



***The House of Lords can boost workplace pensions by voting to allow employers to offer conditionally indexed schemes...***

## **GOVERNMENT NEARS 'LAST CHANCE' TO BOOST QUALITY WORKPLACE PENSIONS IN PENSIONS BILL**

**27 June 2008: the Government is nearing its last chance to boost quality workplace pensions in this year's *Pensions Bill* with the House of Lords about to debate a ground-breaking amendment that will allow employers to offer conditionally indexed pension schemes. The Bill is widely viewed to be inadequate in meeting one of its objectives of promoting quality workplace schemes – both existing and new schemes. As a result, the amendment offering employers greater freedom in pension design is expected to gain widespread support from peers said Keith Barton, Chairman of the Association of Consulting Actuaries (ACA).**

The amendment, drawn up by the ACA, would amend current defined benefit scheme legislation to allow employers to offer new conditionally indexed career-average schemes. For those many mid-sized and larger employers prepared to share risks with employees<sup>1</sup>, these schemes offer a pension arrangement that not only will attract and retain employees, but that also caps employers' costs into the future. Conditionally indexed schemes provide employees with a far less volatile pension benefit than defined contribution schemes and have a proven track-record in The Netherlands, where they are the pre-eminent type of workplace scheme. Key features are:

- **Pensions are based on career average earnings and pensionable service.**
- **Future pension increases are pre-funded, but are conditional on the level of scheme funding.**
- **Save on occasions when the scheme funding falls below 100% (the 'condition'), pension benefits would be indexed in line with a scheme specific index, typically inflation up to a 2.5% cap per annum.**
- **Restoring indexation would be the first priority when the scheme funding level rises above 100%.**
- **Employer contribution rates would normally remain stable whether the scheme funding level is below or above 100%.**
- **Funding would be based, as with existing defined benefit schemes, on the new prudent funding standards set by the Pensions Regulator, who would regulate such schemes.**
- **The schemes would be subject to a PPF levy securing further protection for members (but with lower levies based on the lower risk profile of such schemes).**
- **These are trustee-run schemes offering the prospect of higher investment returns over the longer term due to fewer constraints on investment strategy.**

The Pensions Minister, Mike O'Brien, opposed the 'conditional indexation' amendment in the Commons Bill Committee, whilst mounting few arguments against the initiative. Indeed he said (to quote) 'I do not disagree a great deal with the general argument put forward by the Opposition spokespeople', but instead he favoured a 12 week consultation on the various approaches to risk-sharing, which is not due to finish until 28 August 2008. This delay in getting anything moving will mean that any reforms to help employers establish new risk-sharing schemes could miss this year's *Pensions Bill*, with the consultation promising no guarantee of legislative time in the year or years ahead to 'free up' design. The CBI has given support to the conditional indexation amendment as a valuable addition to the Bill, endorsing the backing already given by pension bodies such as the NAPF.

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<sup>1</sup> ACA surveys in 2006 and 2007 have found over 70% of employers support risk sharing being promoted by legislation.

The ACA has made it clear to Government that the erosion of quality workplace pensions is alarming and ongoing. There are only around 900,000 private sector employees in final salary schemes open to new entrants, with only a small proportion of young or mobile employees now offered the opportunity to join defined benefit schemes. The ACA says this is worrying for a whole range of reasons, not least in terms of dividing private sector employees from public sector employees (where 5 million are in open defined benefit schemes) and dividing the young and mobile from older employees.

“The minor deregulatory measures in the Pensions Bill simply fail to address the scale of what is a genuine crisis in pension provision. It is not too late for the Pensions Bill to be ‘beefed up’ to allow employers some greater freedom and flexibility in benefit design now, to the benefit of employees”, said Keith Barton. “The detail of how conditional indexation schemes would work is far more advanced than the detail of some aspects of personal accounts, where, for example, the administration of collecting contributions and the charges and charging basis are still very uncertain. However, the absence of detail has not delayed the personal accounts legislation.”

This ‘first step’ move allowing greater design freedom is needed ahead of the tidal wave of workplace scheme reviews that the ACA says is inevitable in the run up to the introduction of auto-enrolment and personal accounts in 2012. The *Pensions Bill* is the appropriate vehicle, as it is understood it is unlikely to complete all of its stages until the autumn. Other risk sharing ideas, outlined in the Government’s consultation paper issued earlier this month, are less well developed than the conditional indexation model, which has been the subject of extensive consultations between the ACA and Government over the last two years. These other models may have to await legislation in future years, although the ACA says the Government should as a general principle stand back from ‘controlling’ designs – its sole interest and involvement should be that pension designs provide adequate member protection and, where necessary, compensation.

#### **For further comment:**

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#### **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 1,700 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 the World.

#### **Conditionally indexed pensions**

Conditionally indexed schemes offer to those many mid-sized and larger employers prepared to share risks with employees a pension arrangement that not only will attract and retain employees, but that also caps employers’ costs into the future (a full description of how conditional indexation schemes work is contained in the ACA’s *Written Evidence* to the Bill Committee<sup>2</sup>).

Importantly, under the ACA’s amendment to the *Pensions Bill*:

- Conditional indexation would not apply to the benefits offered by existing types of defined benefit schemes – for simplicity, the amendment only applies to new conditionally indexed arrangements set up after the Bill becomes an Act.
- The amendment in no way stands in the way of existing types of risk sharing arrangements (although the reality is that very few have been taken up by employers due to the complexity and limitations of current legislation and the communication issues involved).
- The amendment does not stand in the way of other possible types of risk sharing arrangements that may come out of the present risk sharing consultation.

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<sup>2</sup> See [www.aca.org.uk](http://www.aca.org.uk) see ‘Recent Publications’, 2 January 2008