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Pensions Bill

Bill 57 of 2003-04

The *Pensions Bill 2003-04* was introduced on 11 February 2004 and published the following day. It is due to have its second reading on 2 March 2004. It comes at a time when confidence in private pension provision has been dented by a number of high profile scheme collapses, which have left members with much smaller pensions than they had been promised. Amongst other things, it will introduce a Pension Protection Fund to compensate those who lose out in this way. However, it will only apply to schemes winding up after the legislation has been brought into force.

It is a large Bill with 248 clauses and 12 schedules containing a range of measures designed to increase "simplicity, security and choice" for private pensions.

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Summary of main points

The *Pensions Bill 2003-04*, published on 12 February 2004, forms part of the Government's programme for increasing "simplicity, security and choice" for private pension schemes. Another major part of this programme is a radical simplification of the tax regime for pensions, due to be included in the *Finance Bill* later this year.

Amongst other things, the *Pensions Bill* will:

- Replace the Occupational Pensions Regulatory Authority (Opra) with a new, more pro-active Pensions Regulator

- Introduce a Pension Protection Fund (PPF) to provide compensation for members of defined benefit occupational schemes whose assets are insufficient to meet their liabilities when they are wound up on the insolvency of their employer

- Replace the Minimum Funding Requirement (MFR) for defined benefit occupational pension schemes with a scheme specific funding requirement

- Require employers taking on employees with pension rights under the *Transfer of Undertakings (Protection of Employment) Regulations* (TUPE) to contribute to a stakeholder pension

- Reduce the cap on the statutory requirement to index occupational pensions in payment in line with the Retail Price Index (RPI) from 5% to 2.5%

- Take reserve powers to compel occupational pension schemes to provide combined pension forecasts and workplace advice on retirement planning

- Bring forward improvements to deferred retirement increments to state pensions and offer a lump sum as an alternative

- Require pension schemes to have one-third of their trustees nominated by members and impose a requirement on trustees to have knowledge about the issues they deal with

The intention is that most of the provisions of the Bill will be brought into force in April 2005.

The Bill applies to England, Wales and Scotland. The establishment of the PPF Board and the Pensions Regulator as bodies covers Northern Ireland as well, but their powers will be contained in a separate Northern Ireland Order. Provisions allowing for web-based retirement planning and relating to the termination of the Social Security Agreement with Australia will apply throughout the UK.

CONTENTS

I Introduction

A. Setting the Scene

1. The UK pension system

Pensions is a technical subject, so this paper starts with a brief outline of the current UK pension system, which introduces many of the terms which will be used throughout. It ends with a list of Abbreviations and a Glossary where readers might find further help in understanding the terminology.

The UK pension system is traditionally described as a "three tier" system:

a. First tier

The first tier is provided by the State and consists of the **Basic State Pension (BSP)** which is a contributory, flat-rate benefit. People with a full record of **National Insurance Contributions (NICs)** qualify for the BSP when they reach **State Pension Age (SPA).** This is currently 60 for women and 65 for men, although it is due to be raised to 65 for women over the period 2010-2020. The BSP is currently £77.45 a week for a single pensioner (rising to £79.60 in April 2004). Lower rates are paid to people with deficient contribution records and deferred retirement increments are paid to those who defer receiving their pension beyond SPA. Although the BSP is paid from the National Insurance Fund, it is financed on a "pay-as-you-go" basis: current contributions pay for current pensions.

Pensioners with relatively low incomes may also qualify for means-tested support through the **Pension Credit**. A single pensioner aged 60 or over with no extra amounts (e.g. for severe disability) would qualify for the **guarantee credit** of the Pension Credit if their income was below £102.10 a week (rising to £105.45 in April 2004). Pensioners aged 65 or over may also qualify for a **savings credit,** designed as a "reward for saving", if they have income (e.g. from a private pension) above the level of the BSP. This too is means-tested and the maximum savings credit for a single person is £14.79 (rising to £15.51 in April 2004). Pension Credit is financed through general taxation.

b. Second tier

The second tier is also provided by the State. It consists of the **Additional State Pension (ASP)** which is a contributory, earnings-related benefit, paid from SPA. There have been three different earnings-related State schemes since 1961: **Graduated Retirement Benefit (GRB)** which operated between 1961 and 1975; the **State Earnings Related Pension Scheme (SERPS)** which operated between 1978 and 2002; and the **State Second Pension (S2P)** which replaced SERPS in April 2002.

SERPS and S2P derive from contributions on earnings between the **lower and upper earnings limits (LEL** and **UEL)** for NICs. Since 1978 it has been possible to **contract**

out of the additional state pension into a private pension scheme. People who are contracted-out pay lower NICs, reduced by the amount of the **contracted-out rebate**: in return their second tier earnings-related pension is provided by the private scheme. Originally the private scheme had to be a **defined benefit occupational scheme** (see below) which provided a **Guaranteed Minimum Pension (GMP)** at least as good as the SERPS foregone. From April 1988 it has been possible to contract out into **defined contribution occupational schemes** (see below) and appropriate **personal pension schemes** (see below). In these cases, the benefits secured through the contracted-out rebate are called **protected rights.** Although these benefits must comply with certain conditions – they must, for instance, be index-linked and must provide a 50% widow(er)'s pension – there is no guarantee that they will equal the additional state pension foregone. From 1997, contracted-out DB schemes have not had to provide a GMP, but only to satisfy a test of scheme quality, known as the **Reference Scheme Test**.

GRB, SERPS and S2P are all financed from the National Insurance Fund on a "pay-as-you-go" basis.

c. Third tier

The third tier is provided by **private pensions**, which are voluntary and not directly funded by the State.

Many employers sponsor **occupational pension schemes** which may be **defined benefit (DB)** or **defined contribution (DC).** In some cases, employers offer **hybrid** schemes which combine DB and DC elements in various ways. DB schemes are often also known as **final salary schemes**. DB schemes promise the employee a pension of a certain size (eg 1/60th of final salary for every year of service) and contributions are adjusted to secure this. DC schemes are often also known as **money purchase schemes**. Employers and employees make specified contributions to a fund and the size of the final pension depends on the performance of that fund.

Individuals may also contribute to **personal pensions** which operate on money purchase principles. Contributions are made to a fund which is used to purchase an **annuity** (a regular payment) on retirement. Since April 2001, individuals have also been able to contribute to **stakeholder pensions**. These are personal pension schemes which satisfy minimum CAT (Cost, Access and Terms) standards. For example, fees are capped at 1% of the fund. Employers with five or more employees who do not offer an occupational scheme for all employees to join within one year of starting work, must offer their employees access to a stakeholder scheme.

Provided the private pension scheme meets certain Inland Revenue rules (and is, therefore, "approved") contributions by both employers and employees are free of tax and the fund does not have to pay tax on interest received or capital gains.

d. *Statutory schemes*

Mention should also be made of the statutory schemes which cover most people working in the public service. The rules of the schemes for MPs, the police, the fire service, armed forces, civil service, teachers, local government and NHS are generally laid down in statutes and regulations made under them. Nearly all the schemes are DB, though the civil service has recently introduced a money purchase option. Some schemes are funded, others are not. Most are contributory: those that are not have an adjustment to pay levels to reflect this.

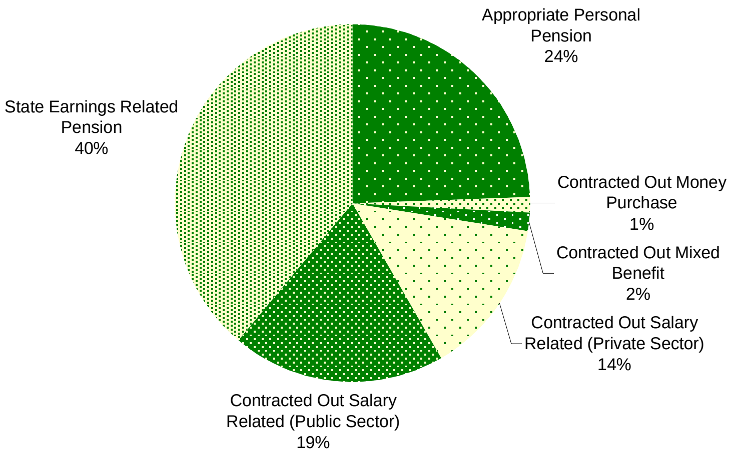
2. Numbers

a. Second and third tier pension provision

The number of employees contributing to some form of second and third tier pension provision has increased almost every year since 1978/9, from 17½ million in 1978/9 to around 23½ million by 2000/1.[1]

In 2000/1, 40% of contributors were making their second tier provision via SERPS, the State Earnings Related Pension Scheme; 34% had salary related schemes (14% private sector and 19% public). A further 25% had Appropriate Personal Pensions – and it is growth in this sector that largely underpins the overall growth in second tier provision.

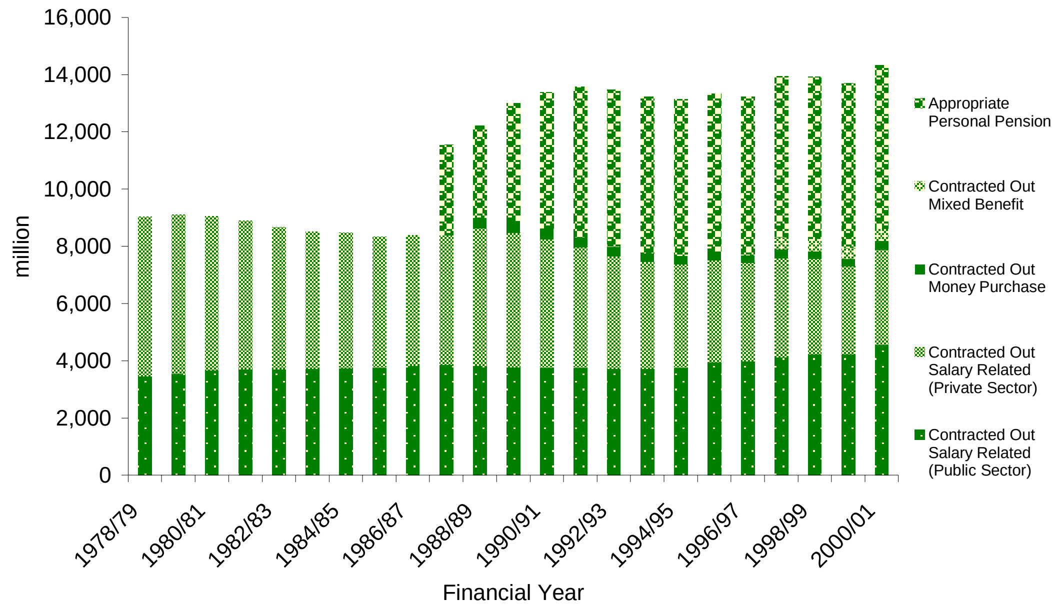
Second tier pension contributors - 2000/1



The numbers contributing to salary-related schemes has remained fairly static over the last 20 years, although within this total the numbers in the private sector have fallen while those in the public have risen.

[1] The statistics on SERPS and contracting out in this section of the paper are taken from DWP *Second Tier Pension Provision 1978/9 to 2000/1* December 2003 – See Appendix to this research paper for data

Contracted out pension scheme members by type of scheme: 1978/9 to 2001/2



While the numbers in occupational schemes have been fairly static, in recent years the number in employment has been increasing and this means that the proportion of employees in an occupational scheme has been in decline. In 1979 49% of employees were in defined benefit schemes and 1% in defined contribution ones. By 2000, 42% were in both these sorts of schemes (38% in defined benefit and 4% in defined contribution).[2]

Employees with defined benefit (DB) and defined contribution (DC) pensions
Totals may not add due to rounding

	Million persons (UK)								Proportion of employees with	
	Private	Of which		**Public**	**Both sectors**			Persons		
	Total	DB [(a)]	DC [(b)]	Total	DB [(c)]	DC	Total	Empl.	DB	DC
1975	6.0	5.8	0.2	5.4	11.2	0.2	11.4	23.1	48%	1%
1979	6.1	5.9	0.2	5.5	11.4	0.2	11.6	23.4	49%	1%
1983	5.8	5.4	0.4	5.3	10.7	0.4	11.1	21.1	51%	2%
1987	5.8	5.3	0.5	4.8	10.1	0.5	10.6	21.6	47%	2%
1991	6.5	5.6	0.9	4.2	9.8	0.9	10.7	22.5	44%	4%
1995	6.2	5.1	1.1	4.1	9.2	1.1	10.3	22.5	41%	5%
2000	5.7	4.6	1.0	4.5	9.1	1.0	10.2	24.1	38%	4%

(a) For 1987, DB figure is the final salary total. Prior to 1987, it is final salary plus the (increasingly small) average salary, salary range and flat sum per year of service totals.
(b) 2000 figure includes members of hybrid (better of both) systems
(c) It is assumed that all public sector pensions are DB

Sources: Government Actuary's Dept, *Occupational Pension Schemes*, 1983, 1987, 1991, 1995, 2000

2 Government Actuary's Department *Occupational Pension Schemes* periodic surveys

b. Sources of income for pensioners

While income from state benefits for pensioners has been declining in importance, the latest figures show it still comprises just over half of average pensioner income.

Average incomes of pensioners - Great Britain (1979 to 2001/2)

	£ pw, 2001/2 prices				% of gross income			% growth	
	1979	1994/5	1998/9	2001/2	1979	1994/95	2001/02	1979-2001/2	1994/5-2001/2
Gross income	165	216	238	268	100%	100%	100%	62%	24%
of which:									
Benefit Income	96	114	122	136	58%	53%	51%	41%	19%
Occupational Pension	27	54	62	70	16%	25%	26%	162%	30%
Personal Pension	-	3	4	7	0%	1%	3%	..	133%
Other	41	45	51	54	25%	21%	20%	33%	20%
Total Non-benefit	67	102	117	131	41%	47%	49%	95%	28%

Source: DWP *Pensioner Income Series*

The poorest pensioners are overwhelmingly dependent on state benefits for their income, while richer pensioners have been getting a growing proportion, usually the majority, of their income from occupational pensions and other private sources.

While the incidence of private pension income is similar across all pensioners, the amounts involved are greater for younger, more recently retired individuals. In 2001/2, 65% of pensioners had private pension income, averaging £118 per week. For those who were recently retired,[3] 69% had income from private pensions, averaging £164 pw.

3. Public/private pension provision

The *Pensions Bill 2003/04* is being introduced at a time when private pension provision is in decline and public confidence in pension security has been shaken. It is designed to restore this confidence, to encourage employers to increase their occupational pension provision and individuals their private pension saving.

The present Government's first Pensions Green Paper – *A new contract for welfare: partnership in pensions* – was published in December 1998. The Green Paper predicted that the reforms it proposed would increase the proportion of pensioner income coming from private pensions from 40% to 60% by 2050. The reforms included the introduction of Stakeholder Pensions (from April 2001), the replacement of the State Earnings Related Pension Scheme (SERPS) by the State Second Pension (S2P) which is more beneficial to those on low and moderate earnings and to certain carers and disabled people (from April 2002) and the replacement of means-tested Income Support for pensioners with the more generous Minimum Income Guarantee (MIG) (from April 1999):

> 14 There are likely to be fewer people on income-related benefits than under current policies as far more people are able to develop a good second pension

[3] where the head of household is within 5 years of the state pension age

> from the state or a private scheme. The reforms will offer security in retirement for tomorrow's pensioners, with extra help for everyone earning up to £18,500 a year, focused in particular on the poorest.
>
> 15 More people will secure, good value, funded private pensions through joining a stakeholder pension scheme or through joining their employer's occupational scheme.
>
> 16 Understanding of pensions will improve, ensuring that people can make the right pension choices for them. As they do so, we expect more people to save for their retirement.
>
> 17 A higher proportion of state support will go to those who need it most.
>
> 18 Over time, the share of national income devoted to pensions will increase, but a higher proportion will come from private, funded pensions. State spending will increase but income from private pensions will increase even more as stakeholder pension schemes become established and occupational pension schemes are strengthened and supported. Currently, about 60 per cent of pension income is accounted for by the State and 40 per cent by the private sector. As a result of the reforms set out in this Green Paper, the State's share is expected to fall to around 40 per cent by 2050. This will allow us to meet the demographic challenge of much higher numbers of pensioners whilst delivering a decent income in retirement for everyone and maintaining public expenditure at prudent levels.

It is, perhaps, too early to judge the effect of these reforms, but, if anything, the trend has been away from private towards state provision. Statistics issued recently by the Department for Work and Pensions (DWP) show that the number of people contracted-in to SERPS had increased from 7.8 million in 1996/97 to 9.1 million in 2000/01. Although the number of people contributing to contracted-out schemes had also increased over the same period (from 13.2 million to 14.3 million) the percentage increase in contracting in was greater.[4] It is possible that the trend has accelerated since 2000/01 as confidence in private provision has decreased and final salary schemes have closed. Insurance companies such as Axa and Standard Life have been advising people to contract back into the state earnings related scheme (now S2P) on the grounds that the contracted-out rebate is too low to provide a private pension as good as S2P.[5] The Government Actuary, in his most recent *Quinquennial Review of the National Insurance Fund*, assumed that the

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4 DWP, *Second Tier Pension Provision 1978/79 to 2000/01*, 15 December 2003, http://www.dwp.gov.uk/asd/asd1/dsu/second_tier/second_tier.asp

5 See, eg, "Opt back to state second pensions or risk a knock", *Daily Telegraph*, 21 June 2003 and "Standard Life guides IFAs to put clients back into state pension", *Sunday Telegraph*, 27 July 2003

percentage of employees contracted-out of the state scheme would decrease from 54% to 35% between 2001/02 and 2060/61.[6]

There are differences of opinion about the success of stakeholder schemes. The Government is optimistic and points to Inland Revenue figures showing that 1.26 million people had taken out stakeholder pensions by 5 April 2003, with about two-thirds of these sold to people earning under £20,000 a year. On the other hand, the Association of British Insurers (ABI) points to the fact that 82% of employer-designated schemes are "empty boxes" with no members and that over 20% of all sales are single premium policies, of which nearly 61% are transfers from other schemes rather than new saving.[7]

In October 2003, the Government replaced MIG with the yet more generous Pension Credit. The Government itself estimates that around half of all pensioners are currently entitled to Pension Credit.[8] The DWP estimates that 65% of pensioners might be entitled to the Pension Credit by 2050, while the Institute of Fiscal Studies has put the percentage at 82%.[9] Although the Pension Credit includes a "reward for saving", many commentators believe that this wide expansion of means-testing for pensioners may, in fact, discourage younger people from making private pension provision for their retirement.[10]

4. Decline in final salary schemes

There has been a dramatic decline in employer support for final salary occupational pension schemes since the 1998 Pensions Green Paper. Adair Turner, Chairman of the Government's Pensions Commission, has said that over the past five years "60 – 70% or so of private sector defined benefit schemes – weighted by number of employees – have closed to new members".[11] In final salary schemes, it is the employer who bears the investment risk, because he has promised his employees a pension of a certain size however well or badly the pension fund performs. In money purchase schemes – to which many employers are switching – it is the employee who bears the investment risk. Employer and employee make a contribution to the scheme and the size of the pension fund available to buy an annuity at retirement depends entirely on the performance of the fund.

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6 *Government Actuary's Quinquennial Review of the National Insurance Fund as at April 2000*, October 2003, Cm 6008, Table 7.2 and paras 14.22-14.26, http://www.gad.gov.uk/publications/docs/qr5-fullreport.pdf

7 "Government and ABI dispute stakeholder success", *Occupational Pensions*, October 2003

8 HC Deb 14 April 2003, c 650W

9 See Pensions Policy Institute, *The Pensions Landscape*, February 2003, Chart 19, http://www.pensionspolicyinstitute.org.uk/uploadeddocuments/PPI-_14_Feb_03-_The_Pensions_Landscape.pdf

10 See, eg, Institute for Fiscal Studies, *Two Cheers for the Pension Credit?*, October 2003, http://www.ifs.org.uk/pensions/bn39.pdf

11 Speech to CBI pensions conference, 17 October 2003, http://www.pensionscommission.org.uk/publications/2003/cbi-pension-conference-17oct03.pdf

A number of reasons have been put forward for the decline in final salary schemes. They include:

- The introduction of controls on pension fund surpluses in 1987, which encouraged employers to take contribution holidays;

- The abolition of tax credits paid to pension funds when they received dividend income net of advance corporation tax (ACT) in 1997. This was originally estimated to cost pension funds £3.5 billion a year;[12]

- The introduction, from June 2001, of a new accounting standard, FRS 17, governing the treatment of pension schemes in company accounts. The new standard requires companies to show full liabilities and assets on the balance sheet - a radical shift from the previous practice of smoothing over pensions figures to avoid volatility in the accounts;

- The fall in the stockmarket since the beginning of 2001 which has had a dramatic impact on the value of pension funds and the returns they receive. Watson Wyatt has estimated the current pension fund deficit at about £120 billion.[13] This has forced employers to end contribution holidays and increase contributions;

- The Minimum Funding Requirement (MFR) introduced under the *Pensions Act 1995* from April 1997. It was designed to protect accrued pension rights by ensuring that schemes have sufficient assets to meet their liabilities should they be wound up. Where valuations reveal an MFR deficit, employers must increase their contributions to eliminate the deficit over a given time frame;

- Increased longevity which means that pensions have to be paid for longer; and

- Excessive regulation which imposes further costs on pension funds.

At base, though, the reasons come down to the cost for employers of providing DB schemes. In practice, employers contribute less to DC than to DB schemes: research for the DWP found that employers typically contributed 15-20% of salaries to DB schemes but only 4-6% to DC schemes.[14]

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[12] Inland Revenue press notice, 2 July 1997, "Companies and their shareholders: tax changes to promote investment by companies"

[13] quoted in *Financial Times*, 14 February 2004, "The pain of pensions"

[14] Department for Work and Pensions, IAD Social Research Division, *Pension scheme changes and retirement policies: An employer and employee perspective*, *Research Report No. 199*, November 2003, http://www.dwp.gov.uk/asd/asd5/rports2003-2004/rrep199.asp

5. Employee confidence

As employers' willingness to support high quality pension schemes has declined, so employees' willingness to contribute has been dented by a series of high profile scheme failures. DC schemes seemed less attractive after Equitable Life closed to new business in December 2000 and followed this with significant cuts to policyholders' and annuitants' benefits. DB schemes seemed less attractive after ASW went into receivership in July 2002 and wound up its pension scheme leaving many employees who had worked for the company for years but had not yet retired facing cuts of up to 85% in their expected pensions.

The Association of British Insurers (ABI) has estimated that 36% of the total working population are not saving enough for their retirement and that 4/5th of these are not saving at all.[15] It puts the annual "savings gap" at £27 billion.[16]

B. The Evolution of Government Policy

The policies outlined in the 1998 Pensions Green Paper were introduced by the *Welfare Reform and Pensions Act 1999* (stakeholder pensions) and the *Child Support, Pensions and Social Security Act 2000* (S2P). The Pension Credit was not foreshadowed in the 1998 Green Paper, but was introduced by the *State Pension Credit Act 2002*. This legislation was concerned primarily with state pension provision and the introduction of a new form of personal pension to encourage people with earnings above the LEL to contract out of the state scheme.

The present *Pensions Bill 2003-04* stems from a series of consultation documents and reports which have concentrated more on how to improve and increase occupational pension provision. They include:

- A consultation document, ***Security for occupational pensions,*** issued by the former Department for Social Security (DSS) and the Treasury in September 2000.[17] This questioned the effectiveness of the MFR in protecting pension rights and sought views on other ways of securing these rights, such as prudential supervision by a regulator, compulsory insurance and a central discontinuance fund

15 ABI, *The state of the nation's savings* , October 2003, http://www.abi.org.uk/Display/File/364/92.03_State_of_the_nations_saving_-_full_report.pdf

16 *Ibid*

17 Department of Social Security, HM Treasury, *Security for Occupational Pensions: a consultation document*, September 2000, http://www.dwp.gov.uk/consultations/consult/2000/mfr/mfrrev.pdf

- The **Myners Report** on institutional investment in the UK published on 6 March 2001.[18] Amongst other things, this recommended that:

  - the MFR should be abolished;
  - trust law should be changed to increase the level of investment expertise; required of pension fund trustees;
  - pension fund trustees should be paid;
  - a code of best practice on investment fund management should be drawn up; and
  - trustees should be required to produce fuller Statements of Investment Principles

- The **Government's proposals on *Security for occupational pensions*,** issued by the DSS and the Treasury in March 2001.[19] This announced that the Government had decided to replace the MFR with a long term scheme specific funding standard, but had rejected proposals for securing pension rights through prudential supervision, compulsory insurance or a central discontinuance fund.

- The **Government response to the Myners review**, published by the Treasury and the Department for Work and Pensions (DWP) on 2 October 2001.[20] This included two sets of principles for investment for pension funds, one for DB schemes and one for DC schemes. The success of these principles in driving change in the pensions industry was to be reviewed in March 2003.

- Consultation documents on ***Recommendations in the Myners Report***, published by the DWP and the Treasury on 4 February 2002.[21] These discussed three proposals for legislative change recommended by Myners: that trustees should be able to take a decision "with the skill and care of someone familiar with the issues concerned"; that there should be a statutory requirement for funds to have independent custody; and that UK law should incorporate an activist duty on those responsible for investment of pension scheme assets.

