



NEWS RELEASE

The Government's Deregulatory Review of Private Pensions must lead to concrete and innovative reforms...

GOVERNMENT MUST ACT 'WITH VISION' AND BACK NEW GENERATION OF WORKPLACE SCHEMES

20 April 2007: The Government must back radical reform measures if it is to capture the imagination of employers, many of whom are looking for a clear lead over the direction occupational pension provision should take in the years ahead. Without that lead, backed by essential legislative reforms, there will be levelling-down in pension provision, particularly if the personal accounts regime goes ahead alone.

This was the message from **Ian Farr, Chairman of the Association of Consulting Actuaries (ACA)**, at a major dinner attended by many senior figures from the pensions world, and also addressed by John Cridland, Deputy Director-General of the CBI.

"There is a real opportunity for Government to re-energise the provision of employer sponsored occupational pension schemes in the UK by providing a new 'third way'. New *shared risk* schemes are an important initiative in this direction and would sit comfortably between the existing defined benefit and defined contribution types of scheme," said Ian Farr.

"*Shared risk* schemes will enable employers to control costs into the future even if there are down swings in investment returns and continued improvements in mortality. For members, the advantages will flow from a more stable benefit platform than money purchase provides and – we think importantly – regular indexation of benefits supported by the new prudent funding regime."

Supporting new innovation in occupational provision, **John Cridland, Deputy Director-General of the CBI** added:

"Looking to the future we also need more choice and innovation in occupational provision. Fresh ideas like *shared risk* schemes are to be welcomed at a time when so many companies are reviewing their pension arrangements in the light of the forward risks those schemes present to their ongoing business. Innovation will need to encompass public sector pensions, where the

Government has to seek with greater determination a sustainable new settlement that is seen to be fair to taxpayers and private sector employees.”

The ACA has put forward a package of reforms to the Deregulatory Review of Private Pensions and has in particular argued that new *shared risk* schemes could work to fill the gap being left as final salary defined benefit schemes close to new entrants and increasingly future accrual. The ACA says that it is vital such schemes are encouraged by legislative reforms in the 2007/08 session of Parliament, in advance of the introduction of personal accounts (*See Note for Editors for further details*).

A paper on *Shared Risk* schemes and a *Questions & Answers* briefing are available on the ACA website at www.aca.org.uk (see ‘Policy Statements’)

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Notes for Editors

How might a shared risk scheme work?

Pensions under a *shared risk* scheme would be based on the member's average pensionable earnings during the period of scheme membership rather than the member's pensionable earnings at retirement (as is the case in a final salary scheme). The pension earned for each year of service would be re-valued from that year to the date of retirement and increased when in payment (up to the 2.5% pa indexation cap in current legislation).

Each year's pension would be a defined benefit, but future annual revaluations to that pension to the date of retirement and future annual increases when in payment would be **targeted**, supported by a funding reserve based on prudent actuarial assumptions under the new scheme specific funding regime. As each year passes, the year's revaluation and pension increase would then automatically become a defined benefit subject to the funding position of the scheme not showing a past service funding shortfall at that time.

New *shared risk* schemes would include those types of cash balance plan, where the retirement benefit is defined as a capital sum at normal pension age and then converted into pension at that time, provided they met the relevant criteria.

The ACA says *shared risk* scheme members should be protected from pension losses by the Pension Protection Fund, but with lower levies on employers reflecting the lower risk associated with such schemes.

What would be the key attractions of a shared risk scheme for employers and employees?

For employers and employees: an employer could expect to provide a pension similar to a defined benefit pension based on a member's average pensionable earnings revalued to retirement and increased in payment in line with price inflation (subject to the statutory 2½% annual cap) but for a stable contribution rate into the future.

For employers: unlike an existing defined benefit scheme, however, there would be under the rules of *shared risk* schemes the flexibility for the employer to:

- not grant a year's revaluation or pension increase if a past service funding shortfall emerged (but in practice, over the long term, past service funding surpluses, emerging because of the new scheme specific funding requirements, would be expected to finance reinstatements)
- reduce the rate of future service pension accrual
- increase normal pension age for active and deferred members subject to sufficient evidence of increasing life expectancy and to certain protections for scheme members
- wind up the scheme without providing full future revaluation and full future increases to pensions in payment (although the expectation would be that, over the long term, sufficient past service funding surplus would have been built up to secure most of the potential future revaluations and pension increases).

In practice, many employers may mitigate the above effects by making modest additional contributions.

For employees: importantly, because of the mechanisms for the sharing of risks between the employer and scheme members and by way of the modest pooling of risks amongst scheme members, the benefits provided by a shared risk scheme should form a much more stable platform for income in retirement than would be achieved by the same contributions paid to a defined contribution arrangement.

The **Association of Pension Lawyers (APL)** has provided input to the ACA on the main legislative changes, which are surprisingly few, required to facilitate *shared risk* schemes.

About the Association of Consulting Actuaries (ACA)

The **Association of Consulting Actuaries (ACA)** is the representative body for consulting actuaries, whilst the Faculty and Institute of Actuaries are the professional bodies. The ACA has over 1500 members working in around 80 firms. ACA Members are all qualified actuaries and are subject to the code of professional conduct of the Faculty and the Institute of Actuaries. Advice given to clients is independent and impartial. The ACA forms the largest national grouping of consulting actuaries in Europe.