The Pensions Bill: Non-state Benefits

Pensions (H.L.), Bill 87 of 1994/95

Research Paper 95/48

18 April 1995

This is one of three Research Papers on the Pensions Bill (HL) as brought from the Lords. Research Paper 95/46 concentrates on the regulation of non-state pensions; Research Paper 95/47 concentrates on state pensions; and this one concentrates on the benefit aspects of non-state pensions. It covers the following topics: protection against inflation; equal treatment; powers to alter and wind-up schemes; sharing pensions on divorce and on entering residential care; breaking the links with the State scheme; and age-related rebates. It also summarises several other provisions of the Bill.

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I. Introduction

Although the Pensions Bill[1] is designed to deal with problems highlighted by the Maxwell Pensions scandal,[2] that is not its only function. Even the *Goode Report*[3], which followed in the wake of the scandal and which underlies many of the proposals in the present Bill, was the work of a committee whose terms of reference included reviewing the framework of law and regulation within which occupational schemes operate while taking into account the rights and interests of scheme members, pensioners and employers.

After publication of the Goode Report, the Government issued a series of consultation papers which expanded on some of the themes that it raised.[4] The White Paper[5] which followed these covered proposals on an even wider range of issues, including equalisation of the state pension age and various measures relating to personal pensions; the Bill as originally published included a number of other measures; and, finally, during its passage through the Lords, there were further additions, notable among which was the introduction of a clause relating to pension rights on divorce.

The dates of the debates in the House of Lords are listed below. References to specific topics are contained in the sections of this Paper in which the topics are discussed:

Second Reading:	24 January 1995
Committee:	7,13,16,20 & 21 February 1995
Report:	13 & 14 March 1995
Third Reading:	21 March 1995

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[1] The Pensions Bill (HL), Bill 87 of 1994-95 (as brought from the Lords).

[2] The death of Robert Maxwell in November 1991 was followed by revelations that substantial assets were missing from the pension schemes of various Maxwell companies - see Library Research Paper 95/10. Although settlement to restore a substantial proportion of the missing funds has now been reached, criminal charges are still pending against a number of individuals.

[3] Pension Law Reform: the report of the Pension Law Review Committee, Chairman:Professor Roy Goode, Cm 2341-I and II, September 1993.

[4] Department of Social Security, *Occupational Pensions: Discussing the Issues* Papers 1-7. Those particularly relevant to this Research Paper are Paper 4 *Indexation* and Paper 5 *Alternatives to Guaranteed Minimum Pensions*. Both were issued in December 1993.

[5] Security, Equality, Choice: the future for pensions, Cm 2594-I & II, June 1994.

This is not to say that the Bill represents a straightforward progression from the Goode Report. Indeed, one of the general criticisms of the Opposition Parties during the Bill's passage through the House of Lords was that in some respects the Bill had watered down the recommendations of the Goode Committee and the Government did expressly reject a number of the report's recommendations.[6]

Nevertheless, the Bill in the form in which it appears before the House of Commons for the first time contains measures relating to the Maxwell scandal together with a good many other issues. Moreover, during the passage of the Bill through the House of Lords, some of the longest and most passionate debates took place on issues which were not contained in the Bill as originally published.

When combined with the attention given to the measures on equal treatment between men and women, including the abolition of the Guaranteed Minimum Pension, the result has so far been that the question of pension rights for women has been one of the major features of the debates on the Bill, in some ways rivalling the attention given to combating fraud and improving the security of pension funds, on which there has been a good deal of, although by no means complete, consensus. It has even been said that although the Bill's main thrust was not diverted, the most far-reaching blow to the Government's intentions was over pension rights on divorce.[7]

Four underlying principles of the Bill were officially described during its Second Reading in the House of Lords by Lord Mackay, Minister for Social Security. These were:

- Improving the security of occupational pension schemes following the undermining of confidence which the Maxwell affair had produced;

- Bringing domestic legislation into line with European law on the equalisation of pension rights for men and women as required by the European Court of Justice rulings, including provisions to make it easier for contracted-out salary related schemes to equalise benefits for men and women;

- Phasing in the introduction, in the next century, of an equal pension age of 65 for men and women;

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[6] The Government's point by point reactions to the recommendations of the Goode report are listed in volume II of the White Paper referred to above.

[7] Pensions Today, April 1995.

- Making personal pensions more attractive across a broader age range by introducing age-related rebates for those investing in personal and money purchase schemes.

This Paper concentrates on the benefit aspects of the Bill, that is the aspects of most direct concern to the individual. It therefore covers the provisions which would fall within the second and fourth categories mentioned by Lord Mackay. It also covers a few of those that fall under the first category and a number of miscellaneous provisions. Another Library Research Paper covers those relating to the state pension age (as well as other provisions relating to the State pension)[8] and another covers the bulk of the provisions that fall within the first category, that is those to do with the regulation and administration of pension funds.[9]

The Paper aims to describe the main thrust of the provisions covered and to highlight some of the debates that have surrounded them. It does not provide a comprehensive clause by clause account as that is available from the Notes on Clauses produced by the Department of Social Security. The Paper includes issues raised during the passage of the Bill through the House of Lords and, in summary form, some of the reactions to the respective measures.

A number of memoranda relating to the Bill received by the Social Security Select Committee were laid upon the Table on 22 March 1995. This Paper has drawn on these memoranda as well as on a number of other sources for its summary of the reactions but because of their existence it has kept the sections on the responses to the Bill very brief. A selection of extracts from the Social Security Committee's memoranda will be published as HC 336 on Monday 24 April and will be available from the Vote Office.

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[8] Library Research Paper 95/47

[9] Library Research Paper 95/46

II. Provisions in the Bill

A. Protection against Inflation [Clauses 45-49 and 146-147]

1. Background

The Goode Report pointed out that, from the individual's perspective, it is not just the adequacy of a pension that is important but also the question of how certain it will be:[10]

> "Most important is the uncertainty with regard to inflation. The individual is concerned not with money amounts but with what the pension will buy."[11]

There is currently no *general* requirement for schemes to increase pensions in payment to maintain their real value but there are a number of specific requirements. In particular, a distinction can be drawn between private and public sector schemes as the latter are, in most cases, required to increase pensions in payment each year fully in line with inflation as measured by the Retail Price Index although a few apply a maximum of 5% or a higher maximum. There is also a distinction between pensions in payment and deferred pensions[12] as the latter are subject to tighter rules.

The cost of existing requirements is borne partly by central government and partly by pension schemes. What the individual receives and what a pension scheme has to pay are therefore not the same and proposals in the Bill can be viewed both from the perspective of the recipient and of the cost-bearer. Much of the existing inflation protection is provided through the Guaranteed Minimum Pension (GMP) which is underpinned by government. As described below, its abolition (see also section E. of this Paper) will therefore change not only the entitlement of the individual but also the cost to be borne by schemes.

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[10] Deferred pensions are the preserved pensions of someone who has left a scheme before retirement. They are payable at a later date, normally when the person retires, i.e. they are *deferred* until retirement.

[11] Goode Report (see above) paras 3.1.10

[12] Deferred pensions are the preserved pensions of someone who has left a scheme before retirement. (Such people are often referred to as *early leavers.*) The pensions are payable at a later date, normally when the person retires, i.e. they are *deferred* until retirement.

At the moment there are four specific indexation requirements which have been brought into force plus two others which were introduced by the Social Security Act 1990 but for which no commencement date has ever been set. (All these provisions are now contained in the consolidation act, the Pensions Act 1993.) According to the Goode Report, the delay was due to the uncertainty caused by a number of cases which were pending for some time in the European Court of Justice in the wake of the *Barber* judgment (see section B. below). The provisions which have been brought into force affect both pensions in payment and deferred pensions; and the GMP is relevant in both situations.

The GMP requirements concern salary-related schemes, not occupational money purchase schemes (with a few exceptions) or personal pensions as the last two generally have to guarantee "protected rights" which are defined in terms of contributions paid in rather than the pension coming out. In such cases the indexation requirements relate to the pension attributable to the "protected rights" and in the case of deferred pensions, the requirements are basically to let the fund grow on the same terms as the fund of those who have not left.

Requirements in force:

> **i) pensions in payment:** As a condition of being allowed to contract-out of the State Earnings Related Pensions Scheme (SERPS), schemes must provide a Guaranteed Minimum Pension (GMP) which on retirement (or early leaving) is roughly the same as the SERPS that an individual foregoes. After retirement the SERPS is likely to be higher because it is increased fully in line with inflation whereas, originally, schemes did not have to increase the GMP. For GMP rights accrued since 1988-89, schemes have to make increases in line with inflation up to 3%.[13] The individual is guaranteed a pension as good as the SERPS foregone and if this is higher than the GMP, the government pays the difference as a "residual" SERPS payment.
>
> **ii) pensions in payment:** A second requirement covers situations where the pension scheme has a surplus. Since 17 August 1990, if any payment from a surplus is to be made to an employer, annual Limited Price Indexation (LPI), which means increases with inflation subject to a required maximum of 5%, for pensions in payment must be introduced.[14]

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[13] Schemes are prohibited from using the benefits guaranteed by their own rules to make the increase - a rule which is known as anti-franking.

