



28 March 2003

Working and Saving for Retirement Consultations  
Department for Work and Pensions  
Pensions Strategy Team  
3<sup>rd</sup> Floor  
Adelphi  
1-11 John Adam Street  
London  
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Dear Sirs

**ACA comments on Green Paper - *Simplicity, security and choice: Working and saving for retirement***

The Association of Consulting Actuaries (ACA) was established over 50 years ago and draws its membership from consulting actuaries working in over 80 consulting firms. Members of the Association are all qualified actuaries – either Fellows of the Faculty of Actuaries in Scotland or Fellows of the Institute of Actuaries – and all actuarial advice given by members is subject to the code of professional conduct of the Faculty and the Institute of Actuaries.

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.

We welcome the intent behind the Green Paper but **we are very concerned that the proposals are simply not radical enough.**

In our ***Pension Strategy*** document dated November 2002 we advocated amendments to the State Pension System to remove the anomalies caused by the level of the basic State pension and means testing and the uncertainties over the future course of S2P. **We regard reform of the State scheme as vital in convincing employers to continue to support private provision.**

We were therefore very disappointed that the Green Paper did not address the complexities of the State scheme and the immense difficulties for both individuals and employers in planning and building private provision on top of this inadequate structure. The absence of radical reforms to address these issues and in other areas drives us to the conclusion that, without greater ambition, **the reforms proposed in the Green Paper are highly unlikely to stem the**

**drift away from occupational provision seen over the last decade, never mind encourage greater provision.** We are not alone in this view.

We recently commissioned a survey of employers to ascertain their views on the Pensions Green Paper (and the Tax Simplification Paper). We enclose a copy of the results.

- As you will see **93 per cent of employers felt the proposals in the Green Paper will be ineffective in encouraging greater occupational pension provision.**
- It is also noteworthy that **95 per cent felt the Government should not exclude simplifying the State Pension scheme from its reform proposals** at the next stage.

We also enclose herewith a copy of our November 2002 *Pensions Strategy* paper for your further consideration.

Change is expensive and time consuming for occupational pension scheme sponsors and so it is desirable and efficient for all changes to be carried out simultaneously. Sponsors of occupational schemes do not have the resources, or aptitude to take 'two bites of the cherry'. **Therefore we encourage the Government to implement more radical proposals to enable the simplification to be achieved in one hit.**

We have pleasure in attaching our comments to the issues for consultation using the headings set out in Appendix 1 of the Green Paper.

**We highlight the following main areas of our response to the questions raised in the consultation paper:**

- **The priority order on wind up should be changed and consideration should be given to the following order:**
  1. pensions in payment
  2. deferred pensions accrued to date of wind up with no further revaluation
  3. future revaluation of deferred pensions
  4. increases to pensions in payment and future pensions in payment

The reduction of priority to the revaluation would recognise the position of older deferred pensioners as the revaluation has a lower relative value for these members than for younger deferred pensioners.

- **Measures should be taken to ensure that the scheme specific funding standard is set at a reasonable level in order to avoid this leading to a material reduction in member security.** The Government, having taken advice, must make it clear to all parties just how secure they want final salary schemes to be and must then ensure that this message is properly communicated to scheme members.
- **The principles of the basis of calculation of debt on wind up should be set by the Government and subject to regular review.** For example it could be based on the

estimated cost of providing the accrued benefits for the pensioners and deferred pensioners without increases or revaluation (ie categories 1. and 2. above) within the scheme assuming that the scheme invests in secure investments.

- **We believe that the introduction of a more equitable priority order and appropriate funding standard will remove many of the inequalities observed in wind ups.** We agree that an insurance type scheme is attractive in theory if a workable equitable proposal is forthcoming which addresses, in particular, the moral hazard.
- **We advocate removing the requirements of Section 67 so that significant rationalisation of schemes' benefits can be achieved but with the protection afforded by trust law.**

Yours sincerely

**Helen James**

Chairman, Pension Schemes Committee

## ACA comments on Green Paper

### *Simplicity, security and choice: Working and saving for retirement*

#### Issues for consultation

##### Chapter 3: Informed choice for individuals

- 3.1 Q simplify the taxation of pension schemes radically so that all pension schemes are covered by a single set of simple rules (paragraphs 23 to 29);**  
A Welcome but inconsistencies with the IR proposals need to be reviewed.
- 3.2 Q improve financial education and awareness by, in particular, continuing its publicity campaign and sending targeted information to people at key points in their lives (paragraphs 31 to 33);**  
A Welcome
- 3.3 Q re-brand tax relief on individuals' contributions to personal and stakeholder pensions to demonstrate the generous incentives that the tax reliefs provide (paragraphs 34 to 38);**  
A This could be misleading as the resultant benefit may result in a reduction in means tested benefits.
- 3.4 Q extend information tailored to individual circumstances, notably combined pension forecasts from employers and pension providers, and automatically issue state pension forecasts to self-employed people, and people who are not members of private pension schemes (paragraphs 48 to 49);**  
A Welcome. However, we are concerned that a requirement for combined forecasts should not increase employers pension costs.
- 3.5 Q simplify savings products, and asks for views on offering the self-employed the right to opt in to the State Second Pension (paragraphs 50 to 52).**  
A The ACA supports this proposal.

