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Louise Robinson  
The Pensions Regulator  
Napier House  
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Dear Ms Robinson

### **Regulating the funding of defined benefits**

I am writing to respond on behalf of the Association of Consulting Actuaries to the Pension Regulator's October 2005 consultation document on regulating the funding of defined benefits.

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association 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. ACA members include the scheme actuaries to schemes covering the majority of members of defined benefit pension schemes.

Our detailed responses are contained in the attachment to this letter. Our key comments are as follows.

### ***Raising the bar***

The proposals would involve employers paying, in aggregate, significantly higher contributions than currently. Based on a review of over 2,000 schemes, we estimate that around three quarters of them will be hit by a trigger of 70% of buy out liabilities. We have estimated that the extra annual contributions across all schemes might be in the region of £15 to £27 billion, an increase of 50% to 90% over the employer contributions paid to pension schemes in 2004. Research commissioned by the Regulator suggests that, for around 35% of schemes, the proposals would impose extra cash requirements in excess of 25% of employer's free cash flow which many employers will regard as an unwanted diversion of money that is required for other parts of the business.

The proposals suggest that target funding levels should be around 100% of FRS17 liabilities, and that shortfall recovery periods should be under 10 years. Our research suggests that very few schemes are targeting liabilities as high as 100% of FRS17, and that 44% of schemes use a longer recovery period, most choosing a period of up to 15 years.

Funding triggers of the kind described in the Regulator's consultation document might be appropriate when schemes are very mature, with few or no employee members. If the targets are to be applied to all schemes, they need to be introduced over a long transition period, perhaps 20 years. If a shorter transition is to be adopted, we do not agree that current funding targets need uplifting to the extent proposed by the Regulator.

### ***The buy-out cost as a reference point***

The Regulator's proposed trigger for funding is between 70% and 80% of a scheme's buy-out cost. As we explain in the attachment, the buy-out cost is not a reliable measure, given the inadequate information available about the buy-out market.

The Regulator's document explains that the target based directly on buy-out costs is a surrogate for the s179 and FRS17 liabilities. Given that this is the case, we suggest instead that the funding target is based directly on FRS17 liabilities where these are available, or otherwise on s179 figures, and not on buy-out costs. We recognise these measures have weaknesses, but we regard these as lesser than for the buy-out measure.

We recommend that triggers take some account of scheme maturity. A possible set of triggers are:

- a funding target of 100% of the pensioner liability and 80% of the non-pensioner liability, based on FRS17 or s179 liabilities, and
- a recovery period of 15 years.

### ***Encouraging employer pension provision***

Employers have faced major rises in DB pension cost in recent years, arising from:

- increased guarantees on accrued benefits;
- extremely adverse financial market movements;
- research on life expectancy resulting in a large one-off rise in the allowance for future longevity improvements; and
- imposition of a Pension Protection Fund levy.

Most UK employers have already closed their DB pension schemes to new entrants. With costs continuing to increase, some have started closing schemes to future accrual. Increases to pension contributions on the scale proposed by the consultation document will significantly accelerate employers' plans to cut back DB pension provision.

The Regulator's proposals may provide extra protection for the existing accrued rights of members of DB schemes, but they will significantly harm the chances of a return to a thriving occupational pension environment.

### ***Transparency***

There are some aspects of the statement which mean that it will be difficult for trustees and employers to interpret how the Regulator expects contributions to be set in specific circumstances. We would ask that the Regulator publishes case studies as soon as possible, to help trustees and employers to comply without having to refer back to the Regulator.

### ***Compliance costs***

At the time of the introduction of the Pensions Act 2004, the Government stated that the impact of introducing scheme-specific funding was expected to be a saving, given the greater investment freedom on the abolition of the Minimum Funding Requirement.

As well as requiring additional contributions, the Regulator's proposed approach to regulation will require significant exchange of information between the Regulator and schemes or their sponsors, particularly where the Regulator is trying to establish the scheme-specific circumstances. The Regulator appears to envisage that trustees will frequently take independent advice on the financial condition of the employer – to be useful, such advice will be expensive, potentially costing as much as the actuarial valuation itself. In assessing the proposals, we believe that the Regulator should undertake a cost impact assessment.

As explained above, we estimate that employers will have to contribute additional contributions in the range of £15 billion to £27 billion a year if the Regulator's proposals are implemented, on top of additional administrative costs. This is a very significant change, that we believe needs to be referred back to Government for confirmation.

We would be delighted to discuss the points raised in this letter.

Yours sincerely

Charles Young  
Chairman, Pension Schemes Committee