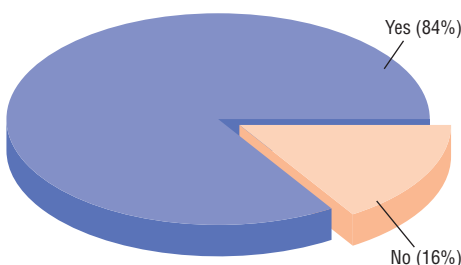
New Pensions Regulator

The *Pensions Bill* spends many pages and paragraphs re-shaping OPRA into a much more pro-active regulator with teeth. Its role, amongst many, will be to police work based schemes so that, in particular, as few defined benefit schemes as possible will fall into the PPF. Whilst the experience of more rigorous regulation elsewhere might be expected to cause further alarm amongst firms over the way regulation of pensions might go, our survey found generally strong support for the powers proposed:

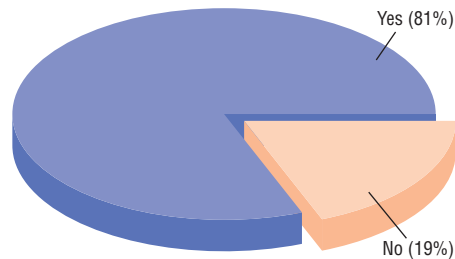
The new Regulator will have powers to gather, retain and share relevant information for analysis to inform the risk-based approach. This is designed to identify those schemes where members' benefits are more likely to be at risk and where regulatory intervention may be required. Do you agree with these new powers? (March 2004)



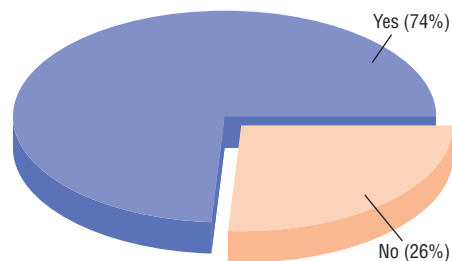
The new Regulator will have powers to 'freeze' a pension scheme to give it time to analyse whether a scheme should be wound up and additionally powers to wind up a scheme where it is considered necessary to limit calls on the PPF. Do you agree with these powers? (March 2004)



The new Regulator will protect the benefits of members of 'work based' schemes, to include personal pensions to which the employer contributes or directs employees' contributions from payroll (eg. GPPs) and stakeholder schemes. Do you welcome this extension in coverage? (March 2004)



The new Regulator will be expected to produce Codes of Conduct, some of which will be mandatory and laid before Parliament and are likely to be 'regulation by another name'. Do you agree with this new power? (March 2004)



Scheme funding

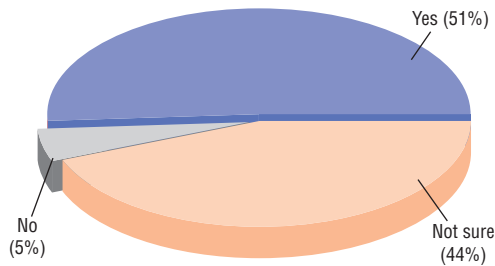
Under the Bill, the Minimum Funding Requirement is to be abolished to be replaced by a scheme specific funding standard. This standard means that schemes must have sufficient and appropriate assets to meet their 'technical provisions' (EU term meaning 'scheme liabilities'). Regulations and guidance as yet unseen will determine how these are calculated.

Again, despite the very woolly nature of how the new scheme funding regime will work (and sit alongside the funding requirement to meet the PPF levels of benefits), the majority of firms are supportive of the measure. This is presumably on the basis that they feel it will allow greater flexibility than that offered by the minimum funding requirement.