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[18] HM Treasury, *Institutional investment in the UK: a review*, March 2001, http://www.hm-treasury.gov.uk/media//843F0/31.pdf

[19] Department of Social Security, HM Treasury, *Security for occupational pension schemes: the Government's proposals*, March 2001, http://www.dwp.gov.uk/publications/dss/2001/opp/opp.pdf

[20] HM Treasury, Department for Work and Pensions, *Myners review: Institutional investment on the UK: the Government's response*, October 2001, http://www.dwp.gov.uk/publications/dwp/2001/myners/response.pdf

[21] Department for Work and Pensions, HM Treasury, *Consultation documents on recommendations in the Myners Report "Institutional investment in the UK: a review*, 4 February 2002, http://www.dwp.gov.uk/consultations/consult/2002/myners/index.asp

- The **Sandler Report** on medium and long term retail savings in the UK, published by the Treasury on 8 July 2002.[22] Amongst other things, this recommended:

    - the introduction of a suite of simple regulated products, with capped charges, which would be sold without the need for regulated advice;
    - tax simplification measures, including an overhaul of pensions taxation. Government action in this area should focus on simplification, and not on attempts to stimulate savings levels with tax incentives; and
    - measures to boost consumer education in financial matters.

- The **Pickering Report** on pension simplification published on 11 July 2002.[23] Amongst other things, this recommended:

    - a new Pensions Act to consolidate all existing pensions legislation;
    - a new more proactive regulator;
    - a better, more targeted approach for communicating with pension scheme members;
    - more flexibility to modify schemes;
    - allowing employers to make membership of their occupational pension scheme a condition of employment; and
    - the ending of compulsory indexation for defined benefit pensions, and compulsory survivors benefits.

- The **Davis Report** of the quinquennial review of the Occupational Pensions Regulatory Authority (Opra), published by the DWP on 17 December 2002.[24] This concluded that Opra had performed the task it had been asked to carry out over the past five years very effectively but that its zero tolerance approach to regulatory breaches should now be replaced by a more risk-based assessment.

- The **Pensions Green Paper,** *Simplicity, security and choice: working and saving for retirement*, published by the DWP, the Treasury and the Inland Revenue on 17 December 2002.[25] This was a wide-ranging paper, bringing together many aspects of Government policy on private pensions. Some proposals were still open for discussion, while others were more or less decided. They included:

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22 HM Treasury, *Medium and long-term retail savings in the UK: a review*, July 2002, http://www.hm-treasury.gov.uk/documents/financial_services/savings/fin_sav_sand.cfm

23 *A simpler way to better pensions. An independent report by Alan Pickering*, The Stationery Office, July 2002, http://www.dwp.gov.uk/publications/dwp/2002/pickering/report.pdf

24 Department for Work and Pensions, *Report of the quinquennial review of the Occupational Pensions Regulatory Authority (OPRA),* December 2002, http://www.dwp.gov.uk/publications/dwp/2002/opra/quin.pdf

25 Department for Work and Pensions, HM Treasury, Inland Revenue, *Simplicity, security and choice: working and saving for retirement,* December 2002, Cm 5677, http://www.dwp.gov.uk/consultations/consult/2002/pensions/gp.pdf

- Radical simplification of the tax regime for pensions, replacing the eight existing regimes with a single regime (see below for more details).
- Measures to encourage people to work longer, including raising the earliest age at which a pension can be taken from 50 to 55; raising the normal retirement age in the public sector from 60 to 65; and bringing forward improvements to the increments added to state pensions for deferring retirement beyond SPA.
- Simplifying the provision of occupational pensions by replacing the MFR with a scheme specific funding requirement; allowing schemes to make some retrospective changes to members' accrued rights; simplifying the procedure for member-nominated trustees; reducing the complexity of contracting out by reducing the minimum accrual rate and allowing conversion of GMPs to scheme benefits; revising the internal dispute resolution procedure.
- Increasing member security by replacing Opra with a new kind of pro-active regulator; revising the statutory priority order on winding up to give those with longer service better protection; improving protection for those transferring to a new employer under TUPE.
- Helping people to build up better pensions by encouraging combined benefit statements; introducing an on-line retirement planning facility; encouraging employers to emphasise the benefits of pensions; introducing immediate vesting.

The Green Paper also announced the establishment of two new bodies: the **Pensions Commission** and the **Employer Task Force.** The first is chaired by Adair Turner and has been set up "to assess trends in occupational and private pensions and long-term saving, and to advise whether there is a case for moving beyond the current voluntarist approach".[26] The second is chaired by Sir Peter Davis and is designed to "draw on business experience and innovation in identifying and promoting good practice" in encouraging "employers to ensure that their current and potential employees understand the value of any pension contributions made".[27]

- A **Technical Paper**, published by the DWP on 17 December 2002 to accompany the Green Paper.[28] This expanded on the proposals for pension simplification, member protection and promotion of pensions included in the Green Paper.

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[26] Website: http://www.pensionscommission.org.uk/

[27] *Pensions Green Paper*, summary, para 37. Website: http://www.employertaskforce.org.uk/index.shtml

[28] Department for Work and Pensions, *Simplicity, security and choice: technical paper*, December 2002, http://www.dwp.gov.uk/consultations/consult/2002/pensions/tech.pdf

- A consultation document on ***Simplifying the taxation of pensions***, published by the Treasury and Inland Revenue on 17 December 2002.[29] This proposed a radical simplification of the system for giving pension schemes tax relief. In place of the existing eight different regimes, there would be a single regime applying to all pension saving from "A-day" (expected to be 6 April 2005).[30] This would involve:

  - a lifetime limit of £1.4 million on the value of pension benefits from all sources. Any excess would be subject to a recovery charge of 33.3%;
  - an annual limit of £200,000 on contributions; and
  - tax free lump sums restricted to 25% of the member's fund.

- The **Pensions White Paper**, or **Action Plan**, published by the DWP on 11 June 2003.[31] This announced a series of decisions, principally in the area of member protection, including:

  - The introduction of a Pension Protection Fund to provide compensation for members of DB schemes wound up on the insolvency of the sponsoring employer with insufficient assets to meet their liabilities.
  - A requirement (to apply from 11 June 2003) that solvent employers should buy out benefits in full if they wound up their pension schemes.
  - Employers to match members' contributions of up to 6% to a stakeholder pension on transfer of an undertaking.
  - Limited price indexation for DB pensions to be reduced from 5% to 2.5%
  - A new approach to vesting, offering employees who had been in a scheme for between three months and two years a choice of a refund of contributions or a Cash Equivalent Transfer Value (CETV) on leaving.
  - A new requirement on employers to consult before making changes to pension schemes.

- A **consultation paper on proposals for implementing the European Occupational Pensions Directive (IORPS),** published by the DWP on 28 October 2003.[32] The Directive requires:

  - a "prudent person" approach to investment;

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29 HM Treasury/ Inland Revenue, *Simplifying the taxation of pensions: increasing choice and flexibility for all*, December 2002, http://www.hm-treasury.gov.uk/media//5E3E9/simppencondoc02.pdf

30 Inland Revenue press notice, 11 June 2003, *Simplifying the taxation of pensions: implementation date*

31 Department for Work and Pensions, *Simplicity, security and choice: working and saving for retirement: action on occupational pensions*, June 2003, Cm 5835, http://www.dwp.gov.uk/consultations/consult/2002/pensions/actionplanfull.pdf

32 Department for Work and Pensions, *Implementing the European Directive on the Activities and Supervision of Institutions for Occupational Retirement Provision: a Consultation Paper*, October 2003, http://www.dwp.gov.uk/consultations/consult/2003/eu-directive/EUpensionsconsultation.pdf

  - regulation of occupational pension schemes by a "competent authority";
  - supervision of cross-border activity by occupational pension schemes;
  - disclosure of information to members and competent authorities;
  - annual valuation of the "technical provisions" (i.e. accrued liabilities) of DB schemes. This can be every three years if there is an annual "report of adjustments"; and
  - DB schemes to hold "sufficient and appropriate assets" to cover accrued liabilities and to adopt a recovery plan if there is underfunding.

- A **Government Statement on Guaranteed Minimum Pensions,** issued by the secretary of State, Andrew Smith, on 20 October 2003, announcing their intention to introduce measures to permit contracted-out DB schemes to convert GMPs into scheme benefits on the basis of actuarial equivalence.[33]

- The Government's proposals on ***Simplifying the taxation of pensions***, published by the Treasury and Inland Revenue on 10 December 2003.[34] This confirmed that the Government wanted to proceed with the proposals described in the December 2002 consultation paper. However, many respondents had argued that the lifetime limit of £1.4 million was too low and would affect many more people than intended. The Chancellor therefore announced in his statement on the Pre-Budget Report that he had asked the National Audit Office to provide an independent assessment. If the decision was made to proceed, the changes would be introduced in April 2005, otherwise "the current regime will remain in place".[35] The document announced some modifications to the original proposals including a reduction in the recovery charge from 33.3% to 25%.

- A paper describing the Government's strategy for enabling people to make ***Informed choices for working and saving***, published by the DWP on 3 February 2004.[36] Amongst other things, this announced that the Government would be testing three approaches to increasing membership of employer-provided schemes: active decisions; commitments to save more in future; and automatic enrolment for new members (with a right to opt out). In addition, reserve powers would be taken to require employers who do not offer their own pension to provide a decent standard of pension information.

The *Pensions Bill 2003-04* does not deal with all the issues covered in the recent Green and White Papers. For example, tax simplification will be taken forward in the *Finance*

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33 HC Deb 20 October 2003, c 26WS

34 HM Treasury/Inland Revenue, *Simplifying the taxation of pensions: the Government's proposals*, December 2003, http://www.hm-treasury.gov.uk/media//8692C/simplifying_pensions_421.pdf

35 HC Deb 10 December 2003, c 1066

36 Department for Work and Pensions, *Simplicity, security and choice: informed choices for working and saving*, Cm 6111, February 2004, http://www.dwp.gov.uk/publications/dwp/2004/inf-choice/informedchoice.pdf

Bill; raising the pension age in public service pension schemes will be taken forward by reviews of the individual schemes and amendments to the regulations specifying their rules; changes to the provisions on winding-up schemes will be made by regulations;[37] and many of the provisions designed to increase individuals' knowledge about pension planning do not require legislation. But the *Pensions Bill* does legislate, amongst other things, to:

- Introduce a new more pro-active Pensions Regulator to replace Opra
- Establish a Pensions Protection Fund
- Replace the MFR with a scheme specific funding requirement
- Reduce the level of Limited Price Indexation
- Provide some pension protection on transfer of employment
- Simplify the provisions on internal dispute resolution and Member Nominated Trustees
- Bring forward improvements to deferred retirement increments and introduce a lump sum option
- Require trustees to have knowledge about the issues they deal with
- Help the Government to promote financial planning for retirement
- Take a reserve power to compel occupational pension schemes to provide combined pension forecasts
- Take a reserve power to require employers to provide access to information about pension choices

Measures to remove the requirement to provide a GMP, amend section 67 of the *Pensions Act 1995* so that schemes could make retrospective changes, and offer people leaving a scheme after three months a transfer value, are not in the Bill, even though they were foreshadowed in the background note on the Bill issued at the time of the Queens Speech.[38] The requirement to consult on changes to pension schemes is not in the Bill either. Nor is it in the *Employment Relations Bill 2003-04* which paves the way for implementation of the *EC Directive on Informing and Consulting Employees*.[39] The DTI issued a consultation document on this directive in July 2003 which merely said that the "Secretary of State for Trade and Industry and the Secretary of State for Work and Pensions will be working together to take this into effect"[40]

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37 The *Occupational Pension Schemes (Winding Up and Deficiency on Winding Up etc.) (Amendment) Regulations 2004*, SI 2004/403, dealing with solvent wind-ups, were laid before Parliament on 23 February 2004. Draft *Occupational Pension Schemes (Winding Up) (Amendment) Regulations 2004* dealing with the priority order for distribution in insolvent wind-ups were issued for consultation on 22 October 2003, http://www.dwp.gov.uk/consultations/consult/2003/ops/ops_wind_up_regs_oct04.pdf

38 DWP Background Note on the *Pensions Bill*, 26 November 2003

39 Directive 2002/14/EC of the European Parliament and of the Council of 11 March 2002 establishing a general framework for informing and consulting employees in the European Community

40 DTI, *Consultation Document, High Performance Workplaces: Informing and Consulting Employees*, July 2003, http://www.dti.gov.uk/er/consultation/i_c_consdoc.pdf

A general criticism of the Government's agenda for pension reform is that it is too narrow. Many respondents to the pensions Green Paper regretted the fact that it ignored the importance of an adequate state pension as a basis on which to build a secure private pension. For example, Age Concern argued that:

> everybody should be able to achieve an adequate income in retirement through a combination of state and private income. Central to achieving this is the need for a non-means-tested state pension sufficient to cover basic costs which would provide a foundation on which to build up additional private pensions and savings.[41]

And the National Association of Pension Funds (NAPF) said:

> The State pension system is becoming increasingly complex and difficult to understand, even for pension professionals, many of whom fear potential mis-selling issues arising from alternatives to means-tested State benefits. It also works as a disincentive to private saving. (…)
>
> The Government has missed a golden opportunity by excluding from the scope of this consultation a review of the complex interrelationship between State pension arrangements, the State Pension Age, means-tested benefits and private retirement provision.[42]

Some commentators compared the relative timidity of the Green Paper proposals unfavourably with the radical changes proposed in the accompanying Tax Simplification paper. The Association of Consulting Actuaries' (ACA) survey showed that:

> whereas employers were pleasantly surprised at the innovative way pension taxes are to be simplified, they felt the Green Paper itself under-performed.[43]

There have also been criticisms of the absence of proposals to simplify DC schemes and the undue concentration on DB schemes at a time when many employers are switching from DB to DC. The Association of British Insurers (ABI) has said that:

> the Pensions Bill can and should also do more to help the growing number of people who are members of defined contribution (DC) schemes.

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41 http://www.ageconcern.org.uk/AgeConcern/media/SimplicitySecurityandChoice.pdf

42 http://www.napf.co.uk/publications/Downloads/PolicyPapers//SectionB/greenrep.pdf

43 Association of Consulting Actuaries, *Occupational Pensions 2003 Pensions Reform: too little, too late? Final results of the ACA 2002 and 2003 studies into UK occupational pension scheme trends Including feedback on the Pensions Green Paper and Tax Simplification Paper*, March 2003, http://www.aca.org.uk/Members_content/Pension_Survey_%202003_Scheme_final_report.doc

> Simplification for DC schemes would benefit everybody, including employers, scheme providers and above all consumers. [44]

II The Bill

The *Pensions Bill* was introduced on 11 February 2004 and published the following day. Andrew Smith, Secretary of State for Work and Pensions, concentrated on the Pension Protection Fund in his introductory comments:

> "Where companies with under-funded pensions have gone bust, workers have found themselves severely short-changed on the pension they were expecting. With the Pension Protection Fund, people in pension schemes can be much surer that they will get the pension they were promised."
>
> The Fund will be complemented by a flexible Pensions Regulator which will make it easier for businesses to get on with running good pension schemes. It will focus on the under-funding, fraud and mal-administration that can threaten members' benefits, whilst minimising interference for well run schemes.
>
> Simplification measures will also make it easier for employers to provide pensions, by cutting through red tape. Schemes will be freed to set their investment strategy to their own particular characteristics, and a host of regulations around administration – including on trustees, dispute resolution and contracting out – will be simplified.[45]

Initial reaction to the Bill included general satisfaction that a Pension Protection Fund was being established with the caveat that the Bill would do little to encourage increased saving for retirement. For example, the Consumers Association warned that:

> Such is the loss of consumer confidence and trust in pensions and the financial services industry that half of today's population are not contributing to a pension and, of these, four in five have no plans to acquire one in the future. Today's Bill will do little to improve confidence.
>
> We are particularly concerned by the Government's reliance on the financial services industry to solve the pension crisis on its own. The Government is transferring too much of the risk for the provision of decent pensions onto individual consumers.[46]

And Terry Faulkner, chairman of NAPF, commented:

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[44] "Pensions Bill must give greater choice to all says ABI – industry calls for an end to 'archaic and inconsistent rules'", ABI Press release, 4 February 2004

[45] DWP press release, 12 February 2004, "The Pensions Bill – simplicity, security and choice"

[46] Press release, 12 February 2004, http://www.which.net/media/pr/feb04/general/pensions.html

> Few could argue with the spirit of the measures proposed, particularly greater security for defined benefit pension scheme members, better information, a more flexible approach to scheme funding, and better regulation. In themselves these are all good things.
>
> But is there anything in today's Bill to simplify our archaic state pension system? Is there anything to encourage firms to offer decent pensions to their employees, or keep existing schemes open? Are there new incentives to encourage people to save? Is there any real long term vision, or a clear pension strategy to achieve that vision. Regrettably, the answer to all these questions is “No”.[47]

There follows a broad overview of the main provisions of the Bill, their background and the reaction to them. A detailed commentary on the Bill’s provisions is contained in the Explanatory Notes published by the DWP.[48]

A. The Pensions Regulator

1. Background

In the late 1980s both personal and occupational pensions were subject to two scandals which raised issues about the regulatory framework in which pensions policy operates.

First, it transpired that the growth in personal pensions was in some cases the result of employees in perfectly adequate occupational schemes being persuaded by enthusiastic pensions sales teams to transfer into inferior personal pensions schemes. This personal pensions mis-selling scandal has not been fully resolved. Second, in the early 1990s it was revealed that the late Robert Maxwell had appropriated the monies in his companies' pension funds. This abuse by an employer of the use of pension fund assets resulted in the Pension Law Review Committee chaired by Professor Roy Goode, which reported in 1993. The *Pensions Act 1995* implemented many of the proposals of the *Goode Report*, and was designed to improve the security of occupational pension schemes.[49] A central provision of this Act, under section 1, was the establishment of the Occupational Pensions Regulatory Authority (Opra).

Opra started work on 6 April 1997. The Opra remit embraces four main areas:

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47 NAPF Press release, “Pensions Bill: short term answers, but no long term vision” 12 February 2004, http://www.napf.co.uk/news/PR2004/release001.cfm

48 *Pensions Bill [Bill 57, 2003-04], EN,* http://www.publications.parliament.uk/pa/cm200304/cmbills/057/en/04057x--.htm

49 The Leverhulme Centre For Market And Public Organisation, University of Bristol, *History of Pensions in the UK,* 5 January 2004, http://www.bris.ac.uk/Depts/CMPO/research/pensions/history.htm

- *To look into reports that pension schemes have broken the law* - Opra can take action on certain reported breaches of pensions legislation. It aims to get problems put right and make sure schemes comply with the law. If things are not put right quickly then it can impose civil penalties on those responsible. Opra also has the power to take criminal breaches of pensions law to court.

- *To help people trace pension schemes that they have lost touch* with - Opra maintains a register of all UK pension schemes at the Pension Schemes Registry in Newcastle upon Tyne and offers a free service to help people trace pension schemes that they have lost touch with.

- *To collect the levies that pay for pension protection* - The Registry collects levies from pension schemes to pay for the activities of Opra, the Pensions Ombudsman, and the Pensions Advisory Service (OPAS). It also collects a levy for the Pensions Compensation Board when necessary.

- *To educate and inform and work with others to raise standards* - Opra produces material to help educate and inform pension scheme trustees, employers and pensions professionals to understand the legal requirements. The Authority works proactively to raise standards with professional bodies and others involved in pensions.[50]

Subsequent to Opra's creation, there have been changes to its remit, deriving from provisions of the *Welfare Reform and Pensions Act 1999*, and the *Child Support, Pensions and Social Security Act 2000*. From April 2001 Opra gained additional responsibility for maintaining a public register of stakeholder pension schemes and monitoring schemes' compliance with stakeholder conditions. At the same time, personal pension providers (insurance companies) were also instituted as "whistle blowers" (as defined in section 48 of the *Pensions Act 1995*) in respect of late or non-payment of either employer or employee contributions into a personal pension scheme.

Under section 103 of the *Pensions Act 1995*, Opra is obliged to disclose summaries of regulatory cases in order that the public can see how the Authority operates and the practices it employs in bringing judgement.[51] As details of more of Opra's investigations came to light, concern mounted that the Authority's efforts tended to focus on relatively low value reports and breaches. In light of these concerns, the government announced a performance *Review of Opra* in May 2002, to be headed by Dr Brian Davis. The Review was initiated in part because of concerns arising out of the limited scope of Opra's original remit.

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50 http://www.opra.gov.uk/insideOpra/role/WhatOpra-01.asp
51 Examples can be seen on Opra's website, http://www.opra.org.uk/legalActivity/caseReports/index.asp

Alan Pickering, in his report on pension simplification, published in July 2002, proposed a "New Kind of Regulator" (NKR) with greater scope to exercise its judgement and to offer appropriate advice":

> 1.18 Therefore, at the heart of our proposals in this area is the establishment of a New Kind of Regulator which, for the sake of brevity, we will call 'NKR'. Some respondents suggested that the Financial Services Authority (FSA) should deal with all aspects of pension provision, rather than have two regulators as at present. However, we have concluded that there is a continuing place for two regulators: one which has the experience and knowledge-base to regulate the wide-ranging commercial retail marketplace, and one with particular expertise in work-based pensions. This means, in broad terms, that the FSA would continue to regulate various aspects of personal pensions and stakeholder schemes, including marketing, selling and product disclosure, and would continue to have its role in the regulation of rights under occupational pension schemes limited to the supervision of investment managers and advisers. There will need to be close co-operation between the two bodies.
>
> 1.19 In fulfilling its regulatory role, the NKR would, as Opra does at the moment, rely heavily on whistle-blowing by professionals. However, the focus of both regulation and whistle-blowing should be at a higher level than is currently the case. It should not be assumed that a minor error is symptomatic of a deeper malaise. On the other hand, Opra is currently constrained in its ability to get involved with schemes where there is a suspicion that things are not being handled properly. In many cases, by the time Opra becomes involved, it is too late and the damage has been done. We envisage the NKR having the authority to intervene in a pro-active way where it feels that it is necessary, and having the skills and knowledge to identify any bad practice or potentially criminal activity at an early stage. We envisage the NKR adopting a risk-based approach, similar to that adopted by the FSA.[52]

The National Audit Office (NAO) also reported on Opra in 2002, and recommended that it needed "to move from handling a large number of small scale reports to focus more on identifying and mitigating the more serious risks faced by members of pension schemes".[53]

Dr Davis' completed *Quinquennial Review* was published on 17 December 2002. The report stated that:

> …Opra has performed the task which it was asked to carry out extremely effectively…however…it has not met the changing expectations of its role to provide pro-active input to the way future regulation should function. This has

52 http://www.dwp.gov.uk/publications/dwp/2002/pickering/report.pdf

53 NAO press release on its report on *Occupational Pensions Regulatory Authority (Opra): tackling the risks to pension scheme members, HC 1262, 2001-02,* 6 November 2002, http://www.nao.org.uk/pn/01-02/01021262.htm

> not been helped by relatively poor communications in the past between Opra and DWP…
>
> More fundamentally, it is clear that many expect the pensions regulator to act as a 'mini FSA' in terms of both its influence and advice to Government, and by operating a more risk-based approach to regulation. Combine this with both the ability to improve overall efficiency by reducing overlaps with the FSA and the fact that, for personal financial planning purposes, individuals and schemes currently have to potentially deal with both Opra and the FSA, and it is my personal recommendation that consideration is given to bringing the two regulators together.[54]

The Department for Work and Pensions (DWP), concurrently with the *Quinquennial Report*, published its consultation document *Simplicity, security and choice: Working and saving for retirement*. This Green Paper put forth the Government's proposal for a new regulator to replace Opra, in accordance with Dr Davis' recommendation. However, the Government preferred the advice of Alan Pickering to that of Dr Davis and proposed that the new regulator would operate 'alongside and complementing the Financial Services Authority (FSA)' rather than be merged with it.[55]

2. The Bill's provisions

Part 1 of the Bill contains the Government's proposals for dissolving Opra and instituting a new Pensions Regulator (hereafter referred to as 'the regulator'). It is proposed that the new regulator will:

> Adopt a pro-active approach … concentrating on the things that threaten [pension scheme] members' interest. That means a focus on fraud and mal-administration, as well as tough new powers on under-funding. But it also means much less of a regulatory burden for those well-run schemes that are best left to their own devices.[56]

When introducing the *Pensions Bill* on 12 February 2004, Secretary of State Andrew Smith stated:

> The Pensions Bill sets out proposals for a new Pensions Regulator to give better protection to members of work-based pension schemes and to reduce the compliance burden on well-run schemes.
>
> It will focus on protecting the benefits of pension scheme members, concentrating its effort on schemes where it assesses that there is a high risk of fraud, bad

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54 DWP, Dr Brian Davis – Independent Reviewer, *Report of the quinquennial review of the occupational pensions regulatory authority (Opra)*, 17 December 2002, pp1-2

55 Cm 5677, p 63

56 Department for Work and Pensions, *Pensions regulator factsheet*, February 2004: http://www.dwp.gov.uk/publications/dwp/2004/pensions_bill/factsheet_regulator.pdf

> governance or poor administration. The Pensions Regulator will have important new powers to tackle under-funding.
>
> The Regulator will not overburden employers who provide pension schemes, enabling well-administered and funded schemes the freedom to continue supporting their schemes without being subject to constant, intrusive and burdensome regulation.[57]

Clauses 1-3 and **schedule 1** deal with the establishment of the Pensions Regulator. It will be a body corporate with a chairman appointed by the Secretary of State, a Chief Executive and five other members appointed by the Secretary of State after consulting the chairman.