[14] Research Paper 95/46 describes the provisions in the Bill for tightening of conditions in which employers will be allowed to make payments to themselves.

iii) deferred pensions (preserved pensions of early leavers): a third requirement relates to the GMP element of a deferred pension. Schemes have several options about the way that they fulfil the requirement to revalue the GMP element but the requirement is related to average earnings rather than prices, with the State picking up the cost of any shortfall so that, as far as the individual is concerned, it is guaranteed to increase in line with average earnings.

iv) deferred pensions: a fourth requirement relates to the amount of the deferred pension which is in excess of the GMP. This has to be increased by the scheme in line with the Retail Price Index subject to a maximum of 5% (i.e. LPI).[15] For those leaving a scheme after January 1991, this requirement applies to the pension attributable to the whole period over which it has accrued. Before that it only related to service from January 1985 (for people leaving from 1986).

Requirements contained in the 1990 Social Security Act but not brought into force:

a) pensions in payment: Schemes were to be required to apply Limited Price Indexation (ie up to 5%) to the pension payable in excess of the GMP. This was to be applied to pension attributable to pension service on or after "the appointed day" (ie the date which has never been fixed).

b) pensions in payment: where schemes were in surplus they were to be required to apply LPI to pensions attributable to service before "the appointed day" as from "the appointed day".

Schemes may, and often do, provide greater protection against inflation than that which is required of them. LPI does not mean that schemes have to apply a maximum of 5%, only that that is all that they are required to do. Increases may be guaranteed by the scheme rules or may be discretionary or both. In the private sector, the latest survey for the Government Actuary shows that about three quarters of members of salary-related schemes are promised annual increases when they retire by their scheme rules.[16] Although the actual amounts vary widely between schemes, a little over half of members of private sector salary-related schemes

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[15] In this case it is calculated over the whole period rather than year by year which means that if inflation is above 5% in some years but below it in others, the rate can be averaged over the whole period. For example, if inflation is 1% in one year and 9% in the next, over the two years the individual's deferred pension is increased by 1% and 9% because the average of the two is 5%. The LPI proposed for pensions in payment would use the annual method so that in this example the increase would only be 1% and 5%.

[16] This refers to annual increases to the amount of pension in excess of the GMP.

are promised increases equivalent to, or better than, LPI. In practice, in 1990, around 60% of scheme members received increases at least as good as LPI.[17]

Although recognising the value of inflation protection, the Goode Report held back from making recommendations about changes to existing indexation provisions because there were major differences of view over how far such protection should go. For example, there were differences over whether indexing should be linked to wages which have risen faster than prices over recent years, over whether it should apply to future benefits only, and over how high a maximum should be prescribed.

However, the Report did recommend that the proposed link with surplus (point **b** above) should be broken except where employers are seeking a payment from the surplus (point **ii** above). The argument for this was that if it was desirable that schemes should provide increases to pensions in payment, this should not be related to the chance existence of a surplus.[18]

2. The Bill

As far as inflation proofing is concerned, the Bill would:

- repeal the two provisions which have not been brought into force described above;
- provide for pensions in payment, including money purchase and appropriate personal pensions,[19] to be increased by inflation subject to a maximum of 5% (LPI) - this will apply to pensions attributable to service from "the appointed day", which is expected to be in 1997;[20]
- remove the top-up inflation-proofing that SERPS has provided.

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[17] Occupational Schemes 1991, Ninth Survey by the Government Actuary, HMSO pages 63-66

[18] Goode Report (see above) para 4.18.68

[19] An appropriate personal pension is the part of a personal pension which is required for contracting-out purposes. The new indexing requirement will not, for example, apply to any personal pension payable over and above that.

[20] See The White Paper and Lord Mackay's statement on Second Reading, HL Deb 24.1.1995 c 977).

In the case of pensions in payment, the new rules will therefore contrast with the present position where part of the pension in payment (the GMP) is increased fully in line with inflation but part is not necessarily increased at all. They will also contrast with both the present and uncommenced 1990 provision in that they will apply to money purchase and appropriate personal pensions. In the case of deferred pensions, the abolition of the GMP will mean that the whole of the deferred pension will be increased by LPI instead of part having to be increased with average earnings and part by LPI. GMPs accrued before the Bill comes into force will "continue to form part of the occupational pension and will continue to be subject to broadly the current rules."[21]

Provisions also include:

> Certain exclusions from the indexing provisions, such as Free Standing Additional Voluntary Contributions and public service schemes (the latter being already covered by separate indexation provisions);
>
> An exclusion for people retired under age 55 who (with certain exceptions) have to wait until they are 55 before receiving their increases, although at that age they will be entitled to receive at a level as if it had been increased over the period since they retired.
>
> Allowing schemes that provide increases over and above what is required in one year to offset the extra against what is required in the next year; and
>
> Continuation of the requirement for schemes to index the GMP by up to 3% a year for GMPs earned between 1988/89 (the year schemes first had to contribute to the increase of the GMP as described above) and the date - expected to be 1997- when GMPs are abolished.

These proposals are largely the same as those announced in the White Paper although the Bill contains more detail, such as the addition of the provision that schemes can offset any 'above-requirements-increase' in one year against the required increase in the next (similar to the provision which currently exists in relation to the requirement for schemes to increase GMPs in payment by up to 3% a year).[22]

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[21] See, Lord Mackay's statement during the Committee Stage debate on the replacement of the GMP, HL Deb 21 February 1995 c1049.

[22] See, for example, Lord Mackay's statement during the Committee Stage, HL Deb 16 February 1995 c 809.

The breakdown of recurrent costs for an illustrative scheme published in the Compliance Cost Assessment issued by the Department of Social Security suggests that for a scheme currently contracted-out of SERPS the costs and savings of the measures just described would be as follows:

Costs and Savings arising from Proposed Changes for an Illustrative Employerrunning a Contracted-out Scheme*:

a)indexation of pension in excess of GMP COST
£60,000
(0.24% of payroll)

b)indexation of previous GMP element COST
£53,335
c)indexation of deferred pension after GMP abolition SAVING
£73,335

b) & c) changes due to breaking the link with SERPS SAVING
£20,000
(0.8% of payroll)

** The illustrative scheme is assumed to have a fund of £16 million; 900 active scheme members, 300 deferred member and 80 pensioners; to guarantee increases of 3% and to make actual increases of 4%. Further details of the assumptions are in the Compliance Cost Assessment.*

For a scheme contracted-in to SERPS, the new requirement to index pensions in payment by LPI is estimated to cost £80,000 (0.32% of payroll). For both contracted-in and contracted-out schemes, the figures relate only to salary-related schemes as costs are not expected to arise for money purchase schemes.

The State will no longer be responsible for indexing the component of occupational pension entitlements earned after the new requirement comes into force but the overall effects of the changes are complicated (see also section E). In practice, the effect on both individuals and schemes will depend on a number of factors, in particular whether the rate of inflation turns out to be more than 5% and the extent of indexation that is now applied. For the individual another important factor will be the proportion that the GMP forms of the total pension - the higher the proportion, the more likely that the abolition will be to the individual's disadvantage.

The table below shows the degree of inflation protection that LPI (applied on an annual *not* an averaged basis) would have provided over the past 10 years. It also shows that increases would have been subject to the 5% maximum on four occasions. The total increase in the Retail Price Index over the period was 61% but, with annual LPI, pensioners would have received 46%:

September Inflation Rates

Year	Inflation %	5% Maximum
1985	5.9	yes
1986	3.0	
1987	4.2	
1988	5.9	yes
1989	7.6	yes
1990	10.9	yes
1991	4.1	
1992	3.6	
1993	1.8	
1994	2.2	

Source: Business Monitor MM23

3. Response

There were no Divisions on the issue of indexation during the passage of the Bill through the House of Lords. The main debate was during the Committee Stage: HL Deb 16 February 1995 c 795-813. Issues raised by speakers to the many amendments, all of which were withdrawn, included those that are listed below. In nearly all cases the Government's response was that a balance must be struck between protection against inflation and the ability of the schemes, and the employers who stand behind them, to afford them:

Level playing field between different types of provision: there was some concern that Free Standing Additional Voluntary Contributions (FSAVC) are to be exempt from the indexation requirement either on the grounds that this would give the providers an advantage over in-house schemes which will have to index the pension attributable to their additional voluntary contributions or on the grounds that this would simply give individuals the chance to choose a provision which would be inadequate.

Higher Maximum: there were several amendments to raise the maximum above 5% on the grounds that this would not have been enough to protect pensioners against inflation in the past or on the grounds that wages have risen faster than prices.

Averaging of yearly RPI: arguments were made in favour of extending the averaging method of applying LPI used for deferred pensions (see 1 iv and accompanying footnote above) as this was considered likely to benefit the individual pensioner.

Objections to exclusion of those retiring under age 55 from the indexation provisions until they are 55.

Objection to allowing schemes that overindex one year to offset the excess against the next year's requirement.

Similar issues were raised in the briefings issued by organisations that have responded to the Bill. The level playing field issue was raised by several in relation to the fact that, of personal pensions, it is only appropriate personal pensions that are to be indexed (that is only pensions or the part of a pension that results from the contracting-out requirements). The level of the maximum was also an issue. There were criticisms that it was too low and that the partial indexation would be a poor substitute for the loss of the GMP. There were some who favoured retaining the requirement that surpluses must be used to index past accruals of pension rights and some who thought that indexation should apply from 1997 but to the whole pension payable from the date as the proposed provisions will take a long time to have an impact. On the other hand, there were also some who opposed compulsory indexation.

