

Deregulatory Review of Private Pensions

A Consultation Paper

Chris Lewin and Ed Sweeney

March 2007

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Executive Summary

In this paper, we outline some options for possible changes in the DWP's regulatory framework for occupational pensions. Our aim has been to explore the scope for possible deregulation and simplification, so that –

- Pension rights for scheme members' future service should be regulated with a light touch, in order that the regulatory requirements should not discourage employers from having their own pension scheme.
- Schemes continue to be well governed, but with greater flexibility as to how this objective is achieved.
- There should be an appropriate degree of protection for existing accrued pension rights.
- The regulations should become easier to understand.

We should like to stress that we retain an open mind. This paper sets out the proposals that have been put to us, and invites comments on those proposals. It should not be assumed that we will be recommending any specific course of action just because it is discussed here. Similarly, because this is only a consultation document, it would be premature for us to describe or consider the mechanisms for delivering any of the changes that we consider here.

Many of the suggestions that we have reviewed centre on ways to make defined benefit provision more flexible and less expensive for employers. We are keenly aware that many of the regulatory requirements that we have been asked to re-examine were put there to protect the value of the benefits earned in defined benefit plans, and there would need to be strong reasons to remove these protections. However, it has been put to us that if employers are to be persuaded to retain defined benefit schemes for their employees' future service, the costs and risks of those schemes must be reduced. It is also argued that some of the changes under consideration could persuade employers to open new schemes where the employer agrees to shoulder some risk.

We must weigh the cost to members and potential members in those schemes – who may as a result of any changes accrue less valuable provision going forward – against the arguments that the enhanced flexibility will encourage employers to keep defined benefit plans open or provide generous alternatives. As a matter of principle, however, we are reluctant to contemplate any change that would result in a reduction of rights which have already accrued.

The main proposals put to us, and explored in the paper, are that:

- The regulatory framework should be adjusted to facilitate the creation of risk-sharing schemes to arrest the shift into pure defined contribution ("DC") arrangements that leave all risks with the employee;
- As part of that adjustment, employers should be offered the opportunity for more flexibility over managing their liabilities going forwards - restrictions on changing normal pension age, limited price indexation and revaluation should be relaxed, with

safeguards where appropriate. The permitted changes could perhaps apply not only to new entrants but also apply to future accruals of existing members to encourage employers to persevere with remaining Defined Benefit schemes;

- At least part of the regulatory framework should be shifted over time to a more light touch, principle-based approach. An early test bed for this approach could be the disclosure regime;
- Consideration should be given to easing the requirements upon trustees; and
- The arrangements on surplus, employer debt and section 67 should be reconsidered to be more sensitive to the wide range of circumstances that can exist.

Before submitting our recommendations to the Minister (James Purnell), we shall need to know the extent to which there is agreement on the four aims listed above and on the specific possible changes which are discussed here. We therefore hope that every reader of this Consultation Document will respond to at least some of the questions we pose, and will take this opportunity to make the case for their own point of view.

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Introduction

1. In its White Paper *Security in retirement: towards a new pensions system* (May 2006), the Government set out its plans for the reform of State pensions and for the introduction of a new low cost system of personal accounts to give those without access to occupational pension schemes the opportunity to save. Personal Accounts are not intended to replace good existing occupational pension provision, and the Government is clear that employers remain key to successful long-term pension reform.

2. We believe that a commitment to private provision, which has always characterised the UK approach to retirement income, remains important. In order to further that commitment, we must foster an environment where employees receive adequate protection, but where employers and trustees feel that they can plan ahead with some confidence regarding the costs of the provision promised, and do not feel that they are stifled by excessive regulation in the design and administration of that provision. Getting the right balance between these two considerations will be key to successful regulatory reform. In particular, we believe that a commitment to preserving those rights that have already accrued is an important cornerstone of pensions provision.

3. The Pensions Commission suggested in the second report that the continuing shift from defined benefit (“DB”) to defined contribution (“DC”) schemes may result in lower pension saving and a reduction in contribution and participation rates, and that this is being played out against a background of increasing longevity.¹ It is probably time, then, to look again at the framework for private pensions, and to consider whether it is fit for purpose.

4. The White Paper devoted a chapter to strengthening existing provision². In addition to a number of measures now being taken forward in the current Pensions Bill, the Government announced the establishment of a rolling deregulatory review, with the aim of simplifying and reducing the burden of legislation. The Government established an advisory group of external stakeholders to help it identify key areas for early progress, and to map out a programme of longer term measures.

5. On 13 December, James Purnell, the Minister of State for Pensions Reform, appointed us to work with the Advisory Group, building on the initial analysis to produce a report, setting out recommendations for change. Our terms of reference are as follows:

to examine regulation with the aim of simplifying and reducing the burden of legislation governing private pensions,

- *drawing on proposals from stakeholders;*
- *seeking consensus on the balance between member protection and encouraging employer provision of pensions; and*
- *having regard to appropriate legal and other constraints.*

The review will ensure that emerging proposals are based on robust analysis and are coherent. The external reviewers will work with the established advisory group to produce an initial report to Ministers by spring 2007.

6. We have drawn on the work of previous reviewers of the pensions regulatory framework – in particular the reports of Professor Goode in 1993³ and Alan Pickering in 2002⁴ - and we have consulted widely within the pensions industry. The proposals that have been put to us are set out in this consultation paper, together with some preliminary thoughts on some of the ways in which these issues might be tackled. Our work has largely been restricted to the legislation for which the Department for Work and Pensions is responsible and we have not made a detailed study of the legislation relating to the tax treatment of pensions. We are aware of the recent European Court of Justice and High Court rulings on pensions issues, but neither case falls directly within our remit.

7. The present system governing occupational pensions has grown incrementally over the course of the past thirty years. It is now, by common consent, lengthy, complicated and hard to understand. Although each successive layer usually had the aim of protecting scheme members, providing them with additional benefits or reinforcing their rights, there have been unintended consequences, leading to undesirable outcomes. There is little doubt that the weight of regulation, whilst by no means the only cause, has contributed to a belief by many employers that the costs and risks of having their own pension schemes are becoming too great.

8. A trend has been identified whereby employers are closing their defined benefit schemes and replacing them with defined contribution schemes⁵ in order to avoid the costs and regulatory burden of DB provision. DC schemes are not in themselves inherently less valuable than DB provision and they have several advantages, including transparency and portability. On the other hand, concerns have been raised about low contribution levels and the risk profile for employees. We are told that many employers would be more comfortable with an approach that left less risk with the employee.

9. We have therefore approached this review on the basis that a new and less burdensome regulatory system should be fostered from now on, to encourage companies to continue to sponsor occupational pension schemes and even to broaden the coverage of such schemes. This could mean allowing a greater range of promises and approaches. Many schemes will see no need to change design going forward. Others may feel that in order to keep their schemes open, they must incur lower costs going forward. Still others are interested in developing new schemes in which a different promise is made to employees. At the same time, there must be protection for scheme members which is commensurate with the promises made. In particular, we would be very reluctant to encourage schemes in which benefits that have already accrued were not protected.

10. With this balance in mind, and using the Better Regulation principles of proportionality, accountability, consistency, transparency and targeting (Better Regulation Task Force “Principles of Good Regulation” 2003), we have sought to identify a package of proposals. These range from solutions to specific problems which have resulted from the existing legislation and which can be tackled in the short to medium term, through to more strategic concerns such as whether the structure of the legislation can be simplified by basing it to a greater extent on outcome-related principles, rather than detailed prescription.

11. There is, in our view, a real need for action. Barely a week passes without news of another high profile scheme closure. It is also important to recognise, however, that there is also discussion that many employers would be interested in shouldering or mitigating some of the risks inherent in DC schemes. As funding levels rise, there have been reports that employers may revisit their current position, which often results in two tiers of benefits for similarly situated employees. We have been determined to keep an open mind on the proposals that have been put to us by stakeholders so that nothing should be prematurely ruled out. As a consequence, this consultation document outlines some radical potential changes to the regulatory framework. We are looking to stakeholders across the pensions world to help us to understand further the possible impact of these proposals, how far the proposed approach is likely to prove acceptable, and whether alternatives exist that might better achieve the objective of encouraging good employer provision.

12. We would welcome comments on the package as a whole and also on individual proposals. In particular, we would welcome evidence or analysis on the impact of any given proposal on schemes' costs and on members' benefits. We shall take all responses into account when finalising our recommendations. Final decisions on what if any proposals are progressed will, of course, rest with Ministers and Parliament.

13. The independent institutional review, which is led by Paul Thornton, is working to a similar timeline as this review and may propose changes to the institutional landscape. We are keeping in close touch with the review as it develops.

14. Finally, we should like to thank all those who have already assisted us, including members of the DWP's Deregulation Advisory Group, (we have listed all those from whom we have taken evidence in an annex) and the DWP Secretariat of Keith Roberts, Penny Pilzer (on secondment from Lovells), Kim Parsons, Mary Ball and Gabrielle Park. Their work has been invaluable in helping to highlight some of the key issues and to suggest possible ways forward.

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Risk sharing

15. There has been a long term shift away from defined benefit to defined contribution occupational scheme provision in the private sector, which is well-documented.⁶ While closure of DB schemes had been a trend for some time, it appears that the pace has become more rapid since 2000, following the decline in the equity markets.⁷ The evidence suggests that many employers that provide pension benefits in any form are moving to DC provision, whether these are occupational schemes established in trust or personal pension products to which the employer contributes⁸. As a result of this shift, employees are increasingly bearing all of the investment, annuity rate and longevity risk inherent in pensions.

16. Many have suggested that employers would be interested in shouldering or mitigating some of the risks inherent in money purchase schemes, but are unwilling to take all of the risks particular to the traditional defined benefit scheme. They observe that although there are advantages to DC provision, there are issues with the current move to pure DC schemes, such as low contribution rates, two-tiered provision within the same workplace, and the fact that employees bear investment and longevity risk.