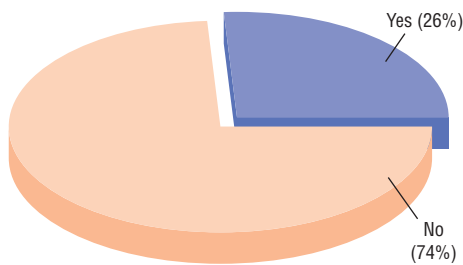
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“Over three-quarters of firms envisage the new ‘knowledge and understanding’ requirements will make it more difficult to persuade members to become trustees”

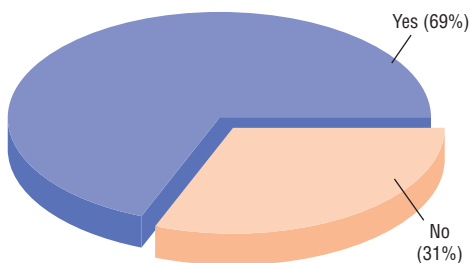
The Government has confirmed that the Minimum Funding Requirement (MFR) will be replaced by a Scheme Specific Funding Standard. Do you welcome this change? (September 2003)



Are you concerned the new funding standard is not what you expected when you were told the MFR was being abolished? (March 2004)



If the new Regulator is concerned by the outcome of an actuarial valuation, ultimately he will have new powers to modify future accrual under the scheme, direct how the scheme's liabilities should be calculated and impose a schedule of contributions. Do you agree with these powers? (March 2004)



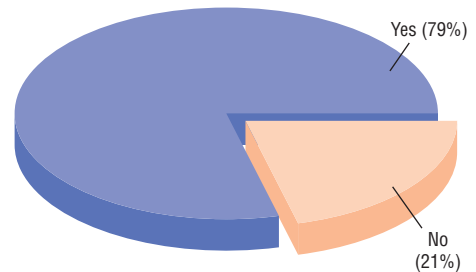
Trustees

In future, trustees will be required to have knowledge and understanding of the laws relating to pensions and trusts, and the principles relating to funding occupational schemes and investing

their assets. This builds on the recommendations put forward by Paul Myners in his report to government on investment issues. The proposed requirements apparently go beyond current requirements placed on lay trustees and, indeed, if more is not being required, it seems odd that additional legislation is needed.

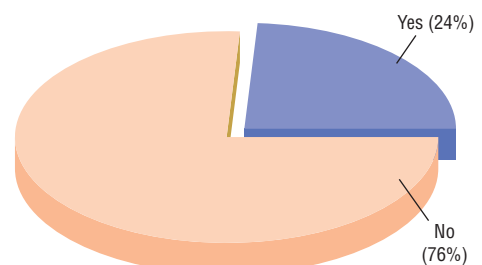
Over three-quarters of firms envisage these new requirements will make it more difficult to persuade members to become trustees.

Do you think these additional requirements will deter individuals from wishing to become trustees or Member Nominated Trustees? (March 2004)



Fewer firms are concerned about the requirement to have one-third Member Nominated Trustees, a requirement that will remove the option to have some other arrangement proposed and agreed at firm level.

The Pensions Bill will require that all trustee bodies include one-third Member Nominated Trustees by a date yet to be decided. Do you envisage any problems in meeting this requirement? (March 2004)



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Transfer of undertakings

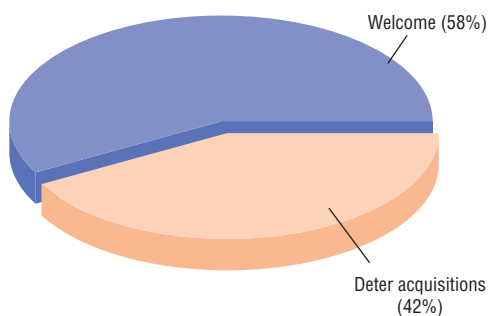
The *Pensions Bill* makes pension provision a benefit that must be included in a transferred employee's contract of employment, either by way of the new employer guaranteeing benefits at least equal to the Reference Scheme benefits or by providing a minimum contribution into a money purchase scheme (up to 6 per cent matching contributions has been suggested in earlier government papers).

Whilst fewer firms running defined contribution schemes are happy with the measure compared to firms running defined benefit arrangement, still a strong majority are in favour. However, 4 out of 10 firms feel the measure will deter acquisitions by increasing the costs of the benefits package that will need to be matched.