Clauses 4 and **5** set out the functions and objectives of the new regulator as follows:

> **4 Regulator's functions**
>
> (1) The Regulator has—
>
> a) the functions transferred to it from the Occupational Pensions Regulatory Authority by virtue of this Act or any provisions in force in Northern Ireland corresponding to this Act, and
> b) any other functions conferred by, or by virtue of, this or any other enactment.
>
> (…)
>
> **5 Regulator's objectives**
>
> (1) The main objectives of the Regulator in exercising its functions are—
>
> a) to protect the benefits under occupational pension schemes of, or in respect of, members of such schemes,
> b) to protect the benefits under personal pension schemes of, or in respect of, members of such schemes within subsection (2),
> c) to reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund (see Part 2), and
> a) to promote, and to improve understanding of, the good administration of work-based pension schemes.

Subsection (2) limits the regulator's remit in relation to personal pensions to Appropriate Personal Pensions (used for contracting out of the state scheme) and stakeholder pensions.

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57 *Ibid*

These provisions are aimed at tackling fraud, bad governance and poor administration by making the regulator more pro-active and at encouraging best practice through an increased education and guidance role. The regulator will:

- have statutory objectives and functions under the Pensions Bill that set a clear framework for its activity and enable it to take a more flexible, pro-active and risk-based approach to regulation;
- be focused on those schemes where the risk to members' benefits is greatest;
- have a number of regulatory tools at its disposal, which are designed to protect members' benefits by improving the governance of schemes;
- be empowered to act quickly to anticipate and tackle issues before they become systemic and stop any practices that are detrimental to scheme members;
- provide education, advice and guidance to those administering, advising or running pension schemes;
- issue Codes of Practice to enable scheme trustees and professionals to understand readily how to comply with legislative requirements; and
- consider, where appropriate, the use of wider powers to undertake investigations and continue to act on reports by 'whistleblowers'.[58]

In addition, the regulator will have new powers to tackle non-compliance with pensions legislation and to wind-up pensions schemes in order to minimise the value of claims on the Pension Protection Fund (see part 2 of the Bill). **Clauses 14** to **18** give the regulator power to:

1. Issue improvement notices where there is non-compliance with pensions legislation. An improvement notice must state that in the regulator's opinion, a contravention of pensions legislation has taken place and must specify the nature of the contravention and the evidence upon which the regulator has based its opinion. An improvement notice may refer to a **code of practice** issued by the regulator under **clause 64** and may allow the person to whom the notice is made a choice of ways to remedy or prevent the recurrence of the contravention.

2. Issue third party notices in cases where the regulator is of the opinion that a contravention of pensions legislation is or was wholly, or in part, due to a failure of another person (third party) to take action, and where the action or failure of the third party does not in itself constitute a contravention of pensions legislation.

3. Apply to the court for an injunction (or in Scotland an interdict) to prevent the misuse or misappropriation of assets of an occupational or personal pension scheme.

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58 *Op cit, Pensions regulator factsheet*

4. Recover assets due to a scheme on behalf of the trustees or managers of the scheme, including employer contributions not paid by the due date.

Clauses 19 to **32** give the regulator the power to:

- Make a 'freezing order' to protect the interests of the generality of members of a defined benefit pension scheme for not more than six months. While a freezing order is in force, no benefits accrue and the scheme may not be wound up;
- Validate by order an action which has been taken in contravention of a freezing order;
- Make directions when a freezing order ends and no wind up order (under section 11 of the *Pensions Act 1995*) has been made; and
- Issue a prohibition order to prevent a person from acting as a trustee of a scheme wherever it considers that the person is not a 'fit and proper' person to act as such (amending section 3 of the *Pensions Act 1995*).

This part of the Bill also provides, in **clauses 76-80** and **schedule 1**, for the establishment of a **Pensions Regulator Tribunal** to hear references from the regulator's determinations

These changes mark a significant increase in the scrutinising and punitive powers formerly held by Opra. Consequently, the *Regulatory Impact Assessment* (RIA) of the Bill indicates that the regulator will cost an average 25% more per year than Opra:

> **Costs/savings**
> 3.1.8 The introduction of the Pension Protection Fund has helped shape the responsibilities of The Pensions Regulator. It is estimated that The Pensions Regulator will have annual running costs of around £23 million per year including the cost of any monitoring and enforcement action that the regulator may need to take in respect of all the provisions in this RIA, once the new regulator is in place and well established. This represents an increase of £6 million per annum compared with Opra, and an increase in the levy of roughly 25%.
>
> 3.1.9 These additional costs would be funded through a levy on occupational and personal pensions. The increase is due to staff and non-staff costs (accommodation, codes of practice, printing, IT) to cover The Pensions Regulator's new powers and responsibilities. There will be one-off start up costs in the region of £6 million, and a further £20 million for IT development, some of which is necessitated by the difference between the new Regulator's responsibilities and those of Opra. Many of these costs would have been incurred in response to the NAO and Quinquennial Review recommendations for Opra.[59]

[59] *Regulatory Impact Assessment: Pensions Bill 2004*, February 2004, p11, http://www.dwp.gov.uk/publications/dwp/2004/ria/pensions_bill_2004.pdf

3. Issues

The 'beefed up' pensions regulator has been welcomed in most quarters and there remain few concerns about its remit, its ability to sufficiently monitor pension schemes or to act pre-emptively. One of the few criticisms of the regulator is the increased costs to occupational schemes of maintaining it. Age Concern noted in their statement in response to the *Pensions Bill*:

> The new regulator and pension protection fund could be important parts of the way forward, but there is a danger they will add to the cost burden on pension funds, so reducing the benefits to members and the enthusiasm of employers to sponsor pension schemes.[60]

The National Association of Pensions Funds (NAPF) shares this concern with costs:

> [We] are concerned about the implications for occupational pension schemes who pay the levy to support Opra/NPR [new pensions regulator]. We consider that those who pay the levy should have a bigger say in how the NPR is run, for example by having more than one nominee on the NPR's board.[61]

B. Pension Protection Fund

1. Background

The Pension Protection Fund (PPF) is being established in response to the growing number of high profile cases in which companies providing defined benefit (DB) schemes have gone bust leaving their employees with very much lower pensions than they expected. For many years, people believed that the pension they had been promised in a DB scheme was the pension they would get. But examples such as ASW in Cardiff and Sheerness, Dexion in Hertfordshire, United Engineering Forgings, Blyth & Blyth in Edinburgh, and Kalamazoo in Birmingham revealed that this was not the case. If a company goes into liquidation, it generally winds up its pension scheme. If there are insufficient assets in the scheme to meet the liabilities, the employer should make up the difference, but an insolvent company may be unable to do this. In such cases, what assets the scheme does possess must be distributed in accordance with a statutory priority order of distribution, introduced in 1997 under the *Pensions Act 1995*. At present this normally ensures that existing pensioners get all their due pension, but active and deferred scheme members (i.e. current and past employees who have not yet retired) may only get a very small proportion of their entitlement. The Government is due to change the priority order to place pensions for active and deferred members higher up the list than increases for existing pensioners, but this will not increase the total pot available to be shared out.

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60 http://www.epolitix.com/EN/ForumBriefs/200402/23728af6-a293-40fd-a252-1fda557f3223.htm

61 NAPF, *Response to the consultation document from the DWP*, March 2003, p24

MPs have raised constituency cases in the House of Commons on many occasions. In one debate, Kevin Brennan, MP for Cardiff West said ASW workers in his constituency were now being told that their pension may only be worth 14% of its expected value:

> That is an 86 per cent. cut in their pension. That is the scale of the catastrophe that has been visited on constituents in my part of Wales and in other parts of the United Kingdom, including those of my hon. Friend the Member for Sittingbourne and Sheppey (Mr. Wyatt), whose Allied Steel and Wire workers at Sheerness have suffered a similar fate.
>
> The state has not exercised a proper duty of care on behalf of those people. The state did not insist on a proper health warning on occupational pensions—on the contrary, it encouraged workers to enter those schemes. The result has been a real injustice for a few who understandably feel bitterness, bewilderment and betrayal, and uncertainty for the many who, on hearing of the plight of the few, lose confidence in the whole occupational pensions system, when even the most rock solid "guaranteed" form of pension fund turns out not to be worth the paper on which it is written, for thousands of people.
>
> That is an injustice, not just a misfortune. Those people feel that they have been duped, and they have been.[62]

Members of the ASW scheme set up a Pension Action Group to try to secure their rights and their campaign attracted enormous sympathy.[63] Dr Ros Altmann, a pensions expert who has been advising the Action Group estimates that the number of people affected is in the range of 10,000 to 40,000.[64] Official figures on winding-up do not distinguish those connected to a solvent employer from those connected to an insolvent employer. The Pension Schemes Registry's most recent data suggest that about 1,400 private sector final salary schemes were in the winding-up process at the beginning of September 2003.[65] Figures often quoted in the press are that some 60,000 workers from about 200 companies face significant pension shortfalls after their companies have gone bust in recent years.[66] Andrew Smith, in a speech on an Opposition Day debate on pension wind-ups, confirmed that, on the evidence the Government had seen,"60,000 seems to be about the right estimate of the scale of the challenge we face".[67] He was not, however, able as yet to give an estimate of the scale of financial loss involved.

The Government has been consulting on ways of securing the "pension promise" made by DB schemes for many years. The Goode Committee, set up in the wake of the Maxwell

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62 HC Deb 23 October 2003, cc 877-878
63 For details, see their website, http://www.pensionstheft.org/1112.html
64 http://www.pensionstheft.org/10303.html
65 HC Deb 10 December 2003, c 472W
66 See, e.g., "Fund plans hit by chorus of complaints", *Financial Times*, 13 February 2004
67 HC Deb 24 February 2004, c 210

scandal in 1991, recommended that compensation should be paid but only in cases where loss resulted from "fraud, theft and other misappropriation".[68] The *Pensions Act 1995* acted on this recommendation and established the Pensions Compensation Board. However, dishonest misappropriation is rare and very few cases of insolvent employers winding up schemes with unfunded liabilities are covered by the existing Pension Compensation Scheme.

The Goode report specifically rejected the idea of a compensation scheme covering all risks, including investment under-performance. It believed that its proposals for what became the Minimum Funding Requirement (MFR) would prevent prolonged shortfalls in assets. However, the MFR, introduced by the *Pensions Act 1995*, did not prove quite the salvation its authors had hoped, and the Labour Government was soon consulting about alternative ways of securing the "pension promise", including insurance schemes and a Central Discontinuance Fund which would take over the assets and liabilities of insolvent schemes.[69] At the time, these proposals were rejected and the Government reported that:

> 5. Very few were attracted to the idea of **a central discontinuance fund** which would be unworkable in the absence of an ultimate financial guarantor. The Government cannot act as guarantor of a discontinuance fund, and there was little support for such an arrangement with costs being levied on employers with occupational pension schemes. (…)
>
> 7. There was also little support for the alternative – some form of **compulsory mutual insurance**. Some of the same problems would apply as above, and many employers sponsoring well-funded schemes would object to subsidising firms which neglected their obligations.[70]

During 2002-03, however, the publicity given to cases such as ASW contributed to what many described as a "pensions crisis", sapping public confidence in final salary schemes.[71] The Government decided to act, and, on 11 June 2003, the pensions White Paper announced that the Government would be establishing a Pension Protection Fund (PPF) to provide compensation for members of schemes which wound up on the employers' insolvency with insufficient assets to meet their liabilities.[72]

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68 Pension Law Review Committee, *Pension Law Reform*, (the Goode Report), Cm 2342-1, September 1993

69 in both the 1998 Pensions Green Paper and the consultation document on *Security for Occupational Pensions*, published in September 2000

70 Department of Social Security, HM Treasury, *Security for occupational pension schemes: the Government's proposals*, March 2001

71 See, e.g., Pensions Advisory Service (OPAS), Review of 2002/2003, *People and Pensions*, http://www.opas.org.uk/AnnualReview/CaseReview_2002-03/Review2003.pdf

72 Cm 5835

Andrew Smith, Secretary of State for Work and Pensions, said in a statement to the House, that ever since he had started looking at the "terrible injustice" of firms going bust without the money to pay pensions that workers had saved all their lives for, he had:

> asked why, if people expect their holiday provider or motor insurer to be covered if the firm goes bust, there is no cover for something as important as an occupational pension. We will therefore legislate to set up a pension protection fund. That fund will take over the schemes of insolvent companies to ensure not only that pensions in payment are protected, but that those still working can be sure of getting 90 per cent. of what they were promised. It will be paid for by a fixed-rate levy and an additional risk-related premium, which, together with a salary cap, will minimise perverse incentives and moral hazard. The fund will be a non-Government body. It will meet its obligations through the power to set and vary the level of charge without recourse to public funds. Taken with the other measures, that is a big extension of pension security, for the first time guaranteeing protection if a company scheme goes bust.[73]

In exchanges following the statement, the Secretary of State resisted calls for the compensation to be made retrospective so that it covered workers like those at ASW:

> He raised the agonisingly awful issue of people who have already lost their pension entitlements. Nothing would be more cruel than for me to come to the Dispatch Box and raise false hopes about what might happen. If we are legislating for the future, in terms of establishing a pension protection fund, that would apply in the future and not retrospectively.[74]

The announcement of the creation of a Pension Protection Fund was widely welcomed. The Pension Ombudsman encapsulated many people's reaction when he said:

> It is unacceptable for a scheme member to work for nearly 40 years having a part of his pay deducted and set aside to provide a pension only for that pension to disappear in a puff of liquidated dust.[75]

2. The Bill's provisions

Part 2 of the Bill establishes the Pensions Protection Fund. It applies to private sector defined benefit schemes.

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[73] HC Deb 11 June 2003, cc 683-684

[74] HC Deb 11 June 2003, c 690

[75] Pensions Ombudsman press release, 9 September 2003, http://www.pensions-ombudsman.org.uk/news/index.asp

a. Pension Protection Board

The PPF will be run by a Pensions Protection Board (referred to as "the Board"), whose chairman will be appointed by the Secretary of State. The Board will consist of the Chairman, the Chief Executive and at least five "ordinary members", who will, in the first instance be appointed by the Secretary of State, but, later, by the Board itself. The Board will take over the functions of the Pensions Compensation Board and will be responsible for paying both "pension compensation" (from the PPF) and "fraud compensation" (from the Fraud Compensation Fund). It will also be responsible for managing the calculation and application of three levies (pension compensation, administration and fraud compensation) and setting the Fund's investment strategy. A Factsheet on the PPF, issued by the DWP, states that:

> The Pension Protection Fund has been designed so that Government funding is not required. The Fund can control its own income (through the levy) and its own liabilities, as well as being able to borrow on the market to smooth these over time. This will avoid the costs falling ultimately on taxpayers, the vast majority of whom will not be members of defined benefit occupational pension schemes.[76]

Clauses 81-93 and **schedule 5** of the Bill are the main provisions setting out the membership, procedures, functions and powers of the Board.

b. Pension compensation

The PPF will provide pension compensation for members of defined benefit occupational pension schemes in cases where the sponsoring employer becomes insolvent and the fund has insufficient assets to meet its "protected liabilities". These are defined in **clause 103** as the PPF level of benefits, the scheme's liabilities other than benefits, and the estimated cost of winding up. The Board is required to obtain and use an actuarial valuation of the scheme's assets and liabilities immediately before the insolvency **(clause 112)**. The Bill provides for an "assessment period" during which the Board can decide whether or not the scheme meets the criteria for inclusion within the fund. During this period no new members may be admitted to the scheme, no further contributions can be paid into the scheme, and no new benefits can accrue **(clause 105)**. Pensions in payment continue but only at the PPF level of benefit **(clause 110)**. The Pensions Regulator is given the power (under **clause 19)** to wind up schemes during the assessment period to minimise claims on the PPF.

If it is decided that the scheme does qualify for inclusion, the Board will issue the scheme trustees or managers with a "transfer notice", transferring the scheme's property, rights and liabilities to the Board **(clauses 122-123).**

Compensation will be

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76 http://www.thepensionservice.gov.uk/atoz/atozdetailed/fs1.asp#whowill

- 100% of pension benefits for members who have reached the scheme's Normal Pension Age (NPA) or who have retired early on ill health grounds at the "assessment date". This is the date at which a company's insolvency triggers a referral to the PPF; and

- 90% of accrued pension benefits (payable at NPA) for members (both active and deferred) who have not yet reached NPA. This compensation will be subject to a "compensation cap", to be set in regulations. The Explanatory Notes on the Bill say that it will be "£25,000 for those who first become entitled to periodic compensation at age 65", with a lower cap for those becoming entitled below age 65 and a higher cap for those becoming entitled above the age of 65.[77] The Pensions White Paper, published in June 2003, had indicated that the cap would be "equivalent to the pension expected by those on a final eligible salary of between £40,000 and £60,000".[78] The cap will be increased annually in line with average earnings.

Members will be able to take up to 25% of their PPF compensation as a lump sum, irrespective of whether or not the insolvent scheme's rules provided for this.

PPF pensions in payment will be indexed in line with the Retail Price Index (RPI) capped at 2.5%, but only in respect of rights built up since April 1997 (which is when the statutory obligation to index occupational pensions in payment was introduced). Deferred PPF pension rights will be revalued in line with the RPI capped at 5%.

Widow(er)s will be entitled to half the deceased beneficiary's PPF compensation.

Compensation levels will be based on the "admissible rules" of the insolvent scheme. These are "the scheme rules disregarding all recent rule changes, if the combined effect of those changes and any recent discretionary increases is that the protected liabilities of the scheme immediately before the assessment date are greater than they would have been in the absence of those changes and increases". This provision is designed to prevent people from manipulating schemes to ensure themselves larger PPF payments than their proper entitlement.

Clause 124 and **schedule 7** of the Bill are the main provisions dealing with pension compensation.

77 EN, Bill 57, 2003-04, para 399
78 Cm 5835, para 2.9

c. Fraud compensation

The PPF will also take over responsibility for paying fraud compensation from the Pensions Compensation Fund. Fraud compensation is payable to both DB and defined contribution (DC) schemes. At present, in DB schemes, the amount of compensation is limited to 100% of liabilities for pensioners and members within ten years of retirement and 90% of liabilities for other members. In DC schemes, compensation is limited to 90% of the loss. The Myners report on *Institutional investment in the UK*, published in 2001, recommended that that the level of compensation for non-pensioner members should be "increased to cover not simply the 90% of MFR liabilities as at present, but something closer to the cost of securing members' accrued rights (or the amount of the loss, whichever is the lesser)".[79] The Government accepted this recommendation, and the Pensions Green Paper, published in December 2002, announced:

> 86. We propose to remove these restrictions so that schemes with an insolvent employer can be compensated for the full amount lost as a result of acts of dishonesty.[80]

Clauses 144-151 deal with fraud compensation. The amount of fraud compensation payments will be determined by the Board in accordance with regulations, but **clause 147 (3)** ensures that the total payment must not exceed the value of the loss, less any recovery payments. **Clause 211** removes the current restrictions in the *Pensions Act 1995* which limit fraud compensation to 90% in certain cases. Most of the details of the fraud compensation scheme are left to regulations. However, the DWP's *Regulatory Impact Assessment* (RIA) on the Bill does confirm that the Green Paper proposal will proceed:

> It is proposed to enhance the current arrangements to remove these restrictions, and ensure that schemes with an insolvent employer can be compensated for the full amount lost as a result of acts of dishonesty.[81]

d. Funding the compensation

The Board of the PPF will take over, and invest, the assets of insolvent employers' schemes. It will also impose a levy on all private sector DB or hybrid schemes. The main levy will be the **pension protection levy,** composed of a **risk-based levy** and a **scheme-based levy**. **Clause 137** provides that the **risk-based levy** should be assessed by:

> (i) the difference between the value of a scheme's assets (disregarding any assets representing the value of any rights in respect of money purchase benefits under the scheme) and the amount of its protected liabilities, and

79 HM Treasury, *Institutional investment in the UK: a review*, (the Myners report), March 2001, para 8.23
80 Cm 5677
81 RIA, para 3.3.3

> (ii) if the Board considers it appropriate, one or more other risk factors mentioned [below]: …
>
> (a) the likelihood of an insolvency event occurring in relation to the employer in relation to a scheme;
> (b) the risks associated with the nature of the scheme's investments when compared with the nature of its liabilities;
> (c) such other matters as may be prescribed.

It provides that the **scheme-based levy** should be assessed by one or more of the following factors:

> (a) the number of persons who are members, or fall within any description of member, of a scheme;
> (b) the total annual amount of pensionable earnings of active members of a scheme;
> (c) the amount of a scheme's liabilities to or in respect of members (other than liabilities in respect of money purchase benefits);
> (d) such other factors as may be prescribed.

If the Board imposes both a scheme-based and a risk-based levy, the risk-based levy must be set so as to raise at least 50% of the total. If the Board only imposes a scheme-based levy, it must not raise more than 10% of the **levy ceiling** which will apply to the total to be raised from the pension protection levy. It will be laid down by the Secretary of State each year under **clause 140,** and can be increased annually by the rise in average earnings. The total raised by the levy will not be allowed to rise by more than 25% in any year under **clause 139 (6)**.

The provision that at least 50% of the levy should be risk-based responds to criticism that any levy on all schemes is unfair on well-funded schemes as they will, effectively, be subsidising the under-funded schemes which are more likely to be taken over by the PPF. Unprincipled schemes might deliberately reduce funding or make risky investments in the knowledge that this will have no effect on their premium and that the PPF will pick up the tab if things go wrong. This is often referred to as the "moral hazard" argument against an insurance scheme. However, it is proving quite difficult to devise practical ways of measuring risk, so to begin with, there will be an **initial levy**, set by the Secretary of State. **Clause 136** provides that this will apply for an "initial period" of one year (likely to be 2005/06) and, possibly a second year (2006/07). The DWP Factsheet on the PPF explains:

> We need to get the PPF in place as soon as possible, even though some of the data needed for the risk-based levy will not be available. So, for the first year, only the scheme-factors based part of the Pension Protection levy will be collected. Well run schemes will not lose out as the Pension Protection levy will be set to raise just half what the levy will raise in later years. We will be enabling the Board to introduce a risk-based component from the second year, so that the risk-related factors can be added in the way that suits schemes best. If they think

> it is in their interest to have an early valuation done, then they can do this as soon as they like; alternatively, they can wait until their next tri-annual valuation is completed. So, schemes face a low levy in the first year and the flexibility to move towards a more risk-based system as it suits them.[82]

After the "initial period", there will be a "transitional period" when "modifications may be made to the provisions governing the PPF Board's setting the levy in the light of practical considerations".[83]

There will also be an **administration levy**, set by the Secretary of State in regulations, to fund the administration and initial start-up costs of the Board (**clause 91)** and – as now – a **fraud compensation levy** which will be levied only when cases of fraud arise (**clause 151)**. As now, the fraud compensation levy will apply to both DB and DC schemes.

The DWP's *Regulatory Impact Assessment* on the Bill estimates that the pension protection levies will cost private sector DB schemes approximately £300 million a year.[84] The administration levy is estimated to cost £15 million a year.[85] The estimated increase in the total which will have to be raised to finance a higher level of fraud compensation is "of the order of £10,000 a year".[86]

e. Pension Protection Fund Ombudsman

Clauses 170-176 establish a "PPF Ombudsman", to be appointed by the Secretary of State, to deal with disputes about PPF matters, if they cannot be resolved by the internal dispute resolution procedure (established by **clauses 167-169**). Clause 167 lists the "reviewable matters" which may be determined by these procedures. They include such things as whether or not a scheme is eligible to pay the levy or to be taken over by the PPF, the amount of the levy imposed on a particular scheme and the amount of compensation for which an individual qualifies. There is a further right of appeal (on a point of law, only) to the High Court.