17. Stakeholders have urged us to recommend changes to the current legal structure with an eye to encouraging creative approaches to benefit design that would allow employers to once again take on selected risks. They have commented that the current regime discourages employers from mitigating any of the risks inherent in a money purchase arrangement, because any scheme that is not a pure money purchase scheme is treated to the full panoply of regulations developed in the context of the traditional defined benefit scheme. They point particularly to the fact that once a scheme is defined as a non-money purchase scheme, the PPF levy designed for a traditional final salary scheme applies (albeit only to the non-money purchase element). Indexation of pensions in payment and revaluation of deferred pensions are also required for all benefits that are not purely money purchase in nature.

18. Some stakeholders have put forward specific scheme designs that would require rebalancing of current rules for their unique designs⁹. They observe that it would be easier to communicate to members precisely what the benefit promise is if there were several main “types” of plans. Others request that increasingly familiar vehicles, like cash balance arrangements, be catered to more specifically.

19. There seems to be growing consensus that the current framework is unduly restrictive, and that gradations between pure money purchase and a salary related defined benefit plan should be recognised. This could be accomplished either by explicitly recognising some small number of distinct species of scheme, each with its own set of rules, or by a more general freeing up of the “not money purchase” regime so that risks and burdens can be more closely associated.

20. Some stakeholders have suggested that a proliferation of risk sharing arrangements could lead to a pensions environment that is even more bewildering to the member than the present one. Any approach to risk sharing will surely need to have a very strong education and disclosure element. It is crucial that the scheme member is given an effective opportunity to understand the nature of the risks he or she would be running, and how they might affect his or her benefits if he or she were to participate in the scheme.

21. That said, we are interested in exploring ways in which the regulatory environment might be shaped to encourage risk sharing, because if present trends continue, employees may bear all of the risk¹⁰. We are attracted to a system under which the employer's legal obligations properly match the promise made. We are interested in hearing about situations in which there is a mismatch under the present regime. Such problems would need to be avoided in the future if risk sharing is to be seen by employers as effective. For example, we are told that recent case law and common conceptions regarding the definition of an accrued (or subsisting) right could cause benefits that were intended by the employer to be contingent – whether on funding or on some external factor – to be treated as guaranteed by virtue of the application of section 67 of the Pensions Act 1995.

22. We would like to learn how the present system could be made more flexible in order to enable employers to institute shared risk schemes. For example, employers have indicated that the current requirement that all non money purchase schemes provide limited price indexation of pensions in payment discourages many from instituting any scheme that includes a risk sharing element, and particularly inhibits any risk sharing regarding future inflation. Mandatory revaluation and the difficulty of changing normal pension age in line with longevity increases have also been identified as inhibiting factors.

23. We must also consider whether the current PPF framework is fit for purpose so far as shared risk schemes are concerned. The way in which the levy and compensation are calculated rest on assumptions that any DB element of a scheme shares the characteristics of a traditional DB scheme. It may be that both need to be revisited to assure that where the promise differs from the traditional defined benefit promise, both the levy and the compensation in case of default reflect the promise made.

We would like to know:

- 1) Do you consider that the interests of employees will be served by the presence of more risk sharing schemes? What risks do you believe are most appropriately shared?
- 2) Do you believe that employers are interested in supporting schemes in which the risks taken by employers and employees are balanced differently than under traditional money purchase or defined benefit schemes?
- 3) Are you aware of situations in which the present framework has prevented the implementation of an arrangement under which risks were shared between the employer and the member in a novel way? Can you describe what specifically prevented implementation?
- 4) What do you believe to be the main obstructions to creativity in scheme design? Do you believe that they should be removed?
- 5) Would you favour an approach under which specific forms of shared risk schemes are recognised, along with appropriate safeguards, or would you prefer that current regulations be loosened to allow a variety of approaches?
- 6) What challenges do you see in the effective disclosure to members of the nature of the risks they are running and how their benefits may be affected in risk sharing schemes?
- 7) What should the role of the PPF be in risk sharing schemes? Are there changes to the present legislation pertaining to the levy and treatment of schemes on wind-up that would be necessary in order to fairly regulate these schemes?

Three Key Areas

24. We discuss below three key areas identified by stakeholders in which changes might well facilitate the development of risk-sharing schemes. Employer representatives have consistently identified three areas where there is scope to make an immediate and significant difference to the ongoing cost and risk of running an occupational pension scheme. These are:

- Removing the statutory requirement, going forward, to provide indexation for pensions in payment;
- Reducing the cap, going forward, on the required revaluation of deferred pensions, and
- Making it easier for employers to change normal pension age to take account of increasing longevity.

25. The possible changes we have identified could also reduce the risks and costs in traditional defined-benefit schemes where all of the risks are borne by the employer. It is important to ensure that any changes for new schemes do not inadvertently precipitate another round of closure of existing schemes, and we have therefore been considering whether similar freedoms could be extended to existing schemes for future accruals. It has been put to us that these three, separate proposals have, individually or together, the best chance of encouraging employers to persevere with their existing defined benefit schemes.

26. Some stakeholders have suggested that in order to make these proposals attractive to employers that now sponsor defined benefit schemes, employers should be able to apply these changes to benefits earned in the past, as well as those accruing in the future. We are very reluctant to go so far, but include these suggestions below for completeness and in the interest of full discussion of the issues.

27. Even assuming that the changes will only affect benefits earned in the future, these proposals will be controversial, because if employers decide to take advantage of any changes, the savings can only arise from reductions in potential benefits for members. But the balance of advantage for members (existing and future) between an ongoing scheme, with reduced benefits going forward, or a closed scheme and transfer into a potentially significantly less generous and more risky pension arrangement, is precisely the problem that needs to be addressed. On the following pages, we set out the basic proposals that have been made, and our initial reactions to them. All three would require changes to primary legislation.

Limited price indexation of pensions in payment

28. Many employers have proposed that they should have more flexibility in relation to indexation of pensions in payment. These employers observe that the risk of inflation during the period of retirement is one of the risks which the member could most sensibly be asked to bear or share in order to keep the cost of pensions provided at a reasonable level. They say that schemes could devise ways in which members could choose to purchase indexation, as money purchase scheme members may do.

29. Limited price indexation (“LPI”) has been mandatory for all private sector DB occupational pension rights accruing since 6 April 1997¹¹. Prior to that date, there was no general requirement for pensions to increase in payment except where a return of surplus to the employer was contemplated, although contracted-out schemes have had to bear part of the cost of index linking contracted-out guaranteed minimum pensions (“GMPs”) accrued since 1988. Many schemes applied some form of inflation protection to pensions in payment on a voluntary basis, however, and many applied LPI as made mandatory in 1997 retrospectively to all service.

30. We are told that mandatory LPI is one of the major obstacles to the growth in numbers of risk sharing schemes. Some have called for LPI for future accruals to be made optional¹². Others we spoke to were attracted to the Dutch model, whereby indexation is expected, but is paid only in years when the scheme is sufficiently funded. Still others cite Alan Pickering’s suggestion¹³ that indexation even in relation to pensions already accrued could be removed in order to give members greater choice over the “shape” of their pension, provided that the pension in payment reflected the accrued value of the foregone indexation.

31. We have looked at the potential savings to schemes, and the effect on members, of making LPI optional for future accruals. It seems that the savings to schemes would be substantial. First, there is a saving of the income not paid to members, which would play out over time. Second, there would be an effect on the funding expectation for such schemes that could lead to a shorter-term decrease in contribution levels.

32. However, these savings arise from a diminished benefit to the member. The table below shows the impact that the proposal might have on an annual pension taken in 2020 after 5, 10, 15 and 20 years in retirement. The individual in the example is assumed to have been in pensionable service for 30 years in a scheme with an accrual rate of 1/60ths, and to have retired in 2020 at an average salary for a DB scheme member that is assumed to have grown in line with current expectations of earnings growth¹⁴. (We assume that indexation has applied to his pension only when mandatory – at up to 5% for accruals from 1997-2005, and at up to 2.5% from 2005 - 2008.)¹⁵ We assume future inflation in line with HM Treasury assumptions. Assuming that this member lives for twenty years after retirement, the savings to the scheme, and the cost to the member, would be £28,800 in 2008 prices.

Retiring in 2020	Annual income under current regime	Annual income if LPI ceases for accruals after 2008
On retirement	£24,790	£24,790
5 years after retirement	£27,430	£26,120
10 years after retirement	£30,430	£27,650
15 years after retirement	£33,850	£29,400
20 years after retirement	£37,740	£31,410

Note: DWP estimates. All figures are in cash terms and rounded to the nearest ten £.

33. The benefit to the member of LPI applied for all accruals is quite clear. If no provision for inflation is made, those living long into their retirement will have a much less valuable pension in their later years. New employees, who potentially would have no LPI protection whatsoever (because all of their benefit would accrue after 2008) would need to be made fully aware of this risk, and it may be that safeguards – such as allowing DB members to purchase inflation protection, or to take lower pensions at the outset that rise with inflation, as DC members can do – will be required if LPI is to become optional rather than mandatory.

34. We should note that some stakeholders have suggested that the application of differing levels of inflation protection for benefits accrued at different times (1997 -2005 with a 5% cap, 2005 to, potentially, 2008 with a 2.5% cap, and optional thereafter) is cumbersome and difficult to administer. These stakeholders have suggested that LPI be made optional for past as well as future accruals. We do not favour an approach that would cut back on rights accrued as a result of past service, and therefore would not favour this approach, but mention it here for completeness.