Table 7.2 Agreement with TUPE changes (September 2003) (by respondent's principal scheme type)

	Yes	No
Defined benefit schemes	65%	35%
Defined contribution	58%	42%

Do you think this TUPE measure is a needed reform or will it deter acquisitions and re-structuring? (March 2004)



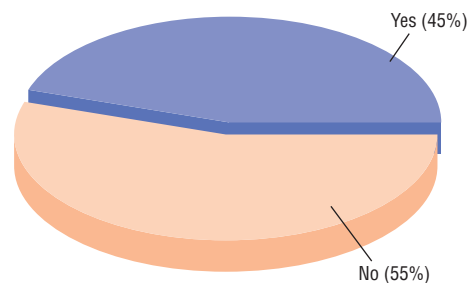
Informed Choice

In the *Pensions Bill* the Government has given itself the option to require trustees to provide combined benefit statements, which give a single statement

of the retirement provision an individual can expect from both the State and private sources.

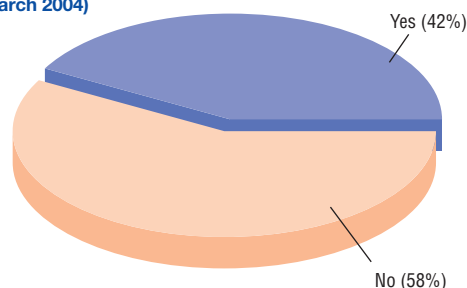
A majority of firms oppose these powers being taken by the Government as, if they are used, they could add considerable administrative costs and time consuming responsibilities. There is also widespread concern at the quality of State data and the responsibility attached to providing such data (if incorrect) to members.

The Government will have powers to require trustees to provide combined benefit statements. Do you agree with this power resting with the Government by way of regulation? (March 2004)



A majority of firms are also opposed to being required to provide access to information and advice, not only on cost grounds but also because of the possible come-back on the firm if, for example, advice given leads onto adverse consequences. Firms do not see why they should carry any responsibility in these matters.

The Government can also make regulations requiring employers to provide employees with access to information and advice about pensions and saving for retirement. Do you agree with the Government having this power? (March 2004)



“A majority of firms oppose the Government having powers to require trustees to provide combined benefit statements”

Other reform proposals

Responding to other measures in the Government's reform proposals, firms are generally supportive.

There are concerns over the 'full buy out' measure - this could push more schemes to cease future accruals.

Following the June 11 Government announcement, there was also a clear majority against trustees having powers to unilaterally wind up a scheme, particularly if this was against the employer's wishes. This is a concern that the Government has responded to in the *Pensions Bill*.

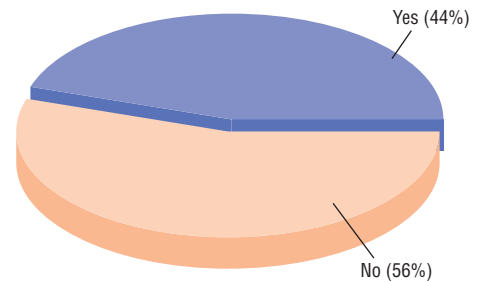
The Government's proposed Limited Price Indexation (LPI) changes are welcomed as are the requirements for consultation ahead of major scheme changes (which many firms already observe).

There is not exactly an enthusiastic response to measures that will allow firms to re-structure accrued benefits - many firms seem unlikely to act to take advantage of this opportunity, probably because they see little cost advantage in so doing set against the opposition to change that might be expected.

