



NEWS RELEASE

The ACA says quality private sector schemes are now under serious threat. Few may survive the impact of the credit crisis on the real economy. The Pensions Bill, in its final stages, can still be used to allow employers to offer quality pension schemes, but the time for action is running out...

ACA CALLS ON PENSIONS MINISTER TO ACT SO PRIVATE SECTOR CAN AFFORD QUALITY SCHEMES INTO THE FUTURE

23 October 2008: As we have seen over the last week, urgent timely action can halt the slide in markets. In a letter to the new Pensions Minister, the Association of Consulting Actuaries (ACA) has called for similar urgent action in the pension sector if quality schemes are to be retained in any number. The letter argues that by allowing employers to offer new 'middle way' conditional indexation schemes, Parliament could help protect the future for close to 3 million private sector employees, whose pensions are now under threat.

"Feedback from our members, who advise the vast majority of mid-sized to large schemes, indicates that the acceleration in closures of defined benefit – mostly final salary – schemes to new entrants and increasingly future accrual will grow at pace over the next year or so as finances tighten," says **Keith Barton**, ACA Chairman.

"Without a new 'middle way' option that allows employers to cap costs, the vast majority of private sector employees will be moved into defined contribution schemes. The absence of choice under current legislation leaves few other realistic options – but the absence of choice certainly won't halt closures."

"Unfortunately, we have seen what adverse market movements can do over the last two weeks in terms of defined contribution pension outcomes. Certainly, as a result, we will see unfulfilled expectations and, in all probability, extra State income support needed for those who are unfortunate enough to retire or be retired at the wrong time. Survey results show that most employees don't want a pension where members take on 100% of all investment and longevity risks and which is subject to the ups and downs of stock markets. Recent events are likely to have reinforced that view," says Keith Barton

Under current legislation, UK employers, unlike anywhere else in the world, must index defined benefit pensions for both pensioners and revalue deferred members' benefits each year, subject to a cap. This can be extremely expensive and must be done even if a scheme is in deficit. A change to the law, drawn up by the ACA, would amend current defined benefit legislation to allow employers to offer new conditionally indexed career-average schemes. For those employers prepared to share risks with employees, this new option would offer a pension arrangement that not only will attract and retain employees, but that also caps employers' costs into the future. Conditional indexation schemes were one of the models featured by the Government in their recent Risk Sharing consultation. The ACA says the conditional indexation model is well developed, has a proven track-record in The Netherlands and its introduction should be the first step in allowing greater freedom in UK workplace pension design.

The ACA says it does not expect all employers closing existing defined benefit schemes will opt for new conditional indexation schemes – sadly, many employers are so disillusioned with the increasing costs and inflexibility of pension schemes, and their inability to cap their costs under existing legislation, that they will do no more than make minimum provision in the future .

“However, if the option is made available of a new type of scheme that truly does enable employers to cap their costs, whilst providing good quality, more predictable pensions, we believe a substantial number of mid-sized to larger employers would be interested enough in their employees' future welfare that they would respond positively. And, over time, we think that interest would grow,” says Keith Barton,

“With no new option, the future is bleak indeed for the pensions of private sector employees and there will be a growing unsustainable divide between private sector and public sector schemes. Already, the inequity is being commented upon in the press on a regular basis.”

The ACA proposals, which are being debated at the Lords Report stage of the *Pensions Bill* on 27th October, will not impact on accrued benefits – the amendment is targeted on future pension service. And, just as important, the reforms have been designed so that they fit into the existing regulatory architecture. These new schemes would have to be prudently funded and would be regulated by the Pensions Regulator. They would also be subject to a PPF levy and thereby members would be protected in the event of employer failure.

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Note to Editors:

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 over 1650 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 Pensions Bill Committee¹).

Conditionally indexed schemes offer to employees a far less volatile pension benefit than defined contribution. Pensions are based on career average earnings linked to service.

¹ See www.aca.org.uk see 'Publications', 2 January 2008

Employer contributions would include a full funding allowance for pension increases. 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).