B. Equal Treatment [Clauses 56-60 and 152]

1. Background

As with indexation, there has been no general requirement in domestic UK law for occupational pension schemes to provide equal treatment for men and women although there is some relevant legislation in place and, in this case, European law has also been important. In its chapter on the historical development of pension schemes, the Goode Report pointed out that in the past many pension schemes operated rules which discriminated directly against women. For example they required longer service or an older age of entry or required married women to resign. Even the provisions of the Equal Pay Act 1970 and the Sex Discrimination Act 1975 as originally enacted did not apply to pension schemes.

In 1975 a social security act introduced a requirement that membership of pension schemes should be open to men and women on the same terms[23] and the Occupational Pensions Board (OPB)[24] was given the power if necessary to modify the trust deeds under which pension schemes are set up in order to achieve this. However, these provisions were considered limited and were criticised for not dealing with indirect discrimination. The OPB was asked to review the status of men and women and in 1976 produced a number of recommendations but said that more far-reaching proposals would have to await the equalisation of state pension ages.[25]

The Equal Opportunities Commission[26] has also taken an active interest and during the 1980s commissioned several special reports.[27] But most of the recent developments have resulted from European law and, in particular from judgments made by the European Court of Justice (ECJ). A Directive on equal treatment in occupational schemes was drawn up but most Member States, including the UK, have not fully implemented it and it may now need amendment as a result of various ECJ judgments.

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[23] The Social Security Pensions Act 1975 sections 53 and 54

[24] A statutory body set up under the Social Security Act 1973 which has certain supervisory functions in relation to contracted-out schemes.

[25] Occupational Pensions Board, *Equal Status for Men and Women in Occupational Schemes* Cmnd 6599, 1976

[26] A statutory body which, under the Sex Discrimination Act 1975, has powers to review national equal treatment legislation and where appropriate to make recommendations for changes to the law.

[27] J Ritchie and R Barrowclough, *Paying for Equalisation*, EOC 1983
Ann McGoldrick, *Equal Treatment in Occupational Pension Schemes*, EOC 1984
Tillinghast, Actuarial Consultants, *Report for the EOC on Unisex Pricing in Long Term Assurance*, EOC 1989

The impact of European law on occupational pension schemes has in practice flowed directly from the Treaty of Rome itself, in particular, Article 119, which embodies the principle of equal pay for equal work. Since the landmark judgment of the ECJ in 1976 on what is known as the *Defrenne* case, it has been enforceable directly by the individual not only against the State but also against a private party.[28] For occupational schemes, another landmark judgment came in 1990 on what is known as the *Barber* case. The ECJ decided that pensions paid by occupational schemes are "pay" for the purposes of Article 119 and therefore that discrimination in such schemes is unlawful.[29]

The *Barber* case was famous but its precise scope was uncertain and the details have had to be clarified in numerous judgments since then. It has now been confirmed, for example, that the decision announced on 17 May 1990 does *not* apply retrospectively except for individuals who had previously commenced litigation - claims can therefore only be made in respect of pensionable service since that date; discrimination is unlawful even if the inequality reflects state retirement ages, dependants' benefits are covered but sex-differentiated actuarial factors for calculating transfer values and lump sums are not; it is lawful to equalise benefits for future service downwards but schemes cannot do so retrospectively for periods back to 17 May 1990, ie from 17 May 1990 to the date of formal equalisation, they must equalise upwards and for periods before 17 May 1990 European law is silent. [30]

However, this has been described as a highly complex and still developing area of law.[31] Issues remain to be clarified probably both at the European level and in the UK courts even though recent ECJ judgements, including six cases decided in September 1994 did clarify many of the issues left unclear by the Barber judgment. In particular, the issue left outstanding by the September judgments which has attracted most attention in this country concerns that of indirect discrimination against part-timers:

Two of the September judgements, known as Fisscher and Vroege,[32] made it clear that the time limit of 17 May 1990 established by the *Barber* cases did not apply to claims for membership of occupational schemes, as distinct from claims relating to the benefits of schemes, with which *Barber* had been concerned. (A previous case, known as Bilka Kaufhaus,[33] had established that the right to join an occupational scheme fell within the scope

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[28] Gabrielle Defrenne v Societe Anonyme Belge de Navigation Aerienne (Sabena), ECJ-43/75, Decision: 08.04.1976

[29] Barber v Guardian Royal Exchange Assurance Group, ECJ 170/84, Decision: 17.05.1986

[30] See, for example, the recent account provided by the Pensions Management Institute in its December 1994 issue of Technical News, *Pension Schemes and Sex Equality*.

[31] Pensions Management Institute, Technical News, December 1994

[32] Fisscher v Voorhuis Hengelo BV & Another, ECJ-128/93, Decision: 28.09.94 and Vroege v NCIV Instituut Voor Volks-huisvesting BVN and Another ECJ-57/93, Decision: 28.09.94.

[33] Bilka Kaufhaus GmbH v Weber von Harz, ECJ 170/84, Decision: 13.05.1986.

of Article 119.) The Fisscher case concerned a married woman but in the UK these judgments are most likely to affect part-timers and, indeed, the April 1995 issue of the journal *Occupational Pensions* reports that unions estimate that 75,000 industrial tribunal claims from part-timers have been lodged.

Points of relevance to part-timers which the ECJ judgments established include:

> Where it can be shown that the exclusion of part-timers constitutes sex discrimination, part-timers have the right to join a scheme unless their exclusion can be justified on grounds unrelated to sex discrimination;
>
> Claims may be backdated to 8 April 1976, the date of the *Defrenne* judgment which established that Article 119 had direct effect in Member States, subject to national rules relating to time limits - as long as these do not render rights conferred by European law inoperable.
>
> The fact that a worker can claim retroactively to join a scheme does not give the worker the right to avoid contributions for that period.

However, the judgments did not establish in detail certain other relevant points, such as the criterion for establishing whether a part-timer has been discriminated against, and a particularly urgent question left open was the appropriate national time limits, if any, both within which a claim must be made and for the backdating of membership if the claim is successful.

2. The Bill

The White Paper, which was published before the September judgments, simply announced that the Government would bring forward legislation to reflect the requirement of the ECJ that occupational pensions should be equalised and this is one of the purposes of the current Bill. Its effect would be to enable domestic courts rather than the ECJ to deal with more of the cases relating to equal treatment in occupational schemes. In addition, the Bill also contains provisions dealing with issues raised by the September judgments.

The Bill introduces a general equal treatment requirement into UK law relating to occupational pension schemes. It provides that for pensionable service on or after 17 May 1990 all occupational pension schemes (including those in the public sector) are to be treated as containing an equal treatment rule in connection with membership of schemes and the treatment of members - except where the scheme can prove that any difference in treatment is due to material factors unrelated to any discrimination on the grounds of sex. There are specific exceptions for differences due to differences in the state retirement age and on the use, in certain circumstances, of sex-related actuarial factors which take account of different in life expectancies of men and women. The Bill also provides for Regulations to make new exceptions or to repeal existing ones.

For periods before equalisation is formally introduced and where a woman is treated unfavourably compared with a man doing like work or work of equal value, equalisation has to be upwards, that is detrimental amendments made in relation to any rights accrued before the scheme introduces equalisation are outlawed. During the Lords Committee Stage, Lord Mackay explained that this went beyond the requirements of European law as these were silent on rules applicable before 17 May 1990.

The Bill's answer to the question of time limits for the claims of part-timers is to bring the question of occupational scheme equality within the scope of the Equal Pay Act 1970. During the Lords debates Lord Mackay explained that this would mean that indirect discrimination would be covered[34] and that the time limits of the Equal Pay Act would apply. Without this, this there were currently no directly applicable time limits for the claims of part-timers. It was up to the courts and industrial tribunals to decide in the particular case what limits should be applied. For claims after the Bill was enacted, the Bill would require claims to be made within six months of leaving the relevant employment and would place a limit on retrospective membership of two years before the date of claim. It will therefore not be possible to backdate claims to 1976 as would have been allowed under European law.[35]

The Compliance Cost Assessment issued with the Bill does not indicate what the cost to schemes of equalisation might be as it points out that the main purpose of the Bill is to bring domestic legislation into line with recent rulings of the ECJ. "...These rulings have direct effect; any costs to industry arising from them are not affected by the Bill and therefore no costs are included in this CCA."

[34] On Report, HL Deb 13 March 1995 c701, he confirmed that the Equal Pay Act would cover indirect discrimination and referred to the case of Rainer v Greater Glasgow Health Board.

[35] HL Deb 16 February 1995 c 879.

3. Response

Many of the amendments put forward during the debates in the House of Lords were probing ones designed to obtain clarification of the Government's intentions. There were no Divisions on the issue of equal treatment although there was some concern over certain issues expressed, for example, in withdrawn amendments designed to allow tribunals discretion to waive the time limits and for certain cases to go directly to the courts.

Among organisations responding to the equal treatment provisions, there was some concern among the unions that the provisions might restrict the minimum provision required to conform with European law. The Equal Opportunities Commission, which has a particular interest in this area of law, has said that it would like to see part-timers have an automatic right to join a company scheme (rather than having to prove discrimination). It is in any case opposed to the two year time limit imposed by the Equal Pay Act for other types of claim and would like to see the rights of women extended in such areas as the right to unisex actuarial factors.