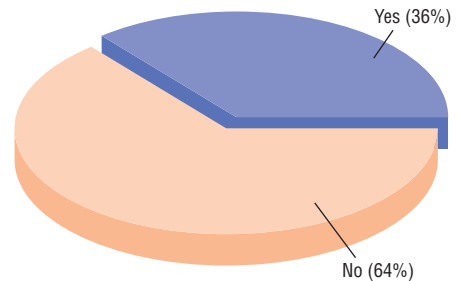
A majority of firms - particularly defined benefit schemes - want to see a new default retirement age set by the Government when the EU directive comes into operation in October 2006 outlawing firms specifying a retirement age. Whilst the largest grouping of firms says this move to remove a specific retirement age will make no difference to their firm, many others feel it will remove flexibility, staff progression and will increase the need for competence related disciplinary proceedings being taken against elderly staff.

Summary of firms' other responses to Government reform proposals:

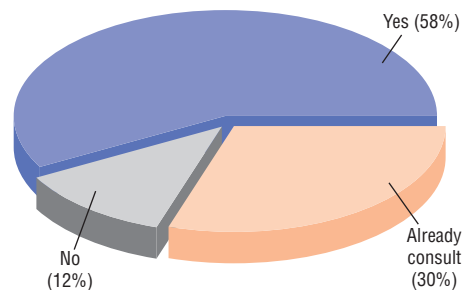
From 11 June all solvent employers wishing to wind up a defined benefit scheme are required to 'top up' their scheme so the full promised benefits can be secured on a buy out basis from a Life Office. Is this likely to cause your firm to consider ceasing accruals for existing members to reduce forward liabilities? (September 2003)



Under the proposals, trustees will be able to trigger a voluntary wind up, whether the employer wishes to wind up the scheme or not. Do you agree with this power (now not being pursued in Bill)? (September 2003)

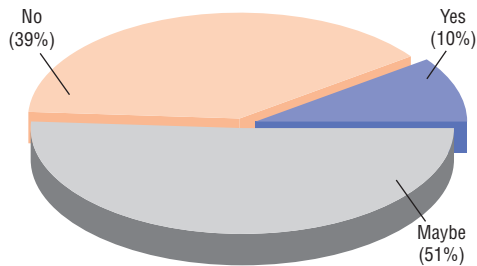


Employers will be required to consult ahead of making significant scheme changes. Do you agree with this proposal?

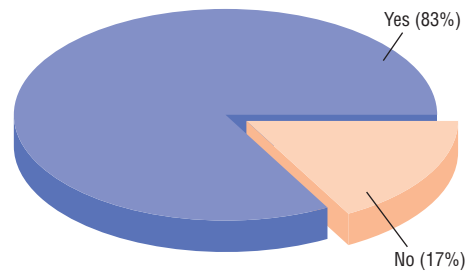


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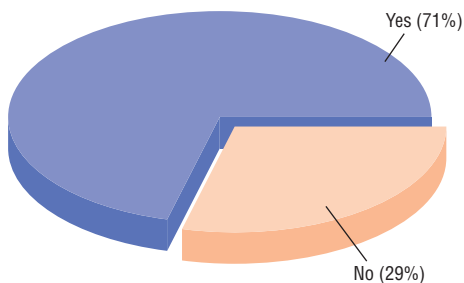
The proposals will allow for the structure of accrued benefits to be revised provided the total value of members' rights are maintained and they remain salary related. Are you likely to consider using this reform to revise your scheme? (September 2003)



In this event, do you believe the Government should (as allowed under the directive) specify a default retirement age (say 70) at which employers would be able to require employees to retire, if they so wished? (September 2003)



Future pension increases under Limited Price Indexation will be required to match inflation up to a maximum of 2.5% per annum (as opposed to 5% from April 1997). Do you agree with this change? (September 2003)



As the Government's *Age Consultation* paper notes, under the European Employment Directive it will be illegal from October 2006 for employers to set a specific retirement age (certainly of 60 or 65), unless it can be objectively justified against certain specific non-age related criteria.