Watson Wyatt, in a Pensions News Flash on the Bill comment:

> To some extent, the Bill suffers from the Government's determination to demonstrate its compliance with the Human Rights Convention principle that every person is entitled to a fair and public hearing by an independent and impartial tribunal. This has led the Government to include exhaustive provisions establishing procedures, reviews and appeal bodies in relation to decisions of both the Regulator and the Board of the Pension Protection Fund.[87]

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82 http://www.thepensionservice.gov.uk/atoz/atozdetailed/fs1.asp#howwork
83 RIA, para 3.2.3
84 *Ibid*, para 3.2.8
85 *Ibid*
86 *Ibid*, para 3.3.9
87 http://www.watsonwyatt.com/europe/pubs/pensionflash/

3. Issues

a. Retrospection

The most controversial aspect of the PPF is the refusal of the Government to backdate its provisions. The DWP's Factsheet explains why this cannot be done:

> **What about those who are at risk of losing out before PPF comes in?**
>
> We are taking urgent steps which will help in advance of the PPF. We have already published draft regulations which will prevent solvent employers from walking away from their responsibilities.
>
> We will shortly publish draft regulations which will change the priority order where a scheme winds up, giving more protection especially to people who have been in the scheme for the longest.
>
> These urgent measures will increase protection significantly in advance of the Pension Protection Fund.
>
> We have enormous sympathy for the difficulties faced by former workers who have already missed out, and these have highlighted the need for the Government to take urgent action. The PPF, however, is an insurance scheme and no insurance scheme can cover against events that have already happened.[88]

The draft regulations mentioned are the:

- *Draft Occupational Pension Schemes (Winding Up and Deficiency on Winding Up etc.) (Amendment) Regulations 2003* which were published in draft for consultation on 11 June 2003.[89] From that date, they require solvent employers who choose to wind up a pension scheme to meet the cost of buying out members' accrued rights in full (rather than only at the Cash Equivalent Transfer Value level which does not guarantee expected benefits). In fact the final version of these regulations was laid before the House on 23 February 2004;[90] and the

- *Draft Occupational Pension Schemes (Winding Up) (Amendment) Regulations 2004* which were published on 22 October 2003.[91] These proposed a change in the priority order on an insolvent wind up to raise the accrued pension rights of non-pensioners above the indexation of pensions already in payment. In his

88 http://www.thepensionservice.gov.uk/atoz/atozdetailed/fs1.asp#whatabout
89 http://www.dwp.gov.uk/consultations/consult/2003/ops/ops.pdf
90 SI 2004/403
91 http://www.dwp.gov.uk/consultations/consult/2003/ops/ops_wind_up_regs_oct04.pdf

speech on an Opposition Day debate on pension scheme wind-ups on 24 February 2004, Andrew Smith confirmed that the Government would:

> move forward in the very near future to rebalance the order so that the basic benefits of those in the run-up to retirement and other deferred members take precedence over the indexation of pensions in payment. That will achieve a substantial rebalancing. Many members may gain 20 per cent. of their pension, so it is a worthwhile interim change before the pension protection fund comes into effect.[92]

Although the draft regulations had proposed a "a secondary rebalancing of the priority order among deferred members, to upgrade the rights of those deferred members with longer scheme memberships against those with shorter tenures", the consultation had revealed that that approach was "impracticable, as many schemes do not keep the data needed to impose it". The Secretary of State reminded the House that:

> all that the proposals to rebalance the priority order can ever achieve is some redistribution of losses, lessening them for some scheme members, but increasing pain for others. The real aim must be to cut, not redistribute, losses for members of schemes in wind-up. That is what the PPF is all about.[93]

By 24 February 2004, 245 MPs had signed Kevin Brennan's Early Day Motion No 200, calling for legislation to compensate those who have already lost their pensions:

> That this House acknowledges the plight of workers who have lost their final salary occupational pensions schemes through company insolvency despite being promised by firms and successive governments that their pensions were guaranteed and in many cases having been compelled to join their scheme as a condition of employment; further believes that the Government has a moral and possibly legal obligation to help those workers who have been stripped of their pensions through no fault of their own; and further calls upon the Government to introduce legislation to compensate victims of this singular injustice.[94]

Kevin Brennan has said that he will table an amendment to the Bill calling for compensation for existing victims of collapsed company pension schemes.[95] Frank Field has promised an amendment at Report stage of the Bill instructing the Government to impose a levy on unclaimed assets in banks and building societies to set up a fund to

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92 HC Deb 24 February 2004, c 214
93 *Ibid*
94 EDM 200, 2003/04
95 "MPs call for victims of pension scheme failures to be compensated", *Sunday Telegraph*, 8 February 2004

assist these people.[96] Steve Webb, the Liberal Democrat pensions spokesman, has signed Kevin Brennan's EDM, but David Willetts, the Conservative spokesman on pensions, has put down another EDM which calls for speed in introducing the PPF, but not for retrospection:

> That this House is alarmed at the number of occupational schemes that are being wound-up, often depriving future pensioners of all their pension rights; records that for the last year the Official Opposition has been offering its full co-operation to the Government when a pension scheme winds up; regrets the Government's continuing delay in addressing the problem; and calls upon it to act now to protect future pensioners who, through no fault of their own, are caught in this trap.[97]

The Pension Action Group has submitted proposals drawn up by their adviser, Ros Altmann, for a Central Fund into which the assets of existing insolvent pension funds would be paid. Benefits due would be paid from this fund for as long as possible, with ultimate responsibility being taken over by the Government. Ms Altmann estimates that the cost of her proposals would average less than £100 million a year.[98]

b. Government guarantee

The Government has also resisted calls for it to act as a guarantor of last resort. Lord McIntosh of Haringey said in the Debate on the Address in the Lords:

> I was asked whether the Government would act as a guarantor. As an analogy, I simply ask one question. If we want to get rid of asbestos in industrial buildings, housing or anywhere else, is the way to achieve it for the Government to guarantee that if people do not do it themselves, the Government will pay for it? Surely that is not the case. Surely, it would be right for those who have benefited from the ups of pension finance, but are now sometimes risking paying the downs, collectively to pay for it. We shall seek to ensure that our fund will be conducted with the utmost sensitivity to the needs of industry. But for the Government to be the ultimate guarantor would be to move exactly in the wrong direction.[99]

Earlier, Andrew Smith had dealt with a similar question in the Commons:

> As far as whether the public should stand as a guarantor of the fund, that would be wholly inappropriate. First, there would be the moral hazard. Secondly, I hope that a moment's reflection would underline the importance of not nationalising that risk, which is what the hon. Gentleman is advocating amounts to. The state

96 "Falling on deaf ears", *Pensions Week*, 16 February 2004
97 EDM 66 2003/04
98 http://www.pensionstheft.org/10303.html
99 HL Deb 27 November 2003, c 91

> cannot stand behind the hundreds of billions of pounds of what are private sector obligations. Moreover, the scheme that operates in the United States has no such underwriting from the US Government.[100]

However, many commentators argue that, without a Government guarantee, the PPF cannot deliver what it promises if there are major calls on its resources. For example, the Association of Consulting Actuaries (ACA) has commented:

> The government should act as Guarantor or be open and honest that no absolute guarantee can be provided and detail examples of the circumstances in which PPF benefits may be cut back.[101]

Many point to the experience of the Pension Benefit Guaranty Corporation (PBGC) in the USA which was established in 1974 under the *Employee Retirement Income Security Act 1974* (ERISA) to protect the basic pension benefits of participants in private sector defined benefit pension plans. To a large extent, the PPF is modelled on the PBGC. The PBGC is a Government Corporation but is entirely self-financing and there is no Government guarantee. Its funding comes from insurance premiums paid by companies with insured schemes, assets from pension plans the Corporation has taken over, investment income and amounts recovered in bankruptcy from companies formerly responsible for failed plans. Its latest Annual Report (for 2003) revealed a record deficit of $11.2 billion on its single employer insurance program (which is similar to the PPF). In her introduction to the report, the Corporation Chairman said:

> Defined benefit pension plans remain the cornerstone of retirement security for millions of American workers and retirees. Unfortunately, the defined benefit system is now confronted with the most significant challenges it has faced in over a decade. As of the end of fiscal year 2003, total underfunding in America's private pension plans exceeded $350 billion, by far the largest fiscal year-end number ever recorded. At the Pension Benefit Guaranty Corporation, not only did the single-employer insurance program show a record $11.2 billion deficit, but the multiemployer insurance program fell into deficit for the first time in over 20 years.[102]

c. Cost

The Regulatory Impact Assessment (RIA) on the Bill put the cost to employers of the pension protection levies at £300 million a year. The *Times* has described this as a "£40-a-year 'stealth tax'" on the eight million workers in final salary schemes.[103] This assumes that the cost of the levy will be passed on to employees in higher contributions. The RIA

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[100] HC Deb 20 October 2003, cc 370-371

[101] http://www.aca.org.uk/Public_content/PPF%20Structure%20-%2018%20September%202003.doc

[102] http://www.pbgc.gov/publications/annrpt/03annrpt.pdf

[103] "Pensions face £40-a-year 'stealth tax'", *Times*, 13 February 2004

says that “employers will be able to recoup the costs of the part of the levy assessed by reference to scheme factors from members, if they choose to do so”.[104]

Many commentators believe that £300 million is an underestimate. John Ralfe, a pensions consultant, has said that the PPF would “need to raise at least £600m a year from FTSE 100 companies alone to cover the ‘risk-based’ – rather than administrative – costs of any potential payouts”. Without “tough solvency measures”, he believes the PPF will fall into deficit as the PBGC has done.[105]

d. Impact on occupational pension provision

Employers are concerned that the cost of the levy will be yet another factor encouraging them to move away from providing final salary pension schemes. Half of respondents to the National Association of Pension Funds’ 2002/03 annual survey said the government’s proposed Pension Protection Fund would make it less attractive for employers to provide defined benefit schemes. [106]

Although the Government argues that the package of measures in the Bill will lead to an overall saving for employers of £130 million,[107] many commentators are very dubious about the basis of these claims. For example, Gordon Pollock, chairman of the ACA, commented:

> When this whole process of reform began it was a recognition by government that over-regulation was seriously discouraging employer pension provision and was driving costs up to unacceptable levels. Whilst considerable progress has been made to simplify pension tax regimes for the majority of people, I really wonder whether this Bill as a whole has in any way really achieved its objective. Whilst there are simplification measures within the Bill that we welcome, it is now difficult to see any major savings set against a whole raft of new extra costs. That being the case, I struggle to see how the Bill will encourage wider provision without some of the powers ‘to require employers’ being invoked, at even greater cost.[108]

However, the DWP Factsheet on the PPF suggests that it could even be an incentive to greater DB provision:

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[104] RIA, para 3.2.2

[105] “Pension safety net ‘will fail without top-up of funds”, *Daily Telegraph*, 20 February 2004

[106] NAPF press release, 20 November 2003, *One in four companies close final salary pension schemes in 2003*, http://www.napf.co.uk/news/PR2003/releasesa018.cfm

[107] RIA, para 2.2.3

[108] ACA press release, 12 February 2004, http://www.aca.org.uk/Public_content/PensBill_release_(12Feb04)%20.doc

> **Won't this reform discourage firms from running Defined Benefit (DB) schemes?**
>
> The levy represents only a very low percentage of the flow of contributions into DB schemes.
>
> It greatly increases the value of DB pensions to firms, as they will be more useful to recruit and retain the best once the workforce have confidence that pensions paid will be pensions delivered.
>
> The Pension Protection Fund is part of a balanced overall package which protects the interests of scheme members but also minimises the burden on employers. The overall impact of the Bill measures on business at introduction is an estimated saving of £130 million per year. This excludes savings from proposals for simplification of taxation of pensions.[109]

e. Abuse

Many reputable companies providing DB schemes are most concerned that, in the absence of a substantial risk-based premium, they will end up subsidising poorly run schemes.

Commenting on the June 2003 Pensions White Paper, the Society of Pension Fund Consultants said:

> Taking the US experience as a guide, we should expect that some employers will use any or all loopholes to dump their pension liabilities on to the Pensions Protection Fund, which will impose additional costs on employers who are maintaining their pension promises, and generally discredit the system. A number of advisers have already been investigating loopholes, and have discovered quite a few. We would be keen to work with you to get these loopholes closed as fast as possible.[110]

Richard Greenhalgh, Chairman of the CBI's Pensions Strategy Group, is wary of Government promises to introduce risk-based premiums within a year:

> Business does not want to see employees left high and dry in retirement because a company has gone bust. That is why firms have strongly backed the idea of a fund.
>
> But companies do want to see serious momentum behind efforts to address their concerns, in particular that the fund should take into account the risk of company insolvency as well as underfunding. Otherwise we will be in the unacceptable

[109] http://www.thepensionservice.gov.uk/atoz/atozdetailed/fs1.asp#whatabout

[110] http://www.spc.uk.com/htm/newsJuly203.htm

> position of well-managed funds with sufficient resources effectively underwriting other schemes.
>
> We appreciate efforts to reassure business on this point and we recognise these issues are difficult to resolve. But we are not convinced that there needs to be further delay. There is no reason why the government cannot make headway on specific proposals over coming months.[111]

On the other hand, as an article in the *Financial Times* point out, there are still problems with a risk-based levy:

> The weakest funds will pay most and, as they get weaker, pay even more; creating the potential for a vicious circle.[112]

It is also thought that a number of currently underfunded schemes are delaying winding up until the PPF is set up and able to take on their liabilities. Hewitt, Bacon & Woodrow welcomed the establishment of the PPF but warned:

> It is vital that the fund is run on a sound financial basis. While much of the detail is not available yet, it seems clear that the levy in the first year is not going to be adequate. This means that the PPF will not get off to a good start. This situation will be exacerbated by schemes which are currently "clinging on" until the PPF is established, at which point they will make a claim. In the first year the PPF will get half the right levy but perhaps double the claims.[113]

C. Scheme Funding Requirements

1. Background

The Minimum Funding Requirement (MFR) was introduced in April 1997 under sections 56-61 of the *Pensions Act 1995*. It was one of "six lines of defence" designed to "restore confidence in the regulatory regime for occupational pensions" following the Maxwell pension fund scandal in 1991.[114]

Under the legislation, a tax approved, private sector, defined benefit occupational pension scheme must conduct an MFR valuation at regular intervals (normally every three years) to see whether it has sufficient assets to meet its liabilities, if it were to be wound up.

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[111] CBI news release, 12 February 2004, "CBI backs Pension Fund but dissatisfied with Government reassurances on levy", http://www.cbi.org.uk/ndbs/press.nsf/0363c1f07c6ca12a8025671c00381cc7/742e931b53d181f780256e380031f969?OpenDocument

[112] "Safety net still has holes in it", *Financial Times*, 23 February 2004

[113] Hewitt Bacon & Woodrow press release, 12 February 2004, "Pension Bill protection is fine but what about simplification says Hewitt Bacon & Woodrow", http://www.online.hewittbaconwoodrow.co.uk/

[114] Peter Lilley, Secretary of State for Social Security, Second Reading debate on the *Pensions Bill 1994-95*, HC Deb 24 April 1995, c 527

This is called a valuation on a "discontinuance basis". The precise way in which assets and liabilities are calculated for the purpose of the MFR valuation is laid down in regulations and Guidance Notes agreed between the Government and the actuarial profession.[115] If the scheme is underfunded on this basis, it must prepare a schedule of contributions which the sponsoring employer will have to make over a prescribed timescale to bring it up to 100% of its MFR.

Essentially, assets are valued at current market rates. Pensioner liabilities are valued by discounting them in line with the prevailing market yield on gilts or, for large schemes, in part by discounting them in line with an assumed long-term UK equity rate of return. Liabilities for the accrued rights of members who have not yet retired are valued by discounting them in line with the assumed UK equity rate of return before retirement and with gilts after retirement, adjusted by a "market value adjustment" (MVA) reflecting prevailing UK equity dividend yields. The rights are valued as if the members had left service immediately.

The MFR is:

> designed to underpin the employer's commitment to support the DB scheme it sponsors, so that in the event of the scheme having to cease, whether the employer is insolvent or not:
>
> - scheme members who are already retired can expect their pensions to be paid in full;
> - scheme members who are not yet retired have a reasonable expectation of receiving the value of their pension rights when they come to retire."[116]

The MFR has been the subject of widespread criticism almost from the start. In practice, the formula did not provide the intended "reasonable assurance" that accrued rights could be delivered.[117] Moreover it distorted pension fund investment decisions by encouraging them to put more money into gilts (and thereby pushing up the price of long-term gilts) than they might otherwise have done. The *Financial Times* has described the introduction of the MFR as a "textbook example of the law of unintended consequences":

> The purpose was to protect pensioners from a repeat of the Robert Maxwell pension fund scandal. Yet in seeking to regulate pension fund solvency the

[115] The *Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regulations 1996*, SI 1996/1536, as amended, and the Faculty and Institute of Actuaries' Guidance Note GN 27, *Retirement Benefit Schemes – Minimum Funding*, http://www.actuaries.org.uk/files/pdf/map/GN27V2-1.pdf

[116] Department of Social Security, HM Treasury, *Security for Occupational Pensions: a consultation document*, September 2000

[117] William Hague, Minister for Social Security, debate on the *Pensions Bill 1994-95*, SC Deb (D), 23 May 1995, c 355

> government not only failed to provide a guarantee of pension scheme members' rights but also distorted the pattern of capital market returns.[118]

In March 1999, the DSS asked the Pensions Board of the Faculty and Institute of Actuaries to review the MFR and in March 2000, the Chancellor of the Exchequer asked Paul Myners of Gartmore Investment Management to review the pattern of institutional investment in the UK. In September 2000, responding to the Pensions Board report, the DSS published a consultation document, *Security for Occupational Pensions*, which put forward a number of proposals for improving protection for pension scheme members.[119] These were not confined to amendments to the MFR, but also included prudential supervision by a regulator, compulsory insurance and a central discontinuance fund. In March 2001, the Myners report was published. This recommended the abolition of the MFR and its replacement with a "scheme-specific long-term approach based on transparency and disclosure under which pension funds would report publicly on the current financial state of the fund and on future funding plans". It concluded that:

> the MFR is distorting investment patterns without providing effective protection for members of defined benefit pension schemes. By making calculations based on standard assumptions it can give a misleading picture of the level of security of pensions. It is distorting investment choices. It is increasing the cost of defined benefit provision and thereby creating artificial incentives to move to defined contribution. Indeed, its effects may actually be counterproductive to the extent that it gives trustees a spurious sense of certainty about funding levels, weakening the sense of fiduciary responsibility.[120]

In his Budget statement on 7 March 2001, Gordon Brown announced that, "to promote long term investment and to protect investors", he had accepted the recommendations of the Myners report and would be abolishing the MFR.[121] Further details were contained in a joint DSS/HM Treasury document, *Security for Occupational Pensions: the Government's Proposals*, published that month. This set out the six key elements of the proposals which would "provide protection for members while at the same time avoiding damaging consequences for investment":[122]

- a long-term, scheme specific, funding standard;
- a strong regime of transparency and disclosure;
- a recovery plan for returning schemes to full funding;
- a statutory duty of care on the scheme actuary;
- stricter conditions on wind-up of a scheme with a solvent employer; and
- an extension to the fraud compensation scheme.

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118 "Perverse pensions", *Financial Times*, 15 September 2000
119 *Op cit*, *Security for Occupational Pensions: a consultation document*, September 2000
120 HM Treasury, *Institutional investment in the UK: a review*, March 2001, para 8.62
121 HC Deb 7 March 2001, c 298
122 Department of Social Security, HM Treasury, *Security for occupational pension schemes: the Government's proposals*, March 2001

In September 2001, a further consultation document, *The Minimum Funding Requirement: the next stage of reform*, announced that a consultation panel would be established to help the Government develop the details of the replacement of the MFR.[123] In the meantime, some interim changes to the existing regime would be made by regulation. The main changes, which came into force on 19 March 2002, were:

- an extension of the deficit correction periods in which scheme funding is made good. Originally, employers had to bring scheme funding up to 90% of the MFR funding level within one year and up to 100% within 5 years. These timescales were increased to 3 years and 10 years respectively;

- removing the requirement for annual recertifications of schemes that are fully funded; and

- introducing stricter conditions on voluntary wind-up. The employer would have to meet the actual costs of winding up the scheme, the cost of annuities for pensioners and Cash Equivalent Transfer Values on an MFR basis for non-pensioners.

These interim changes were made by the *Occupational Pension Schemes (Minimum Funding Requirement and Miscellaneous Amendment) Regulations 2002*, SI 2002/380.

The pensions Green Paper, published in December 2002, and the pensions White Paper, published in June 2003, confirmed that the Government would be replacing the MFR with more flexible scheme specific funding requirements. In both cases, the change was put forward as a way of reducing the burden on employers who wanted to provide defined benefit schemes. The White Paper estimated that the change would save pension schemes £100 million:

> 6. We estimate that replacing the Minimum Funding Requirement (MFR) with scheme-specific funding arrangements will result in funding savings of £100 million across all private sector defined benefit schemes. The MFR is considered to have had an impact on the demand for gilts, and its removal will therefore lead to some reversal of this trend. At present it is estimated that schemes have some £100 billion invested in gilts overall. On the assumption that 5 per cent (£5 billion) of this was switched to equities following the removal of the MFR and that an extra 2 per cent return was achieved on those assets as a result, the extra investment income would amount to £100 million.[124]

[123] Department for Work and Pensions, HM Treasury, *The Minimum Funding Requirement: the next stage of reform*, September 2001, http://www.dwp.gov.uk/consultations/consult/2001/mfr_next/mfr.pdf

[124] Cm 5835, Annex. This estimate is repeated in the RIA on the Bill, para 4.1.15

It set out the key elements of the scheme-specific funding requirement as:

> ● scheme trustees will be required to draw up a Statement of Funding Principles;
>
> ● trustees will be required to obtain a full actuarial valuation of their scheme at least every three years;
>
> ● following the valuation, the trustees will be required to put a Schedule of Contributions in place, setting out how much the employer and employee will pay into the scheme;
>
> ● where trustees and employers cannot reach agreement on issues fundamental to the funding of the scheme, the trustees will be given, as a last resort, powers to freeze or wind up the scheme;
>
> ● trustees will be required to send regularly updated information to scheme members each year, containing key information about the funding position of their scheme, in line with the likely requirement of the EU Occupational Pensions Directive; and
>
> ● the scheme actuary's duty of care towards scheme members will be clarified.[125]

2. The Bill's provisions

Part 3 of the Bill replaces the MFR with a scheme specific funding requirement. It applies to private sector defined benefit schemes. It has been influenced by the need to comply with the *European Directive on the Activities and Supervision of Institutions for Occupational Retirement Provision* (the IORP directive), which has to be implemented in the UK by 23 September 2005.[126]

a. Statutory funding objective

Clause 179 requires schemes to have "sufficient and appropriate assets to cover [their] technical provisions". "Technical provisions" is a term used in the IORP directive, article 16 (1) of which requires pension schemes to have "at all times sufficient and appropriate assets to cover the technical provisions". Article 16 (2) allows schemes to have insufficient assets for a "limited period of time" provided they adopt a "concrete and realisable recovery plan" to increase the assets to meet these technical provisions.

The DWP's consultation paper on implementing the directive says that the "technical provisions" are taken to mean something more than the "liabilities" of the scheme. They are:

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[125] *Ibid*, para 3.6

[126] Directive 2003/41/EC of the European Parliament and the Council of 3 June 2003, commonly known as the IORP Directive

> taken to be the actuarial value of the accrued liabilities of the scheme based on the actuary's assumptions on matters such as future investment returns, future wage growth and life expectancy. Therefore the technical provisions at any point in time will depend on the benefits provided by the scheme and the membership profile of the scheme at that date, and the actuary's demographic and economic assumptions about the scheme's future experience.[127]

The Bill defines "technical provision" as "the amount required, on an actuarial calculation, to make provision for the scheme's liabilities" (**clause 179 (2)**).

Details of how assets and liabilities are to be calculated will be laid down in regulations and actuarial guidance, but there will be alternative methods, and scheme trustees or managers will be able to choose the method most appropriate to their scheme.

Schemes will have to conduct actuarial valuations to see whether they are complying with their statutory funding objective every year, or, if they obtain actuarial reports for the intervening years, every three years (**clause 181**). The Government had originally intended to require only three-yearly valuations, but the IORP directive, in article 15 (3) requires annual calculations of the "technical provisions".[128] The article does permit three-yearly calculations if the scheme "provides members and/or the competent authorities with a certification or a report of adjustments for the intervening years".

If the valuation shows that the funding objective has not been met (i.e. there is underfunding), trustees or managers will have to put a recovery plan in place (**clause 183**).

b. Statement of funding principles

Clause 180 requires trustees or managers to prepare a Statement of Funding Principles (SFP) setting out their policy for ensuring that the statutory funding objective is met, and such other matters as may be prescribed. The Government intends that the SFP should be reviewed at least every three years.[129]

It is also proposed that trustees should send members key information about the funding position of their scheme each year. These "annual funding statements" can be introduced by regulations under section 113 of the *Pension Schemes Act 1993*, so there is no need for primary legislation in this Bill.[130]

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[127] Para 5.8, http://www.dwp.gov.uk/consultations/consult/2003/eu-directive/EUpensionsconsultation.pdf
[128] RIA, para 4.1.18
[129] EN Bill 57, para 419
[130] RIA, para 4.1.23

c. Schedule of contributions

Under **clause 184**, trustees or managers are required to draw up a schedule of contributions to be made by the employer and employees. The schedule may be part of a recovery plan or, where the actuarial valuation has revealed no underfunding, designed to ensure that this situation continues. The Government intends that, in the latter case, the schedule should cover five years; in the former, it should cover the length of the recovery plan.[131] Significant failures to make payments in accordance with the schedule are to be reported to the regulator.

d. Agreement between trustees and employer

Clause 186 lists the matters on which the trustees or managers must obtain the agreement of the employer:

> (a) any decision as to the methods and assumptions to be used in calculating the scheme's technical provisions;
> (b) any matter to be included in the statement of funding principles;
> (c) any recovery plan;
> (d) any matter to be included in the schedule of contributions.

