ASSOCIATION OF CONSULTING ACTUARIES

PRIVATE PENSIONS SIMPLIFICATION: PICKERING REVIEW

A. INTRODUCTION

The Association of Consulting Actuaries (ACA) welcomes the opportunity to comment on the consultation paper on pension simplification.

Members of the ACA are all qualified actuaries who act in a consulting role in respect of occupational pension schemes and also in other areas such as life insurance, health and general insurance. The ACA's members are advisers to UK pension schemes with assets in excess of £650 billion, including the vast majority of larger schemes and thousands of smaller arrangements.

We are very pleased to submit this response at this time. Before setting out our proposals, we would like to explain why we believe that this simplification project, together with the review of MFR and the Inland Revenue review of the tax treatment of occupational pension schemes, is of critical importance.

Over the last few years, companies have become increasingly concerned at the costs and risks involved in providing defined benefit schemes. The impact of lower real returns generally available on investments and the improvements in longevity of members increase the costs of pensions. Two years of poor investment performance has made sponsors more aware of the costs and risks associated with providing defined benefit pension schemes and the disclosure requirements of the accounting standard FRS 17 focuses attention on these issues.

A history of judgements extending legislation, plus Governments requiring compulsory benefit increases, has extended schemes beyond the level most employers considered good practice at the time their scheme was established and removed some of their flexibility, thus increasing employer risk.

Consequently, this has reduced employer support for the concept of a funded voluntary private pensions system on the current basis. Many employers are looking to redesign their pension schemes for new entrants and/or for future service for all members to reduce the cost and risks involved.

Therefore, in order to extract the full value from the current and future pension provision it is essential that the aim of your review "to reduce the cost of compliance whilst retaining member protection" is achieved.

If these employers are to continue with their final salary schemes then, as a minimum, they will be looking for a strong and unambiguous signal that the Government recognises their concerns and is prepared to do something about them. This could be achieved by positive action in response to this Simplification Review

In Section B, we consider how we have ended up in the current position and use this analysis to establish principles for the simplification review and for future pension legislation.

In this submission we have focused on broad points of principle but we would be pleased to provide a further response covering points of detail if this would be considered appropriate

B. HISTORY OF OUR COMPLICATED LEGISLATION

Legislation has been built up layer upon layer. In addition, some layers of legislation have been constructed under different policies producing inconsistencies.

A classic example is the principle included in the preservation legislation that preserved benefits or accrued rights can be transferred without consent as long as the receiving scheme offers benefits of equivalent actuarial value. That was reflected in the actuarial certification requirements of Regulation 12 of SI 1991/167 the Occupational Pension Schemes (Preservation of Benefit) Regulations. That provision provides a lower level of protection than Section 67 of the Pensions Act 1995, which aims to protect accrued rights against scheme rule amendments. There the level of protection is of the amount of pension in payment, or due, to a beneficiary at any particular time. That level of protection permits only upward change or the continuation or compounding of complication. The level of protection provided by the preservation legislation permitted change and simplification as long as the prospective actuarial value of the member's benefits, i.e. the member's wealth, was not ultimately reduced, and this provided a practical compromise between the ability to make changes for administrative simplification purposes and protecting members' entitlements.

We are also seeing the burden of legislation increased by judgements of the Pensions Ombudsman, many of which extend, rather than interpret, legislation and hence upset the previously agreed balance between scheme sponsor and member. That, ultimately, contributes to the loss of control, and closure of schemes, by sponsors.

Furthermore, the non-plain English culture of the current and past parliamentary draftsmen, with the proliferation of increasingly complex amendments to already complicated legislation, only serves to compound the problems.

C. ACA SIMPLIFICATION PROPOSALS

We have, where possible, followed the format suggested in the consultation document.

However, our proposed change to Section 67 – see Section 4.1 – merits a special mention here as it is fundamental to our other proposals.

The policy wish, to completely preserve accrued rights as defined by amount, rather than by actuarial value, prevents simplification on amalgamations of schemes and in other instances, for example the rejection of the industry proposals for “GMP equalisation” a few years ago

Our understanding is that the Goode Committee originally intended this to be a change test based on maintaining the overall actuarial value of the accrued benefit, not the amount of pension in payment to any prospective beneficiary at any point of time under any contingency. Hence its recommendation that the Scheme Actuary completes the required certificate. An "amounts" test would have been more appropriate for legal certification.

We believe that if the simplification exercise is to achieve anything, this test needs to revert to what the Goode Committee originally intended and be used to over-ride scheme rules. This would enable scheme benefits to be simplified and equalisation issues to be more easily adopted.

In practice, it may be appropriate to have limits on the extent of change allowed on past service benefits under this route. For example, it may not be acceptable to change the level of increases on pensions in payment without members’ consent.