35. Of course, current pensions in payment would not be affected by any of the possible changes to LPI discussed above.

We would like to know:

- 1) How likely are schemes to remove the promise of LPI for pension accruals going forward if they were allowed to do so?
- 2) Would employers be more likely to continue defined benefit plans if LPI were made optional?
- 3) Would employers be more likely to establish risk sharing schemes if LPI were made optional?
- 4) Do you have any information on the impact that optional LPI would have on scheme costs?
- 5) Are there particular approaches to LPI (see paragraph 30) that appeal to you? Why?
- 6) Do you believe that the cost savings to pension schemes if LPI is no longer mandatory outweighs the reduction of benefits to members?

Revaluation of deferred pensions

36. Many employers have also suggested that revaluation of deferred pensions is an area in which the members of defined benefit schemes could take on more risk in order to decrease the cost of provision and thereby continue in DB schemes. There are many early leavers, that is, members who are no longer active members of defined benefit schemes, usually because of a change of employment. The most recent GAD survey puts the estimated total number of private sector preserved pension entitlements in defined benefit schemes in 2005 at 5.23 million.¹⁶

37. Revaluation of the pension entitlement of early leavers prior to retirement age has been required in some form since 1986. Currently, Part IV, Pension Schemes Act 1993 requires that the pension entitlement be revalued in line with the retail price index, capped at 5% until the benefits are taken or the early leaver reaches normal pension age.

38. Some stakeholders believe that the 5% cap may be higher than is appropriate. At the time revaluation was introduced, inflation was considerably higher than it is now. Stakeholders have also observed that as a matter of consistency, the same rate should apply to revaluation of deferred pensions and rises to pensions in payment. Currently, indexation of pensions in payment is capped at 2.5%, whereas revaluation of deferred pensions is capped at 5%. However, few have called for removal of revaluation requirements altogether.

39. Revaluation prevents erosion of pension value due to inflation up to retirement. Some stakeholders fear that members will be reluctant to leave their employment if their deferred pension would devalue over time, and that labour mobility would decline as a result. They observe that it will be more difficult to convince younger people to value pensions earned early in their working lives if those pensions are known to devalue. These reasons may have influenced Alan Pickering's conclusion that revaluation on some basis should be continued, even as he recommended abolition of LPI on pensions in payment.¹⁷

40. The effect of revaluation on the benefits available to the member on retirement is quite striking. Let's look at what the effect would be on a member who joins a DB scheme in 2005 at age 30, accrues at 1/60th for ten years before leaving in 2015, and then retires 25 years later at age 65 in 2040.¹⁸ His annual pension income (based on a salary of £38,990¹⁹ when he left the scheme) would be (in cash terms):

- £11,810 per annum under the current system (revaluation capped at 5%);
- £11,020 per annum if revaluation is capped at 2.5% from 2008;
- £7,140 in the absence of revaluation for accruals from 2008, and
- £6,500 in the absence of any revaluation at all.

41. If a member continues to participate in a final salary scheme, inflation protection is likely to be afforded through rising wage rates. However, unlike DC members, the pension benefits of DB members earned early in their working life have a potential to erode in value significantly where the member leaves service because the revaluation is in line with prices (of up to 5% per annum) rather than the person's pay²⁰.

42. Cost savings to schemes are once again difficult to quantify, and as with LPI, they relate directly to the reduction in benefit to members.

43. We should note that some stakeholders have suggested that the application of differing levels of revaluation to deferred benefits during different time periods is cumbersome and difficult to administer. These stakeholders have suggested that the same (presumably lower) rate of revaluation be applied over the entire period of deferment. We do not favour an approach that would cut back on rights already accrued, and therefore would not favour this approach, but mention it here for completeness.

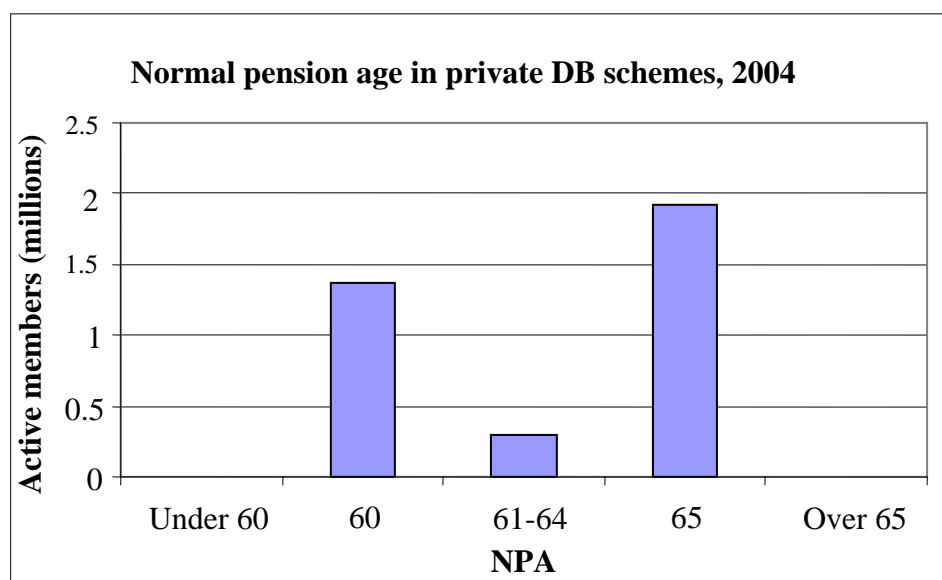
We would like to know:

- 1) How likely are schemes to implement a reduction in revaluation if the cap on mandatory revaluation is reduced for accruals after 2008?
- 2) Do you think that reducing the cap would maintain a fair balance between stayers and leavers in defined benefit schemes?
- 3) Do you think that a reduced cap would have a significant impact on labour mobility?
- 4) Do you have any information on the impact that this change would have on scheme costs?
- 5) Would there be any impact on long term funding strategy if liabilities are measured based on a 2.5% cap?
- 6) Would employers be more likely to continue defined benefit plans if revaluation is reduced?
- 7) Would employers be more likely to implement risk-sharing schemes if the cap on revaluation is reduced?
- 8) Do you believe that the cost savings to schemes that would result from reduced revaluation outweighs the loss of benefit to members?

Normal pension age

44. In its first report the Pensions Commission noted that average male life expectancy at 65 had grown from 12 years in 1950 to an estimated 19 in 2004, and is projected to rise to 21 by 2030 and 21.7 by 2050²¹. Of course, life expectancy does not apply equally across all sectors of the population, and those who earn less tend to live less long²². However, the general trend towards longer lives is thought by many to require longer working lives for most.

45. The Commission observed that the response to the demographic challenge posed by rising life expectancy and falling birth rates should include a rise in average age of retirement, a development which it observed was already in progress²³. The trend towards a longer work life has been addressed to some extent in the rise in age of entitlement to state retirement benefits, scheduled to begin in 2024. Most private provision, however, continues to operate by reference to a normal pension age (“NPA”) set when life expectancy was considerably lower. Currently, as shown below, NPA tends to cluster at ages 60 and 65 for most defined benefit schemes in the private sector.²⁴



46. Some employers have observed that as a result of the increases in life expectancy, the value to the member and the cost to the employer of defined benefit provision have grown to levels not anticipated even a few years ago. They propose that measures be taken that will allow NPA to rise, and that any rights accrued in respect of earlier NPA be adjusted accordingly²⁵.

47. Many schemes have raised or are considering raising NPA²⁶. Under current law, such an adjustment can normally be made only for future accruals. Members will accordingly have accrued benefits in relation to one NPA for one period of employment, and in relation to a later NPA for subsequent pensionable employment. Other trustees and employers are considering offering incentives to members in order to obtain their consent under section 67 Pensions Act 1995 (which governs changes to benefits attributable to past service) to changes to NPA covering both past and future service. Neither approach is ideal from the point of view of clarity, efficiency or fairness.

48. The National Association of Pension Funds (“NAPF”) has proposed that legislation be introduced to allow schemes to adjust NPA in accordance with future rises in a longevity index that could be established by the Government or devised by the scheme actuary. Any future changes to NPA would be effective for the entire period of scheme membership. Certain safeguards are recommended, for example, that those within ten years of the NPA established prior to the rise would not be affected and would retain the earlier retirement date²⁷.

49. Proponents of gradual adjustment of NPA for all service in line with increasing longevity point out that the actuarial value of the benefit would remain more or less constant because the income is expected to be paid over a more or less constant period of time, albeit later.

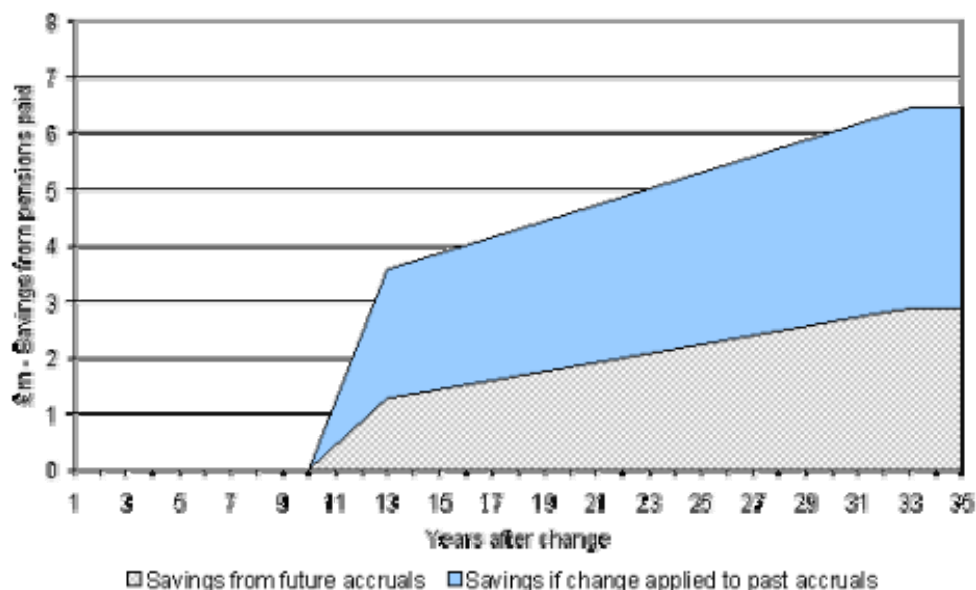
50. Others have suggested that recent past rises in projected longevity might also justify raising NPA for past as well as future service, subject to safeguards to protect members nearing retirement age. Suggestions have ranged from:

- allowing schemes to re-set the NPA immediately at a level reflecting past changes for all past service, subject to safeguards similar to those described by NAPF, to
- allowing schemes to not only re-set NPA now, but to also allow gradual changes to NPA going forward based on rising life expectancy, to
- simply exempting all changes to NPA from both the procedures required under section 67 Pensions Act 1995 and restrictions imposed by scheme trust deeds and rules.

