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Young and mobile employees particularly at risk as ACA Chairman says Pensions Bill not yet fit for purpose...

PENSIONS BILL MUST BE 'BEEFED UP' TO ALLOW EMPLOYERS TO OFFER NEW TYPE OF SCHEME

17 April 2008:The *Pensions Bill*, which is set to receive its Third Reading in the Commons next Tuesday (22 April), before moving into the Lords, 'is simply not yet fit for purpose' said Ian Farr, Chairman of the Association of Consulting Actuaries (ACA).

"The erosion of quality workplace pensions is alarming. The reality is that we have 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. 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 Government to 'beef up' the Pensions Bill to allow employers greater freedom and flexibility in benefit design.

"At present employers have a stark choice in what they can offer employees – either defined benefit schemes where they take 100% of the investment and longevity risks or defined contribution schemes where employees take on these risks in toto. There are legal complexities involved in designing 'middle way' options, so the vast majority of employers are presently switching to defined contribution to reduce their forward pension liabilities. Employers need to have the option to offer a 'middle way' option, otherwise more and more employees will have to take on risks they are generally ill-equipped to deal with.

"The ACA has proposed an uncomplicated way to help both employers and employees. It is a first step that could be added into this Pensions Bill. We will continue to press for this amendment, which secured Conservative and Liberal Democrat support at the Commons Committee stage.

The ACA proposal would amend current defined benefit scheme legislation to allow employers to offer new conditionally indexed career-average schemes (see *Note for Editors* for further details). These schemes would offer employees a far less volatile pension benefit than defined contribution schemes, whilst enabling employers to cap their future costs.

The Pensions Minister 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, but not starting until June. This delay in getting anything moving will mean that any reforms to help employers establish new risk-sharing schemes will miss this year's Pensions Bill, with no guarantee of legislative time in the year or years ahead.

"The Pensions Bill promotes the extension of private pensions linked to the stock market through personal accounts and, indeed, where new workplace schemes are presently being introduced they too are mostly defined contribution. As I have said, increasingly this means 100% of the investment and longevity risks are with individuals. Interestingly, the latest *2008 Pension Trends Report*

published on Monday by the Office of National Statistics¹ shows 68% of individuals feel that a pension linked to the stock market 'was too much of a risk'. Amongst the un-pensioned, the figure is even higher. Policymakers and our own industry need to be careful in evaluating just how far the growing reliance on defined contribution schemes and plans can take us in both extending pension coverage and in providing reliable incomes for pensioners in the future," said Ian Farr.

"More flexible forms of trustee-run defined benefit schemes cannot be opened safely as the law stands. That situation is not good enough. Existing legislation needs to be amended now – well ahead of the tidal wave of scheme reviews that I foresee will take place in the run up to the introduction of auto-enrolment and personal accounts in 2012. This Pensions Bill offers that opportunity, as we now understand it is unlikely to complete all of its stages until the autumn. There is still time for the Government to allow employers the option to offer and for employees to benefit from new conditionally indexed schemes."

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 1700 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.

Conditionally indexed pensions

New conditionally indexed schemes offer to those many mid-sized and larger employers prepared to share risks with employees² 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 Committee³).

Conditionally indexed schemes offer to employees a far less volatile pension benefit than DC. Pensions are based on career average earnings linked to service. Save on occasions when scheme funding falls into deficit (the 'condition'), pension benefits would be indexed in line with a scheme specific index, typically price inflation up to a 2.5% cap per annum. Restoring indexation would be the first priority when a scheme returns to surplus.

Funding would be based, as with existing DB schemes, on the new prudent funding standards set by the Pensions Regulator, who would regulate such schemes, with PPF levies securing further protection for members (but with lower levies based on the lower risk profile of such schemes).

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 might be identified in the future, but which are not ready for this Bill.

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 charging basis are still very uncertain.

¹ *2008 Pension Trends*, Chapter 5, page 7, published 14 April 2008 by the Office of National Statistics.

² ACA surveys in 2006 and 2007 have found over 70% of employers support risk sharing being promoted by legislation.

³ See www.aca.org.uk see 'Recent Publications', 2 January 2008