Table 7.3 Will this later default age damage your business? (by respondent's principal scheme type)

	Yes	No	Makes little difference
Defined benefit schemes	38%	20%	42%
Defined contribution	30%	24%	46%

APPENDIX

Summary of the Pensions Bill

- Establishes the **Pension Protection Fund (PPF)** to guarantee a minimum pension when a defined benefit scheme of an insolvent employer is in shortfall, funded by a levy to be paid by all private sector defined benefit schemes
- Establishes the **PPF Ombudsman**
- Establishes a more risk-focused and proactive **Pensions Regulator**
- Establishes The **Pensions Regulator Tribunal**
- **Scheme funding:** striking a balance between schemes' long-term liabilities and the assets they are required to hold on an on-going basis
- Pension protection on transfer of employment
- Specifies the debt due to the pension scheme in the case of an employer's insolvency with insufficient assets

Simplification measures

- Mechanism for resolving disputes between scheme trustees and scheme members
- Changing the rules on limited price indexation so that it is capped at 2.5%pa instead of 5%
- Modifications to rules for private pension schemes which are contracted out of the State Second Pension (previously SERPS)
- Clarifying that overpayments of pension benefits may be recouped through deductions from future payments

Rewards for taking the state pension late

- Better enhancements to the pension where it is deferred
- A new lump sum option

Other measures

- At least one third of scheme trustees must be nominated by the scheme members
- Trustees must inform members of their investment principles
- Trustees must have knowledge about the issues that they deal with
- Ensuring that pension contributions, in particular by employers, are made in good time
- Promoting and facilitating financial planning for retirement, including introducing an online retirement planner
- Making it compulsory for occupational pension schemes to provide combined pension forecasts if sufficient numbers do not take up this option voluntarily
- Requiring employers to provide access to information and advice in the workplace if the pilots indicate that this helps people to make better choices about their retirement planning
- Extending data sharing gateways between DWP and other bodies to allow Departmental analysts to use the data for policy modelling and development with respect to private pensions

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GLOSSARY OF TERMS

Accrual Rate

See 'Defined Benefit Scheme'

Annuity

A series of payments, which may be subject to increases, made at stated intervals until a particular event occurs. This event is most commonly the end of a specified period or the death of the person receiving the annuity.

Asset Allocation

The splitting of the assets of a pension scheme between various asset classes such as equities, fixed interest and cash.

Career Average Revalued Earnings Schemes

These are defined benefit schemes where the pension is based on an employee's average earnings throughout his / her career with the employer, revalued.

Contract-in

To remain in S2P (see S2P) .

Contract-out

To opt out of S2P (see S2P) through an arrangement whereby, in return for paying a reduced rate of National Insurance contribution and providing a number of further conditions are met by the pension provider, an individual forgoes some of their right to S2P on retirement.

Contribution 'Gap'

The gap between the total employer and employee pension contributions between different types of schemes.

Debt on the Employer

The statutory debt due from the employer to a defined benefit scheme where, on winding up of the scheme or liquidation of an employer, the assets are insufficient to meet the actuarial liabilities calculated on a prescribed basis.

Defined Benefit Scheme

A defined benefit (often called "final salary" or "career average" based) scheme typically guarantees employees a fraction (commonly an accrual rate of 60ths or 80ths) of their salary at retirement for each year of scheme membership. Company contributions to fund this promise may vary from time to time, but any employee contributions would typically be a fixed percentage of salary.

Defined Contribution Scheme

A defined contribution (or "money purchase") scheme is one where usually both the company and the members pay a stated level of contributions, usually expressed as a percentage of salary. The contributions are accumulated and invested, with the amounts invested for each individual separately identifiable. The retirement benefit depends on investment returns achieved in practice, and costs or charges deducted as well as annuity rates on retirement. There is no guarantee related to salary or service.

Discontinuance Valuation

An actuarial valuation carried out to assess the position if a scheme were to be discontinued.

Flex or Flexible benefits

The concept of 'Flex', also known as 'cafeteria benefits' and 'flexible remuneration packages' refers to a remuneration system which enables employees to choose from a range of benefits within an overall cost limit.

Group Personal Pension (GPP) Plan

An arrangement made for the employees of a particular employer to participate in a personal pension scheme on a grouped basis. Strictly speaking, this is not a company scheme; merely a collecting arrangement. GPPs are defined contribution arrangements (see above).