Guidance on the way that equal treatment is to be achieved for the period 1990-97 has also been an issue. (During this period GMPs, which are linked to the SERPS entitlement of an individual, will continue to exist and, like the state pension during this period, be based on unequal pension ages.) The EOC has specifically asked for guidance to be made available to schemes and the issue was raised during the House of Lords debates. Lord Mackay replied that he admitted that there were difficulties for schemes with regard to GMPs accrued between the date of the Barber ruling in 1990 and the abolition of GMPs in 1997.

C. Powers to alter and wind up schemes [Clauses 61-71 and 145]

1. Background

In its general discussion of interests and powers, the Goode Report argued that the needs of members of schemes had to be balanced against the needs of employers but that schemes were: "established primarily for the benefit of scheme members and should therefore be run on this basis." It considered that this view was not fully reflected in the existing distribution of powers.[36] In particular, there was nothing to prevent employers from setting up schemes which gave them power to amend scheme rules adversely as far as members were concerned. They could do this in relation to past as well as future service.

The report recommended that some general shift in the distribution of powers was therefore necessary. In particular, scheme members should be protected against adverse amendment of scheme rules affecting the rights that they had already acquired.[37] More specifically, in the context of its discussion of the rules relating to modification and winding-up of schemes, it said that:

> "Our view is that the present law is inadequate and that scheme members need greater safeguards than they currently enjoy."[38]

In addition to the recommendation relating to accrued rights, it made 15 specific recommendations, most of which were accepted by the Government although several were accepted only in part or only in principle with some disagreement over the details. Some were also to be given further consideration.[39]

Among topics discussed by the report were modes of winding-up and priorities to be given to different classes of beneficiary when schemes wind up without enough assets to pay everyone. As regards the latter, existing trust deeds of individual schemes normally set out how benefits should be secured and the order of priority on wind-up. For contracted-out salary-related schemes, priority has to be given to GMPs and accrued rights to GMPs but, apart from that, although priorities vary from deed to deed, those with pensions in payment normally received priority over all other classes of scheme member.

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[36] Goode Report Para 4.1.15

[37] Good Report Para 4.1.18

[38] Good Report Para 4.6.3.

[39] White Paper Volume II.

The Goode Report pointed out that these rules were only significant where the scheme did not have sufficient assets to meet its liabilities and, in that case, it was inevitable that some class or classes of member would suffer from the insufficiency of the fund. However, it also believed that its proposals for a minimum solvency requirement would limit the risk of this happening. It considered that existing priority rules for contracted-out schemes should be retained as overriding rules and that, subject to these, the priority distribution on wind-up should generally be left to be determined in accordance with scheme rules. It also recommended that on winding-up, benefits should, at a minimum be calculated on the basis of cash equivalents but if additional assets were available, they should be calculated in accordance with scheme rules.

The White Paper also considered that the minimum solvency requirement proposed by the Government would limit the risk of schemes ending up without enough assets in the event of a wind-up. Nevertheless, in case of need, it proposed legislation to override scheme priority rules to ensure that, in general, each member would on wind-up actually receive the cash equivalent of their accrued rights. Remaining assets would then be allocated according to the priority rules of the scheme. If scheme assets were insufficient, all members' entitlements would be reduced on an equitable basis but avoiding any reductions to pensions in payment.[40]

2. The Bill

Following the Goode recommendation, the Bill would prevent amendments to scheme rules which would have a detrimental effect on members' accrued rights except where individual members have given their consent.[41] It also makes various other provisions relating to the right to modify schemes. For example, it would enable trustees to modify schemes by resolution for specified purposes such as meeting other requirements for which the Bill makes provision and modifications to allow payments from a surplus to an employer are only be allowed if authorised by the new Regulatory Authority.

In relation to winding up, current requirements will be affected not only by the specific clauses in the Bill but also by the abolition of the GMP as this is currently the first claim on a salary-related contracted-out scheme. As for the specific provisions, in contrast with the Goode Report's recommendations, the Bill provides for a list of priority payments to be set out in legislation (ie overriding scheme rules) which would apply to all salary-related schemes

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[40] White Paper Para 1.31.

[41] HL Deb 16 February 1995 c 886.

which are subject to the minimum solvency requirement.[42] These would only come into play where a scheme cannot meet its liabilities. Where it can, each member will be entitled to the actuarial value of their accrued rights, including their rights to indexation.[43]

In outline, the priority order proposed in the Bill is as follows:

- Rights resulting from Additional Voluntary Contributions
- Pensions in payment
- Accrued pensions and benefits (for those with less than two years service, the return of their contributions)
- Increases to pensions in payment

The Bill also provides for trustees of schemes to have a choice over the way that they discharge their liabilities. This is in contrast with the current position where most schemes currently require trustees to discharge their liabilities by purchasing an annuity.[44] They are to be able to discharge them in one or more of the following ways (subject to the scheme at the receiving end being willing to accept the transfer):

- by transfer to another approved scheme
- by transfer to a personal pension scheme
- by purchasing an annuity from an insurance company chosen by the member
- by other means which satisfy prescribed requirements

These provisions are intended to affect only those schemes that start to wind up after the Bill comes into force, that is, if a scheme starts to wind up before 1997, the old rules will apply even if the wind-up is not completed until after the Bill comes into effect in 1997. The Government has announced that secondary legislation is to give effect to this timing provision.[45]

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[42] See Research Paper 95/46 for details of the minimum solvency requirement.

[43] Lord Mackay, Minister for Social Security, HL Deb 16.2.1995 c 890.

[44] Lord Mackay, Minister for Social Security, HL Deb 16.2.1995 c893.

[45] Lord Mackay, Minister for Social Security, HL Deb13.3. 1995 c 708.

3. Response

There were no Divisions on the issues relating to modification and winding-up during the passage of the Bill through the House of Lords. These were held on the following dates: Committee 16 February 1995 c886-893; Report 13 March 1995 c 706-713; Third Reading 21 March 1995 c 1171-1176. The Government successfully introduced a number of amendments which were largely technical but other amendments were withdrawn.

There was some concern about the order of priorities. Some wanted increases paid to existing pensioners to come higher in the ranking, particularly on the grounds that existing pensioners are less likely to have the opportunity to make up for any loss but the Government's argument was that their proposals were better than offering total protection to one class of member and prejudicing the right of other members who might be in no better position than a pensioner to make good the loss. The real difficulty with most schemes current rules was that they produced a step or series of steps around retirement age so that those above it might be fully protected but those just below it could have their rights significantly reduced.

There was a similar concern from some organisations but many accepted the new ranking as fair. Some of the unions were either neutral towards, or accepted, the new ranking in itself but argued that this reduction in the rights of existing pensioners strengthened the case for pensioner trustees.

D. Sharing Pensions: Divorce [Clauses 85 and 150] Residential and Nursing Home Care

1. Divorce: Background

Women are still in the minority as far as membership of occupational schemes is concerned. This is demonstrated by official figures which show that in 1991 only 37% of employed women as compared with 57% of employed men were members of schemes.[46] The Goode Report, which quoted these figures, remarked that throughout the period that it had considered, women had found themselves severely disadvantaged in the provision of occupational pensions:

> "This is a reflection of their overall position in the labour market, both in types of job and in pay. This has itself been seen as following from the historic assumption that most women would marry and that their husbands would be the main breadwinners."[47]

The report gave particular attention to the situation where a couple divorced after the wife had spent many years bringing up a family and had few career prospects while the husband, a member of his firm's occupational pension scheme, was the sole or main earner :

> "The effect of the divorce is that the wife, who could have looked forward not only to sharing the benefits of her husband's pension during his lifetime but also to receiving widow's benefits after his death, now finds that she has no rights or expectations of any kind under the pension scheme."[48]

However, the report also said that the the treatment of pension rights on divorce was a contentious issue which raised acute problems.[49] In particular, both under English and under Scottish law the ability to reallocate a scheme member's pension rights depended on those rights surviving after divorce. In practice this was not the case because of the inalienability of pension rights, that is pension scheme rules provided that a pension was personal to the member of the scheme. A husband could not transfer, and could not be ordered by the court to transfer, any part of his pension rights to his divorced wife.

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[46] Ococupational Schemes 1991, Ninth Survey by the Government Actuary, Table 2.1.

[47] Good Report Para 2.1.51.

[48] Goode Report Para 4.16.1.

[49] Goode Report, see chapter 4.16 , *Pension Rights on Divorce*, for these and subsequent references to the Goode Report and pension rights on divorce.

This situation arose mainly because employers set up pension schemes, and the State encouraged them by giving a wide range of tax reliefs, in order to provide replacement income for the scheme member after retirement. (In other words, pension rights are not like other assets, such as a house or an investment which can be bought and sold.) Nearly all scheme rules provided that pensions rights could not be assigned and might even be forfeited if an attempt was made to do so.

All that the courts could do was to take the value of the pension rights into account when deciding how non-pension assets should be distributed. However, in England the court was not required to do this except where pension rights were payable "in the foreseeable future"[50] and in practice, the meaning of "in the foreseeable future" had been much discussed. The courts were also required to have regard to the value of any benefit, including any pension, that a party to a divorce lost the chance of acquiring.[51] The Scottish law[52] did specifically provide that the value of pension rights were part of the matrimonial property but in neither Scotland nor England was there any guidance on the method of valuation.