In cases where agreement cannot be reached, the regulator is given the power to resolve the matter (**clause 188**). He could, for example, impose a schedule of contributions on a scheme or give directions about how, and over what period, any failure to meet the statutory funding objective should be rectified. This is a change from the June 2003 White Paper proposal that, in these circumstances, the trustees would be given, as a last resort, powers to freeze or wind up the scheme. Commentators on the White Paper had suggested that this would strengthen the hand of trustees vis-à-vis sponsoring employers. Given that solvent employers are now required to meet the full buyout cost on wind-up, they will be reluctant to allow this to happen.[132]

3. Issues

a. Costs

The replacement of the MFR by a scheme specific funding requirement is supposed to reduce the cost of providing DB pension schemes. However, the RIA on the Bill suggests that the annual administrative costs of maintaining an SFP, compiling annual funding statements and producing inter valuation reports will outweigh the savings from having to produce MFR valuations by £16.75 million.[133] All the savings come from the assumption that schemes will switch 5% of their investments from gilts to equities and that this will

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[131] EN Bill 57, para 437
[132] See, e.g., "How will it work?", *Pensions Week*, 14 July 2003
[133] RIA, para 4.1.27

yield an additional 2% rate of return. This is assumed to increase investment returns by about £100 million a year.[134]

Christine Farnish, Chief Executive of the National Association of Pension Funds, has said:

> We have deep reservations about the assumptions made. There is by no means any guarantee that funds will shift from bonds to equities, in fact there is evidence to suggest the opposite is happening.[135]

b. Member security

Before the June 2003 announcement that a Pension Protection Fund would be introduced, many consumer and pensioner organisations were concerned that abolition of the MFR, despite all its faults, would leave scheme members almost completely unprotected. For example, the Pensions Advisory Service (OPAS), in its response to the December 2002 Green Paper, argued that scheme specific funding is not really a minimum funding standard at all, just a return to the situation that existed before the MFR was introduced:

> 3.1 If employees are to be persuaded to join company final salary schemes they must have confidence that the employer is properly funding it. Whatever the de-merits of the MFR system, it did at least impose some minimum standards on employers. The new proposal for scheme specific funding requirements does not.
>
> 3.2 The proposed new system seems to be a reversion to what applied before MFR. Indeed to call what is proposed a funding regime is reminiscent of the story of the emperor with no clothes.[136]

The introduction of the PPF may have reassured consumer representatives that scheme members will get much of their entitlement even if the scheme is not properly funded.

c. Inconsistency

A survey by the Association of Consulting Actuaries found that 69% of employers welcomed the replacement of the MFR by a scheme specific funding requirement, with only 6% opposing the move, but there was concern at the variety of approaches which might be adopted.[137]

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[134] RIA, para 4.1.15

[135] "Pensions face £40-a-year 'stealth tax'", *Times*, 13 February 2004

[136] OPAS press release, 1 April 2003, *Greater security for pension scheme members fundamental, says OPAS report*, http://www.opas.org.uk/PressReleases/20030401.htm

[137] Association of Consulting Actuaries, *Occupational Pensions 2003 Pensions Reform: too little, too late?* March 2003, http://www.aca.org.uk/Members_content/Pension_Survey_%202003_Scheme_final_report.doc

d. Relationship with risk-based premium for PPF

The Society of Pension Consultants, like other experts in the field, has pointed to the link between the risk-based premium for the PPF and scheme funding standards. The RIA suggests that schemes which are over 100% funded relative to the PPF level of compensation, will not have to pay a risk-based premium.[138] This might encourage employers to use this funding standard as their own:

> There is also tension between the proposal for risk based premiums and the government's intention to replace the minimum funding requirement by a scheme specific funding standard. The basis for setting the risk-based premium could easily become in effect a new minimum funding requirement. It should also be recognised that risk comes not only from the funding level, but also the investment policy, and the strength of the employer's covenant. Ideally, these factors should be taken into account in the risk-based levy. [139]

Ian Morse, writing in *Pensions Week*, quoted other practitioners with the same view:

> SSFs [scheme specific funding requirements] will be introduced alongside the new pension protection fund (PPF).
>
> This will have a two tier premium structure, flat rate member levy and risk-adjusted premium reflecting the scheme funding position and solvency of the sponsoring employer. All schemes setting SSFs will contribute to the PPF.
>
> Deborah Cooper, senior research actuary at Mercer Human Resource Consulting, says: "So there is a very real possibility that the risk adjusted premium to the PPF will become a de facto benchmark, replacing the MFR and effectively outweighing the SSF in the minds of trustees and sponsors". (…)
>
> Andy Cox, an associate at Hewitt Bacon & Woodrow, adds: "FRS17 is now gaining importance as a benchmark, but our view is that the level at which risk-adjusted PPF premiums become payable will become the basis for measuring the adequacy of scheme funding".[140]

Stephen Kandarian, outgoing executive director of the US Pension Benefit Guaranty Corporation, has stressed that, for the PPF to work properly, it is essential that it is underpinned by properly funded schemes:

> Mr Kandarian said: "The biggest single thing that needs to be addressed is that employers need to fund (pension schemes) properly." He criticised rules that allow employers to withhold contributions during years when their plans appear to be well funded - known as "contributions holidays". He urged governments

[138] RIA, para 3.2.4

[139] http://www.spc.uk.com/htm/newsJuly203.htm

[140] "How will it work?", *Pensions Week*, 14 July 2003

> considering setting up a pension insurance system from scratch - such as the UK - to face up to politically painful choices at the very start. "The advice I'd give is that there is going to be a trade-off between how strong your funding rules are and either how large the premiums (to the insurance scheme) are, or how large the implicit taxpayer back-up is," he said. The only alternative to tough funding rules is to charge painfully high premiums to the corporate sponsors of pension schemes or to shift the cost of a possible bail-out to taxpayers. "There is no free lunch," he said.[141]

D. Planning for Retirement

1. Background

The Government, and many in the pensions industry, are concerned that people are not saving enough to ensure a comfortable retirement. The 'savings gap' is estimated at about £27 billion by the Association of British Insurers.[142] At the same time, recent publicity about pension shortfalls has made people increasingly concerned - and at a younger age - about their pension provision later in life.

The Government aims to address these problems by increasing the planning and forecasting tools available to individuals planning for their retirement – whatever their age or the level of provision they currently possess. The Pensions' Green Paper, *Simplicity, security and choice: working and saving for retirement*, published in December 2002, proposed a collection of initiatives designed to increase consumer take-up of state and combined pension forecasts and statutory money purchase illustrations (SMPIs).

The Government has issued state pension forecasts on request for many years, but in May 2003 it began a programme of issuing them automatically to people without access to a combined forecast from their employer or pension provider. By the end of 2003/04, the Government expects to have issued automatic state pension forecasts to 1.6 million self-employed people, and it intends to send automatic forecasts to 8 million people in 2005/06.[143]

The Government has also been encouraging occupational schemes to join with them in issuing combined pension forecasts showing the pension members can expect from the state and that particular scheme combined. This service was formally launched in October 2001 and it is expected that combined forecasts will have been issued to over 1.3 million people by the end of 2003/04. Nearly 600 employers and pension providers have

[141] "US pension warning for UK", *Financial Times*, 9 February 2004
[142] Association of British Insurers, *Life and Pensions*, 2004 http://www.abi.org.uk/Display/File/87/Tony_Herbert_Pensions_TF.doc
[143] Cm 6111, para 4.8

expressed an interest in participating to date, and the Government hopes that 6.3 million combined forecasts will have been issued by the end of 2005/06.[144]

Since April 2003, all money purchase schemes have been required to issue their members with annual SMPIs showing the amount of pension that might be payable when they retire expressed at today's prices. SMPIs have to be calculated on a standard actuarial basis, laid down in the Faculty and Institute of Actuaries' *Technical Memorandum 1 (TM1)*.[145] The Illustrations are not fully tailored to individual circumstances: a member's actual pension may differ significantly from the amount illustrated because future experience may differ from the assumptions made and the member's individual circumstances may not be reflected in the calculations.

The response to the Government's consultation exercise on the Green Paper confirmed that one of the key elements of making an informed choice is the provision of personalised information, and in particular, a projection of the likely pension income someone will receive in retirement from their occupational, private or state pension. For example, the Trades Union Congress (TUC) commented: "More personalised information, sent direct to individuals, is essential if people are to have a clearer picture of how much they will receive when they retire."[146]

This prompted the Government to announce in the June 2003 White Paper that, if voluntary persuasion failed, it would legislate to require employers to provide combined forecasts:

> *Combined pension forecasts*
> A combined pension forecast adds state pension information to the forecast of an individual's current occupational or private pension scheme, and is delivered through the employer or pension provider. Currently, pension schemes are not required to provide state pension information, but many do so on a voluntary basis.
>
> Feedback from the consultation exercise suggests a high level of support for the provision of combined pension forecasts, particularly from those who are already providing them. Prudential plc reports: "[We are] now issuing combined [pension forecasts] for the majority of our personal pension policyholders ... we support improving communication in this way to consumers and have experienced a positive reaction by increased increment business as consumers recognise the gaps in their planning ... [and believe that] building best practice is a better approach than mandating their issue."
>
> There are concerns that some businesses may not have the resources to deliver combined pension forecasts. While we acknowledge that some organisations have

[144] *Ibid*, para 4.12
[145] http://www.actuaries.org.uk/files/pensions/tm1-may02.doc
[146] Cm 5835, p31

> a number of questions and concerns over the practicalities of the proposal, the Government remains convinced that combined pension forecasts have the potential to be a key motivator in encouraging people to engage in financial planning.
>
> Therefore, we wish to **extend this service across the pensions industry, in the first instance by encouraging voluntary participation through concerted and targeted marketing activity.**
>
> However, if the voluntary approach does not achieve the desired coverage, we will reconsider the question of whether there should be a statutory requirement on pension schemes and employers to provide this service. **We will legislate to allow us to require pension schemes to issue combined pension forecasts on a regular basis if we believe it to be necessary in the future.**[147]

The White Paper also announced that DB schemes, like DC schemes, would be required to issue annual benefit statements to their members:

> *Statutory Money Purchase Illustration*
> **We will expand this initiative so that members of all types of pension schemes get information of this kind, by legislating to require defined benefit schemes to issue annual benefit statements to their members** showing the amount of pension they have already built up in their scheme as well as the likely amount they will receive when they retire. Most large defined benefit schemes are already providing this information to their members and we see this as a basic building block for pension planning and want all members to receive it.[148]

A further document in the *Simplicity, security and choice* series was issued in the week before the *Pensions Bill* was published. This confirmed that the Government would legislate on combined forecasts and annual DB statements and announced that it would look at the possibility of requiring employers to enrol employees in their scheme automatically. Where the employer only provided access to a stakeholder scheme, the Government would consider whether employees should "by default" make a contribution:

> 7. We will work with partners, to explore different approaches, to establish which are the most effective in delivering increased pension saving in the UK. We will develop and test mechanisms for increasing membership of employer-provided schemes, for example:
>
> - active decisions – when new employees are required to make a decision whether or not to join their employer's scheme;
> - commitment to save more in the future – where employees commit potential future earnings to their pensions savings; and

[147] *Ibid*, p32
[148] *Ibid*, p31

> ● automatic enrolment – for new employees, but retaining an opt-out if they decide against membership.

> 8. In addition, we will take further steps to address the risks and under-provision that individuals too often face as a result of inertia. We will examine proposals for new employees to make a default contribution into a stakeholder pension.[149]

This paper also announced that the Government would "take powers in the forthcoming Pensions Bill to require all employers who do not actively support their employees' pension saving to give them access to a decent standard of pension information in the workplace."[150]

The Green and White Papers and this most recent document all referred to the Government's proposals for developing a "web-based retirement planner which will for the first time give people the opportunity to look at all their pension information together. The planner will allow people to view their total projected pension income from both state and private sources against their expectations for retirement, calculate any savings shortfall and consider options to address it."[151]

2. The Bill's provisions

Part 4 of the Bill deals with retirement planning.

Clauses 191-193 and **schedule 9** will enable the Secretary of State to establish the Web-based retirement planning facility. He will be able to take action necessary to enable someone:

> (a) to estimate the financial resources the individual is likely to need after his retirement;
> (b) to estimate the financial resources that are likely to be available to the individual after his retirement, from pensions and other sources;
> (c) to ascertain what action might be taken with a view to increasing the financial resources available to the individual after his retirement

Anyone holding relevant information (e.g. a pension scheme or the tax authorities) will be able to supply it to the Secretary of State for these purposes. Limits are placed on the extent to which the Secretary of State can pass on this information.

Clause 194 provides that trustees or managers of an occupational or personal pension scheme can be required by regulations to provide scheme members with combined (state and occupational or personal) pension forecasts at the times specified in the regulations.

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[149] Department for Work and Pensions, *Simplicity, security and choice: informed choices for working and saving*, Cm 6111, February 2004, p 2,
[150] *Ibid*

The intention is that this should be a reserve power of the Secretary of State, its use depending on the extent to which combined pension forecasts are issued by schemes on a voluntary basis. **Clause 222** in part 6 of the Bill is also relevant in this context, since it facilitates the provision of state pension information to occupational and personal pension schemes who apply for such information in order to provide a combined pension forecast.

Clause 195 provides that employers may be required to act so as to enable employees to have access to information and advice about pensions and saving for retirement. This requirement would be detailed in regulations which, for example, would define the type of information and advice employers must provide access to. The clause also requires employers to provide information to the regulator about what they have done to comply with the regulations.

Those groups most likely to benefit from workplace advice and information are described in the *Regulatory Impact Assessment*:

> 5.2.3 Employees in organisations with low scheme membership and/or low or zero levels of contributions to pension schemes are one of the groups most likely to benefit from pensions information and access to advice through the workplace. The employer audience which has both these key characteristics - low or no contribution and low membership rates - is the group of employers who are required to designate a stakeholder pension scheme. Employees in this group may not previously have had adequate access to information on pensions in the workplace as some of the employers required to designate a stakeholder pension scheme have done so without promoting the fact, and have made little or no effort to support employees with retirement planning.
>
> Previous stakeholder pensions analysis data indicate that there are at least 350,000 employers who employ five employees or more and who do not provide access to an occupational pension scheme, or who do not contribute at least three per cent of employees' salary to a group personal pension arrangement. Around 82% of employer-designated stakeholder schemes have no members. [152]

In order to assess the effectiveness of various approaches in improving employees' awareness of issues around retirement planning, the Government proposes to pilot:

1. A Pensions Information Pack which will give information to employers on pension messages they are able to communicate to their employees, plus an employee pack to be distributed in the workplace;

2. A Pension Information Pack plus a presentation to employees from the designated stakeholder pension provider about pensions and saving for retirement;

3. A Pensions Information Pack, a presentation and a one-to-one interview with the designated stakeholder provider to discuss pensions information; or

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[151] *Ibid,* p 3
[152] RIA, p 40

4. A Pensions Information Pack, a presentation and one-to-one interview with an Independent Financial Adviser who will give limited pensions-focussed advice.

The pilot is scheduled to commence from spring 2004 with the aim of producing research findings by the following summer. The findings from the pilot will be used as a basis for deciding whether and how to invoke the reserve powers in this clause.

3. Issues

There have been criticisms that the Government's plan for providing better information to individuals about their pensions is over complex and could become too intrusive if vast amounts of personal financial information are collated in one place (probably central government). However, in general the proposals have met with little controversy.

Hewitt Bacon & Woodrow support the idea of combined forecasts but hope that "the Government recognises that employers already need to make significant changes to their administrative systems as a result of the Inland Revenue proposals. Any moves to make combined benefit forecasts compulsory need to be deferred to allow pension administrators to catch their breath."[153]

E. Trustees

1. Background

a. Member nominated trustees

In order to ensure member representation on the board of trustees, section 16 of the *Pensions Act 1995* requires an occupational pension scheme to give its members the opportunity to nominate up to one third of the trustees. These are member-nominated trustees (MNTs). The trustees are obliged to ensure compliance with the terms of the *Pensions Act 1995* relating to the appointment of MNTs. To do this, they may either use the ready-made rules set out in the *Occupational Pensions Schemes (Member Nominated Trustee) Regulations 1996* (SI 1996/1216) or adopt their own rules so long as these have been approved under the statutory consultation procedure. Under section 17 of the *Pensions Act 1995* there is also an employer opt-out, which allows the employer to suggest its own arrangements as an alternative to the use of the rules set out in the 1995 Act or rules formulated by trustees.

The statutory arrangements have long been criticised as over-complex, and, in most cases, employers have used the opt-out to introduce their own alternative arrangements.

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[153] Press notice, 12 February 2004, http://www.online.hewittbaconwoodrow.co.uk/

Sections 43-46 of the *Child Support, Pensions and Social Security Act 2000* amended the provisions on MNTs to remove the right of employers to opt out and to replace the existing selection procedures with two alternative nomination and selection arrangements. However, these provisions have remained uncommenced pending the outcome of the Pickering review on simplification and flexibility.

In its 2002 Green Paper *Simplicity, Security and Choice: Working and Saving for Retirement*, the Government reaffirmed its commitment to boards of pension trustees containing one-third MNTs. It intended to remove the employer opt-out, but to reduce the level of prescription in the method for selecting MNTs "so that legislation focuses on the outcome to be achieved … and not, as now, on the detailed processes that schemes must follow to achieve that outcome".[154] The Technical Paper issued with the Green Paper proposed two options:

> The option put forward in the Pickering Report that provides for only a minimum requirement in legislation –schemes must have at least one third MNTs; and
>
> An option that qualifies this minimum requirement with a further condition in the legislation that arrangements for nominating and selecting MNTs must be "fair and open".[155]

During the consultation "some concerns were expressed that more flexible and less prescriptive legislation would give unscrupulous schemes the scope to avoid MNTs altogether, or to disenfranchise certain members or groups of members. This was balanced by views that schemes should be free to adopt arrangements to suit their circumstances, and focus more on outcome than process. There was widespread concern that enforcing a "fair and open" test would be difficult, time consuming and expensive and lead to vexatious complaints to the regulator."[156] As a result the Government decided to adopt the first option.[157]

b. Requirement for knowledge and understanding

The Myners Report on *Institutional investment in the UK*, published in March 2001, was very critical of the level of understanding of many pension fund trustees when it came to taking investment decisions and proposed that:

> there should be a legal requirement that where trustees are taking a decision, they should be able to take it with the skill and care of someone familiar with the issues concerned. If they do not feel that they possess such a level of skill and care, then they should either take steps to acquire it, or delegate the decision to a

[154] Cm 5677, p 61
[155] Technical paper, December 2002, p 33
[156] RIA, para 3.5.5
[157] *Ibid*, para 3.5.6

> person or organisation who they believe does possess this level of skill and care.[158]

A consultation paper on this proposal was issued in February 2002.[159] According to the *Regulatory Impact Assessment* on the Bill, consultations revealed that practitioners thought it was "inappropriate to limit coverage to investment, since trustees require expertise across the full range of their responsibilities (including, for example, funding requirements)".[160]

c. Statement of Investment Principles

Section 35 of the *Pensions Act 1995* requires trustees to prepare and maintain and from time to time revise a written Statement of Investment Principles (SIP) governing decisions about the schemes investments. This would cover such matters as the balance between different kinds of investment, the expected rate of return, policy on ethical investment or exercise of voting rights, and the advice they receive on investment. Myners recommended that:

> the Statement of Investment Principles (SIP) should be strengthened so that members gain access to better quality information as a matter of course, and that it should be sent out to members annually.[161]

The European Occupational Pensions Directive also contains provisions on investment principles, including a requirement that SIPs should be reviewed every three years.

2. The Bill's provisions

Clauses 196 to **198** introduce the new simpler arrangements for MNTs. Schedule 12 repeals the existing provisions in sections 16 to 21 of the *Pensions Act 1995* and the uncommenced sections 43-46 of the *Child Support, Pensions and Social Security Act 2000*. The salient points covered in **clause 196** are as follows:

- Subsection (1)(a) requires trustees of an occupational pension scheme to make arrangements for at least one-third of the total number of trustees to be member-nominated trustees. The arrangements must be put in place within a reasonable time of the clause applying to the scheme. The regulator must issue a code of practice on the meaning of "reasonable time" under **clause 64**.

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158 HM Treasury, *Institutional investment in the UK: a review*, March 2001

159 Department for Work and Pensions, HM Treasury, *Consultation documents on recommendations in the Myners Report "Institutional investment in the UK: a review*, 4 February 2002

160 RIA, para 3.4.2

161 *Op cit*

- Subsection (2) defines "member-nominated trustees" as trustees of an occupational trust scheme who are nominated by a process that involves at least all the active members of the scheme, and selected by some or all of the members.

- Subsection (4) provides that, where an employer approves, the arrangements may provide for more than the minimum number necessary to meet the one-third requirement under subsection (1).

- Subsection (6) ensures that a member-nominated trustee cannot be removed without the agreement of all the other trustees.

- Subsection (8) provides for exceptions. The section does not apply in the case of an occupational trust scheme if:
    1. every member of the scheme is a trustee of the scheme and no other person is such a trustee;
    2. every trustee of the scheme is a company or;
    3. the scheme is of a prescribed description.

- Subsection (9) provides for civil penalties to apply to any trustee who has failed to take reasonable steps to secure compliance if the arrangements securing at least one-third member-nominated trustees are not in place or are not being implemented.[162]

Clause 197 sets out broadly the same requirements as **clause 196**, except that it applies where one or all of the trustees is a company. In this case, the requirement is for at least one third of the directors of the company to be member-nominated directors.

Enforcement of the MNT provisions will be the responsibility of the regulator, (see part 1 of the Bill). The full range of proposed powers will be available to investigate any alleged breaches of the requirements and take corrective or punitive action

Clause 199 replaces section 35 of the *Pensions Act 1995* with a new provision on Statements of Investment Principles. The detailed requirements will be set out in regulations, but the Explanatory Notes on the Bill state that they will specify that:

- the statement must be reviewed at least every three years (in compliance with Article 12 of the IORP Directive);

- the SIP must cover the kind of investments to be held; the balance between different types of investment to be held; risk; the expected returns on investments; the extent (if at all) to which social, environmental or ethical considerations are

[162] EN Bill 57, paras 473-479

taken into account in the selection, retention and realisation of investments; and their policy (if any) in relation to the exercise of the rights (including voting rights) attaching to investments; and

- before a statement is prepared or revised, trustees must obtain and consider written advice from a suitably qualified and experienced adviser and consult the employer.[163]

Clauses 200-202 establish a general principle that an individual trustee of an occupational pension scheme must be conversant with or have knowledge and understanding of specified documents and matters relating to the performance of his functions. These include the trust deed and scheme rules, any statement of investment principles, where appropriate, the most recent statement of funding principles and any other document recording policy on the administration of the scheme generally. Where appropriate for the performance of his functions, he should also have knowledge and understanding of the law on pensions and trusts, the investment of assets and scheme funding.

The regulator must issue a Code of Practice on the discharge of trustees' duties in relation to the requirement for knowledge and understanding.

3. Issues

During the consultations, some commentators questioned the value of MNTs. The Association of British Insurers (ABI), for example, was keen to highlight the potential for overstating the benefits of MNTs in its response to the Government's simplification review:

> One area of legislation that is excessively complex is the law governing the selection and election of member-nominated trustees (MNTs) … We recognise that MNTs can add value in some instances. But we are of the view that MNTs are not a panacea for all perceived problems with occupational pension schemes.[164]

The Confederation of British Industry (CBI) echoes this view, stating in response to the Green Paper that: "We are not convinced that having MNTs necessarily raises the standard of scheme governance."[165]

The Society of Pension Consultants has voiced further concerns that not only will the changes add more administrative burdens to pension schemes but also that:

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163 *Ibid*, para 483

164 Association of British Insurers, *Response to the DWP simplification review*, January 2002: http://www.abi.org.uk/Display/default.asp?Menu_ID=863&Menu_All=1,861,863

165 Confederation of British Industry, *Pensions Green Paper – CBI Official Response*, April 2003, para 53.

> The main consequence of the proposed legislation will be to squeeze out capable lay trustees with a particular affinity for the scheme for which they have responsibility. This seems to be contrary to the declared government policy of encouraging greater member involvement in the running of pension schemes.[166]

The findings of a survey by the Association of Consulting Actuaries in March 2003 would appear to reinforce this view. Employers foresaw the following difficulties with the proposed changes to MNTs:

- Obligations on trustees are unreasonable;
- Fragmented membership over many sites makes MNT election process very difficult; and
- Recruitment of trustees will get more difficult because of growing trusteeship obligations.[167]

Much will depend on the content of the regulator's code of practice, but the RIA on the Bill foresaw significant savings for most schemes from the removal of the statutory consultation procedure. While admitting that the costs and benefits of amending the MNT provisions are difficult to assess with any degree of accuracy, it goes on to state:

> 3.5.8 There will be start-up costs for schemes that do not currently have MNTs. This is likely to be spread across a small number of large schemes, and a large number of small schemes. Schemes with MNTs already may have some costs associated with checking that their arrangements meet any new statutory requirements. Overall, the one-off costs could be in the region of £25 million.
>
> 3.5.9 There will be significant on-going savings for most schemes through not having to undertake a statutory consultation procedure, and through having more flexibility to adopt arrangements that suit their own circumstances. These could be in the region of £15 million per year across all schemes. The savings will be greater for large schemes because they have more members to consult, but there is no reason to believe that different business sectors will be affected in greatly different ways.[168]

In disagreeing with these views, the Trades Union Congress (TUC) has been a strong proponent of increasing MNT representation. However, the Bill has not accepted the TUC's argument – put forth in response to the Green Paper - that at least 50% of trustees should be MNTs.[169]

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166 Society of Pension Consultants, *SPS News Summary*, July 2003: http://www.spc.uk.com/htm/newsJuly203.htm

167 Association of Consulting Actuaries, *Pensions reform: too little, too late?*, March 2003, 023

168 RIA, p18

169 Trades Union Congress, *TUC response to the pensions green paper*, May 2003: http://www.tuc.org.uk/pensions/tuc-6479-f0.cfm

Watson Wyatt, in a news flash on the Bill, warned that the new requirements on trustees for knowledge and understanding might set "an unrealistically high standard and could discourage members from assuming the responsibility of trusteeship". It recognised however, that "the regulator will issue guidance which might provide comfort in this respect and this statutory duty is to be modified in relation to newly-appointed trustees".[170]

F. Transfer of Undertakings

1. Background

The *Transfer of Undertakings (Protection of Employment) Regulations 1981* (TUPE) protect the terms and conditions of employees transferred from one employer to another. However, occupational pensions are not covered by this protection. In 1998, the EC amended the *Acquired Rights Directive* (which is implemented in the UK by TUPE) to give Member States the option of extending the protection to include occupational pensions.