Guaranteed Minimum Pension (GMP)

This applies to contracted-out defined benefit schemes but only on rights accrued between April 1978 (when SERPS was introduced) and April 1997 (when it was replaced by the 'Reference Scheme Test', see below). It is the minimum that the scheme must pay and is related to the amount of SERPS that the individual would have received if he / she had stayed in the State scheme.

Hybrid or Mixed Schemes

These are occupational pension schemes that have usually been the result of the modification of one type of scheme into a blend incorporating features of, for example, both a defined benefit and defined contribution scheme.

Industry-wide Scheme

A centralised scheme for non associated employers in a particular industry or profession.

Insured Scheme

A pension scheme where the sole long term investment medium is an insurance policy (other than a managed fund policy).

Limited Price Indexation (LPI)

A statutory requirement, introduced under the *Pensions Act 1995*, for occupational schemes to increase pensions in payment by the lower of the RPI or 5% pa (to be reduced to 2.5% under the *Pensions Bill*).

Minimum Funding Requirement (MFR)

Introduced by the *Pensions Act 1995* it applies to private sector defined benefit schemes. They are required to have a triennial actuarial valuation to establish their funding level using a specified actuarial method and set of assumptions. Trustees must then enforce a Schedule of Contributions to ensure the scheme remains funded at 100% of this level, or, to bring it up to 100% funding over a specified time period. The *Pensions Bill* will replace MFR with a scheme specific funding requirement.

Member Nominated Trustees (MNTs)

Trustees of occupational pension schemes who have been nominated by members of that scheme. Under the *Pensions Bill* a third of trustees must be MNTs replacing any 'opt out' that hitherto might have been in operation.

Multi-employer Schemes

Designed to take the hassle and cost of running individual schemes away from particularly smaller employers. With the right tax regime, these could offer a new pensions option for thousands of small and medium sized firms.

Myners Principles

In order to comply with the principles, schemes would (amongst other issues) have to set an overall investment objective linked to the fund's liabilities; ensure that those taking investment decisions have the skill and information to do so; and agree clear mandates with their fund managers, including a time-scale over which managers' performance will be measured.

Opra

The Occupational Pensions Regulatory Authority set up to regulate occupational and stakeholder schemes. Opra will be replaced by the new Pensions Regulator when the *Pensions Bill* is implemented.

Pension Protection Fund (PPF)

To be introduced under the *Pensions Bill* to provide compensation for members of defined benefit occupational schemes whose employers become insolvent leaving the pension fund with insufficient assets to meet its liabilities.

Reference Scheme Test

Since April 1997, defined benefit schemes have been able to contract out of the State Second Pension provided that their benefits meet an overall test of scheme quality. This replaced the requirement to provide a GMP (Guaranteed Minimum Pension) as a basis for contracting out.

Scheme Deficit

The excess of the actuarial liability over the actuarial value of assets, on the basis of the valuation method and actuarial assumptions used. In a stricter sense, the terms surplus and deficiency might be used in relation to the results of a 'Discontinuance valuation', (see above).

SERPS

The State Earnings Related Pension Scheme (SERPS) was the additional earnings related component of the state pension scheme and was replaced by S2P (State Second Pension) from April 2002.

State Second Pension (S2P)

Replaced SERPS as the State Second Pension from 6 April 2002.

Stakeholder Pensions

A type of defined contribution scheme, introduced from April 2001, which fulfils the regulatory requirements for such a scheme and which is registered with Opra. Employers with 5 or more employees who do not offer an occupational scheme for all employees must, after a year, offer access to such a scheme.

Transfer of Undertakings (Protection of Employment) Regulations (TUPE)

These regulations preserve the terms and conditions of employment of employees transferred from one undertaking to another. Under the *Pensions Bill* their coverage will extend to pensions.

Winding-up

The process of terminating a pension scheme, usually by applying the assets to the purchase of immediate and deferred annuities for the beneficiaries, or by transferring the assets and liabilities to another pension scheme, in accordance with the scheme documentation.