There have been many attempts to reach a consensus about law reform in this area as the Goode Report showed by listing them:

- Law Commission, *Financial Provision in Matrimonial Proceedings*, Law Com No 25, 1969
- Occupational Pensions Board, *Equal Status for Men and Women in Occupational Schemes,* Cmnd 6599, 1976
- Law Commission, *The Financial Consequences of Divorce*, Law Com No 112, 1981
- Lord Chancellor's Department, *Occupational Pension Rights on Divorce: A Consultation Paper,* 1985
- Michael Meacher, *Pensions, Couples and Divorce: Consultation Paper*, Labour Party 1990
- Law Society, *Maintenance and Capital Provision on Divorce*, 1991
- Pensions Management Institute (PMI), *Pensions and Divorce,* 1991

[50] Matrimonial Causes Act 1973 Section 25(2) (a) which does not specifically mention pensions although they are assumed to be included

[51] Matrimonial Causes Act 1973 Section 25 (2) (h) - in this case pensions are specifically mentioned but this provision also requires interpretation.

[52] The Family Law (Scotland) Act 1985

- Pensions Management Institute, *Pensions and Divorce*, Report of the independent working group on pensions and divorce appointed by the PMI in agreement with the Law Society, 1993

The last of these reports, by the Pensions Management Institute (PMI), has been much quoted, particularly during the debates during the passage of the Pensions Bill through the House of Lords. Among its recommendations were that the valuation problem should be solved by applying the statutory 'cash equivalent', used at present as the normal basis of individual transfer values payable from one pension scheme to another and that courts should have certain, though limited, direct powers over the trustees (or other authority) of a pension scheme.

The PMI Report examined four ways of reallocating the value of pension rights when divorce takes place before the pension comes into payment:

i) Pension rights continue undisturbed by the divorce but their value is taken into account and any reallocation between the couple is made by adjustment of non-pension assets. According to the PMI Report, although this is possible now, it is not practicable where there are insufficent other resources to set against the pension assets.

ii) Earmarking: pension rights continue undisturbed but a specified amount of whatever benefit eventually becomes payable to or in respect of the scheme member is earmarked for payment direct to the former spouse when the time comes. This may also be regarded as a form of deferred maintenance. According to the PMI Report, it is possible now for a court to make an order contingent on a benefit becoming payable at some future date but it may in practice be avoidable.

iii) Splitting within a scheme: a member's pension rights are reduced by the same amount as would be earmarked but the resources released are used to provide, within the scheme, a package of rights for the former spouse as a separate scheme member. This is not possible now.

iv) Splitting and transfer: a scheme member's pension rights are reduced as above and the resources released are made available to the former spouse in the form of a transfer payment to another pension arrangement. This is not possible now.

The Report favoured the last method and recommended that courts should have power to require the scheme trustees or other authority to reduce the value of a member's pension rights by a specified sum, and to make the sum available to an ex-spouse as a transfer payment to an individual pension contract, such as a personal pension or to another occupational scheme of which the ex-spouse was a member.

The Goode Report endorsed the thrust of the PMI recommendations including the one above. It recommended that further detailed work be done to address this issue and other problems identified by the PMI report. It also recommended that the calculation of transfer values should take account of its own recommendations concerning cash equivalents generally. In making these recommendations, it stressed that it regarded the reallocation of rights on divorce as a special case which should not be extended. The primary purpose of pension schemes was to provide replacement income for scheme members on retirement and pension rights, in being personal to the scheme member, should not be regarded as ordinary assets capable of disposal or seizure by creditors.

2. Divorce: the Bill and Response

The White Paper which preceded the Bill said that there was no clear evidence of the extent of the problem and that a detailed research programme would therefore be undertaken to ascertain the extent of the problem before the issue was considered further.[53] In keeping with this, the Bill as orginally published contained no provisions relating to divorce. It was only after much debate and a Vote in favour of an amendment put forward by Lady Hollis (who led the debates from the Labour benches) that the Government agreed to accept a new clause put forward by Lady Young (from the Government benches) and an amendment to it from Lady Hollis. The new provisions can therefore be seen as a response to the Bill as it originally was as well as forming part of the Bill which is now before the Commons.

The issue of pensions on divorce was raised several times during the debates in the Lords, starting with the Second Reading when Lady Hollis, Lady Seear (Liberal Democrat) and Lady Young announced that they would be taking up this issue, among other issues relating to women. The last in fact spoke at some length.[54] The issue was raised during the Committee Stage: HL Deb 20 February 1995 c918-94, but it was not until the Report Stage: HL Deb 14 March 1995 c727-754 and 838-839, that changes were actually made to the Bill. There was a further debate on Third Reading : HL Deb 21 March 1995 c1188-1195.

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[53] White Paper, Para 1.45.

[54] HL Deb 24.1.1995 c992-994.

At the Committee Stage, the three peeresses already mentioned plus other peers and peeresses, spoke in favour of allowing what might be considered the most far-reaching of the PMI's options, that is of allowing pensions to be split at the point of divorce. The general argument put by Lady Hollis is reproduced below as it runs through the options considered by the PMI Report and set out above but the speeches of both Lady Young and Lady Seear appeared to support these points:

> "In tabling the amendments today, we are asking that the courts shall have a duty to take pension assets into account as part of the financial settlement on divorce and that the courts shall have the power to divide them, override any trustees to that effect and without jeopardising Inland Revenue status. The way that they are apportioned will be determined by the courts at the point of divorce and in the light of the family circumstances. We are providing a duty on the courts to take them into account and a power on the courts as to how they do so.
>
> The PMI Report outlines three basic ways in which the courts might take those assets into account. The first is offsetting; the second is earmarking and the third is splitting.[55] We favour the third suggestion; but perhaps I may enlarge on all three. The first way of taking a pension asset into account is by offsetting. The courts can do that now; that is, they can offset against the pension, which must remain with the scheme member (who is usually the husband) and other assets such as saving or the matrimonial home. The courts can do that now; and very often, all too often, it does not work. Why is that? As the noble Baroness, Lady Young, said there are insufficient offsetting assets and the pension is worth very much more than the rest of the assets put together so that the wife is short-changed.
>
> Alternatively, even where both the material and pension assets balance each other out, immediate assets are being set against long-term assets. Therefore, in order to keep a pension which he may never live to enjoy, the husband is stripped of his short-term assets such as the matrimonial home and savings. Neither party would wish that to be the way forward. Therefore, offsetting does not work although it could continue if there are sufficient assets and that is what both parties want. We have that already but it does not work.
>
> The second route is to earmark so that the pension is divided at the point of retirement. That is uncertain unless one is receiving a pension at the time at which the divorce occurs. What happens when the scheme member changes jobs? Does he carry the earmarking with him to four, five, or six different jobs, with the employer having to make a record of that? What happens if the scheme member dies before he is 65 and the scheme deeds allow a widow but

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[55] ie options iii and iv of the PMI report are run together here by Lady Hollis.

> not somebody who is divorced to be a beneficiary? What happens if there are two or three spouses each with a charge on a pension but not knowing what they will receive or when, so that they have to wait until the age of 65 to know what are their future prospects?
>
> Earmarking merely delays to the point of retirement the financial settlement which should have been made properly at the point of divorce. What most people would like is a clean break so that they can get on sanely and sensibly with the rest of their lives rather than continuing in an on-going financial relationship for 20,30 or 40 years after the marriage has ended.
>
> We have offsetting now and it does not work. Earmarking is messy and chancy and leaves all parties insecure. Therefore, what is the right way forward? As the noble Baroness, Lady Young said, it is to divide pension rights at the point of divorce. That is what the PMI, the Law Society, Goode, Fair Shares and the EOC call for, and I believe that that is what voices call for on all sides of this Committee.
>
> On divorce, the cash value of the pension so far accrued would be calculated precisely as it is now, often several times during a working life, when a scheme member changes jobs and wants his pension rights transferred with him. In other words, in relation to divorce we should be using the well-established procedure which is easily and continually used by scheme professionals and members every time a scheme member changes jobs...."[56]

On Report, an amendment which would have allowed the courts to use all the PMI options was moved by Lady Hollis but withdrawn. Lady Young introduced an amendment which did *not* introduce earmarking by the pension scheme or splitting and according to Lady Young would not be retrospective.[57] Its main purpose would be to specify more fully some of the court's existing powers and, in so doing, it referred to the court's power to make a deferred order. The court would have to take into account any benefits under a pension scheme which a party has or is likely to have in the foreseeable future and the court would also have to take into account any benefits under a pension scheme which a party would lose the chance of acquiring.[58]

Lady Young's amendment is now Clause 150 but it contains an additional element which might significantly change its purpose. Although Lady Hollis withdrew her main proposal, she put forward an addition to Lady Young's which was designed to avoid the situation where the court makes a deferred order but the husband fails to make the payments. Her proposal was

[56] HL Deb 20 February 1995 c922-923.

[57] HL Deb 14 March 1995 c734.