In September 2001, the Government issued a consultation paper on proposals for reforming TUPE.[171] This discussed a number of ways in which the UK might make use of this option. A wide range of views was expressed in response to this consultation and the Government put forward further options for consideration in the pensions Green Paper, published in December 2002.[172] The pensions White Paper published in June 2003 announced the Government's proposal that transferee companies should be obliged to match employee contributions to a stakeholder pension scheme up to a level of 6%:

> **Extending Transfer of Undertakings (Protection of Employment) regulations to private sector transfers**
>
> 30. Over the last 18 months, the Government has been consulting on extending the Transfer of Undertakings (Protection of Employment) regulations (TUPE) to pensions. The Government's aim is to ensure that workers who already enjoy pensions contributions will not have them withdrawn by reason of a transfer, or because a company is taken over. In achieving this we want to make sure that we do not place an excessive burden on the new employer.
>
> 31. **The Government proposes a flexible and worthwhile provision for a contribution to a stakeholder pension. We envisage that this will consist of**

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170 http://www.watsonwyatt.com/europe/pubs/pensionflash/

171 Employment Relations Directorate, DTI, *Transfer of Undertakings (Protection of Employment) Regulations 1981 (TUPE). Government Proposals for Reform. Public Consultation Document*, September 2001, http://www.dti.gov.uk/er/tupe/consult.htm

172 Department for Work and Pensions, HM Treasury, Inland Revenue, *Simplicity, security and choice: working and saving for retirement*, December 2002, Cm 5677, http://www.dwp.gov.uk/consultations/consult/2002/pensions/gp.pdf

> **an obligation to match employee contributions up to a level of 6 per cent.** Moving forward with TUPE in this way will bolster confidence in pensions.
>
> 32. The responses to the Green Paper consultation suggest that this proposal will be welcomed both for the protection it will offer employees and because the majority of businesses which already offer workers pensions on transfer would gain from a level playing field.[173]

The Secretary of State, made it clear in his statement on the White Paper that the requirement applied only in cases "where pension rights have been established" and that an "equivalent alternative" to the 6% stakeholder contribution would be acceptable:

> In February, we tackled the challenge of two-tier work forces to extend protection of pension rights to new starts working in many previously public enterprises. However, it must be wrong that solely because of a takeover workers in any private company have their rights scrapped. That is why I can announce that we are extending the protection of pensions provided by TUPE—the Transfer of Undertakings (Protection of Employment) Regulations 1981—to private sector transfers. We will insist that where pension rights have been established, the new employer will need to match employee contributions up to 6 per cent to a stakeholder pension or offer an equivalent alternative. That is a fair adjustment. It builds confidence in pensions and reflects company best practice.[174]

In a statement of practice on *Staff transfers in the public sector*, published in January 2000, the Government undertook to ensure that appropriate arrangements were made to protect the pensions of their own employees transferred to the private sector.[175] Ministers expect the policy to be followed by other employers in the public sector. A *Code of Practice on Workforce Matters in Local Authority Service Contracts*, published in March 2003, protects the pensions of local government employees who are transferred to the private sector.[176] The *Local Government Act 2003* provides statutory backing for this Code.

2. The Bill's provisions

Clauses 203 and **204** introduce a minimum level of pension protection for employees transferred from one employer (the "transferor") to another (the "transferee") under TUPE. If the transferor provided either a DB scheme or a DC scheme to which he contributed more than the contracted-out rebate, the transferee will have to provide:

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[173] Cm 5835

[174] HC Deb 11 June 2003, c 681

[175] http://www.cabinet-office.gov.uk/civilservice/2000/tupe/stafftransfers.pdf

[176] Office of the Deputy Prime Minister (ODPM) Circular 03/2003, 13 March 2003, *Local Government Act 1999: Part 1:Best Value and Performance Improvement*, Annex D http://www.odpm.gov.uk/stellent/groups/odpm_localgov/documents/page/odpm_locgov_609121.pdf

- An occupational DB scheme which satisfies the Reference Scheme Test, laid down for contracting out purposes, or any alternative standard which may be prescribed; or

- An occupational DC scheme to which the employer makes a "relevant contribution"; or

- An employer "relevant contribution" to a stakeholder pension scheme of which the employee is a member.

The "relevant contribution" will be defined in regulations "and will specify that the transferee must match the employee's contributions up to a maximum of 6%".[177]

It is not clear whether acquiring employers will have to provide this level of contribution even if the transferor's contribution was lower.

3. Issues

a. Level of protection

As the consultation on extending TUPE to pensions has progressed, so the degree of protection on offer from the Government has reduced. One of the four options under the 2001 consultation document was that "if the transferor offered either a contracted-out salary related scheme (COSR) or a contracted-out money purchase scheme (COMP), then the transferee would be required to offer a scheme of the same type". The stakeholder option was not even suggested as one of the four main options. One of the two options under the 2002 Green Paper was that, where the old employer offered a DB or a DC scheme, the new employer would have to offer either a DB scheme or a DC scheme with a comparable contribution to the old employer (option 1). The second option was for the new employer to provide either a group personal pension or a stakeholder pension with a minimum contribution.

In the event, the Government is supporting the simplest option which imposes the lowest costs on transferee employers. Many consumer representatives argued strongly for a more generous approach during the consultation. For example, in their response to the Green Paper OPAS said:

> 12.1 We would strongly support the proposal to include pension rights within the scope of TUPE. Pensions provision is an important element of the remuneration package and must be preserved on transfer.

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[177] EN Bill 57, para 499

> 12.2 We would want to see a basis used after the transfer that as closely as possible reflects the benefits being accrued prior to the transfer. To that end we prefer basis 1.
>
> 12.3 However, the transfer should not be used as an excuse to move from DB to DC. To discourage employers who might wish to do so, we would suggest that a transfer from DB to DC should carry a premium to compensate for the movement of risk from the employer to the employee, say 20%.
>
> 12.4 We do accept that the number of employees involved may be small and therefore it would not be practical or prudent in every situation to replace a DB scheme with a DC scheme. However, in such cases the premium should also apply.
>
> 12.5 We would also point out that a comparable contribution must reflect age. DB pension costs for older employees are more expensive than for younger employees. If such a switch were allowed on the basis of a uniform contribution rate, younger employees would be greatly advantaged whereas older employees would lose out substantially.
>
> 12.6 Another important factor is contingent benefits. We have recently seen the European Court, in the Beckmann case, confirm that enhanced pension benefits on redundancy were already covered by TUPE.
>
> 12.7 Any extension of TUPE should cover other contingent benefits such as ill health retirement, enhanced or non-discounted early retirement and death benefits.[178]

Similarly the TUC argued:

> 1.133 The TUC welcomed the government's success at securing an amendment to the Acquired Rights Directive to protect occupational pensions we are pleased that the government plan to include TUPE. However, we believe that the options in the Green Paper on private-to-private sector transfers fall short of full protection for employees'.
>
> 1.134 The Green Paper proposals on TUPE are vague, and we would welcome clarification on many points. On that basis our initial views on the proposals are that option two is unacceptable, and no employee should be transferred to a GPP or stakeholder pension if they had been members of a final salary scheme. Option one, would be our preferred option though again the information provided is insufficient to make an informed decision on its adequacy to protect members in the case of a TUPE transfer.

[178] OPAS press release, "Greater security for pension scheme members fundamental, says OPAS report", 1 April 2003, http://www.opas.org.uk/PressReleases/20030401.htm#undertake

> 1.135 We propose that the new employer provides a pension scheme of equal quality to the member's old employer. A business transfer must not be an excuse to reduce employee's pension rights.[179]

b. Cost

The RIA estimates the annual cost of this proposal at around £5 million in any one year:

> 3.6.11 It is estimated that between 145,000 and 175,000 employees in the private sector are affected by transfers each year. Of these an estimated 40% or 64,000 people are eligible to join an occupational pension scheme. It is assumed that 70% of these are active members, with the rest qualifying but not taking up the scheme.
>
> 3.6.12 It is most likely that transferee employers will want to offer a stakeholder-type pension. Assuming that the average earnings of those transferring are around £15,000 a year, and that employee contributions (and hence employer contributions) to this type of scheme are around 2.5%, the estimated annual cost in respect of those transferring in any one year is £5 million.
>
> 3.6.13 These costs reflect the cost of pension provision or contributions in the first year after transfer only. This is because the new protection is explicitly only designed to protect workers who would otherwise lose pension rights by reason of a transfer. Continuing provision of pension accrual or contributions for transferred employees will be a matter for the new employer, just as it is in respect of other

G. Internal Dispute Resolution

1. Background

The *Pensions Act 1995* required trustees to put in place internal dispute resolution procedures to deal with disputes with members (active, deferred or pensioner), prospective members and beneficiaries. Regulations under the Act (the *Occupational Pension Scheme (Internal Dispute Resolution Procedure) Regulations 1996*, SI 1996/1270) contain the details of the procedure. The procedure is complex and in two stages. It must include provision for the original decision to be reconsidered by the trustees or managers if the complainant is unhappy with the decision reached in the first stage. The regulations set out details of how the process should work, including how the complaint should be raised and time limits in which responses must be given. Trustees or managers can be fined by Opra if the arrangements are not set up or followed.

The Pickering Report on pension simplification, published in July 2002, thought it "right that members should have access to an effective mechanism where disputes arise" but did

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179 http://www.tuc.org.uk/pensions/tuc-6478-f0.cfm

"not think that the existing system works to their best advantage". It therefore proposed that "the legislative requirement should simply be for members to be told how to raise a query if they unclear about or dissatisfied with their pension scheme entitlement".[180]

The pensions Green Paper, published in December 2002, proposed that "scheme trustees should be given more flexibility to adopt a procedure which best suits the scheme and its members".[181] The Technical Paper accompanying the Green Paper suggested that the current arrangements should be replaced with one where:

- All schemes must have a published formal dispute procedure but can choose whether it is in one or two stages;

- Complainants must have access to the trustees or managers as part of the process;

- There is a prescribed time limit for the decision in the case to be reached (say six months) and if the scheme fails to give a decision the member can take his complaint to the Pensions Ombudsman; and

- The complainant must be told that the Pensions Advisory Service (OPAS) can help when the complaint is received and about the role of the Pensions Ombudsman if the scheme cannot settle the dispute.[182]

2. The Bill's provisions

Clause 210 replaces section 50 of the *Pensions Act 1995* with a new section 50 which does not contain a requirement for a two stage procedure. A new section 50B sets out the matters which must be included in the dispute resolution procedure:

- The procedure must provide for the representation of a person who is a party to the dispute where (i) that person dies, (ii) that person is a minor or a person otherwise incapable of acting, or (iii) in any other case, that person nominates a representative.

- The procedure may include provision about the time limits for making an application for the resolution of a dispute but further provides that the procedure must require a six-month time limit for making the application where a person ceases to be a person with an interest in the scheme …

[180] *A simpler way to better pensions. An independent report by Alan Pickering*, para 6.11,
[181] Cm 5677, p 61
[182] Technical Paper, December 2002, p 39

- The procedure must set out details about how the application is to be made; what information should be included in the application; and the way in which decisions are to be reached and given.

- The procedure may cease if, after the application is made, the dispute becomes one in respect of which proceedings have been commenced in any court or tribunal or the Pensions Ombudsman has commenced an investigation as a result of a complaint made or a dispute referred to him.[183]

For most schemes, the measure is not likely to result in significant administrative savings, as the same investigative work will need to be undertaken for each complaint, regardless of the number of stages that a dispute goes through before a decision is reached.

The *Regulatory Impact Assessment* that accompanies the Bill states that:

> 4.6.7 The administrative cost of dealing with a case that triggers the internal dispute procedures can obviously vary enormously, depending on the nature and complexity of the case. An average administrative cost of around £1,700 is assumed per case, based on consultation with industry sources. For these schemes, it has been assumed that this change will result in a 25% reduction in the cost per case, and overall administrative savings are therefore around £40,000 a year. The proposal is likely to be of greater benefit to smaller schemes and gives no rise to compliance issues as the proposal is optional.[184]

H. Limited Price Indexation

1. Background

Before April 1997 there was no general obligation on pension schemes to increase pensions in payment at all. The *Pensions Act 1995* introduced a requirement to increase pensions in payment by the lower of the Retail Price Index (RPI) or 5%. This is known as Limited Price Indexation (LPI). It only applies to rights accrued since April 1997.

The LPI applies to all tax approved occupational pension schemes, whether they are DC or DB. It also applies to the protected rights part of any appropriate personal pension (APP) or stakeholder pension – i.e. that part of the pension deriving from the contracted-out rebate.

Contracted-out salary-related (i.e.DB) schemes (COSRS) are required to index that part of the pension which replaces SERPS – the Guaranteed Minimum Pension (GMP) – which accrued between 6 April 1988 and 5 April 1997 by the lower of the RPI or 3%.

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183 EN Bill 57, paras 526-530
184 RIA p 34-5

Similarly, contracted-out money purchase (i.e. DC) schemes (COMPS) are required to index that part of the pension which derives from the contracted-out rebate – the protected rights – which accrued between 6 April 1988 and 5 April 1997 by the lower of the RPI or 3%.

When contracting out was originally introduced under the *Pensions Act 1975*, the state took on responsibility for post-retirement inflation proofing through additional pension (SERPS) payments. The *Social Security Act 1986* which introduced contracting out through money purchase schemes (COMPS and APPs) also limited the state's responsibility for post-retirement inflation proofing to increases above 3%. The *Pensions Act 1995* broke the link between SERPS and GMPs or protected rights, so that the state has no responsibility for inflation-proofing contracted-out benefits accrued after 6 April 1997.

The Pickering Report on pensions simplification, published in July 2002, recommended that LPI should be abolished altogether as it was expensive for schemes and one of the drivers behind the switch from DB to DC provision:

> 2.10 The lack of matching assets for LPI, and the shortage of index-linked gilts, has meant that the compulsory provision of LPI is disproportionately expensive. In the case of a defined benefit scheme, this cost falls to the employer and currently has to be funded to the Minimum Funding Requirement (MFR) standard and show up as a liability in the accounts, now more transparent as a result of the new FRS17 accounting standard. This means that compulsory LPI can be one of the drivers for employers switching from defined benefit to defined contribution schemes. In a money-purchase arrangement, the cost of LPI falls on the pension scheme member. Our proposal is that the provision of LPI for the future should cease to be compulsory for any type of pension scheme (people already receiving a pension would not be affected).[185]

The Government, in the 2002 Green Paper, was unwilling to make changes to the LPI unless it "had good reason to believe that the coverage of and contributions to occupational pensions would be higher than would otherwise be the case", but it did seek views on removing the requirement for that portion of pensions above a suggested level of £30,000:

> 44. Women could also be expected to lose out more than men if the indexation requirement were removed, as they have greater life expectancy and tend to have lower pensions. In the case of indexation, however, there might be an approach that would give schemes greater flexibility while also maintaining protection for those with smaller pensions. For example, we could maintain compulsory indexation of pensions below a certain level to protect those who most need it, while removing compulsory indexation for those with large pensions. This would

185 *A simpler way to better pensions. An independent report by Alan Pickering*

> mean retaining compulsory indexation for that portion of the pension up to, say, £30,000 a year, but not for the pension above that level.
>
> 45. We would not introduce these changes unless we had good reason to believe that the coverage of and contributions to occupational pensions would be higher than would otherwise be the case. We would, however, welcome views on the proposal to limit compulsory indexation to pensions up to £30,000 a year.[186]

By the time the White Paper was published in June 2003, the Government had decided instead to reduce the LPI to 2.5%, arguing that this was more realistic as inflation was only running at about 2.4%. However, it expected that pension schemes would make large savings from this reduction – between £345 million and £415 million a year and that this would offset the extra costs imposed by the Pension Protection Fund levy:

> 9. The Government has considered all these views carefully, and accepts that mandating some level of protection from inflation remains desirable. It believes, however, that the current level of compulsory inflation insurance is excessive. In 1995, when the legislation introducing LPI was passed, long-term expectations of inflation were significantly higher: the 5 per cent cap was only intended to provide for partial cover against inflation. But the Government's success in reducing inflation means that mandatory indexation has effectively become full inflation cover, something which is proving disproportionately expensive for some schemes to provide.
>
> 10. We have therefore decided that we will relax this requirement, so that schemes are required only to index pensions in payment by inflation, as measured by the September annual increase in the Retail Price Index (RPI), capped at 2.5 per cent each year. This reflects the reality of an economic climate where inflation has been driven down to average just 2.4 per cent over the years since 1997. The change will also better align the regulation of defined benefit and defined contribution schemes – members of the latter are not generally obliged to purchase any cover against inflation at all.
>
> 11. This will ease the funding liabilities for scheme sponsors in the future, without imposing the significant effect on pensioners' incomes that could have arisen if indexation were removed entirely. It will be up to individual schemes to decide whether to change their provision in this respect. Pensions in payment will be unaffected by this change.
>
> 12. We believe that this change could reduce funding costs for employers of between £345 million to £415 million a year. This is part of our balanced package, which will ensure that costs for employers and pension providers need not increase overall as a result of our reforms.

[186] Cm 5677

> 13. We have taken care to assess the impact on women’s incomes. Women’s life expectancy is greater than that of men by around three years at age 65, which means that there will be a greater proportionate impact from any reduction in indexation on women’s retirement incomes than on those of men. However, because the legal requirement to index is capped at 2.5 per cent, as measured by the RPI, we believe there will only be a marginal impact on the incomes of both women and men. We have concluded that it is likely to be a fairer and more reliable outcome for women as a whole to reduce compulsory indexation slightly, as part of a balanced package that also improves the security of occupational pensions.[187]

2. The Bill’s provisions

Clauses 212 amends section 51 of the *Pensions Act 1995* so that occupational pension rights accrued after the day the section comes into force will only need to be increased by the lower of the RPI or 2.5%. **Clause 213** amends section 162 of the 1995 Act to achieve the same effect for the protected rights element of APPs. **Clause 214** amends section 40 of the *Welfare Reform and Pensions Act 1999* which deals with pension sharing on divorce. A pension deriving from a pension sharing order made before the commencement day will be increased by the lower of the RPI or 5%. A pension deriving from a pension sharing order made on or after the commencement day will be increased by the lower of RPI or 2.5%.[188]

3. Issues

a. Lower pensions

It is, of course, highly unlikely that inflation will remain below 2.5% throughout a person’s retirement. It was running at 2.8% in December 2003 and 2.6% in January 2004.[189] The cut in LPI (if applied by pension schemes) will mean that occupational pensions will lose value as retirement progresses.

The RIA on the Bill assumes an average long term inflation rate of 2.5% with a 1.5% fluctuation either way. It suggests that the cut in the LPI will reduce total pensioner income (i.e. from all sources, not just the occupational pension) by just under 2%:

> ***Costs***
>
> 4.2.6 In light of the additional funding costs that schemes will incur as a result of the PPF, it is estimated that around 75% of DB private sector schemes would take this option up – resulting in actual aggregate savings of approximately £370m a year, if applied to all future accruals for existing and future members.

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[187] Cm 5835
[188] EN Bill 57, para 552
[189] Office of National Statistics, http://www.statistics.gov.uk/cci/nugget.asp?id=19

4.2.7 The above savings are based on the assumption of an average long-term inflation rate of 2.5%, with 1.5% fluctuation either way. This is because our proposals should result in schemes removing the cost of having to ensure against the risk of inflation moving significantly above 2.5%. This will reduce scheme costs as resources will no longer be needed to cover this risk of higher inflation.

4.2.8 Clearly individuals would lose a proportion of their pension income as a result of these proposals. The impact of these proposals will depend on the:

- age of the individual and length of service, at the point at which the new requirement commences;
- gender, given women’s longer life expectancy; and
- proportion of total income accounted for by DB occupational pension income

4.2.9 If a pensioner had the same composition of income as the ‘average pensioner unit’ in the UK, then the effect of this alteration in indexation on lifetime retirement income would be a reduction of around 2%. At present, around 60% of pensioners’ income is made up of State sources, the rest being made up by occupational and personal pensions, earnings and investment. Although the composition of pensioners’ incomes will change over time, this example shows how the LPI cap might affect the average pensioner ‘unit’ today (single pensioner or couple). According to the latest Pensioners’ Income Series, the average pensioner unit has the following make-up of weekly income.

The composition of average pensioners’ weekly incomes (2001/02)

State Benefit income	Occupational pension	Personal Pensions	Investment income	Earnings	Other	Total
£136	£70	£7	£27	£24	£3	£268

4.2.10 Assume, for illustrative purposes that the other sources of income keep pace with inflation (although some do better than that, in practice). Then, even if all the occupational pension income were from a private sector DB scheme and were fully affected by the LPI change, the effect on total income would be just under 2%. This is illustrated below:

Effect of LPI cap on weekly and total income in retirement for the average pensioner

	Weekly income in retirement				
Increase in occupational pension income	5 years	10 years	15 years	20 years	Total income over retirement £'000s
LPI capped at 5%	£296	£335	£379	£428	£356
LPI capped at 2.5%	£294	£329	£369	£414	£349
Difference	£2	£6	£10	£15	£7
% difference	0.8%	1.7%	2.6%	3.4%	**1.9%**

4.2.11 The easing of indexation requirements will affect women more than men because of their longer life expectancy. However because women's life expectancy is only three years more than men, the policy will impact marginally more on women. In the above example, an extra three years in retirement would cause the 1.9% total loss of retirement income to 2.2% over the lifetime.[190]

The TUC, commenting on the White Paper, said:

> Whilst we recognise the need for a balanced package in a voluntary environment we are disappointed that the government has chosen to allow employers to cut inflation proofing for scheme members. This could result in workers in retirement seeing the value of their pension reduce significantly if we return to a period of high inflation. The need for compulsory contributions to pensions becomes more evident as we see the government trying to juggle with the voluntary approach. Long awaited pensions protections should not be paid for by reductions in benefits - we need more money in the pension pot.[191]

b. Complexity

The pensions industry generally supported the idea of complete abolition of LPI. While a reduction may be better than nothing, they are concerned that it is not retrospective: The Society of Pension Consultants, in their response to the White Paper, said:

> The government's decision on changes in the indexation requirements give rise to a number of concerns:-
>
> By relaxing the requirement only for future service, it creates another layer of legislation for schemes which wish to take advantage of the relaxation and complicates communication with scheme members. For defined benefit schemes which close for future accrual, to existing members, as well as being closed to new members, which we expect to increasingly happen, there will be no cost

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190 http://www.dwp.gov.uk/publications/dwp/2004/ria/pensions_bill_2004.pdf

191 http://www.tuc.org.uk/pensions/tuc-6736-f0.cfm

> saving. We suggest that schemes should be permitted to make the new rate of capped indexation retrospective. This would have a real impact on funding costs and increased flexibility of investment strategy.
>
> We are disappointed to see no change in the indexation requirements for deferred pensions, matching those for pensions in payment.[192]

Others believe that the savings of £370 million may not be realised as schemes may choose not to take advantage of the change, preferring to protect the value of members' benefits.[193]

I. Contracting out Simplifications

1. Background

The UK is unusual in having a state pension system which allows employers and employees to opt out of the earnings-related second tier provision if alternative private provision, meeting specified requirements, is made. This process is known as contracting out.

Contracting out was introduced in April 1961 with the graduated pension scheme which yielded Graduated Retirement Benefits (GRB). Employers were able to contract out of this scheme, and pay lower National Insurance Contributions (NICs) if they provided Equivalent Pension Benefits (EPBs). The scheme was wound up in 1975, and most contracted-out employers bought prospective pensioners back into the state scheme, thereby removing any need to preserve EPBs. There was no provision for revaluing accrued rights over time, or for inflation-proofing benefits in payment.[194] As a result any remaining EPBs are extremely small and, since April 2002, it has been possible for schemes to commute these when they are the member's only rights under the scheme and pay them to members as a lump sum before normal pension age.

A much more significant form of contracting out was introduced from April 1978 under the *Pensions Act 1975* which introduced the State Earnings Related Pension (SERPS). Originally, employers were only able to contract out of SERPS if they provided defined benefit (DB) schemes and a Guaranteed Minimum Pension (GMP) which at least equalled the SERPS they would have earned had they not been contracted-out.

A Department of Health and Social Security (DHSS) leaflet, *New Pensions: a more secure future*, (NP34), issued in January 1978, shortly before the new scheme came into force, explained how it would work:

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192 http://www.spc.uk.com/htm/newsJuly203.htm
193 "Pensioners face a £40-a-year stealth tax", *Times*, 13 February 2004
194 although the state did start to inflation proof GRB in payment after 1978

> The new state pension will operate in partnership with good occupational schemes … if your employer operates such a scheme he can apply to contract you out … of the state scheme's additional pension and you would then pay lower contributions to the state scheme … Your basic pension would then be provided by the state scheme and your additional pension by your employer's occupational scheme, with inflation-proofing after the pension is in payment provided by the state (…)
>
> **Guaranteed minimum pensions**
>
> A contracted-out occupational pension scheme must provide you with at least a guaranteed minimum pension, to match the additional pension you would have earned from the state scheme … Your occupational pension may, of course, be much higher than the guaranteed minimum pension, particularly if you are already a member of a scheme.