1. CONTRACTING OUT

The current contracting-out regime is extremely complicated and, given the forthcoming changes to the second-tier of the State Pension Scheme, has completely lost the initial close link between the GMPs under contracted-out schemes and the State pension.

Some of the major problems with the current contracting-out regime are:

- the current contracting-out rebate structure produces too low a rebate for occupational pension schemes and, in practice, penalises efficiency;

- the administration of contracted-out benefits, including notifications to the Inland Revenue National Insurance Contributions Office, is very complex;

- it is difficult to explain the benefits to which a member of a contracted-out scheme is entitled in a simple manner;

- because GMPs effectively have different pension ages for men and women, it is difficult for contracted-out final salary schemes to deal with equalisation;

- the fact that in many cases all the benefits earned after April 1997 in a contracted-out final salary scheme are regarded as 'protected rights' introduces constraints on the transferability of these benefits.

We believe that the contracting-out regime needs to reviewed as follows

- the same level of rebates for both final salary and money purchase schemes;

- simplify the requirements for schemes to contract-out, for example for a money purchase scheme it should be a "minimum contribution test" and for a final salary scheme a "value test" and, once these requirements have been met, impose no specific restrictions at all on these schemes;

- there is no need for there to be different security measures for GMP/PR/Post97 rights and other rights and the change to Section 67 outlined above would enable scheme benefits to be simplified so that these classes of benefits were indistinguishable;

- this principle would automatically be extended to transfers of contracted-out benefits, and, in particular this would address the issues in relation to a) transfers of PRs without consent to a salary related scheme and b) transfer of post-97 contracted out benefits to a money purchase arrangement, whether or not it is contracted-out;

- the anti-franking regulations are complex and we would like to see these replaced by a general principle that increases to an early leaver's benefits should not be met from the GMP, or increases to the GMP. In addition, the calculation of rights accrued pre and post April 1997 should be kept separate. This, together with the Section 67 changes described above would enable schemes to deal with the implementation of the anti-franking requirements in a practical way.

- the changes proposed to Section 67 and to contracting out should apply to past accrued rights. This would permit a solution to the problem of "Equalisation of GMPs" along the lines proposed by Joint Working Group a few years ago.

2. TRANSFERS AND PRESERVATION

2.1 TRANSFER VALUES

The basis of calculation and terms and conditions of a cash equivalent transfer value should not be enshrined in legislation but should be determined by the trustees on advice from their actuary. This basis could then be consistent with the scheme's own funding basis and any guarantees could be consistent with the scheme's investment and administration arrangements.

2.2 VESTING

Current legislation permits schemes to have a vesting period of up to two years. We do not think that it is appropriate to reduce this period as this would increase employer costs and increase the administrative burden.

3 DISCLOSURE OF INFORMATION

Whilst we fully support the principle of full disclosure of pension scheme information to scheme members and interested parties, the current disclosure regulations are unnecessarily voluminous and complex.

We would like to see the existing regulations replaced by general requirements that:

(a) any changes which affect either the management of the scheme or an individual's benefit entitlement should normally be communicated within 3 months of the change (communications about benefits already in payment being communicated two months in advance of the change); and

(b) a requirement that scheme trustees prepare an annual report to members containing all the information which the trustees consider is relevant to the members of the scheme.

Furthermore, we believe that the extent to which scheme benefits would be covered on winding-up should be disclosed to members of final salary schemes.

This principle of leaving decisions on points of detail to the trustees (or scheme managers) acting in scheme members' interests could be extend to Defined Contribution projections. We are concerned that there is a danger that the prescribed basis for these projections will be over-complicated and we propose that a scheme should have the option of substituting its own actuarially-certified projections for the default statutory basis.

4. SCHEME ADMINISTRATION

4.1 SECTION 67

For all the reasons set out above, we propose that Section 67 is removed and replaced with a GN16-type amendment provision based on equivalent actuarial values.

4.2 INLAND REVENUE REQUIREMENTS

Inland Revenue requirements in relation to occupational pension schemes are extremely complicated. Consequently, they are time-consuming to comply with and extremely confusing for employers and scheme members.

Whilst we do not propose to comment any further on these requirements in this submission, as we understand they are subject to a separate review, we do want to record that they are a major obstacle to simplification and to emphasise that we believe that real simplification can only be achieved if pension policy is reviewed, and agreed, jointly by the Treasury and the DWP.

4.3 ADDITIONAL VOLUNTARY CONTRIBUTIONS

Under current legislation, employers operating occupational pension schemes are required to offer members the facility to pay additional voluntary contributions ('AVCs') into the scheme in order to enhance their retirement benefits.