## Chapter 4: Pensions and the workplace

### *Simplification*

#### **4.1 Q introduce more flexible rules for scheme funding to reduce the short-term burdens on schemes (paragraphs 31 to 35);**

A

- a) We support the introduction of a scheme specific funding standard however care needs to be taken that the balance of power between the employer and trustees is not altered significantly, that schemes do not use this as a means to funding benefits at an unreasonably low level, and that there are no inducements to encourage trustees to wind up schemes.
- b) Increasing flexibility in funding arrangements can be advantageous for the employer, but it does not reduce the cost of schemes.
- c) We disagree with the last sentence of paragraph 34, that transfer values will be higher if there is no MFR. In theory this should make no difference as many schemes have already moved away from MFR. We are concerned that the three month guarantee for cash equivalents is a heavy burden, especially for small schemes and so we suggest that the guarantee is optional.
- d) We disagree with the implication of the last sentence of paragraph 35 that the proposals increase protection for members.

#### **4.2 Q undertake a major simplification and restructuring of the contracting-out regulations (paragraphs 38 to 58);**

A

- a) We believe that the requirement to provide LPI should be removed for occupational schemes. This will aid simplicity as some schemes do not provide LPI on pre'97 benefits and afford schemes some flexibility in dealing with adverse financial conditions – incidentally, a recent ACA Survey indicates that the majority of schemes would continue to provide LPI even if the compulsion to do this were to be removed. This will also remove an inconsistency between occupational and personal pensions.
- b) The proposal to limit compulsory indexation up to £30,000 would increase complexity.
- c) We welcome changes to the RST but we believe that a weaker test is appropriate. Also we suggest that the current test should be retained as an option for employers who do not wish to change their current arrangements. If LPI and spouses pensions are not required it should be clear whether the State will pick up this liability.
- d) If the Government wish to encourage schemes to remain contracted out then fair (ie larger) rebates need to be provided.
- e) We support the proposal to simplify GMPs by converting to RST benefits of equivalent value.

- f) We believe that the Government needs to settle the equality issues of GMPS and then allow for simplification of GMPS.
- g) We support the proposal to double the trivial pension but this should be available at retirement not just at age 65 and the amount should continue to be reviewed from time to time.

**4.3 Q give schemes much greater flexibility in how they comply with the regulations (paragraphs 59 to 62).**

A

- a) We believed that a substantial easing, or complete removal of, Section 67 is required to enable significant simplification, for example a change of LPI to higher nominal pension and simplification of GMPs while not changing the nature or actuarial value of the DB benefit. We believe that trust law provides sufficient protection for scheme members.
- b) We support proposals for MNTs but would like to retain flexibility if MNTs are not forthcoming.
- c) Support proposals for IDR. We believe that schemes should be required to have a dispute resolution procedure, but it should be left to them to decide how to operate it. Members who are dissatisfied should have the opportunity to appeal to the Pensions Ombudsman.

***Protecting employees***

**4.4 Q develop a new pensions regulator whose objectives and resources are focused on protecting the benefits of scheme members (paragraphs 63 to 66);**

A We support the creation of a new pension regulator with wider protective powers. Its role should be to advise Government on the regulation of occupational schemes, comment on new legislation, offer guidance to pension providers and advisers and pursue cases of serious or persistent wrongdoing. It is not appropriate to regulate occupational pension schemes in the same way as life companies and therefore regulation of them should not fall under the FSA.

**4.5 Q take steps to give members greater confidence that, when schemes are wound up, they will get the benefits they were promised (paragraphs 67 to 92);**

A

- a) We support the need to amend the priority order on wind up. In particular we would support an advance in the move to the post 2007 priority order (pension increases at the end) and priority given to older deferred pensioners by revaluation of the deferred pension having a lower priority than the deferred pension. As a separate issue, we would strongly urge the Government to give wider advance publicity to the planned changes to the priority order on wind up.

- b) We understand that amending the priority order of creditors would not be acceptable to businesses.
- c) We do not believe that a centralised arrangement would result in the reduced costs or higher benefits for employees.
- d) It has been estimated that the deficit on wind up of all UK schemes is in excess of £300bn at the end of February and it is unlikely that this could be afforded. We agree that an insurance type scheme is attractive in theory if a workable equitable proposal is forthcoming which addresses, in particular, the moral hazard. We have grave concerns on the practicality as the risks are related to the sponsors' covenant, the investment policy of the scheme, and the funding level and there is no obvious way in which these risks can be priced at an affordable level for some schemes. A flat contribution to such an insurance scheme from all DB members / scheme sponsors appears similar to a tax on members / scheme sponsors with DB benefits rather than an insurance premium as there is no guarantee that their benefits will be protected at reasonable cost unless there is a Government guarantee. DC Scheme members/DC scheme sponsors would not be subject to this levy. Very great care would be needed to avoid runaway costs as experienced in the US PBGC. We believe that if the priority order and benefits and the funding standard are appropriate then the attraction of such an insurance scheme is much reduced.
- e) We support a fixed, regularly reviewed basis for the calculation of debt on wind up. The principles of this basis should be set by the Government and the liabilities could exclude pension increases and revaluation. For example it could be based on the estimated cost of providing the accrued benefits for the pensioners and deferred pensioners without increases or revaluation within the scheme, assuming that the scheme invests in secure investments.