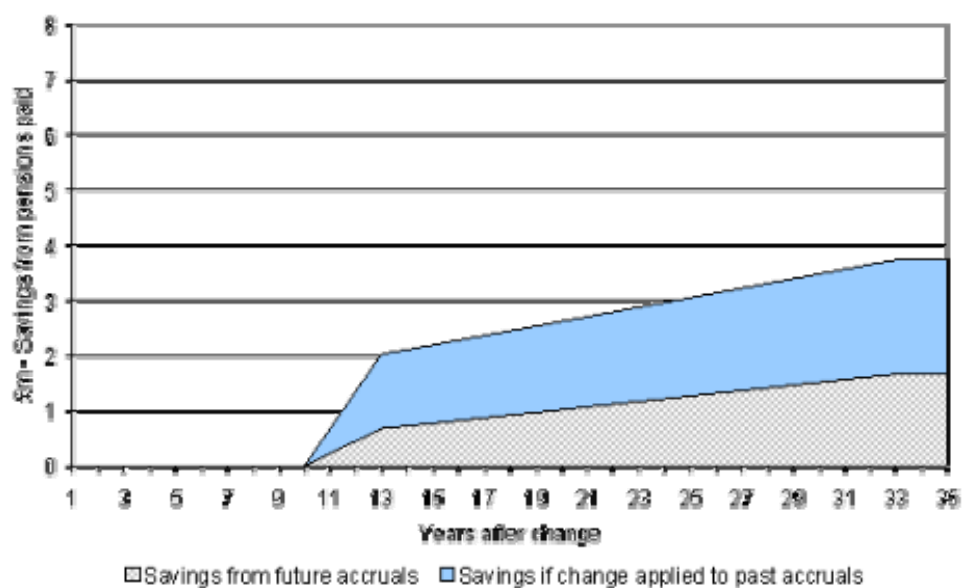
51. The costs and benefits of the various proposals are difficult to ascertain. For any given scheme, cost savings will be dependent on demographics and the level of protection afforded to those nearing retirement. If scheme members continue to work longer as a result of the changes in NPA, eventually savings to schemes will be offset by the additional benefits accrued.

52. Overleaf we try to explore the financial effect over time on a “UK average” scheme and a mature scheme, each with 5000 members, where NPA changes from age 60 to age 65. For each scheme, we assume that members within ten years of the prior NPA (age 60) will be protected from the change and will retire at age 60, that all other members take their retirement at age 63 and that all live on average, to age 85. We assume that the reduction for early retirement is at 5% of the member’s pension per year. Because some stakeholders have requested that changes in NPA apply to rights attributable to past as well as future service, we break out the scheme-level savings to show where they would come from on this basis.

UK average scheme²⁸



Mature scheme²⁹



53. We can see that although savings would accrue as a result of the change so long as employees continue to retire earlier than NPA, they level off over time. As employees extend their working lives, and retire closer to age 65, the savings would diminish because members will earn more pension benefit, payable further down the line. Since the change only applies to those members who are 10 years or more away from retirement at the old NPA, scheme savings only begin 10 years after the initial change has been introduced. Savings are much less for a mature scheme, where there are a larger number of members with pensions in payment (or within ten years of the earlier NPA) who would not be affected by the changes.³⁰

54. The impact on the employee who does not continue to work to the new normal pension age is clear. An employee currently earning the average level of income for a member in a DB scheme³¹ and participating in a DB scheme who retires at age 63 in 2020 from a scheme in which NPA has been moved from age 60 to age 65 would receive as initial pension income (once again assuming a 5% per year reduction for

early retirement):

- £15,171 if NPA has been changed in respect of all service;
- £15,733 if NPA had only been changed in respect of service after 6 April 2008; and
- £16,086 if NPA had remained at age 60.

55. We are open to further submissions on changes to NPA, but at this point are reluctant to go so far as to recommend changes that would result in reductions to rights which have accrued during past periods of service. Enabling changes to NPA in respect of past service in any of the ways suggested would be unsettling and costly to members. As a practical matter, an override to present provisions in section 67 of the Pensions Act 1995 and in most cases to the language in scheme documentation would be required. We are aware that such overrides have sometimes been used in the past in order to allow schemes to be administered in accordance with the law – but not in circumstances where member benefits are being diminished (see discussion below regarding statutory overrides).

56. We are curious, however, to know whether we should consider making a rising NPA for accruals going forward easier. We are interested in hearing more about the advantages and disadvantages of an NPA set to a longevity index, whether set by the scheme actuary or on a national basis. We would like to hear whether stakeholders believe that a modification of the present provisions under section 67 Pensions Act would be necessary or desirable even if the change to a “floating” NPA was effective as to prospective accruals only (for example, in a new scheme).

57. We are aware that there could be a knock-on effect for the calculation of the PPF levy and the treatment of schemes in wind-up as well, and are interested in comments touching on these points.

We would like to know:

- 1) Do you believe that an NPA set to a longevity index is feasible (leaving aside any application to past accruals)? Why or why not? What changes to present laws and procedures would be required?
- 2) If you believe that an NPA set to a longevity index is feasible, would changes to present regulation of pensions be necessary? What changes would be required?
- 3) Do you believe that established pension schemes should be allowed to set NPA to a longevity index, or to change NPA, in regard to the entire period of scheme membership? Why is this your view?
- 4) If your answer to question (3) is “yes”, should there be statutory protection for members in respect of these changes? What sorts of protection would be appropriate? For example, should members nearing retirement be allowed to keep a lower NPA?
- 5) If your answer to question (3) is yes, would this be only under particular circumstances? What circumstances? Should a rise in NPA be allowed even for schemes that are closed?
- 6) Do you have any information on savings and costs in relation to your responses to the questions above?

Legislative override

58. Employers, and in some cases trustees, have asked us to consider whether overriding legislation should be passed that would enable them to take advantage of any new flexibilities offered, thus perhaps avoiding the scheme being closed. Our attention has been drawn to the number of schemes that have been unable to take advantage of the change to the cap on LPI for pensions in payment in the Pensions Act 2004 because provisions in their trust deeds and rules make such changes difficult or impossible. We are reminded that LPI and the former cap were often inserted due to overriding legislation in the first place.

59. Employers that sponsor schemes that contain language limiting changes even to benefits accrued in the future argue that they are put at a competitive disadvantage due to language placed in their schemes for historic reasons, or even by accident. They request that the playing field be levelled by giving the employers and/or trustees of such schemes the same power of amendment contained in most pension schemes.

60. In addition, there are substantial impediments to changes affecting rights attributable to past service, which some employers have asked us to examine. Most trust deeds and rules include language that would preclude changes to accrued benefits. Of course, where accrued benefits may be affected, procedures under section 67 of the Pensions Act 1995 also normally would be required (see discussion of section 67 below).

61. We are aware that overrides to the provisions of trust deeds and rules can disturb the balance of power between trustees and employers in unintended ways. We are also aware that even provisions limiting changes to future benefits are sometimes there quite deliberately, as a result of negotiations related to the sale of the employer. Finally, we are aware that statutory overrides to scheme documentation and section 67 have not in the past been granted in order to allow the exercise of discretion to reduce accrued or future benefits.

62. However, the question of statutory override has been put to us sufficiently frequently that we believe it worth examining. In particular, even if there are doubts about the practicality and lawfulness of a general override (for example, applying to any change to benefits accruing in the future), there may be a case for overrides in more particular circumstances (for example, to allow the scheme to reduce indexation for pensions accrued in the future). Of course, the wider implications of any such override, such as any effect on human rights or the problems around any proposal for retrospective effect would need to be considered in detail. But at this stage we would like to gauge interest via responses on the possibility of any such legislative override.

We would like to know:

- 1) Would a statutory override to provisions in scheme trust deeds and rules that prevent changes to rights attributable to future service be appropriate? If it would be appropriate only in some circumstances, what would those circumstances be?
- 2) Do you believe that a statutory override to provisions in scheme trust deeds and rules that would prevent changes to rights already accrued would be appropriate? If it would be appropriate only in some circumstances, what would those circumstances be?
- 3) What form do you think any appropriate statutory override should take?

The Framework for the Regulation of Occupational Pensions

63. We have also discussed with stakeholders the possibility of introducing some other significant changes in the regulatory framework. While these proposals, discussed in more detail below, may appear less dramatic than the focused changes outlined above, they are, in our view, equally important to the overall aim of encouraging occupational pensions. If implemented they would make the regulatory framework easier for everyone to understand and would remove some of the disincentives to being a pension scheme trustee.