[58] HL Deb 14 March 1995 c732-733.

designed to ensure that instead of the pension fund sending a cheque to the husband each month, from which he is supposed to forward a cheque to his wife, the pension scheme should itself make the payment to the wife so that she would not have to chase him through the courts. In practice, lady Hollis envisaged that the scheme member's record would be flagged and the "flag" would transfer with the scheme member if he transferred to another scheme.[59]

There was a Division on Lady Hollis' new clause, which was accepted by 178 votes to 173 and is now Clause 85. In addition, Lady Hollis moved an amendment with the same purpose but with slightly different wording to Lady Young's proposal. This was accepted by Lord Mackay and is now part of Clause 150. The result may be confusing but, in accepting the second version, Lord Mackay said that he would sort out the wording between the two.[60] The Financial Memorandum to the Bill (see below) suggests that, as currently worded, the Hollis amendments could have far-reaching costs because they would allow pensions to be split on divorce, not just at the time the husband retires as suggested by Lady Hollis' speech.

In response to criticisms that Lady Young's proposals did not go far enough, Lord Mackay, Minister for Social Security, said:

> "What is needed, and what is delivered by the amendments proposed by my noble friend Lady Young, is a means of ensuring that divorcing couples benefit from a wide range of powers already available to the courts for taking pensions into account. It is clear from most of the anecdotal evidence which has been quoted in the House and in the media that pension rights may not always be taken into account in divorce settlements.
>
> That is borne out by the very recently received preliminary results of the research project which my department has commissioned - research which has quite wrongly been represented as being unnecessary. Interviews with a sample of divorced women whose husbands were in an occupational scheme reveal that some two-thirds of the women concerned say that pension rights were simply not discussed during the settlement process..."[61]

Because the divorce clauses are so new, there has been little time for outside bodies to respond. It also seems likely, in view of Lord Mackay's statement that he would be examining the wording of Lady Hollis' amendment and the suggestions made in the Bill's Financial Memorandum that the clauses as drafted may not achieve what was intended (see below), that

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[59] HL Deb 14 March 1995 c 730-1 and 750-1.

[60] HL Deb 14 March 1995 c 839.

[61] HL Deb 14 March 1995 c749.

the provision will be redrafted. It is also possible, as with any clause, but particularly in the case of one covering a controversial issue, that there will be new amendments in the Commons which involve more than mere redrafting.

Lady Young's amendment clearly does not go so far as proposals that the Equal Opportunities Commission, the Pensions Managment Insititute and the group Fair Shares have supported. Fair Shares, a group largely made up of divorced women, which has been actively campaigning for pensions to be split on divorce throughout the passage of the Bill, has welcomed the new provision on the ground that the unfairness of their position has been recognised but argues that, "the only fair solution is to divide all the assets including the pension entitlement at divorce."[62]

The Financial Memorandum to the Bill estimates that clauses 85 and 150 will increase employers' recurrent costs by around £10 million net of corporation tax. It says that the public expenditure costs are expected to include an increase in expenditure on legal aid of around £70 million a year from 1997/98 and that the redistribution of pension rights will produce an income-related benefit savings which will build up over time, reaching £40 million a year by 2010.

The Memorandum also says that, as drafted, the clauses might allow courts to direct schemes to make a payment at the time of divorce or any time thereafter. Tax revenue could thereby be reduced by as much as £300 million a year in the longer term. The extra administation costs faced by public service schemes would be around £10 million a year and these schemes could also be required to pay as much as £500 million a year in transfers from 1997/98 although in the longer term this expenditure would be offset by a corresponding reduction in pension payments. In addition, as drafted, the clauses could be interpreted as encompassing the State scheme, which would lead to extra expenditure from the National Insurance Fund of around £25 million a year by 2010 and additional administration costs of around £10 million a year falling on the Fund from 1997/98.

[62] Fair Shares Briefing 11 April 1995.

3. Residential and Nursing Home Care

Amendments that would give a spouse a right to half the occupational pension of the other spouse when he or she enters a residential care or nursing home were introduced several times during the passage of the Bill through the Lords. They were supported by organisations such as Age Concern and the Alzheimer's Disease Society. Although they were unsuccessful, they are briefly mentioned here as they gave rise to a good deal of interest and controversy and are sometimes considered to raise similar issues to those relating to pension splitting on divorce because of the inalienability of pension rights.

References to the debates are set out below:

- in Committee: HL Deb 20 February 1995 c 960-966
- on Report: HL Deb 14 March 1995 c 759-767 [Division on amendment to allow splitting defeated 159-183]
- on Third Reading: HL Deb 21 March 1995 c1176-1184

Although the relevant amendments were not supported by the Government, Lord Mackay did suggest guardedly that there was some sympathy within the Government for the issue with which the amendments were trying to deal. Lord Mackay's remarks during the debate on this issue on Third Reading which might be taken to indicate some sort of commitment to consider the issue again in future are reproduced below:

> "As the Committee will have deduced, I cannot commend the amendment to the Committee. However, it raises difficult and complex issues. I shall be grateful if any noble Lords care to draw particular cases to our attention. My right honourable friend the Secretary of State for Health is fully aware of the discussion about the problem and is sympathetic to the concerns which underlie it, as I am. That is why I shall be grateful for details of particular cases.
>
> It is important to provide proper support for spouses and for other carers in the circumstances we are discussing. My right honourable friend the Secretary of State for Health keeps under regular review the whole question of the charging system for residential care. I can assure the Committee that this particular issue is one which will be considered as part of that process. I shall certainly draw the attention of my right honourable friend to the discussion we have had today and to any letters which any Member of the Committee cares to send me after the debate." [63]

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[63] HL Deb 20 February 1995 c964-5.

The background to this is that under the National Assistance Act 1948, local authorities are required to charge for the homes in which they place people. In particular, leaving capital rules aside, if the person's income is less than (or the same as) the fees, the local authority takes the whole of the income of the person entering the home *except for* an amount allowed for personal expenses.[64] The amount allowed for personal expenses in 1995-96 is £13.35 which is clearly not enough to support a partner still living in the family home. However, local authorities do have the power to allow a different amount. Guidance issued to local authorities by the Department of Health lists as one example of where local authorities might consider allowing a different amount:

> "Where the person in residential accommodation is the main recipient of the couples' overall income (eg occupational pension), the LA can use their discretion to increase the residents personal expenses allowance in special circumstances to enable the resident to pass some of that income to the spouse remaining at home. In considering this the LA should bear in mind the effects it could have on benefits such as Income Support, Housing Benefit and Council Tax Benefit of increasing the spouse's income (i.e. increasing the income in this way may lead to a reduction in benefits resulting in the spouse being no better off)."[65]

Given that the power to allow personal expenses beyond the £13.35 is discretionary, the question then arises as to whether local authorities are in practice using this power. This question was raised several times during the debates in the House of Lords. On the last occasion, Lord Mackay said:

> "...I gave a clear, unequivocal commitment to the House at Report and Committee stages that I would pass on to my right honourable friend the Secretary of State for Health the points that have been made. She is indeed considering these issues."

He also said that he would be very interested to receive some documented evidence that local authorities have indeed refused to apply their discretionary powers where it would have been appropriate to use them.[66]

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[64] Section 22 of the National Assistance Act 1948.

[65] Charges for Residential Accommodation Guide Section 5, Department of Health.

[66] HL Deb 21 March 1995 c1182.

E. Breaking the Links with the State Scheme [Clauses 124, 128-9 and 134]

1. Background

Individuals have been able to contract out of the State Earnings Related Scheme (SERPS) ever since it was set up in 1978 and until 1988 they could only do so by joining a "contracted-out" occupational pension scheme which provided a salary-related pension. Since 1988 individuals who wish to contract out have had a wider choice over the kinds of scheme that they can join and these include certain money purchase and personal pension schemes. However, it is the former which is most affected by the proposals to break the link with the state scheme.[67]

Schemes do not have to contract-out of SERPS but if they do, employers and employees both pay a lower rate of National Insurance Contributions than they otherwise would. In return schemes have to make certain guarantees, which differ depending on the type of scheme. The Goode Report said that there were roughly 30,000 schemes which were contracted-out, of which 13,500 were salary-related.[68] In the case of the latter, the guarantee means that they must provide a Guaranteed Minimum Pension (GMP) which is roughly the same as the SERPS that the individual foregoes.

For various reasons this GMP may not precisely equal an individual's SERPS entitlement but the individual in a contracted-out salary-related scheme is, nevertheless, guaranteed a pension as good as the SERPS that he or she has foregone. If this SERPS is higher than the GMP, the government pays the difference as a "residual" SERPS payment.[69] In practice, the SERPS is likely to be higher partly because it has to be increased fully in line with inflation whereas schemes did not originally have to increase the GMP at all.

In this sense the contracting-out requirements have retained a link with the State scheme. The decision to break this link was announced in the White Paper in June 1994. The break, as proposed, would mean that the GMP requirement would be abolished and, with it, the State's

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[67] Money purchase and personal pensions do not usually provide a defined pension. The schemes are usually defined in terms of the money paid in and the requirements placed on them for contracting-out purposes are usually realted to the contributions rather than salary.

[68] Goode Report Para 2.3.29.

[69] In practice, the SERPS is likely to be higher partly because it has to be increased fully in line with inflation whereas, originally, schemes did not have to increase the GMP. For GMP rights accrued since 1988-89, schemes have to make increases in line with inflation up to 3% and the government pays the difference if inflation is higher. There are also rules relating to deferred pensions which can result in a "residual" SERPS payment (see section A of this Research Paper).

involvement in underpinning the contracting-out requirements. The Government had issued a consultation document in December 1993 which discussed this as one of several possibilities[70] and before that the Goode Report had considered the issue but had tended to reject it .