**4.6 Q ensure that members are consulted about changes to their pension scheme (paragraphs 99 to 101).**

- A We would support the requirement for employers to consult with employees on pension changes but only to the same extent that they are required to consult on other elements of the remuneration package. We suggest that this is extended to TUPE transfers. We would not support further requirements for TUPE transfers.

***Better information and promotion of pensions***

**4.7 Q get the active involvement of employers through an employer task force (paragraphs 102 to 104);**

- A Support

**4.8 Q encourage employers who provide pensions to do more to highlight their value (paragraphs 105 to 108);**

- A Support

**4.9 Q encourage and facilitate all employers to provide better information (paragraphs 109 to 113);**

A Support, but should be voluntary

**4.10 Q help to extend pension provision, including increasing take-up by employees (paragraphs 114 to 126);**

A

- a) We support compulsory transfer of small amounts and if this is available we would support immediate vesting.
- b) We do not believe that there is a need for compulsory scheme membership. In the current conditions we do not believe that employers would
- c) No need for extending complications of introducing a further DC Option after PP and Stakeholder.

**4.11 Q encourage employers who do not provide pensions to provide their employees with pensions information and advice (paragraphs 127 to 129).**

A Support

## Chapter 5: Informed choice in pensions – building trust and understanding in financial services

- 5.1 **Q** develop generic financial healthcheck products, and financial advice through the workplace (paragraphs 33 to 36);  
A No comment
- 5.2 **Q** consult early in 2003 on how to bring stakeholder pensions into the simple product suite proposed by the Sandler review. The Financial Services Authority (FSA) will be consulting in parallel on the appropriate sales regime for Sandler products (paragraphs 37 to 52);  
A Noted (serious consideration should be given to the effect of the 1% charges cap).
- 5.3 **Q** make the annuities market work better, including the introduction of value protected and limited period annuities (paragraphs 63 to 69);  
A Welcome
- 5.4 **Q** ensure that the regulation of equity release and home revision plans protects consumers and allows the market to work effectively (paragraphs 71 to 72);  
A We have no comment on this proposal
- 5.5 **Q** ensure that pension fund trustees have appropriate investment expertise (paragraphs 78 to 82).  
A Response to follow.

**Comment [DR1]:** I have asked for this comment, but received no response. If not forthcoming, I suggest we leave out unless any of those circulated wants to have a bash at inserting a few words.

## Chapter 6: Extending opportunities for older worker

**6.1 Q provide extra back-to-work help for those aged 50 and over (paragraphs 25 to 29) and pilot measures to help recipients of incapacity benefits return to work (paragraphs 30 to 32);**

A We Support these proposals.

**6.2 Q treat men and women between 60 and women's State Pension age as active labour market participants, when women's State Pension age rises from 2010 (paragraphs 33 to 38);**

A Noted

**6.3 Q bring forward more generous increases for deferring State pensions (paragraphs 39 to 42) and maintain State Pension age at 65 (paragraphs 44 to 52)**

A Welcomed, but we are disappointed that there are no proposals to extend SPA. We believe that delaying a decision on a later SPA – which we believe is an inevitable change within a matter of years - will mean many individuals will be given a shorter period to adjust for the change than if a 'brave decision' was taken now.

**6.4 Q implement age legislation covering employment and vocational training by December 2006, in which compulsory retirement ages are likely to be unlawful unless employers can show that they are objectively justified (paragraphs 54 to 58);**

A Noted. Care will be needed to ensure this change does not add to costs.

**6.5 Q allow people to continue working for the sponsoring employer whilst drawing their occupation pensions, raising the earliest age from which a pension may be taken from age 50 to age 55 by 2010, and consulting on best practice to ensure that occupational pension rules do not discourage flexible retirement (paragraphs 59 to 64);**

A Welcomed. But it would be helpful to have a longer phase in period for the change to the minimum early retirement date of 50. This is a particularly significant issue for those employers who have negotiated redundancy agreements which allow early retirement from age 50.

**6.6 Q to change public service pension schemes, for all new members initially, to make an unreduced pension payable from age 65 rather than age 60 (paragraphs 65 to 69).**

A Noted

## **Chapter 7: Women, work and pensions**

**7.1 Q The Government proposes to look at how best to ensure that women are aware of their pension position and the choices they face (paragraphs 56 to 59).**

A. We support this initiative.