Principles based regulation

64. In 1993 the Pensions Law Reform Committee recommended “there should be a move towards more general statements of principle in primary legislation and a reduction in the amount of detailed prescription”. The Committee said it was “better to have a relatively small number of rules which are vigorously enforced than a proliferation of regulations which are regularly broken....”.³²

65. In 2002³³ Alan Pickering followed this up by recommending a more principles-based approach to pensions regulation whereby four principles sat “at the top” of the new Pensions Act, the supporting legislation being mainly purposive in nature³⁴. A regulator would issue a small number of codes of practice, and prescription would be used only where necessary and appropriate. Greater reliance would be placed on the exercise of judgment by pension professionals.

66. When drafting subsequent pensions legislation, consideration has been given to adopting a principle based approach. However in practice it has been difficult to achieve. Stakeholders report that this approach has been successfully achieved in relation to the member-nominated trustee requirements³⁵.

67. Many stakeholders have observed that this approach continues to have a great deal of appeal, and have questioned whether the time has come to look at these recommendations afresh. They note that the approach is currently meeting with approval in the press and is given some of the credit for the perceived primacy of London’s financial markets. We believe that it is appropriate to explore whether and how a principles based approach might apply to pensions.

68. Of course, principles based regulation means different things to different people. We see it as less prescription in rules (primary and secondary legislation), the focus being on outcomes having regard to the principle concerned, rather on than the process for achieving that outcome. It may look therefore like less law, less complex law or differently formatted law, or a combination of the three.

69. The enhanced freedom and flexibility said to result from a principles based approach is attractive, but some stakeholders are sceptical. They point out that the principles based approach, properly conceived and executed, results in uncertainty, and less safety for decision makers. The regulated community must exercise its own judgement more frequently, with an eye to the regulating bodies’ desired outcomes, rather than following a prescribed mechanism. This transition may require a change in skill sets and levels of knowledge and understanding on the part of trustees and their advisers. Some argue that important safeguards for members will be lost altogether where the approach is less prescriptive regarding those safeguards.

70. On the other hand, it has been observed that clear principles may provide better protection for members than labyrinthine rules through which a way could be found to evade the intention of those rules. These stakeholders observe that the interaction between primary legislation, secondary legislation, codes of practice, guidance notes and pension scheme rules currently creates uncertainty, and that schemes are incurring large fees for professional advice in order to provide such certainty as exists. Some suggest that a contribution towards principles based regulation could take the form of replacing the present Codes of Practice with guidance, which can be equally helpful in terms of gathering the strands of primary and secondary legislation, while having a less heavy-handed effect from a legal point of view³⁶. Member protection is often better gauged by an employer or scheme administrator, and they could benefit from a less prescriptive, more tailored approach.

71. The behaviour of the regulatory authority would also need to change. There are costs attached to this change, and potential problems as well. For example:

- The regulatory authority could become responsible for setting all or some of the principles, possibly subject to Secretary of State approval. Some stakeholders fear unless enforcement capability was separated somehow the regulator could possibly set and enforce its own agenda independent of statutory limitations.
- The ability of the regulatory authority to bring an enforcement action based on breach of a principle rather than breach of a specific rule may expose schemes to the danger that a standard will be retrospectively applied
- The dialogue between the regulatory authority and the industry would change from discussion about compliance with the statutory rules towards discussion on the practicalities of achieving desired outcomes
- There is likely to be a need for more guidance at the outset to enable the regulated community to understand the standards expected and the ways the principles might be implemented in practice.³⁷

72. The transition would mean that substantially more resource would need to be committed to the regulatory authority, at least while the principles are developed and implemented. There could be a knock-on effect to the administrative levy.

73. There may still be a need for detailed regulation in some areas. It has been suggested that in suitable cases the regulations could be time bound and replaced by principles subsequently. If detailed regulations are replaced by principles there may be concern that this might necessitate a complete re-examination of the scheme rules. However, this should not be necessary where the scheme rules already comply with the detailed regulations which are being replaced.

74. We believe, despite these difficulties, that it may be time to test the waters by adopting a principles based approach in certain areas of pensions practice. Areas suggested as particularly ripe for this approach include disclosure, preservation and transfer, and protection for accrued rights (see questions regarding section 67 below).

75. We are interested in hearing views on whether it is time to apply a principles based approach, either to the entirety of pensions regulation, or to some of it.

We would like to know:

- 1) Do you think a principles based approach would be appropriate for pensions regulation? Why or why not?
- 2) Are there particular areas of existing legislation that you consider particularly suitable for a principle based approach? If there are, why?
- 3) Do you believe there would be cost savings arising from a principles based approach? To whom would they accrue?
- 4) What steps could be taken to allay concerns about the lack of certainty that is inherent in a principles based approach?
- 5) Do you believe that a principles based approach will have any impact on member protection? If so, would this impact be positive or negative?
- 6) What impact do you consider this may have on the running costs of the regulatory authority?
- 7) If a principles based approach were adopted do you think there would be a continuing need for codes of practice and guidance notes to supplement primary and secondary legislation?
- 8) What impact do you consider this may have on the levels of skills, knowledge and understanding of trustees, employers and their advisers?

Disclosure

76. The desirability of simplifying and consolidating regulation dealing with disclosure to members has been touted for some time. The Pensions Law Reform Committee commissioned research³⁸ that found widespread ignorance amongst members about details of their scheme and a perception that much of the information provided was “gobbledegook”. Alan Pickering noted that communications to members needed to be more focused and recommended that regulation of disclosure be principle based.³⁹

77. In September 2005 DWP consulted on amendments to the Occupational Pension Schemes (Disclosure of Information) Regulations with a view to simplifying these. After publication of the White Paper in May 2006, James Purnell, the Minister for Pensions Reform announced that a more radical review of the regulations was in order and that DWP would look again at the broader framework of regulation, to deliver a more comprehensible, rational and directed approach.

78. The burdens imposed by the disclosure requirements have been raised during our meetings with stakeholders. Allowing schemes a greater degree of flexibility to design bespoke disclosure arrangements, within boundaries, may benefit members. In addition, concerns were expressed about the discrepancies in the disclosure requirements for occupational and contract based schemes. It was felt that both regimes could be harmonised and be made less prescriptive.

79. We have been exploring ways to put these thoughts into practice and we feel that a principle based approach may work in this area (see earlier discussion on principles based regulation) A principle could be expressed at a high level, for example

- The trustees shall provide reasonably up to date information about benefits and contributions (including any detrimental changes) to all members automatically and in a timely way.

The principle could be extended to give a right for members to have access to all or some scheme documents.

80. Alternatively the legislative requirements could be more detailed in which case they might be expressed as follows:

- The trustees shall provide to all members within a reasonable period such information as they consider relevant about how the scheme works and the benefits it delivers. In particular, this information shall cover:
 - the level of contributions payable by the member and the employer
 - the type of benefit payable under the scheme, and how it is calculated
 - the scheme’s normal pension age
 - survivor’s benefits.

81. Or the principle might be more outcome focused, in line with Alan Pickering’s recommendations, for example

- The trustees shall provide information as and when required aimed at influencing the behaviour of prospective or new members to enable that individual to decide whether to join, stay or leave a scheme.⁴⁰

82. Any of these approaches would be less prescriptive than the current regime, and would allow trustees to consider whether and when less may be more in terms of enhancing members' understanding. Timing of information could also be more customised.

83. There may be some areas in which a more prescriptive approach will better safeguard beneficiaries. Some have suggested that trustees should have a statutory responsibility to encourage or require the member to consult his spouse or civil partner about their benefits under the scheme, including the absence of rights where applicable. Others have noted that a degree of prescription may be necessary in order to comply with European Union directives, for example the IORP directive.⁴¹

84. We are concerned that where non-money purchase benefits are not guaranteed by the employer in a risk-sharing scheme, an extra level of disclosure may be appropriate. The member must be fully apprised of which benefits are and are not guaranteed. If the guarantees attaching to benefits change within a traditional DB scheme (for example where a risk-sharing or targeted approach is taken going forward), then it is essential that accurate and effective information reach the member prior to the implementation of such changes.

85. We are also particularly interested in information presented about options at retirement. We are deeply concerned that some members currently retiring from defined contribution occupational schemes may not be getting adequate information about the (often significant) extent to which they could improve their pension position by using their open market option to "shop around" for the best pension option. We are aware that HM Treasury and the DWP are currently conducting a review around the operation of the open market option that builds on the work undertaken by the FSA to increase the financial capability of consumers⁴². In the meantime, we would be interested in your views as to whether the trustees should be given a statutory responsibility to ensure that such information is effectively provided at retirement.

We would like to know:

- 1) Do you think that a principles based approach to disclosure would work?
- 2) If the answer to question (1) is "yes", do you feel that any of the approaches outlined above (or an alternative to those approaches) would be most appropriate and why?
- 3) If the answer to question (1) is "no" are there any other changes that should be made to improve the current disclosure regime?
- 4) Do you think there are circumstances in which members and/or trustees should be required to consult with or get the permission of spouses and civil partners – for example, where changes to scheme rules reduce their contingent benefits, or when the member is choosing a single life pension?
- 5) Do you agree that there are particular disclosure issues in relation to risk sharing schemes? How should these issues be handled?
- 6) Do you think that trustees should be required to provide more information at the point of retirement? What sorts of information should they provide?

Trustees

86. Anecdotal evidence suggests that some schemes are encountering difficulty recruiting trustees, although there is no evidence as yet that this is translating to high trustee vacancy rates.⁴³ Reasons given for increasing difficulty include conflict of interest, concerns about taking on personal liability and the burdens associated with the current trustee knowledge and understanding curriculum of the Pensions Regulator.

87. Concern about conflict of interest has caused members of employer finance teams to resign from the board of trustees. Stakeholders point out that the company's interest and the interests of the scheme's members are not identical, and that the ways in which those interests may conflict when scheme funding is under discussion has become more obvious. Therefore some individuals do not believe that they can exercise their fiduciary duty to both at all times. Some stakeholders report that this has had a negative impact on the effectiveness of trustee boards.