The *Social Security Act 1986* introduced many changes to SERPS and contracting out from April 1988. The SERPS changes (designed to reduce its emerging costs by reducing the rate of accrual and increasing the period over which it accrued from 1999-2000) were reflected (though not precisely replicated) in the GMP calculation. At the same time, contracting out into defined contribution (DC) occupational schemes and appropriate personal pensions (APPs) was permitted. In these cases, a "minimum payment" ("minimum contribution" in the case of APPs) equal to the contracted-out rebate had to be made to the scheme.[195] The benefits secured by these minimum payments were called "protected rights" and had to meet certain conditions. There was no guarantee that they would produce a pension equal to the SERPS foregone, but nevertheless, a "notional" GMP was calculated by the DHSS for purposes of the contracted-out deduction from the state pension eventually payable.

The *Pensions Act 1995* broke the link between SERPS and contracted-out pension schemes with effect from April 1997. Contracted-out salary-related schemes (COSRS) have not had to provide GMPs in respect of benefits accrued after 1997, but they still have to provide them in respect of benefits accrued between 1978 and 1997. To contract out, COSRS must now meet a test of scheme quality known as the Reference Scheme Test (RST).

The pensions industry has long complained that the rules their schemes must comply with to satisfy the contracting out requirements are unnecessarily complex and a particular disincentive to the provision of DB schemes. The Pickering Report, published in July 2002, made the case for a major simplification of the contracting out rules:

[195] these minima also included the special 2% incentive payments designed to encourage people to contract out into money purchase schemes which applied until 1993

> Contracting out is by definition complicating. Some who have contributed to our review have suggested that contracting out may not be appropriate in the future especially if the State Second Pension becomes flat rate.
>
> 2.4 If the Government is committed to a public/private partnership based on contracting out, urgent simplification of the system is essential. This is particularly so as there is increased awareness of the risk associated with providing benefits in the private sector that would otherwise be provided by the State. The current contracted-out rebates do not include a risk margin – that is to say they have been calculated by the Government Actuary to replicate as closely as possible the value of benefits foregone in the state scheme, with no additional incentive to contract out.
>
> 2.5 In this context, unnecessary administrative complexity and cost becomes all the more important, and may lead, by default, to the ending of contracting out in practice if not in theory. Indeed, the existing rules on contracting out make this element of pensions among the most complex to administer. We do not intend to spell out in detail all the complexities involved in contracting out. However, symptomatic is the need for employers and commercial providers to undertake double record keeping because of the different rules pertaining to pension derived from contracted-out National Insurance Contribution rebates, compared with pension derived from other sources.
>
> 2.6 If contracting out were to be abolished, that would not herald the end of the public/private partnership – that can flourish even in a world without contracting out. However, contracting out is one way of nourishing this partnership, and we set out in Appendix 1 a package of measures which we believe can help to simplify contracting out.[196]

The pensions Green Paper, published in December 2002, confirmed the Government's belief that "contracting out should remain" but accepted that "the arrangements for doing so should be simplified".[197] The Green Paper, and the accompanying Technical Paper,[198] contained a number of proposals for discussion, including:

- Survivors' benefits – the Pickering Report proposed that the requirement on contracted-out schemes to provide survivors' benefits should be removed. The Green Paper said the Government "would not introduce these changes unless [it] had good reason to believe that the coverage of and contributions to occupational pensions would be higher than would otherwise be the case".

- Reference scheme test – reducing the minimum accrual rate in the RST from 1/80ths to 1/100ths. (This was the "central proposal" of the Pickering Report.).

[196] *A simpler way to better pensions. An independent report by Alan Pickering*
[197] Cm 5677, para 4.39
[198] Department for Work and Pensions, *Simplicity, security and choice: technical paper*, December 2002

Allowing schemes to contract out on the basis of career average, as opposed to final salary, earnings. Requiring all earnings to be included in pensionable salary.

- GMPs – permitting schemes to convert GMPs to simpler RST benefits of equivalent value

- Removing restrictions on the age at which benefits can be taken – Inland Revenue rules currently allow benefits from private pension schemes to be taken at any age from 50 (although the tax simplification proposals will increase this to 55). Contracted-out benefits, however, cannot be taken until state pension age (age 60 in DC arrangements)

- Removing restrictions on taking benefits as lump sums – Inland Revenue rules allow part of the pension to be taken as a lump sum: with a very limited exception on grounds of triviality, no part of the contracted-out rights may be taken as a lump sum.

- Trivial commutation – where total scheme benefits do not exceed £260 a year, contracted-out schemes can commute them into a lump sum. The Green Paper proposed raising this to £520 a year.

- Contracted-out mixed benefit schemes (COMBS) – abolishing the right of COMBS (which combine DC and DB schemes) to contract out

- Safeguarded rights – where a pension sharing order has been made on divorce, any element of the share derived from contracted-out rights is "safeguarded" and subject to certain requirements. The Green Paper took up Alan Pickering's proposal that these extra conditions should be removed

- EPBs – removing the requirement to obtain a member's consent before commuting EPBs

It also suggested making changes to section 67 of the *Pensions Act 1995* which prevents changes from being made to the rules of a scheme which would reduce a member's accrued rights without the member's consent. (This applies to all occupational schemes, not just those that are contracted-out.)

The 2003 White Paper announced that the Government would "introduce a package of measures to simplify the operation of contracting out" which would:

> ● relax some restrictions on contracted-out rights forming part of the tax-free lump sum permitted under Inland Revenue rules;
> ● relax some restrictions preventing contracted-out rights being paid at the same time as other benefits;
> ● increase the level at which small pensions derived from contracted-out rights can be commuted;

> ● remove the requirement to obtain member consent for the commutation of pension into a lump sum when their entitlement consists solely of Equivalent Pension Benefits arising from the graduated pension scheme which ceased to accrue in 1975; and
> ● extend commutation on grounds of serious ill-health to contracted-out rights in Appropriate Personal Pensions. This did not form part of our Green Paper proposals, but we have listened to the comments received during the consultation exercise and will now move forward with this proposal.[199]

It also announced that it would:

> amend the restriction in Section 67 of the Pensions Act 1995 which heavily restricts schemes' ability to change any member's accrued rights without the member's consent. Schemes will be able to make such rule changes if:
>
> ● there is a power in the scheme rules to make the change;
> ● the change does not involve converting defined benefit rights into defined contribution rights;
> ● the trustees approve the change;
> ● the total actuarial value of members' accrued rights at the point of any change is maintained;
> ● pensions already in payment are not reduced; and
> ● members are consulted before a change is made.[200]

The Government wished "to simplify the administration of GMPs which ceased to accrue in 1997, and the anti-franking legislation that protects benefits over and above the GMP from being eroded" and was "continuing to explore options in this area".

On 20 October 2003, Andrew Smith, Secretary of State for Work and Pensions, announced that the Government would be introducing measures that would permit schemes to convert GMPs into scheme benefits on the basis of actuarial equivalence. He estimated that this and the other simplification measures already announced would save pension schemes up to £16 million a year:

> We intend to introduce measures that will permit contracted-out defined benefit schemes to convert GMPs into scheme benefits. Where a scheme converts its liabilities in this way, it will no longer be required to offer a scale of benefits incorporating the complex GMP rules for the period 1978 to 1997 and will be free to design a benefit structure that best reflects the needs of its members. If schemes take up this option they will have to convert on the basis of actuarial equivalence: the trustees will be required to offer scheme benefits of equal accrued value in exchange for the benefits given up, including the GMP.

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[199] Cm 5835, para 3.25
[200] *Ibid*, para 3.17

> As a result of this and other measures announced previously, pension schemes will be able to achieve significant simplification in their administration. On top of the other proposals for simplifying contracting out in "Action on Occupational Pensions", we estimate that these measures should result in administrative savings for pension schemes of up to £16 million a year.
>
> Because of the process of actuarial conversion, any resulting changes will not affect the value of individual accrued rights. Members' interests will also be protected by other measures already outlined in our Green Paper "Working and Saving for Retirement" and "Action on Occupational Pensions".
>
> For example, the new Pensions Regulator will be able to issue a code of practice aimed at protecting the interests of members of schemes wishing to take advantage of the GMP conversion measure. Also, the Pensions Advisory Service and the Pensions Ombudsman will be able to consider any complaints that members have as a result of any change.
>
> Nothing in these proposals forces schemes to change and we appreciate that many of them may not wish to do so. We are simply offering schemes the option to design their benefits more flexibly across the piece in this way, while protecting the value of members' accrued rights. This means we are striking the right balance between making it easier (and more cost effective) for employers to run schemes and safeguarding members' rights.[201]

2. The Bill's provisions

In the event, the Bill, as published on 12 February 2004, does not contain provisions permitting schemes to convert GMPs into scheme benefits on the basis of actuarial equivalence. Nor does it amend section 67 of the 1995 Act to allow retrospective modifications to scheme rules. Moreover, it does not remove the requirement to obtain member consent for the commutation of Equivalent Pension Benefits.

Clause 218 paves the way for removing age and commutation limits which are more restrictive than those imposed by the Inland Revenue by regulations. The Regulatory Impact Assessment (RIA) on the Bill describes the expected use of the powers:[202]

<u>Age</u>

> 4.3.1 Currently, under Inland Revenue rules, benefits in private pension schemes can be taken from age 50, and part of the accumulated fund can be taken as a tax-free lump sum. Under DWP rules, the whole of the fund derived from the contracted-out rights must be used to provide for a pension and, except in certain limited circumstances, cannot be given effect to before State Pension Age (age 60

[201] HC Deb 20 October 2003, c 26WS
[202] RIA

in a DC arrangement). This increases the complexity and the administrative burden on schemes.

4.3.2 Consequently, the Pensions Bill allows for some of these requirements to be relaxed and allows for the protected rights in money purchase arrangements to be given effect to at the same time as all other rights, and for the protected rights to be commuted to a part lump sum. There will however be rules to ensure that the rate of commutation applied to the protected rights is not higher than that applied to the pension rights as a whole.

Trivial commutation

4.4.6 … the option of increasing the trivial commutation limit was welcomed in both written responses and feedback at the consultation event. This proposal was viewed as a useful simplification, and whilst it is still proposed to increase the trivial limit this will no longer be increased to £520 per year.

4.4.7 Responses to the consultation process expressed similar views that there should be uniformity between DWP and IR requirements. This could be achieved for example by defining the trivial commutation limit as a percentage of the IR's £1.4 million lifetime tax allowance should the Chancellor announce that the changes to taxation of pensions are to go ahead following review of their estimated effects by the NAO. This would also remove the problem of having to periodically increase the trivial limit as it would be automatically index-linked.

4.4.8 We are therefore making the working assumption that the trivial limit will be defined as a percentage of IR's lifetime tax limit. We see no requirement for separate contracting out rules and therefore intend to allow trivial commutation where it would not cause loss of tax approval for the commuting scheme and other detailed Inland Revenue conditions are met.

Ill health commutation

4.5..1 Currently an individual may commute the whole of their contracted-out rights under an occupational pension into a lump sum, excluding the Guaranteed Minimum Pension (GMP) and half of the value of the protected rights (the other half being used to provide a survivors' benefit where the member is married on the date at which the lump sum becomes payable) on grounds of serious ill health. This allows those people with less than a year's life expectancy to manage their financial affairs whilst retaining some pension provision for a surviving spouse.

4.5..2 There is no corresponding provision for protected rights in Appropriate Personal Pensions (APPs) and this creates an unlevel playing field. There is further inconsistency between contracted-out rights in final-salary schemes where all of the section 9(2B) rights (contracted-out rights accruing post April 1997) can be commuted on grounds of serious ill health, yet none of the GMPs accruing before April 1997 can be commuted.

4.5..3 IR is proposing to extend the facility to commute on grounds of serious ill health to all rights in all forms of pension scheme. Therefore, maintaining the current arrangements for contracted-out rights and not allowing commutation of protected rights in APPs on grounds of serious ill health will maintain the inconsistency.

4.5..4 Extending commutation on grounds of serious ill health to protected rights in APPs was not formally consulted on in the Green Paper or Technical Annex. However, the issue was discussed during the consultation and was seen as providing a welcome simplification.

4.5..5 As well as extending the requirement to protected rights in APPs, it is also the intention to create a level playing-field across all contracted-out rights that can be commuted on the grounds of serious ill health. To achieve this the Pensions Bill will allow commutation of section 9(2B) rights and GMPs on grounds of serious ill health, but requiring that any entitlement to a survivors' benefit is retained. We are also proposing to allow commutation of all protected rights in Contracted-out Money Purchase Schemes and APPs on grounds of serious ill health, except where the member is married at the date of commutation where 50% of the value of the rights should be retained to provide a survivors' benefit.

4.5..6 Allowing commutation of protected rights in APPs on grounds of serious ill health will create a level playing field and uniformity between the arrangements in contracted-out occupational and personal pension schemes. This is further achieved by the proposal to align the percentage of contracted-out rights that must be retained to provide a survivors' benefit.

3. Issues

The pensions industry is disappointed that the more substantial simplifications are not contained in the Bill. An article in *Pensions Week* sums up the reaction:

> The chances of regulatory simplification – the chief objective of the pensions reform – has been lost in the Pensions Bill due to the Department for Work & Pensions' failure to match the Inland Revenue's imaginative thinking contained in its earlier proposals for tax changes, critics say.
>
> The Bill reveals inaction on two highly difficult areas – section 67, which deals with the technicalities of making scheme modifications, and guaranteed minimum pensions.
>
> Chris Norden, senior pension consultant at consultancy Hewitt Bacon & Woodrow said this will prevent employers from creating flexible pension schemes and that measures proposed by the Inland Revenue risk being rendered ineffectual by the DWP's refusal to follow suit.
>
> "What was welcome about the Revenue's proposals was that they swept away historic layers of regulation. The DWP has fallen into the usual trap of layering

> more regulations on top of existing regulation. There is no ability for employers to simplify scheme design going forward or to rationalize their administration", he added.[203]

J. Deferred Retirement Increments

1. Background

Deferred retirement increments are paid to individuals past state pension age (SPA) who forego collecting their state pension for up to five years. Individuals receive a higher weekly pension to compensate them for the amount they have forgone. At present these increments amount to about 7.5% of pension for a whole year. Under provisions in the *Pensions Act 1995*, these increments are due to increase to about 10.4% of the pension for a whole year in April 2010. At the same time the five year deferral limit is due to be removed.

The initial legislative impetus for increasing pensions for deferred retirement was contained in the Beveridge Report, *Social Insurance and Allied Services* (Cmnd 6404), published in 1942, on which the 1948 National Insurance scheme was based. Beveridge recommended that:

> 1. There should be no fixed age for retirement but only a minimum pension age of 65 for men and 60 for women, at or after which each individual would have the option of retiring and claiming pension. Such a flexible age of retirement would meet human as well as economic realities.
>
> 2. In order to give people an incentive to continue at work after minimum pension age, additional pension should be payable related to the period for which retirement was deferred. The addition should be sufficiently strong to encourage deferment but below the full actuarial value of the pension foregone.[204]

The Report's recommendations on retirement pensions were put into effect in the *National Insurance Act 1946*, which came into operation on 5 July 1948. Minimum pension age was fixed at 65 for men and 60 for women and increments of pension for deferred retirement were related to the number of contributions paid in respect of work done during the period of deferment. An individual entitled to a retirement pension on their own contributions could earn increments to their pension by deferring their retirement for a period of up to five years after minimum pension age. Different considerations applied to married women and widows relying on their husband's contributions for a pension.

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[203] "Chance lost for simplification", *Pensions Week*, 16 February 2004

[204] As reported in: Secretary of State for Social Services' Report under Section 6 of the *Social Security (Miscellaneous Provisions) Act 1977* on *The Earnings Rule for Retirement Pensioners and the Wives of Retirement and Invalidity Pensioners*, HC 697: 1977-78, p27

State pensions remain payable to men at age 65 and to women at age 60, though the pension age for women is due to be increased to 65 over the period 2010-20 under the *Pensions Act 1995*. The state pension can be composed of a number of components: flat rate Basic State Pension (BSP), Graduated Retirement Benefit (GRB, earned between 1961 and 1975), State Earnings Related Pension (SERPS, earned between 1978 and 2002) and State Second Pension (S2P, earned from 2002 onwards). Increments are payable on all these components of the state pension. The Pension Service leaflet, *A guide to state pensions* (NP46, October 2003), explains how the increments are calculated:

> **How much you get**
>
> *Before 6 April 2010*
>
> For every six days you decide to give up your pension, each part of your pension will increase by about 1⁄7p per £1.00 of the weekly rate payable to you at the time you became entitled to the pension. This works out at about an extra 71⁄2% of pension for a whole year. (…)
>
> *From 6 April 2010*
>
> From 6 April 2010, for every six days you decide to give up your pension, each part of your pension will increase by about 1⁄5p per £1.00 of the weekly rate payable to you at the time you became entitled to get the pension. This works out at about an extra 10.4% of pension for the whole year.[205]

A DWP Factsheet on *Taking up the state pension later*, published in February 2004, says that:

- currently about 2% of pensioners defer (about 15,000 a year)
- the average length of deferral is 2 years
- around 9% of current pensioners are receiving increments[206]

In explaining the low take-up of deferred retirement increments, a briefing note by the Pensions Policy Institute (PPI), offers the view that:

> There is no bar to earning while receiving state pension. Therefore, the only rational reason to defer would be that an individual thinks he or she is likely to live long enough for receiving the enhanced amount to be worthwhile.

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205 http://www.thepensionservice.gov.uk/pdf/np46oct03.pdf

206 Department for Work and Pensions Factsheet about *State Pension Deferral*, February 2004 http://www.dwp.gov.uk/publications/dwp/2004/pensions_bill/tsp_factsheet.pdf

> There is no research on why people actually do defer. There is a strong hypothesis that people defer by accident, particularly women who assume that the start of their pension is linked to their husband's pension age, and overseas residents whom the DWP may not have a correct address to send the notice about claiming pension at state pension age.[207]

In fact, a very large number of people leave the workforce well below before SPA. A DWP research report shows the percentage of men and women still in the labour market at various ages between 50 and 79:[208]

Age range	Men	Women
50-54	82%	69%
55-59	68%	53%
60-64	45%	25%
65-69	13%	8%
70-74	8%	3%
75-79	4%	2%

Source: FRS 1997-2000

The Government is keen to encourage people to work past 65 where they want to, by developing further the concept of flexible retirement. The 2002 Green Paper proposed that improvements to the size of deferred retirement increments should be brought forward from 2010 to 2006 and that people should be offered the option of a taxable lump sum instead of a higher pension.[209]

In his speech to the Labour Party Conference in Bournemouth on 2 October 2003, the Secretary of State emphasised the potential size of the lump sum which might be available:

> So I announce today, we will offer the people the choice –for the first time ever – of a lump sum, as much as £30,000 where they defer for five years. So poorer pensioners can get sums which have until now been the preserve of the better off.[210]

2. The Bill's provisions

Clause 221 and **schedule 10** amend the *Social Security Contributions and Benefits Act 1992* to introduce the lump sum provisions and the *Pensions Act 1995* to bring forward

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[207] Pensions Policy Institute, *Deferring State Pension* PPI Briefing Note Number 4, September 2003, http://www.pensionspolicyinstitute.org.uk/uploadeddocuments/PPI_Briefing_Note_4_-_23_Sept_03.pdf

[208] Department for Work and Pensions, IAD Social Research Division, *Working after state pension age: quantitative analysis*, Research Report No 182, February 2003, http://www.dwp.gov.uk/asd/asd5/rports2003-2004/rport200/Main.pdf

[209] Cm 5677, pp 101-102

[210] *A pension promise paid must be a pension promise answered*, 2 October 2003

the commencement date of the 2010 changes to April 2005. No other substantive changes to the structure or calculation of increments are proposed.

The Explanatory Notes on the Bill explain how the new system will operate:

> 595. The lump sum will be an option only after a person has deferred for at least 12 months (in contrast to increments, which, following the change in accrual rate, will be payable after five weeks' deferment). However, as with increments, there will be no upper limit on the length of time a person may defer and accrue a lump sum. …
>
> 596. It is intended that the lump sum will comprise the pension a person would have been entitled to had they not deferred, plus a rate of return that will be applied weekly and compounded. The pension forgone will be calculated at the rate that would have been applicable in each week (or "accrual period") for which the person defers. …
>
> 597. Both members of a married couple may defer their pension entitlement, either by deferring their own individual Category A pension, or as a consequence of the spouse, from whose contributions the other partner's pension is derived, deferring his. Each member of the couple will have the choice of either increments or (providing the deferment period is at least 12 months) a lump sum, in respect of their deferred pension. So, for example, a woman may prefer an increase to her weekly pension, while her husband elects to receive a lump sum.
>
> 598. If a deferrer dies before claiming it is intended that his surviving spouse will be able to choose to "inherit" either a lump sum or increments based on the deceased's deferred entitlement. This choice will only be available if the person had deferred for at least 12 months. In all other respects, the conditions for "inheriting" a lump sum will be the same as for inheriting increments, that is, that the survivor was married to the deceased at the time of death, has attained state pension age and has claimed their own pension.
>
> 599. Should the death occur before the spouse has attained state pension age, the value of the lump sum as nominally accrued at the date of the deferrer's death will be maintained in line with prices up to the point at which the surviving spouse claims his or her pension. The value of increments earned by a deceased partner is currently protected in a similar way.
>
> 600. The calculation of the lump sum for survivors will reflect the proportion of increments that can be inherited; that is, 100 per cent. of the lump sum derived from the basic Category A pension, a proportion of the lump sum derived from the additional pension and one-half from deferred Graduated Retirement benefit.
>
> 601. In order to maintain consistency with the existing rule relating to the inheritability of increments, before April 2010 a widower's entitlement to an

> inheritable lump sum will be restricted to cases where the widower is himself over pension age at the time his wife dies.[211]

After a person has deferred for 12 months, they will have to choose between increments and a lump sum. Regulations will prescribe:

> How the election is to be notified and the period within which the choice must be made. If no choice is made within the prescribed period however, a person will be deemed to have chosen the lump sum ... In other areas of social security legislation where potential entitlement to more than one benefit exists, the Secretary of State has the power to make the decision which is most advantageous for the claimant. In this instance, we recognise that for many people, a weekly increase to their pension would, over time, be financially more beneficial; however the lump sum is the "safe" alternative, as it carries no actuarial risk.[212]

There are many complex provisions relating to the impact of the lump sum alternative on GMPs, invalidity additions, increases for dependants etc. These provisions are described in the Explanatory Notes.

Following the publication of the Green Paper in December 2002, there was much discussion of how the lump sum would be calculated (see section 3 below). A complex formula is laid down in the new paragraph 3B to be inserted in schedule 5 of the *Social Security Contributions and Benefits Act* 1992, by paragraph 8 of schedule 10 of the Bill. According to the Explanatory Notes, “this is modelled on the same principle as an interest-earning savings account: "interest" will be applied each week to the amount "saved", and compounded”. The interest rate will be prescribed in regulations, but a press release issued by the DWP on 24 February 2004 announced that the interest rate used to calculate the sum would be “at least 2% above the Bank of England base rate” (currently 4%).[213] It contained a table showing the “possible gains from deferring”:

[211] EN Bill 57
[212] *Ibid,* para 609
[213] DWP press release, 24 February 2004, *Generous interest rate set for state pension lump sum*

Type of Pension	Underlying amount at point of Claim		Years of Deferral	Lump Sum Accrued before tax
	Weekly	Annual		
Average newly retired woman	£60.00	£3,120.00	1	£3,214
			2	£6,622
			5	£18,120
Basic pension only (single rate)	£77.45	£4,027.40	1	£4,149
			2	£8,548
			5	£23,390
Basic pension only (Couple rate)	£123.80	£6,437.60	1	£6,632
			2	£13,663
			5	£37,388
Average newly retired man	£100.00	£5,200.00	1	£5,357
			2	£11,036
			5	£30,201
Basic plus large additional state pension	£150.00	£7,800.00	1	£8,036
			2	£16,555
			5	£45,301

All figures are in 2003/4 price terms. Lump sum calculated at 6%.

This press notice also sought to give reassurance on the tax and benefit implications of taking the lump sum:

> New tax arrangements mean the lump sum will be taxed at the marginal rate applied to people's other income in the year they claim it, so no one will be brought into tax or move up a tax band as a result of claiming a lump sum. People will also be able to choose to delay receiving it until the following tax year when their income may be lower. The lump sum will not affect the age-related personal allowance.
>
> Poorer pensioners need not worry about being short-changed. Pension Credit and other benefits will be adjusted so that building up a large lump sum need not reduce entitlement.[214]

3. Issues

Several criticisms were made of the Government's deferment plans following the publication of the Green Paper in 2002. By and large the Government has responded to these criticisms in the Bill.

[214] *Ibid*

The Northern Pensions Resource Group and Independent Pensions Research Group stated that:

> We do not believe that the plans to provide larger increases for deferred State pensions will have much effect, unless it is made possible for those who defer, and die before they start to draw the benefit, to bequeath an equivalent lump sum to others.[215]

The Government has responded by making it possible for a widow(er) to inherit the deferred lump sum or increased increments (after 12 months) under **clause 221**.

Further, Age Concern asked that the Government consider bringing forward its proposed changes from 2006. The Bill makes provision for the new deferment rules to come into force in April 2005.