Employers, however, set up pension schemes in order to provide certain retirement benefits for their employees and however valuable AVCs may be (and, given the availability of other tax-efficient savings vehicles, such as ISAs, free-standing AVCs and 'concurrent' personal pensions, they may not be the best savings vehicle for a particular individual). We fail to see why the burden of offering, and administering, AVCs should be imposed unilaterally on employers who choose, voluntarily, to set up a pension scheme for their employees.

Whist we would expect that many schemes would continue to offer AVCs on a voluntary basis, we propose that the requirement for all occupational pension schemes to offer AVCs should be removed.

4.4 DIVORCE

Dealing with the implementation of the divorce legislation has been very time-consuming, primarily because the legislation is much too detailed and complicated. The amount of time spent on this by Government officials, professional advisers and scheme trustees has been disproportionate, particularly in relation to the relatively small number of cases to which the new legislation has applied.

We would like to see the divorce legislation brought back to basic principles and the opportunity taken to simplify the trustees' obligation to an ex-spouse. In particular, the trustees should have the right to transfer the safeguarded rights to any stakeholder scheme, unless the ex-spouse requests an alternative option within 3 months.

4.5 INTERNAL DISPUTE RESOLUTION PROCEDURE

We do not see the need for the internal dispute resolution procedure to be set out in detail in regulations.

We believe that it would be more effective to simply require schemes to have an internal dispute resolution procedure and to be required to communicate this to members when they join the scheme and whenever the procedure is changed.

This would give scheme trustees the flexibility to set up whatever internal dispute resolution procedure best suits their particular circumstances.

4.6 MEMBER-NOMINATED TRUSTEES

In a similar vein to the above comments on the internal dispute resolution procedure, we do not see the need for the member-nominated trustee regulations to set out in great detail the way in which member-nominated trustees are chosen.

We believe that it would be more effective to simply require there should be at all times at least one-third member-nominated trustees for trustees' decisions to be valid in law.

This would give employers/trustees the flexibility to set up whatever procedure for selecting member-nominated trustees best suits their particular circumstances.

4.7 MYNERS

We are concerned at the further complexities that are proposed in order for an occupational pension scheme to comply with Myners. The Myners' proposals are particularly burdensome for smaller schemes. We suggest that the proposal for prescriptive legislation is reviewed in order to simplify the requirement to a set of basic principles.

5 SOCIAL POLICY

5.1 LIMITED PRICE INDEXATION

One of the major changes to the occupational pension regime over the years has been the intervention by Government in the benefits being provided by occupational pension schemes. Bearing in mind that the establishment of an occupational pension scheme is a voluntary act by the employer, it is difficult to understand why the Government should feel that it is appropriate to impose certain benefits conditions on the scheme. In times of low inflation, LPI appears to be an inefficient benefit to provide, it is expensive to purchase from an insurance company and there are very limited opportunities for schemes to match the liabilities.

We would like to see the requirement for final salary schemes to provide limited price indexation removed.

5.2 SPOUSES AND DEPENDANTS

There are various restrictions and requirement for benefits in the legislation which are only appropriate for previous UK social and economic structures and which do not reflect the common current situation of all adult members of a household being available for work or the reality of same-sex long-term relationships.

These provisions prevent the development of pension provision from being appropriate to current social and economic structures and should be removed.

5.3 OPRA

The Goode Committee recommended legislation in principle rather than detail and a regulator that would apply common-sense and judgement. However, we have ended up with a 'tick-box regulator' that checks compliance against legislation in detail via whistle-blowing reports. Although judgement does still rest with the requirement for reporting by professional advisers, OPRA has issued pronouncements encouraging reports regarding offences against the detail of the legislation even where the spirit is being met. There is simply no practical flexibility built into the system.

We would strongly support a change in the method of regulation so that we can have a regulator who is, indeed, able to apply common-sense and judgement. This will work particularly well in a regime where the legislation is based on broad points of principle, rather than detailed regulations. Whilst this may require higher quality of staff, this may not cost more than the existing approach, as there would be a trade-off between level of skills and numbers of staff.

5.4 OMBUDSMAN TO ENFORCE LAW RATHER THAN EXPAND INFLUENCE OF LAW AND OFFICE

We are seeing the burden of legislation increased by judgements of the Pensions Ombudsman, many of which extend, rather than interpret, legislation and hence upset the previously agreed balance between scheme sponsor and member. That, ultimately, contributes to the loss of control, and closure of schemes. We propose that the scope of the Ombudsman is restricted to established legislation.

For further information:

Association of Consulting Actuaries

No.1 Wardrobe Place, London EC4V 5AG.

Tel: 020 7248 3163 Fax: 020 7236 1889 Email: acahelp@aca.org.uk