88. Concerns about personal liability have also been voiced. It is observed that there are gaps in indemnity coverage and that not all schemes provide for such coverage from scheme assets. Schemes are no longer able to provide indemnity coverage for liabilities arising from investment functions, or for criminal fines and regulatory penalties⁴⁴. Moreover, indemnities from insurers are likely to be of specific duration, and from employers are dependent on the financial strength and continuation of the employer. Potential trustees are sometimes concerned that even if they are eventually found to have acted properly, and are indemnified, they would still have been required to front costs for their defence.

89. Trust deeds are still permitted to offer exemption of trustees from liability except in the circumstances for which indemnity is not available, but many schemes do not include an exemption clause. It has been suggested that such an exemption, or even a wider one, be available to all trustees by statute. Any exemption from liability would exclude dishonesty and serious acts of negligence, bearing in mind that there is no concept of "gross" negligence at English law. On the other hand, some stakeholders have raised concerns about exemption because where an exemption clause operates there is no source from which the scheme or its members can be compensated for any loss caused by a trustee's breach of duty. Stakeholders have also commented on the fact that in practice the need for indemnification should not arise where trustees have acted reasonably.

90. Stakeholders have pointed out that individuals who might otherwise consider volunteering are sometimes discouraged by the trustee knowledge and understanding regime introduced by the Pensions Act 2004⁴⁵. This requires every individual or corporate trustee to be conversant with their scheme documentation⁴⁶ and have an understanding of the law relating to pensions and trusts, funding and investment of scheme assets and any other matters prescribed. Other stakeholders report no real change and have said that trustees were required to have this knowledge and understanding under trust law.

91. It is said that potential trustees may often have specific expertise that would be useful to the trustee board as a whole, but they are put off by the need to have to learn about all the required aspects in order to sit on the board. Some stakeholders have suggested that as long as the trustee board as a whole has sufficient knowledge, experience and understanding (in the same way as a company board operates) this should be sufficient.

92. Concern has been expressed that moving to a principles based approach to regulation will extend the skill sets and levels of knowledge and understanding required of trustees, as greater reliance will be placed on the exercise of judgment rather than following a prescribed route (see discussion on principles based regulation).

93. The Labour Party manifesto in 2005 included a commitment to increase the number of member nominated trustees for each scheme to at least half. The current rules require at least one third of trustees to be member nominated. The Secretary of State has power to make an order increasing the number to at least half.⁴⁷ We are interested in hearing your views on the impact these concerns may have on this commitment.

94. We are interested in hearing your views regarding whether these concerns are legitimate and whether, if they are, changes should be made to mitigate them.

We would like to know:

- 1) Is it more difficult to find and retain suitable volunteers for trustee positions? If so, why do you think this is the case?
- 2) If conflict of interest is an issue, do you believe that conflicts are inevitable, or are there specific aspects of regulation that are causing individuals to be needlessly concerned that they may be compromised?
- 3) If personal liability is an issue, are there steps that could be taken under the law that would protect both the trustees and the members' interests? Would a statutory exemption of trustees from all or most liabilities incurred in the course of their functions be advisable?
- 4) Do you believe that the current focus on trustee knowledge and understanding is discouraging individuals who have valuable expertise from volunteering to serve as trustees?
- 5) Would your answers to any of the above questions depend in part on whether the trustee involved is a professional trustee, paid for his or her services to the scheme?
- 6) What would the impact of any change in this area be on scheme liabilities?
- 7) Do you think moving to principles based regulation would have an impact on retaining or recruiting trustees?
- 8) What bearing do your views in relation to the above bring to the proposal that at least 50% of trustee boards should be member trustees?

Technical Proposals

95. Inevitably, in such a complex area, discussions with stakeholders have also flushed out a host of individual issues that could be addressed. We have not had time to address many of these in detail. However, we are sharing the issues raised with the Department. A list of issues that have been submitted for our consideration, but which we do not address in detail below, is attached as Annex B. Below we set out some of the key technical issues as we see them, and invite comments on whether these are priorities for action, or whether indeed there are other areas where action should be taken.

Return of surplus to the employer

96. From 6 April 2006, legislation⁴⁸ has allowed trustees to authorise payment to the employer from the funds of an ongoing defined benefit pension scheme, provided the scheme is funded to a “full buy-out” level and the trustees are satisfied that such a payment is in their members’ interest⁴⁹.

97. Some concerns have been expressed that these requirements for return of surplus may be too onerous, and that they may be leading some employers to resist agreeing to appropriately strong funding objectives. While excess funding levels (or “surpluses”) have not been an issue for most schemes recently, there are those who believe that scheme funding levels will significantly improve in the near future.

98. Some employers have expressed concern payment of contributions constitutes a “one way valve” and that contributions will become “trapped” in a pension fund where they are not needed to fund agreed benefits. Evidence about the impact of the current rules does not yet exist because many companies have not yet completed the first full valuation cycle under the new scheme funding rules, and so far few (if any) requests for a payment to the employer under the current legislation have been considered.

99. An informal limited consultation was held by DWP in July 2006, and following further discussions with the Pensions Regulator, the Regulator has agreed to issue guidance which will give trustees and employers opportunity to agree the circumstances under which a payment to the employer will be made when they develop funding objectives and the statement of funding principles. We believe that this will offer some reassurance to sponsoring employers who are concerned that a payment will never be permitted. (Trustees are required to identify any arrangements under which any power to return funds will be exercised in the funding principles.⁵⁰) That said, there may also be room for further changes to Section 37 of the Pensions Act 1995 and its attendant regulation.

100. It has also been represented to us that an arrangement whereby employers must reach agreement with trustees before withdrawing surplus would not achieve with any certainty the objective of assuring that funds be used only for benefits already promised, because the trustees might demand a share of the surplus for the benefit of the members before giving their agreement to a return of surplus. We are asked to consider, therefore, whether there should be some relatively high level of solvency (for example, a premium of 10% above buy-out level) above which the employer could unilaterally withdraw funds (subject to a period of notice), in addition to a lower threshold where the employer could withdraw surplus funding with trustee agreement.

We would like to know:

- 1) Do you believe that the current legislation discourages employers from agreeing to appropriate contribution levels due to concerns that any funding surplus would not be returned, should it arise?
- 2) If the answer to question 1 is “yes”, is your concern that the threshold at which a payment to the employer may be considered by the trustees is inappropriate? Is there a threshold that would better balance interests of employers and members?
- 3) If the answer to question 1 is “yes”, is your concern the ability of the trustees to block return of surplus?
- 4) Do you agree that a refund should be payable on request to an employer once a scheme’s funding level reaches a certain threshold? If so, should that threshold be at a premium over the buyout level of funding, or some other level of funding?

Section 67 Pensions Act 1995

101. The principle that accrued rights cannot be diminished without member consent has been part of the statutory framework for almost ten years. Although most would agree with the principle in the context of a traditional DB scheme, section 67 of Pensions Act 1995 (“section 67”), in which it has found statutory expression, has been controversial from the outset. Many commentators observed that the legislation was not sufficiently flexible and the barriers it posed to rationalisation of benefit structures were disproportionate to the potential harm to members.

102. In response to the general consensus that section 67 should be more flexible in application, it was substantially amended in the Pensions Act 2004. Under the new procedures, only detrimental changes to subsisting rights are covered, and trustees may make changes without consent, so long as each member from whom consent has not been obtained retains benefits that are actuarially equivalent to those he had prior to the change.

103. The changes to section 67 have been effective for less than a year, and so it is too early to judge their effect. However, stakeholders have indicated that the procedures remain too onerous, and the definition of subsisting rights too nebulous, to address all of their concerns.

104. Some stakeholders have suggested that an approach allowing for some diminution of benefits should be allowed. For example, the National Association of Pension Funds has suggested that schemes should be able to amend accrued rights so long as no member’s benefits reduced in actuarial value by more than 5%.⁵¹ Other stakeholders have made similar proposals, or suggested both overall and individual ceilings.

105. Many stakeholders believe that some of the changes that would be most useful to schemes going forward, such as changes to make it easier to change normal pension age, require an exemption from section 67 in order to be useful. Exemptions from section 67 have been given in the past, for example, to allow trustees to administer their schemes in accordance with Finance Act 2004. It would be useful to get more views on the circumstances in which an exemption from section 67 should be available, and how that exemption might operate.

106. Finally, the application of section 67 to rights that are targeted, but not guaranteed, is not entirely clear. It may be that in order for some risk-sharing schemes to operate, the circumstances under which subsisting rights accrue should be made more clear.

We would like to know:

- 1) Does section 67 as currently drafted continue to stop trustees from making small changes that would help their schemes run more efficiently?
- 2) Are the procedures set out in Section 67 too complex and, if so, how should they be simplified?
- 3) Under what circumstances do you think an exemption from section 67 – whether or not it retains its current form – would be justified?
- 4) Do you believe that it would be useful to allow some leeway for changes in actuarial value? To what degree?
- 5) Would it be helpful to define the “subsisting rights” in more detail? How would you define them?

Employer debt

107. Employers have voiced frustration to us over the way in which employer debt under section 75 of the Pensions Act 1995 is imposed. They complain that normal corporate activity can be impeded in inappropriate ways. Under present law, an employer is considered to exit the scheme when its active members are transferred to another employer (even if that employer also participates in the scheme), or when the last active member employed by that employer leaves service. This can cause hardship not only for participants in multi-employer schemes, but for small employers when the one remaining employee in the scheme leaves service.

108. In particular, employers participating in multi-employer schemes have complained that a large payment into an ongoing scheme can be required in circumstances such as corporate reorganisations that involve no significant change to scheme membership, the character of the sponsor, the solvency of the participating employers or the ongoing nature of the scheme.