However, some criticisms remain unresolved by the Bill, particularly those relating to incentivisation. Both Age Concern and the Pensions Policy Institute (PPI) voiced concerns about how the deferment would be calculated and whether this in fact would represent a sufficient incentive to people to put off claiming the state pensions. The PPI's calculations were most stark:

> The current deferral incentive is not particularly generous, especially for men. A man would have to live until age 86 and a woman to age 81 to benefit. The probability of doing so is 40% and 70% respectively.
>
> A man would have to live to 81 and a woman to age 76 for the proposed more generous deferral incentive to be worthwhile [1⁄5p per £1.00 of the weekly rate]. This is obviously more likely, with probabilities 60% and 82% respectively. Although the probabilities are such that it is more likely than not that a person would live beyond the breakeven age, even the proposed more generous deferral incentive is not compelling. Given that the benefit for deferring is small and depends on the unknowable of age at death, people may still prefer to take the pension at SPA, and bank it to secure some return, knowing that they can pass the money on if they die in the deferral period.
>
> The deferral incentive gives an extra tax break to high rate taxpayers who would like to carry on earning after SPA in a 40% tax band, but would prefer to take state pension later when in a lower tax band. On the proposed more generous basis, the breakeven age for men reduces to 79 (67% survival probability) and for women to age 74 (86%).

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[215] Northern Pensions Resource Group and Independent Pensions Research Group, *Response to Simplicity, Security and Choice: working and earning for retirement*, para. 87 http://www.prg.org.uk/papers/simplicity.html

It is also proposed that the maximum period of deferral be removed. A long deferral means a higher breakeven age is required which has a lower probability of being achieved. A lump-sum alternative is also suggested, which may sound more attractive. However, if the lump-sum simply reflected the value of pension payments forgone, an individual may still prefer to take the pension at normal age and invest it in case of death before claiming.[216]

K. Miscellaneous

The Bill contains a number of miscellaneous measures which clarify the existing law or restore original policy intentions. These include:

1. Statutory adoption and paternity leave

Clause 205 provides that employer pension contributions should be paid normally during periods of paid paternity or adoption leave. This was the original intention when statutory paternity and adoption leave were introduced from April 2003 under the *Employment Act 2002*. The Regulatory Impact Assessment on the Bill (RIA) explains:

> 4.8.2 Eligible fathers are entitled to take one or two weeks' statutory paternity leave around the time of the birth of their child. Most fathers will be paid Statutory Paternity Pay (SPP) during their paternity leave. Eligible adopters are entitled to 26 weeks' ordinary adoption leave, during which time they will generally receive Statutory Adoption Pay (SAP). This is followed by 26 weeks' additional adoption leave, which is generally unpaid. Employed mothers are entitled to 26 weeks' ordinary maternity leave during which they may receive Statutory Maternity Pay (SMP) followed by 26 weeks' additional maternity leave, which is generally unpaid. Employers may also offer occupational maternity, paternity or adoption pay to employees during their leave.
>
> 4.8.3 The Government intended that rights which apply to parents taking adoption or paternity leave would reflect the rights which apply to women taking maternity leave. This has generally been achieved. However there is an unintended lack of parity when it comes to pension rights during paternity and adoption leave.
>
> 4.8.4 Paragraph 5 of Schedule 5 to the Social Security Contributions and Benefits Act 1992 requires that during paid maternity leave employers should make contributions to occupational pensions as if the woman were working normally and receiving the usual pay for doing so. Paid maternity leave is any period of maternity leave during which the woman receives either SMP or occupational maternity pay. The proposal will align the treatment of pension contributions during paid paternity leave and paid adoption leave with treatment during paid maternity leave, by requiring that employers make contributions as if the employee were working normally. Paid paternity leave and paid adoption leave

[216] Pensions Policy Institute, *Deferring State Pension* PPI Briefing Note Number 4, September 2003: http://www.pensionspolicyinstitute.org.uk/uploadeddocuments/PPI_Briefing_Note_4_-_23_Sept_03.pdf

> are defined as periods of paternity or adoption leave during which the employee receives SPP, SAP and/or occupational paternity or adoption pay.[217]

It puts the cost to business at £9 million.

2. Social security agreement with Australia

The UK first made a reciprocal social security agreement with Australia in 1953.[218] However, Australia terminated the Agreement with effect from 1 March 2001 because the UK refused to increase the frozen pensions of UK pensioners resident in Australia. Before its termination, the Agreement provided that:

- UK citizens living in Australia could gain early access to the social security system. It helped them satisfy the 10-year residence test for the Age Pension.
- The Australian government paid (and continues to pay, in the case of those already in receipt of benefit prior to March 2001) extra income support payments to top up the decreasing value of frozen UK pensions.
- Where people living permanently in the United Kingdom had previously lived in Australia, their Australian residence counted as periods for which Class 3 National Insurance Contributions had been paid for the purpose of determining their entitlement to certain UK benefits, notably retirement and widow's pensions.

The position of UK residents who were already receiving benefits in reliance on the Agreement, or had made a claim in reliance on the Agreement, before 1 March 2001 is protected by the Agreement itself.[219] However, the Agreement did not protect the position of people who had lived in Australia before 1 March 2001 but who had not made a claim for UK benefits by that date. The DWP is currently protecting the position of these people by extra statutory means, as the Minister explained in reply to a PQ in December 2000:

> **Liz Blackman**: To ask the Secretary of State for Social Security if he will make arrangements to protect the position of pensioners reaching pension age after 28 February 2001 who have periods of residence in Australia. [144171]
>
> **Mr. Rooker**: As I have indicated in response to letters from right hon. and hon. Members who have raised the issue on behalf of constituents, we have been considering how to make transitional arrangements. I am pleased to announce we are putting arrangements in place to protect the position of those people who have periods of residence in Australia, on their return to live permanently in the UK.

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217 http://www.dwp.gov.uk/publications/dwp/2004/ria/pensions_bill_2004.pdf

218 *The National Insurance (Reciprocal Agreement with Australia) Order* SI 1953/1772.

219 *Social Security (Australia) Order 1992*, SI 1992/1312, schedule 1, article 26

> We are protecting such periods of residence up to and including 5 April 2001 for the purpose of basic retirement pension and bereavement benefits.
>
> We shall, in advance of Primary Legislation, top up the pensions of people with residence in Australia prior to 6 April 2001 with an extra statutory payment if they have less than the full rate of basic pension. We will do this when they claim their pension.
>
> There will be no extra cost to public funds as we would have made such payments if the Agreement with Australia had continued. I am arranging to write to all Members of both Houses who have raised the issue specifically with me.
>
> We are protecting the basic pension position of people with residence in Australia before 6 April 2001. [220]

Clause 223 regularises the statutory basis for these payments which have been made under the extra-statutory scheme.

III Further reading

a. Pensions Bill

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[220] HC Deb 21 December 2000 c 260W

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IV Abbreviations and Glossary

(NB not all the terms defined here are actually contained in this Research Paper, but they are included as they are closely related to the issues discussed. Similarly, there are terms used in the paper which are not defined here, though they may well be defined in the text. The Pensions Management Institute produces a comprehensive glossary of *Pensions Terminology* available at http://www.pensions-pmi.org.uk/terminology.pdf)

Accrual rate – this term may be used in relation to a scheme where the benefits payable are related to previous earnings, such as SERPS, or a final salary occupational scheme. It means the rate at which pension benefits build up for the member. Typically, if the accrual rate is 1/60th, scheme members receive 1/60th of their final salary for every year they have been in the scheme.

Annuity – this is purchased, usually from an insurance company, to provide a regular income from a lump sum. It is the method by which the fund from a money purchase scheme is converted into a pension.

Anti-franking rules – This refers to the legislation which prevents the scheme rules of final salary occupational schemes offsetting increases in the Guaranteed Minimum Pension against other scheme benefits.

APP – appropriate personal pension – this is a personal pension which has been certified by the Inland Revenue's National Insurance Contributions Office as satisfying the conditions required for contracting out of the state additional pension scheme.

ASP - Additional State Pension – this is the part of the national insurance state retirement pension which provides an additional earnings-related pension, on top of the basic state pension, to people with earnings above the lower earnings limit. Between

1978 and 2002 it was commonly known as SERPS. From April 2002, it has been known as S2P.

BSP - Basic State Pension – this is the part of the state scheme into which all those earning above the lower earnings limit currently contribute. It is paid at a flat rate and is administered by the Pension Service. The full weekly rates in 2003/04 are £77.45 for a single pensioner and £123.80 for a couple. They are due to rise to £79.60 and £127.25 respectively in April 2004.

CARE – career average revalued earnings schemes – these are defined benefit schemes which base the pension on an employee's average earnings throughout his career with the employer, revalued. They may yield lower pensions than final salary schemes, as people tend to earn more as their career progresses, but they may be fairer to people whose career does not follow this pattern.

Cash balance schemes – in cash balance schemes, the employer promises the employee a cash pot (based on his earnings and length of service) at retirement. The employee then uses this to buy an annuity. The employer takes the pre-retirement risk; the employee takes the post-retirement risk

CEP - Contributions Equivalent Premium – where people leave a contracted-out occupational scheme, within two years of joining, the scheme may opt to return any contracted-out contributions to reinstate them in the state scheme. The CEP is the amount that they must pay to do this and will end any liabilities the scheme may have had in respect of the employee.

CETV – Cash Equivalent Transfer Value – the minimum transfer value payable to an early leaver from an occupational pension scheme under sections 93 and 94 of the *Pensions Act 1995.* It must be calculated in accordance with actuarial guidance note GN 11. If the early leaver's pension rights are held by a defined benefit occupational pension scheme subject to the Minimum Funding Requirement (MFR), the CETV must not be less than that calculated according to actuarial guidance note GN 27 on the MFR. In practice, therefore, schemes subject to the MFR use this basis on which to calculate transfer values.

COD – contracted-out deduction – this is the deduction made from an individual's entitlement to SERPS because they were contracted-out during the period 1978-1997. It is equal to the Guaranteed Minimum Pension (GMP) calculated by the Inland Revenue. In the case of contracted-out salary related schemes, the occupational scheme is required to provide the GMP in place of the SERPS. In the case of contracted-out money purchase and appropriate personal pension schemes, a COD equal to the notional GMP is still deducted though the benefits from the protected rights may be more or less than the GMP.

COMBS – contracted-out mixed benefit schemes – a contracted-out occupational pension scheme which has separate defined benefit and defined contribution sections.

COMPS - contracted-out money purchase scheme – this is an occupational scheme where members have contracted-out of the state scheme. The benefits payable on retirement depend on the fund that has built up from contributions from the member and the employer.

Contracted-out rebate – this is the reduction in NICs paid by people who are contracted-out of the state additional pension scheme. It is set by the Secretary of State at five-yearly intervals on the advice of the Government Actuary and is designed to reflect the cost of providing benefits of an actuarial value equivalent to that of the benefits forgone. At present the rebate is 1.6% of earnings between the lower and upper earnings limits for employees and 3.5% of the same range for employers with salary-related schemes. For employers with money purchase schemes, the rebate is 1%. People who are contracted-out into appropriate personal pensions pay the full contracted-in rate and the Inland Revenue pays a sum equal to the rebate into the individual's personal pension plan.

Contracting out – this is the process in which people opt out of the state scheme into a private scheme. This may be an occupational, approved personal or since 2001 a stakeholder pension. The person contracting out and the employer may pay reduced NICs and the rebate must be used to fund the pension.

COSR - contracted-out salary related scheme – this is a contracted-out occupational scheme which pays benefits based on the member's salary.

DB - Defined-benefit schemes – these are occupational pension schemes that pay benefits according to the members' earnings while they were in the scheme. They do not require the purchase of an annuity on retirement. They include final salary and career average revalued earnings schemes.

DC - Defined-contribution schemes - these are private pension schemes that pay benefits according to the level of the pension fund on retirement. The fund builds up from contributions from members, and in some cases employers, and returns from the fund's investments. Part of the pension fund that has been built up must be converted to a regular income, usually through the purchase of an annuity.

DHSS – Department of Health and Social Security – Government Department responsible for pensions policy until July 1988, when it was replaced by the DSS

DSS – Department of Social Security - Government Department responsible for pensions policy until June 2001, when it was replaced by the DWP.

DWP – Department for Work and Pensions – replaced the DSS as the Government Department responsible for pensions policy in June 2001.

Earnings factor – this is the figure that is used to calculate entitlement to SERPS and the S2P. Essentially it is an individual's earning between the lower and upper earnings limits for NICs.

EPB – Equivalent Pension Benefit – benefits which must be provided by employers who were contracted-out of the earliest earnings-related state pension scheme, the Graduated Retirement Scheme, which operated between 1961 and 1975.

Final salary schemes – this is the name for defined-benefit schemes which base pensions on salary earned in the last year (or last few years) of employment. Sometimes it is used loosely to mean any form of defined benefit scheme.

GMP - Guaranteed Minimum Pension – this applies to contracted-out defined benefit occupational schemes but only on rights accrued between April 1978 (when SERPS was introduced) and April 1997. It is the minimum that the scheme must pay and is related to the amount of SERPS that the individual would have received if he or she had stayed in the state scheme.

GRB – Graduated Retirement Benefit – the pension payable under the earliest form of state earnings related pension scheme, the Graduated Retirement Scheme, which operated between 1961 and 1975.

HRP - Home Responsibilities Protection – this is the system which discounts years from an individual's working life when calculating their entitlement to the Basic State Pension. This helps them meet the conditions of entitlement and applies to people with certain caring responsibilities. From April 2002, it has also helped certain carers to qualify for S2P.

Hybrid schemes – an occupational pension scheme in which the benefit is calculated as the better of two alternatives, for example on a final salary or money purchase basis. Or an occupational scheme which offers both final salary and money purchase benefits.

Income Support – this is the name for the means-tested social security benefit which may be paid to certain people who have low incomes. The name applied (technically) to the means-tested benefit for pensioners from April 1988 to October 2003, but, between 1999 and October 2003, the Government referred to Income Support for people aged 60 and over as the Minimum Income Guarantee. Since October 2003, it has been replaced by the Pension Credit.

LEL - Lower Earnings Limit – this is the minimum amount someone must earn before they are covered by the national insurance scheme. It is currently £77 per week (rising to £79 in April 2004). Employed people do not, however, actually start paying NICs until their earnings reach the primary threshold of £89 a week (rising to £91 in April 2004).

LET - Lower Earnings Threshold – this concept was introduced by the *Child Support, Pensions and Social Security Act 2000*. It is £11,200 in 2003/04 (rising to £11,600 in 2004/05) and is the figure around which entitlement to the new State Second Pension is based. Those earning above the LEL but below the LET and certain carers and long-term sick and disabled people are, at present, treated as if they have earnings equivalent to the

LET for the purposes of S2P. S2P rights accrue at 40% on earnings in this "first earnings band" (between the LEL and LET). In the second phase all those in the State Second Pension will be treated as if they had earnings equivalent to the LET. (See S2P)

LPI – Limited Price Indexation – a statutory requirement, introduced under the *Pensions Act 1995* for occupational pension schemes to increase pensions in payment by the lower of the RPI and 5%. The *Pensions Bill 2003-04* will reduce the cap to 2.5%.

MFR – Minimum Funding Requirement – this was introduced by the *Pensions Act 1995* and applies to private sector defined benefit occupational pension schemes. They are required to have a triennial actuarial valuation to establish their funding level using a specified actuarial method and set of assumptions. The trustees must then enforce a Schedule of Contributions to ensure that the scheme remains funded to at least 100% of this level, or, to bring it up to 100% funding over a specified time period. The *Pensions Bill 2003-04* will replace the MFR with a scheme specific funding requirement.

MIG - Minimum Income Guarantee – the Government's name for means-tested Income Support paid to people aged 60 and over, between April 1999 and October 2003, when it was replaced by the Pension Credit .

MNTs - Member Nominated Trustees – these are trustees of occupational pension schemes who have been nominated by the members of that scheme. Provisions in the *Child Support, Pensions and Social Security Act 2000* requiring each scheme to have one-third MNTs have not yet been brought into force, and will be repealed by the *Pensions Bill 2003-04.* They will be replaced by different requirements for one-third MNTs.

Money purchase schemes – this is another name for defined-contributions schemes.

NICs - National Insurance Contributions – the contributions which are paid into the National Insurance fund by employees and employers. The amount paid is used to calculate entitlement to certain benefits and these are paid from the fund. Employees pay primary Class 1 contributions, employers pay secondary Class 1 contributions and self-employed people pay Class 2 and 4 contributions. These contributions provide different entitlements to different benefits.

NPA – Normal Pension Age – the age at which members of an occupational pension scheme qualify for their pension without actuarial reduction under the rules of the scheme.

Occupational Pension Scheme – this is a private pension scheme provided by an employer.

OPAS – (Office of the) Pensions Advisory Service - this is an independent and voluntary organisation giving free help and advice to members of the public who have a problem concerning either a company or personal pension scheme. It is grant aided and non-profit making.

Opra - Occupational Pensions Regulatory Authority - this is a statutory body set up by the *Pensions Act 1995* to ensure that occupational schemes operate within the law. The *Pensions Bill 2003-04* will replace it with the Pensions Regulator.

PBGC – Pension Benefit Guaranty Corporation – US equivalent of the Pension Protection Fund. It was established in 1974.

Pension Compensation Board – established under the *Pensions Act 1995* to provide compensation for members of occupational pension schemes who lost money as a result of fraud or dishonesty. It is to be transformed into the Fraud Compensation Fund under the Pension Protection Board by the *Pensions Bill 2003-04*

Pension Credit – see State Pension Credit

Pension Credit – this term is most often used for the means-tested State Pension Credit introduced in October 2003. However, it is also the technical name for the amount credited to an ex-spouse from a scheme member's pension when shared on divorce. Pension sharing on divorce was introduced from 1 December 2000 under the *Welfare Reform and Pensions Act 1999*.

Personal Pension – a private pension that belongs to an individual. It may be approved by the Inland Revenue and can be contracted-out of the state scheme.

PPF – Pension Protection Fund – to be introduced under the *Pensions Act 1995* to provide compensation for members of defined benefit occupational pension schemes whose employers become insolvent leaving the pension fund with insufficient assets to meet its liabilities.

Protected rights – that part of a contracted-out money purchase pension which is derived from the contracted-out rebate. It must be used to provide benefits which meet certain conditions (e.g. they must provide a pension from no earlier than age 60, must be index-linked and must provide a 50% widow(er)'s pension).

RIA – Regulatory Impact Assessment - An RIA is a policy tool which assesses the impact, in terms of costs, benefits and risks of any proposed regulation which could affect businesses, charities or the voluntary sector. A full RIA is signed by the accountable Minister and placed in the House libraries when the regulation/ legislation is presented to Parliament.

RST – Reference Scheme Test – since April 1997, defined benefit schemes have been able to contract out of the additional state pension provided that their benefits meet an overall test of scheme quality (the RST). For example, the accrual rate must not be lower than 1/80ths, the pension must be payable at least from age 65 and must continue for life and there must be a widow(er)'s pension of 50%. This replaced the requirement to provide a GMP as a basis for contracting out.

S2P – State Second Pension – the replacement for SERPS as the state additional pension. It provides a more generous pension for low and moderate earners and certain carers and people with a long-term illness or disability. It was introduced by the *Child Support, Pensions and Social Security Bill 2000*, and started to accrue from April 2002. (See also LET). The Government's intention is that, when Stakeholder Pensions are successfully established, S2P should become fully flat-rate, with all contributors and "deemed" contributors being treated as if they had earnings at the LET.[221]

SERPS - State Earnings Related Pension Scheme – the common name for the state additional pension, which operated between April 1978 and April 2002. Entitlement is based on earnings between the lower and upper earnings limit and the pension is paid in addition to the Basic State Pension.

SFP – Statement of Funding Principles – to be introduced under the *Pensions Bill 2003-04* as part of the new scheme specific funding requirement.

SIP – Statement of Investment Principles – under the *Pensions Act 1995*, trustees are required to draw up a written SIP explaining in detail their investment strategy and how they comply with it.

SMPI - Statutory Money Purchase Illustration – from April 2003 all money purchase schemes have had to issue their members with SMPIs showing the amount of pension which might be payable on retirement, based on a standard set of assumptions.

SPA - State Pension Age – this is the age from which the State Retirement Pension is payable. At present, it is 60 for women and 65 for men, but the pension age for women is due to be increased to 65 over the period 2010-2020.

Stakeholder pensions – these are personal pension schemes which satisfy minimum CAT (Cost, Access and Terms) standards. For example, fees are capped at 1% of the fund and there must be no penalty charges for transferring the benefits or stopping contributions. They have been available since April 2001 under provisions in the *Welfare Reform and Pensions Act 1999*. Employers with five or more employees who do not offer an occupational scheme for all employees to join within one year of starting work, must offer their employees access to a stakeholder scheme. They are targeted at people on "middle incomes", which – in 1998, when they were announced – meant those earning between £9,000 and £20,000 a year.[222]

State Pension Credit – this was introduced in October 2003 when it replaced the MIG as the main means-tested benefit for pensioners. There is a **guarantee credit** which ensures

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221 Explanatory Notes on the *Child Support, Pensions and Social Security Act* 2000, para 350
222 Cm 4179, para 10

that no pensioner has an income below a certain figure, and a new **savings credit** designed to help those with modest incomes who currently gain little or nothing from any small amounts of pension income because of the way the MIG rules operate. At present, the guarantee credit is £102.10 a week for a single pensioner and £155.80 a week for a couple. From April 2004, this will rise to £105.45 and £160.95 respectively.

State Retirement Pension – strictly, this phrase covers both the state basic pension and the state additional pension, though it is often used to mean just the basic pension.

TUPE – Transfer of Undertakings (Protection of Employment) Regulations 1981 – these regulations preserve the terms and conditions of employment of employees transferred from one undertaking to another, but do not, at present, cover pensions.

UEL – Upper Earnings Limit – this is the upper limit on the range of earnings over which NICs build up entitlement to state additional pension. At present it is £595 a week (rising to £610 in April 2004). Until April 2003 employees did not have to pay NICs on earnings above the UEL, but since that date, the Chancellor has levied a 1% contribution on these higher earnings to finance improvements to the NHS. The annualised UEL (currently £30,940) also acts as the ceiling on the "third earnings band" for S2P purposes. Rights to S2P accrue at 20% on earnings between the UET and UEL. (See S2P, LET, UET)

UET – Upper Earnings Threshold - this concept was introduced by the *Child Support, Pensions and Social Security Act 2000*. It is £25,600 in 2003/04 and is the upper limit of the "second band" of earnings for the purposes of the State Second Pension. The second band is roughly equivalent to the earnings band at which Stakeholder Pensions are targeted. S2P rights accrue at 10% on earnings in this "second earnings band" (between the LET and UET). In the second phase of S2P all contributors will be treated as if they had earnings equivalent to the LET and the UET will become irrelevant. (See S2P)

Vesting – when scheme members become entitled to accrued rights. Some schemes would not offer the choice of a preserved pension or a transfer value to people who had been a member for less than one or two years. All they would get on leaving the scheme early would be a refund of contributions.

Appendix: Scheme membership by type of pension 78/9 to 00/1

Type of scheme	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90
Contracted Out schemes current at the year end												
All contracted out schemes[2]	**9,027**	**9,110**	**9,056**	**8,901**	**8,663**	**8,515**	**8,468**	**8,337**	**8,381**	**11,551**	**12,213**	**13,003**
Appropriate Personal Pension	.	.	.	.	.	.	.	.	.	3,159	3,218	4,124
Contracted Out Money Purchase	.	.	.	.	.	.	.	.	.	.	386	409
Contracted Out Mixed Benefit	.	.	.	.	.	.	.	.	.	.	.	.
Contracted Out Salary Related (Private Sector)	5,561	5,560	5,391	5,202	4,953	4,788	4,730	4,575	4,554	4,525	4,790	4,696
Contracted Out Salary Related (Public Sector)	3,465	3,550	3,664	3,699	3,710	3,727	3,738	3,762	3,827	3,867	3,819	3,774
State Earnings Related Pension[2]	**8,515**	**8,992**	**8,627**	**8,048**	**8,060**	**8,282**	**8,657**	**9,867**	**9,975**	**7,366**	**7,201**	**6,984**
All second tier memberships at the year end[2]	**17,542**	**18,102**	**17,683**	**16,949**	**16,723**	**16,797**	**17,125**	**18,204**	**18,356**	**18,917**	**19,414**	**19,987**

Type of scheme	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00[1]	2000/01[1]
Contracted Out schemes current at the year end											
All contracted out schemes[2]	**13,379**	**13,575**	**13,464**	**13,228**	**13,142**	**13,322**	**13,218**	**13,949**	**13,925**	**13,694**	**14,332**
Appropriate Personal Pension	4,749	5,260	5,485	5,473	5,469	5,497	5,525	5,636	5,668	5,740	5,727
Contracted Out Money Purchase	383	362	327	304	301	323	267	311	288	267	316
Contracted Out Mixed Benefit	.	.	.	.	.	.	.	426	415	383	413
Contracted Out Salary Related (Private Sector)	4,485	4,192	3,922	3,722	3,601	3,564	3,439	3,449	3,336	3,066	3,321
Contracted Out Salary Related (Public Sector)	3,762	3,761	3,730	3,729	3,771	3,939	3,988	4,127	4,219	4,238	4,556
State Earnings Related Pension[2]	**7,028**	**6,425**	**6,300**	**6,549**	**7,097**	**7,533**	**7,812**	**8,266**	**8,860**	**9,414**	**9,082**
All second tier memberships at the year end[2]	**20,407**	**20,000**	**19,764**	**19,777**	**20,239**	**20,855**	**21,030**	**22,215**	**22,785**	**23,108**	**23,414**

Notes: 1. Provisional   2. Figures are based on a 1% sample and shown to the nearest thousand
Source: DWP *Second Tier Pension Provision* December 2003