The Goode Report argued that the GMP requirements were complicated to comply with and placed a considerable administrative burden on earnings-related schemes. GMPs were also proving to be a stumbling block for schemes that were trying to provide equal treatment in order to comply with European law. This was because existing requirements meant that even if the total pension (and any other benefits) were equal, the GMP and pension benefits in excess of it were unequal because the GMP was linked to SERPS and unequal state pension ages (which are not due to be equalised until 2020[71]).

The Report said that the Committee had had detailed discussions about the suggestion made by the CBI and others that the GMP test should be replaced by a simple quality test such as existed before 1987 (*in conjunction* with the GMP test). It concluded that although this could have the advantage of simplicity for the future, there were two major difficulties. One was the quality standard that would be required to ensure that there would be no losers by such a change. The other was to devise transitional arrangements that, again, meant that no-one lost entitlement for service since 1978 when accrual to SERPS began.

Any form of simplification was likely to either increase the costs of the scheme - costs which would usually be met by employers or the state - or result in the reduction of benefits for some people. A more fruitful line of approach, in terms of simplification, would be improved liaison between the Department of Social Security[72] and pension scheme administrators. There had been many complaints about delays in the DSS and over complex reporting requirements. The DSS should work with major providers and administrators to see where the delays could be cut and reporting arrangements simplified.[73]

The White Paper announced that after taking into account the views offered in response to the consultation which took place after publication of the Goode Report, the link with SERPS would be replaced by a more general test of scheme quality based on requisite benefits which would be defined in legislation and, "will mean that the value of overall future benefits offered by schemes should be superior to those offered by SERPS."

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[70] Department of Social Security, *Occupation Pensions-Discussing the Issues, Paper 5: Alternatives to Guaranteed Minimum Pensions*, December 1993.

[71] See Research Paper 95/47.

[72] that is the DSS's Contracted Out Employment Group.

[73] The replacement of GMPs is discussed in Para 4.18.60 - 4.18.66 of the Goode Report.

Individuals would be either fully contracted-in or fully contracted-out, that is there would no longer be any "residual" SERPS and indexation requirements would no longer be shared between the State and employers. The intended date for the introduction of the changes was April 1997: "GMPs and protected rights accrued before the new proposals come into force will continue to form part of the occupational pensions of those who have earned them, and will broadly continue to be subject to the rules currently in force."

With the links between SERPS and occupational schemes broken, the level of the rebate was likely to be higher than it would be if current arrangments continued. Under these, the rebate was set at a level sufficient to enable salary-related schemes to provide benefits equivalent to SERPS and was currently 4.8% of earnings subject to National Insurance contributions (3% in respect of employer contributions and 1.8% in respect of employees). The actual level in 1997 would depend on estimates and projections made by the Government Actuary in the next quinquennial review.[74]

Following the White Paper another consultation paper was issued in July 1994 specifically on details of a requisite benefits test.[75] This set out ways in which such a test might work and discussed several options. The results of this consultation are now in the Bill and further details will be contained in Regulations.

2. The Bill

During the debates at the Committee Stage in the House of Lords, Lord Mackay, Minister for Social Security, confirmed the objectives of breaking the link with the State scheme set out in the White Paper, that is to simplify the contracting-out requirements and to ease the problems of occupational schemes which were having difficulty in meeting European requirements to provide equal treatment. He also outlined the main provisions of Clause 124 which would replace the GMP test with a requisite benefits test. It would do this by adding new sections to the Pensions Schemes Act 1993 as described below:

> "New section 12A sets the statutory standard which schemes must meet. It requires schemes to provide benefits for earners and their widows/widowers which are at least broadly equivalent to the reference scheme defined by new section 12B. The scheme actuary will be required to certify that this requirement is met.

[74] Proposals for breaking the links with SERPS are set out in chapter 2 of the White Paper.

[75] Department of Social Security, *A Requisite Benefits Test*, July 1994. Other consultation papers were also issued at this time but these were on aspects of the Bill not covered by this Research Paper.

The new section makes powers for regulations to set the criteria for the comparison of scheme benefits to the reference scheme. It also has powers to allow the method of comparison to be explained by a guidance note prepared by a body prescribed by the Secretary of State, such as the actuarial profession. The approach of a mixture of secondary legislation and professional guidance received widespread support during the consultation exercise on the new contracting-out test.

New section 12B sets the benchmark for the reference scheme which must be met by contracted-out salary-related schemes. The benchmark for members' benefits will be based on an accrual rate of 1/80ths - I referred to that on the last amendment - a definition of final average salary and 90% of band earnings (that is, earnings between the upper and lower earnings limit) payable at a normal pension age of 65. The benchmark for survivors' benefits will be 50% of the members' benchmark. This takes account of the response to the consultation exercise and the benchmark has been set at a level which strikes the right balance between the interests of employers and scheme members. The reference scheme has been set to ensure that contracting-out continues to offer an attractive alternative to SERPS.

The section provides powers for detailed requirements for the reference scheme to be set out in regulations. It also contains powers to make additional provisions relating to benefits for widows and widowers. Those will cover exceptions to the general requirements.

New section 12C provides powers to prohibit or restrict the transfer of a liability or the commutation of part of the benefit into a lump sum except in prescribed circumstances. The regulations governing transfers will be used to ensure that liability for the payment of pensions, or in respect of accrued rights to pensions, can be transferred only to appropriately secure arrangements. The intention regarding lump sums is to follow current Inland Revenue limits with appropriate exceptions for public sector schemes. There will be a small effect in the long term on income-related benefit costs, although this will be a relatively insignificant amount.

New section 12D provides a power to prescribe the ages at which benefits become payable in the case of a salary-related contracted-out scheme where members have service which falls after the principal appointed day."[76]

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[76] Lord Mackay, HL Deb 21 February 1995 c 1049-1059.

The Bill also provides for "residual" SERPS to be abolished and for the conditions in which an individual would be able to transfer back into SERPS in conditions of insolvency. The Bill would also abolish the Occupational Pensions Board, whose function it has been (among other functions) to oversee the contracting-out requirements.

The Financial Memorandum to the Bill suggests that there will be savings to business from breaking the links with SERPS due to the higher rebate which is likely to result from the new system although the exact size of these savings will therefore depend on what the rebate actually is. It also says there will be costs as a result of the indexation proposals. The public expenditure effects are more complicated in that there are direct effects but also effects due to the government's role as employer and provider of public service pension schemes.

3. Response (see also the Response in section A of this Paper)

This is another of the Bill's provisions which has been considered to have a particular impact on women. Labour peers expressed opposition to it from the start. For example, Lady Hollis, on Second Reading said that, "we will seek to re-introduce the guaranteed minimum pension within occupational pensions so that poorest members - usually women - do not lose out."[77] In Committee, where most of the debate on this issue was held,[78] Labour peers opposed the clause but did not press it to a Division.

Opposition to the abolition of GMPs rested on the argument that GMPs were guaranteed whatever the reason for the shortfall (eg in the Maxwell case) but that some types of loss would not be covered by the new system and that the new test was a test of the scheme rather than a guarantee to the individual. Lady Castle, who was Minister for Social Security when SERPS was introduced, argued that the Government's ultimate aim was that the State should have no insurance scheme of its own at all and that, "those of us who resist that aim and believe that you cannot provide security and dignity in old age for everyone without the State coming in with its support must rally against this clause in particular."[79]

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[77] HL Deb 24 January 1995 c 981.

[78] HL Deb 21 February 1995 c1045 - 1050. There was also a brief debate at the Report Stage when Lord Buckinghamshire moved a group of amendments designed to provide a choice between GMPs and a requisite benefits test (HL Deb 14 March 1995 c 819-823) but withdrew them.

[79] HL Deb 21 February 1995 c 1047.

Responses from organisations could crudely be divided into two. Those from unions and those representing pensioners tended to be strongly opposed to the abolition of the GMP whereas those from employers and from people concerned with the administration of schemes were in favour of the proposed simplification. Indeed, the CBI was concerned that the GMP for rights already accrued would be allowed to continue as that would mean that there would not be simplification for a very long time. A typical view on the union side was given by Union Pension Services: "What the Government present as simply a technical change to ease implementation of equal treatment is actually an assault on the State's role in providing pensions. It is also likely to mean in the longer-term a significant cut in many people's pensions."

F. Age-Related Rebates [Clauses 125-127]

1. Background

As mentioned in section E above, since 1988 individuals have had a choice over the way that they can contract-out of SERPS (if that is what they wish to do). Self-employed people are not eligible for SERPS so that the option to contract-out does not apply to them. The new options opened in April 1988 include an employer's contracted-out money-purchase scheme or an appropriate personal pension scheme.[80]

In both cases there is a rebate of National Insurance contributions although the way that the rebate works is slightly different in each case. In the former case, employer and employee both pay lower contributions than they otherwise would but the employer has to guarantee to put an amount equal to the amount thus saved into the scheme for it to be invested in order to build up a fund. In the latter case, employer and employee pay National Insurance contributions at the full rate but the government repays part of it (i.e. the rebate) directly into the individual's personal pension plan.