109. Under the Pensions Act 1995 and relevant regulations⁵², when an employer exits a multi-employer pension scheme, a debt becomes due from that employer equal to its share of the scheme's liabilities on a buyout basis (the "section 75 debt"). Unless the rules to the scheme prescribe an alternative manner of allocating liabilities, the debt will equal the liabilities associated with the past service of scheme members employed by that company on a buyout basis.

110. Employers say that it is unfair to require large payments, based on a debt that would only arise on wind-up in these circumstances. Although trustees often agree to allocate the debt in sensible ways, the present climate makes some payment into the scheme and/or guarantee by the parent inevitable, and the process usually involves clearance by the Pensions Regulator and is expensive and distracting. Alternatively, employers must devise work-arounds to keep the debt from arising, such as closing the scheme to future accrual in advance of the transaction, which are in no one's interest.

111. One way the amount due from the withdrawing employer can be reduced on exit is through a withdrawal arrangement, under which another party guarantees to pay the section 75 debt at a later time. Withdrawal agreements must be approved by the Pensions Regulator and the trustees. Employers point out that trustee approval is often conditioned on demands for higher contributions and that the requirements for Regulator approval are difficult to meet. For example, the employer must show that any guarantor is more likely than the withdrawing employer to be able to meet the debt when it is called. In any case, critics claim that such arrangements as presently constituted are inflexible, time consuming and often inefficient from a tax point of view.

112. Many stakeholders argue in response that it is entirely fair to require exiting employers to meet their share of any existing underfunding or to put in place ironclad agreements that the debt will be met when necessary. They observe that the pressure to bring scheme funding to a higher level is useful. These stakeholders say that often the participating employers that remain after a transaction are not as strong as the departing company, and that the debt is only large when the exiting employer is associated with a large historic past service liability -- that should be paid. Under the former, less prescriptive statute, trustees did not always pursue employer debt sufficiently vigorously in these circumstances. In the absence of this legislation, schemes, and ultimately the PPF, would be insufficiently protected.

113. The Pensions Regulator has formed a working group to consider the issues surrounding the present operation of section 75 Pensions Act 1995. This working

group includes external stakeholders and the DWP, and is looking at how the debt arises and the ways that withdrawal agreements can be made more workable. It is our understanding that amendments that minimise the unintended consequences flowing from the way in which section 75 is presently implemented are likely to result.

114. In the meantime, we request your views on what would help make the legislation less onerous for employers while giving trustees and where necessary the Pensions Regulator the tools to assure the obligations of exiting employers are met.

We would like to know:

- 1) Do you believe that the operation of present section 75 and its regulations create unnecessary problems? When and why do these problems arise?
- 2) Are there ways in which the present legislation could be amended to minimise these problems, keeping in mind their purpose to protect members of the scheme and minimise calls on the PPF? For example, should the circumstances under which a section 75 debt is triggered in multi-employer schemes be changed?
- 3) Are present requirements or procedures relating to withdrawal arrangements too onerous? Which requirements and in what way?

FRS17

115. A number of stakeholders have suggested that the requirement to comply with accounting standard FRS17, promulgated by the Accounting Standards Board⁵³ for accounting periods beginning on or after 1 January 2005 has contributed to the decline of defined benefit provision. Pension liabilities are shown in a company's financial statements in accordance with FRS17 or the equivalent International Financial Reporting Standard (IFRS) IAS19⁵⁴.

116. FRS17 works on the assumption that where the liabilities of a pension scheme have to be met by the sponsoring employer, they should be recognised on the company balance sheet. The principal aim is to provide transparency for shareholders and users of the accounts, including pension scheme members and their representatives, about the financial impact of the employer's pension provision.

117. Under FRS17, a snapshot is taken as of a certain date of the assets and liabilities of the pension scheme. Defined benefit scheme liabilities are measured on an actuarial basis using the projected unit method. The liabilities are discounted at a rate that reflects the time value of money and the characteristics of the liability. This is assumed to be the current rate of return on high quality corporate bonds. The assets are measured at their air value on the balance sheet date. Some have observed that this measure tends to overstate scheme liabilities relative to assets and has led to a more volatile number in relation to pension debts than many consider appropriate for such a long term commitment.

118. Anecdotal evidence is that while some companies have addressed concerns caused by FRS17 by funding well above the level of their technical provisions, perceived pressure from the investment community has caused others to close their schemes, or consider doing so. For this reason, we are concerned about the impact of FRS17 on pensions provision. We have received evidence that suggests that investment management companies, while welcoming the greater disclosure of pension liabilities, would prefer an accounting standard that would lead to greater stability in company balance sheets, and that such greater stability would be less of an incentive to scheme discontinuance.

119. We are grateful to the staff of the Accounting Standards Board who came to give evidence to us, and we recognise that the ASB is an independent body, and wholly outside the domain of the Department of Work and Pensions, our commissioning department, but we nonetheless feel that the impact of FRS17 has been so significant that it cannot pass without mention.

120. The ASB is currently reviewing the whole area of financial reporting of pensions. FRS17 was published in 2000 when the legal and regulatory landscape was quite different, notably, this was before the Pensions Act 2004 was enacted. The ASB is reconsidering the fundamental principles of pensions accounting and is expecting to issue a discussion paper on the subject over the summer. The International Accounting Standards Board (IASB) has now taken a project on pensions onto its agenda and the ASB hopes that its work will contribute to the development of improved international accounting standards, which may provide a suitable basis to replace FRS17.

121. Now that companies and investors have become more aware of the impact of pension liabilities, we believe that the time has come for reconsideration of the requirements for company balance sheets. Elsewhere we have discussed encouraging risk-sharing and if this is acted upon it would provide another pressing reason for looking again at accounting standards, with a view to ensuring that they accurately reflect the degree of risk borne by the employer.

We would like to know:

- 1) Do you consider FRS17 has had an impact on defined benefit pension provision by employers?
- 2) If your answer is yes, please explain whether this impact has been good or bad, and why.

Consultation arrangements

We would welcome comments by close on 6 April 2007. Comments can be sent to:

Gabrielle Park
Deregulatory Review
Department for Work and Pensions
3rd Floor
Adelphi
1 – 11 John Adam Street
London
WC2N 6HT

Email: adelphi.deregulatoryreview@dwp.gsi.gov.uk
Phone: 0207 712 2122

It would be very helpful when responding to indicate whether you are responding as an individual or representing the views of an organisation. If responding on behalf of a larger organisation please make it clear whom the organisation represents and, where applicable, how the views of members were assembled.

According to the requirements of the Freedom of Information Act 2000, all information contained in the response, including personal information may be subject to publication or disclosure. By providing personal information for the purposes of the public consultation exercise, it is understood that a Respondent consents to its disclosure and publication. If this is not the case, the Respondent should limit any personal information which is provided, or remove it completely. If a Respondent requests that the information given in response to the consultation be kept confidential, this will only be possible if it is consistent with Freedom of Information Act obligations and general law on this issue. The contact point if you want to discuss this is:

Charles Cushing
Freedom of Information
Department for Work and Pensions
2nd Floor
Adelphi
1-11 John Adam Street
London
WC2N 6HT

More information about the Freedom of Information Act can be found on the website of the Department for Constitutional Affairs:

<http://www.dca.gov.uk/foi/guidance/exguide/index.htm>.

Endnotes

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- ¹ Chapter 2, "Security in retirement: towards a new pensions system" 2006.
- ² "A New Pension Settlement for the Twenty-First Century: the Second Report of the Pensions Commission" 2006.
- ³ "Pensions Law Reform", The Report of the Pensions Law Review Committee 1993.
- ⁴ "A simpler way to better pensions" Alan Pickering July 2002.
- ⁵ Chapter 2, "Pensions: Challenges and Choices: The First Report of the Pensions Commission"; Chapter 3.4, "The purple book – DB pensions universe risk profile," Pensions Protection Fund, The Pensions Regulator 2006; Chapter 3.3, DWP Employers' Pension Provision Survey 2005.
- ⁶ The Pensions Commission in its first report noted that the trend away from private DB provision started in the 1970s (page 80, "Pensions: Challenges and Choices: The First Report of the Pensions Commission" 2004). DWP figures show that between 1996 and 2005, membership in private DB plans went from 26% to 17%. The figure declines from 24% to 10% if we look at open schemes. (Figure 3.1, Chapter 3.3, "Employers' Pension Provision Survey 2005"). See also, page 24, "The purple book: DB pensions universe risk profile 2005", Pension Protection Fund, The Pensions Regulator 2006
- ⁷ See footnote 6.
- ⁸ Page 85, "Pensions: Challenges and Choices: The First Report of the Pensions Commission" 2004.
- ⁹ We especially wish to thank the Association of Consulting Actuaries and the Association of Pension Lawyers for the valuable time and thought those organisations have devoted to the issues attendant on risk sharing and the platform for scheme design that they have shared with us.
- ¹⁰ See generally "Risk sharing and hybrid pension plans", Department for Work and Pensions Research Report 270.
- ¹¹ Section 51, Pensions Act 1995. The cap on mandatory LPI was lowered from 5% to 2.5%, effective 6 April 2006, by Pensions Act 2004.
- ¹² Page 55, "Security in retirement: towards a new pensions system: NAPF response"; Page 30, CBI Response to Pensions White Paper September 2006.
- ¹³ Para 2.14, "A simpler way to better pensions", Alan Pickering 2002.
- ¹⁴ Approximately £49,950, based on a salary at the time of the rule change of £27,200 (estimated to be the average salary of a DB scheme member in 2006/2007) and average earnings growth in line with HM Treasury assumptions. The maximum pension income is 50% of final salary.
- ¹⁵ For an individual working and retiring later, the effect would be greater, as a larger part of the accruals would fall under a new regime.
- ¹⁶ Table 3.11, "Occupational Pension Schemes 2005", Government Actuary's Department June 2006. The 2004 GAD survey, indicates that in the private sector 81% of deferred members are in schemes offering just the statutory minimum level of revaluation (see page 93). Recently published information indicates that 41% of members of schemes are deferred members, 26% are active members and 33% are pensioner members. See Chart 3.4, "The purple book: DB pensions universe risk profile", Pension Protection Fund, the Pensions Regulator.
- ¹⁷ See paragraph 4.25, "A simpler way to better pensions", Alan Pickering, 2002
- ¹⁸ Once again we assume inflation at the Treasury rate.
- ¹⁹ Based on calculations that the average DB member earns £27,200 in 2006/07 and that this rises in line with HM Treasury's assumptions on average earnings growth.
- ²⁰ DC scheme members have the opposite problem, of course – benefits earned later in working life do not have sufficient time to appreciate in value.
- ²¹ Page 2, "Pensions: Challenges and Choices: The First Report of the Pensions Commission" 2004. The position is similar for women.
- ²² Page 47, "Pensions: Challenges and Choices" The First Report of the Pensions Commission" 2004
- ²³ Chapter 2, "Pensions: Challenges and Choices: The First Report of the Pensions Commission" 2004.
- ²⁴ This information is taken from page 3.14, GAD 2004 Occupational Pension Schemes Survey. Normal pension age is of little significance in defined contribution schemes, because benefits are based on the money accumulated. In defined benefit schemes, on the other hand, normal pension age is usually the age at which benefits may be taken without actuarial reduction for early withdrawal, and therefore is quite significant.
- ²⁵ Page 27, CBI Response to Pensions White Paper, September 2006.
- ²⁶ Section 4, "A view from the top – 2006", A survey of business leaders' views on UK pensions provision by Mercer Human Resource Consulting in conjunction with the CBI.
- ²⁷ We are aware that there could be problems under the Employment Discrimination (Age) Regulations 2006 to this approach, but for the purposes of discussion do not address them here.
- ²⁸ We define a UK average scheme as one that is open to new members and has a mix of 28% active members, 40% deferred members and 32% pensioners.
- ²⁹ We define a mature scheme as one that remains open to new members and has a mix of 15% active members, 25% deferred members and 60% pensioners.

