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*This week the Pensions Bill Committee has the opportunity to end the ban on employers being able to offer conditionally indexed pension schemes...*

## **Pensions Bill: will the Government seize the opportunity to halt the decline in quality company pension schemes?**

**18 February 2008: This week, the Pensions Bill Committee will debate 'new clause 5' which proposes an amendment to the *Pensions Bill* that would end the ban on employers being able to offer new conditionally indexed pension schemes.**

The amendment has been proposed by the **Association of Consulting Actuaries (ACA)**, with advice on the legal aspects provided by the Association of Pension Lawyers (APL), and is the culmination of work undertaken over the last 2 years in developing an initiative to re-invigorate quality workplace pensions in the UK.

In a final briefing to MPs on the Pensions Bill Committee, the ACA says that 'unless the ban on conditionally indexed schemes is removed, private sector employers who decide to close their current pension arrangements in the run up to auto-enrolment and personal accounts in 2012 will have no credible option for the future other than to choose defined contribution (DC) types of pension'.

The ACA adds, that whilst 5 million public sector employees enjoy open defined benefit (DB) schemes backed by the taxpayer, since 1995 the number of employee members of open private sector defined benefit schemes has declined from 5 million to just 900,000 now – and this figure is going in one direction only.

Existing DB schemes are largely final salary based and, under present legislation, must offer mandatory indexation of benefits. The ACA briefing points out that **mandatory indexation of both deferred pensions and pensions in payment in private sector defined benefit schemes is unique to the UK. No other Parliament in the world has placed such an onerous obligation on private sector firms to take on open-ended commitments in terms of the costs and liabilities involved.**

The ACA says that it knows of no employers or pensions organisation that feel the Pensions Bill's deregulatory measures as they stand are in any way sufficient to stimulate retention of quality existing or new private sector pensions. More is needed – personal accounts are not enough and have not been designed to replace quality workplace schemes.

Last week the CBI became the latest body to support the 'new clause 5' amendment, endorsing the backing already given by pension bodies such as the National Association of Pension Funds (NAPF), the Society of Pension Consultants (SPC) and the Association of British Insurers (ABI).

Commenting on the amendment, **Ian Farr**, ACA Chairman said:

"If the 'conditional indexation' amendment is rejected by the Bill Committee – and we see no reason why a political consensus should not embrace this initiative across the parties – then Parliament will be held responsible for what is likely to then occur. We expect a continued drift to DC, leading to a situation where 100% of investment and longevity risks will fall on the vast majority of private sector

employees, exposing millions of private sector employees to the volatility in pension outcomes that are associated with DC.”

The ACA says new conditionally indexed schemes offer to those many mid-sized and larger employers prepared to share risks with employees<sup>1</sup> 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>).

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 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.

Some have argued – notably the TUC – that more time is needed to study conditional indexation and to consider it alongside other possible risk sharing options before proposing possible legislation some time in the future.

In fact, over the last two years there has been a very substantial amount of consultation on risk sharing in general - as part of the *Deregulatory Review of Private Pensions* - and on conditional indexation in particular. Over the last six months, there have been numerous meetings with DWP Officials and with the Pensions Regulator to discuss how conditionally indexed schemes would work. The ACA says no substantive arguments have been sustained against this type of benefit design, which works so successfully in The Netherlands.

“Unfortunately, if this legislative opportunity is lost to remove the ban with no certainty of another Bill in the near future, it is expected that the decline in DB types of arrangements, coupled with the need of employers to review their pension offerings in the light of auto-enrolment and personal accounts, will mean the near wholesale switch to DC will be completed in a matter of a few years. Once done, the switch back to any form of risk sharing may be slow and difficult – with generations of private sector employees paying the price of a missed opportunity in this Bill”, added Ian Farr

“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. However, personal accounts legislation is not being

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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.

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

delayed even though consultations continue on key aspects of the Bill. The conditional indexation amendment should therefore find its way into the Act before it is finalised.”

The ACA briefings concludes that ‘conditionally indexed schemes are the first important step in re-invigorating quality UK pensions – the only new form of risk sharing pension design that is ready to implement **now**. Country-wide, consulting actuaries, who advise the vast majority of employers who would take up such schemes, are ready to promote the new design opportunity as employers plan the shape of their pension arrangements in the run up to 2012’.

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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.