2004 SMALLER FIRMS PENSIONS SURVEY: A DIVIDED NATION

ABOUT THE ASSOCIATION

The Association of Consulting Actuaries was established over 50 years ago and draws its membership from individual consulting actuaries working in over 75 consulting firms.

Members of the Association are all qualified actuaries – either Fellows of the Institute of Actuaries or Fellows of the Faculty of Actuaries in Scotland – and all actuarial advice given by members of the Association is subject to the code of professional conduct of the Faculty and Institute of Actuaries. Relationships with clients are direct and confidential, and all advice given is independent and impartial.

Top Pension Advisers

The major part of our members' work is as advisers to UK pension funds with assets in excess of £650 billion. The vast majority of the country's largest pension schemes are advised by ACA members and they, amongst thousands of other pension funds, companies and organisations take advantage of a wide and varied range of services offered by our members.

Scheme Design and Administration

Members advise, for example, on the design and implementation of new pension schemes as well as on amendments to the benefits available from existing schemes. This work includes advice on contribution levels and funding, drafting explanatory literature, explaining the scheme to its members and carrying out actuarial valuations. Advice on, and where required the provision of, computerised systems for pensions administration is also given. This covers record keeping, benefit calculations, annual benefit statements, the payment of pensions and the maintenance of scheme accounts. While the administration of most schemes is usually carried out by the individual employer, our members will, if required, act as administrators, maintaining records, paying benefits and so on. Members also analyse the employer cost and employee value of all elements in a total remuneration package, as well as designing flexible benefits and healthcare arrangements.

Advice on Investment Strategy

On the investment front, members advise on investment objectives and on asset allocation strategies appropriate to these objectives, taking into account the particular scheme's liabilities. They will analyse and monitor the investment performance of the pension fund and advise on the selection of investment managers when required.

Mergers, Acquisitions and Sales

A particularly important area in which our members are active is advice in connection with mergers and acquisitions, and the subsequent rationalisation of the pension arrangements already created by the companies concerned. It is not always appreciated that the sums at stake in negotiations of this kind can be very substantial, compared with the purchase consideration.

Pensions for Controlling Directors

Many directors who control companies can benefit from small self-administered company pension schemes which, if approved by the Inland Revenue, bring considerable tax advantages with them. They are of particular benefit and value to directors of family-owned companies and our members are active in advising on and establishing such schemes.

Personal Financial Planning

Our members – directly or through associated companies appropriately authorised under the Financial Services Act – provide completely independent and impartial personal financial planning advice to individuals considering pensions, life assurance or related investment products.

Advising Insurers

ACA members act as advisers to life assurance companies both in the UK and overseas. Some of these UK companies also have Association members as their Appointed Actuary. As actuarial and statistical skills become increasingly recognised in the field of general insurance, our members are often involved in advising on premium rates, reinsurance limits and reserve levels both for insurance companies and commercial and industrial companies which operate self insurance arrangements or insurance through an offshore subsidiary.

Corporate Finance and Risk

Members also are increasingly active in new areas, advising on – for example – actuarial issues involved with corporate finance and risk.

Legal Matters

Our members also advise clients, normally through legal advisers, on the valuation of life and reversionary interests in settled property as well as, for instance, advising on assessment of damages for future financial loss arising from accidents, injuries or divorce, assessing compensation for loss of office and acting as expert witnesses.

Our Clients First

Increasingly corporate bodies and individuals look for independent advice when examining their pension and other financial arrangements – the sums involved and the consequences of a 'wrong' decision point to the need for assistance of the highest quality. Members of the Association of Consulting Actuaries are available to provide this advice.

The Association of Consulting Actuaries

No.1 Wardrobe Place, London EC4V 5AG
Tel: 020 7248 3163 Fax: 020 7236 1889
E-Mail: acaahelp@aca.org.uk
Web: www.aca.org.uk



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Tel: 020 7248 3163 Fax: 020 7236 1889
EMail: acahelp@aca.org.uk Web Site: www.aca.org.uk