These two types of scheme are alike in their main difference from the salary-related schemes, that is the pension is not related to salary; it is based on the contributions paid in and the performance of the fund in which the contributions are invested. But there are some differences between the non-salary schemes. For example, in order to have the option to contract-out into an employer's occupational scheme, be it a salary-related or a money purchase one, the employee must be in a job where such a scheme is on offer. As far as contracting out into an appropriate personal pension is concerned, the employee can do this regardless of whether there is an employer's scheme or not.

If the employeee is working in an organisation where there is a contracted-out employer's scheme, the employee has to make a choice between the employer's scheme and an appropriate personal pension. If the employee is working in an organisation where the scheme is contracted-into SERPS (and some, albeit a minority, are), the employee can stay in the employer's scheme and take out an appropriate pension just to replace the SERPS. However, in the latter case, it has to be a rebate-only pension, which, as the name implies, is a personal pension in which the contributions are basically only the rebate.[81] (There are other possibilities. For example, an individual could contract-out of SERPS using free-standing additional voluntary contributions instead of an appropriate personal pension.).

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[80] As mentioned in section E these are subject to certain contracting-out requirements which are different from those for salary-related schemes.

[81] Contributions can also include any incentive payment and, in the case of appropriate pensions, the tax relief that is allowed on the part of the rebate relating to the employee's own contributions.

The size of the rebate is set by the government on advice from the Government Actuary. It is supposed to roughly represent the cost of buying a pension equivalent to the SERPS entitlement foregone by an average member of a large employer final pay scheme. Between April 1988 and April 1993 it was 5.8% (of earnings between the Lower Earnings Limit and the Upper Earnings Limit).

Over that period the Government also paid an incentive or bonus, that is an extra 2%, to those who contracted out of SERPS for the first time (i.e. for those who had not already been contracted out for a certain amount of time through their employer's scheme). Currently the rebate is 4.8% and the incentive has also changed. It is now worth 1% to everyone (i.e. not only those contracting out for the first time) aged 30 or over who is contracted out through an appropriate personal pension plan.

At the moment, as nearly all the guides to pensions point out, it is likely to be to the advantage of older people to stay in SERPS or even, if they have contracted out when they were younger, to opt back in.[82] This is basically because it is much harder to build up a substantial pension fund over a short period than over a long period so that, at a certain age, it becomes more likely than the SERPS pension (which is related to "lifetime" earnings not to the size of any particular fund) will be the better bet. The precise age will depend on a number of factors such as the size of the government rebate and whether the employee is a man or a woman (because of the different pension ages for men and women) as well as expectations about returns on investment.

The White Paper announced that the Government intended to introduce age-related rebates for appropriate personal pensions from April 1997 in order to fufil its manifesto commitment to ensure that personal pensions remained attactive across the age range. The White Paper also announced that there would be separate age-related rebates for contracted-out occupational money-purchase schemes.[83] The contracted-out salary-related schemes will continue to entitle employer and employee to flat-rate rebates although the level is likely to be affected by proposals relating to such schemes (see section E of this Research Paper).

On 8 December 1994, Peter Lilley, Secretary of State for Social Security, announced that there would be an upper limit or "cap" of 9% on the size of the rebate. This would probably mean that at some of the ages closest to retirement, it would not be beneficial for an individual to opt out of SERPS. This proposal is explained further in a letter from Peter Lilley to John Butterfill MP[84] which suggests that, in order for the pension at the end to be roughly

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[82] See also Lord Mackay's speech on Second Reading, HL Deb 24 March 1995 c 978.

[83] White Paper Para 3.6.

[84] Letter dated 8 December 1994 which has been deposited in the Library.

equivalent to SERPS, the rebates that would need to be paid at ages close to retirement age would be unacceptably high without the cap. According to estimates published in the Report of the Government Actuary on the Pensions Bill 1994,[85] they could be between 14% and 16% for someone aged 55.[86]

Peter Lilley's letter explained why he believed that the cap of 9% would not bite all that hard in practice, at least not in the long-run. In particular, under provisions contained in the Social Security Act 1986, the value of SERPS is to be progressively reduced and there are provisions in the current Pensions Bill which will reduce the value of SERPS in the future.[87] As a result, the rebate, which is supposed to provide a pension roughly equivalent to an average SERPS, will not need to be so high as it would be under the original SERPS rules. Peter Lilley's letter says that, because of this, in the long-run the 9% cap is likely to be redundant.

2. The Bill

The Bill contains three clauses relating to age-related rebates: one for personal pensions, one for occupational money-purchase schemes and one on the verification of ages. During the debates, Lord Mackay confirmed that as in the case of the flat-rate rebates payable in the case of salary-related schemes, the precise levels of the rebate would be set following a review a review by the Government Actuary. They would be made by order subject to affirmative resolution.[88]

Lord Mackay explained that provision was being made for lower rebates to be payable in the case of occupational money-purchase schemes than in the case of personal pensions. He argued that this was partly to do with the fact that occupational money purchase schemes have lower expenses. As the rebate, when invested, is intended to replace the SERPS that an individual foregoes, it has to be higher where expenses of running the pension are higher. Another reasons was that the rebate on occupational money purchase schemes was paid during the course of the tax year but the rebate on personal pensions was paid at the end of the tax year. This meant that personal pensions lost out in terms of the return on the rebate invested.

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[85] Cm 2714, December 1994.

[86] Cm 2714, December 1994. Appendix C.

[87] See Research Paper 95/47.

[88] HL Deb 21 February 1995 c1056.

3. Response

Like the abolition of the GMP described in the previous section, this was a measure strongly opposed by Labour peers who spoke on the issue but they did not press the case as far as a Division. Lady Hollis made clear Labour's intentions on Second Reading. She said of the Government that, "they propose to raise still further the bribes into personal pensions - at the expense of occupational pensions. This folly must stop. We will seek to amend the Bill accordingly in order to protect people from being bribed by the Government into poverty in old age."[89] In general the debates raised the question of a "level playing field" between different types of scheme and referred to the now well-known problems of people who had been encouraged to contract-out when it was not in their interests to do so.

During the Committee Stage [HL Deb 21 February 1995 c1051-1057] additional concern was expressed from the Labour benches that the Government had skewed pension provision not only against salary-related schemes but against occupational schemes in general. A similar concern was raised at the Report Stage [HL Deb 14 March 1995 c824-832] when the Government was questioned on why it was subsidising the higher cost, and therefore probably less efficient, schemes. The case for a level playing field between personal and occupational money purchase schemes was again made at the Third Reading Stage [HL Deb 21 March 1995 c1184-1188] when the issue of people who had been missold personal pensions was also raised.

Similar issues were raised by organisations commenting on the Bill although there has possibly been less comment on this issue than on some others.

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[89] HL Deb 24 January 1995 c 981.

G. Other Measures

There are several other measures in the Bill which have an impact on the benefits than an individual receives which are not covered in this Paper. Several of the more notable ones are briefly mentioned below.

Deferred Annuities [Clauses 130-132]

Provisions to allow greater flexibility than at present in the purchase of annuities for pension purposes were set out in the White Paper. Details are also contained in the Finance Bill which is currently nearing the end of its passage through Parliament and are therefore not covered here.

In summary, at the moment, in order to qualify for tax relief, annuities have to be purchased at the time of retirement. The White Paper made the point that the annuity rates that happened to rule at the time someone retired could influence the size of the pension. It therefore proposed to allow members of personal schemes to choose when to convert their fund into an annuity provided this was done by the time they reached the age of 75. The White Paper also proposed to allow retired individual who have deferred their annuity to draw sums from their pension although these would be subject to strict annual limits in order to ensure that the fund would still be sufficient to purchase broadly the same pension as it would have done at normal retirement age.[90]

The Finance Bill as published provided for maximum and minimum income withdrawal. In the Bill as originally published, the minimum level was to be 70% of the maximum. However, following representations that this was too high, the Inland Revenue issued a Press Notice on 28 March 1995 announcing that the Chancellor had tabled an amendment for Report Stage of the Finance Bill reducing the minimum income withdrawal amount to 35% of the maximum.

The provisions in the Pensions Bill amend the Pensions Schemes Act 1993 in order to extend the ways in which benefits can be taken from the protected rights in an appropriate personal pension (ie that part of the personal pension fund which is subject to the contracting-out requirements), in particular by allowing payments to be made to the member between his/her 60th and 75th birthday and to enable payments to be made to the member's widow/er.

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[90] White Paper Paras 3.6 and 3.7.

2. Transfer Values [Clauses 136-138]

Under current rules, those who left a pension scheme "early", before 1986 are not entitled to a cash equivalent of the rights that they have built up. As announced in the White Paper,[91] the Bill provides for this right to be extended to them subject to certain conditions.

3. Disputes [Clauses 44 and 140-144]

The White Paper announced that schemes would be required to set up formal internal dispute resolution procedures to consider, and wherever possible, resolve members' complaints. Where internal resolution failed, members would continue to be able to refer cases to the Occupational Pensions Advisory Service (OPAS) or to the Pensions Ombudsman. The Ombudsman's jurisdiction would be extended to cover disputes between employers and trustees and between trustees of different schemes so as to provide schemes with an alternative to court action. [92] The Bill makes provision for these changes.

[91] White Paper Para 1.32.

[92] White Paper Para 1.30.