³⁰ In 2000, the latest date for which figures are available, the average assets of a scheme with 5000 – 9999 members was £309 million. Table 6.3, “Occupational Pension Schemes 2003,” Government Actuaries Department 2003.

³¹ Estimated to be around £27,200 in 2006/2007.

³² Recommendations 4 & 6, The Report of the Pension Law Reform Committee, 1993 (the Goode Report).

³³ Recommendations 2, 3, 6 and 7, “A simpler way to better pensions”, Alan Pickering, 2002

³⁴ Indeed, similar recommendations were made in the Report of the Pension Law Reform Committee (the Goode Report) in 1993.

³⁵ The Pensions Regulator, Code of Practice No 8.

³⁶ Codes of Practice are more formal in effect than guidance. Codes have evidential admissibility in any legal proceedings and there is less flexibility to change them as they require the approval of the Secretary of State and must be laid before Parliament. Guidance can be more easily and flexibly generated. However this flexibility means that it is easier to change and brings us back to the certainty point raised above.

³⁷ Some suggest that, at least at first, it might be desirable for the regulatory authority to be given responsibility for giving very specific advice to stakeholders who were uncertain about the application of the principles in particular circumstances, perhaps in exchange for a fee. However, it may be that if advice as to how to deal with individual circumstances is obtainable from the regulating authority, the approach can no longer be called principles based.

³⁸ Conducted by Social and Community Planning Research (SCPR)

³⁹ Chapter 3, Para 3.8, Appendix 1, paragraph C-5, “A simpler way to better pensions,” Alan Pickering 2002.

⁴⁰ Appendix 1, “A simpler way to better pensions,” Alan Pickering 2002.

⁴¹ Directive of the European Parliament and of the Council on the activities and supervision of institutions for occupational retirement provision, Article 11, 2003/41/EC.

⁴² We note that with the assistance of the ABI, a minimum industry standard has been introduced to improve consistency and consumer understanding in this area.

⁴³ Para 24, page 19, “Institutional Investment in the UK Six Years On”, National Association of Pension Funds, January 2007

⁴⁴ Section 33 of the Pensions Act 1995 forbids indemnity or exoneration for exercise of discretion in investments. However, this discretion can be and usually is delegated to an authorised person under the Financial Services and Markets Act 2000, in which case the trustees will not be liable. Section 256 Pensions Act 2004 forbids meeting the cost of indemnity from scheme assets, or from purchase of insurance from scheme assets, that would cover payment of any criminal fine or penalties under the pensions statutes.

⁴⁵ Sections 247 -249, Pensions Act 2004

⁴⁶ The trust deed, scheme rules, statements of investment and funding principles and any documents recording scheme policy relating to the administration of the scheme

⁴⁷ Section 243(1) Pensions Act 2004

⁴⁸ Section 250, Pensions Act 2004; The Occupational Pension Schemes (Payments to Employers) Regulations 2006 (SI2006/802).

⁴⁹ Previously, HMRC (formerly Inland Revenue) restrictions on DB scheme funding levels applied. Trustees were required to obtain regular actuarial valuations to assess their scheme’s funding level against the Inland Revenue ceiling, and to take action to reduce funding if it exceeded 105% of the Inland Revenue limit.

⁵⁰ Regulation 6, The Occupational Pension Schemes (Scheme Funding) Regulations (SI2005/3377).

⁵¹ Pages 52-53, “Security in retirement: towards a new pensions system: NAPF response,” September 2006.

⁵² Section 75 Pensions Act 2004; The Occupational Schemes (Employer Debt) Regulations 2005 (SI2005/2224)

⁵³ The Accounting Standards Board is an independent body recognised under the companies legislation. Its main role is to issue accounting standards. The ASB collaborates with similar bodies from other countries and with the International Accounting Standards Board (IASB) to both influence the development of international standards and in order to ensure that its standards are developed with due regard to international developments.

⁵⁴ Under EU Regulation 1606/2002, EU-listed companies have, for financial years beginning on or after 1 January 2005, been required to apply IFRS as adopted in the EU for their consolidated financial statements, rather than UK standards. Individual listed companies, and any other companies, have the option to apply IFRS as adopted in the EU.

Annex A – list of stakeholders who have given evidence

Accounting Standards Board

Association of British Insurers

Association of Consulting Actuaries

Association of Pensions Lawyers

British Chamber of Commerce

Confederation of British Industry

Engineering Employers Federation

Faculty & Institute of Actuaries

Federation of Small Businesses

Financial Services Authority

HM Revenue and Customs

HM Treasury

Investment Management Association

National Association of Pension Funds

Pensions Protection Fund

Society of Pension Consultants

Slaughter & May

The One Hundred Group

The Pensions Regulator

Trades Union Congress

Travers Smith

Annex B – list of issues that have been raised with us

We have been given details of a number of areas of legislation which could be clarified or where changes are needed to make the provisions easier to operate. Although we have been provided with full information to enable the problems and possible solutions to be identified, the following is only a brief summary to give you a flavour of the issues raised

Primary legislation

Employment Rights Act 1996

- To facilitate the auto enrolment into a personal pension, sections 13 to 16 should be amended to remove the requirement for the member's signature.

Pension Schemes Act 1993

- Buy outs to personal pension schemes without member consent should be allowed subject to safeguards.
- The set periods for payment of a transfer value and implementing a pension credit should be replaced with "within a reasonable period" and the requirement to report to the Regulator when in breach should be removed.
- Cash equivalent transfer values in money purchase arrangements should not need to be guaranteed for a period of time.
- Cash equivalent transfer values from money purchase schemes should be calculated and paid by reference to assets on the date on which the member's application is received by the trustees
- Safeguarded rights are an unnecessary complication and should be removed.
- The rules regarding preservation of pensions for early leavers should be simplified and rationalised.
- Section 87(4)(d) should be amended to make clear that the Later Earnings Addition does not apply where future accrual in the scheme in question is on a money purchase basis.
- The requirement to have a different earliest date from which pension credit rights are payable should be removed.
- Article 7(4)(d) of the Taxation of Pension Schemes (Amendment Order) 2006, which requires that protected rights be drawn down proportionately to other benefits, should be removed.
- Trustees should be required to arrange for members of DC schemes to receive financial advice upon entry to the scheme, retirement and at regular intervals between.
- A "value test" should be substituted for the reference scheme test for contracted out benefits.

Pensions Act 1995

- Requirements for the reporting of late payments to be removed.
- On winding up, schemes should be able to provide LPI pension increases capped at 2.5% for all service since 1997 (in line with that provided by the PPF).
- It should be made clear that an amendment under section 67 to which a member had consented cannot subsequently be challenged as a forfeiture of benefits prohibited under section 91.

- It would be helpful to have clarification of the circumstances in which it is permissible for a member to waive or forfeit rights to benefit.

Pensions Act 2004

- The requirements setting out information to be provided to the Regulator should reflect the information the Regulator needs and which cannot be obtained from other sources and be requested from the person who holds the relevant information.
- There should be more flexibility as to the frequency of the levy collection and the facility to levy interest if payments are made late.
- There should be more flexibility in the return dates for the scheme return to enable all schemes to be brought in line.
- Section 253 should be simplified so to make it easier to allow expatriate employees working in the UK to remain in their home pension schemes.
- Section 255 (1) should be interpreted to apply at a scheme level, so that schemes with some members who only have life assurance benefits could continue to supply those benefits to those members.
- The definition of “normal pension age” in para 34 Schedule 7 should be amended to make clear that pensions from the PPF will not be available earlier than normal pension age.
- Compensation provisions need to be amended to deal with pensions which change in value eg bridging pensions.
- The requirement for member nominated trustees should be relaxed where there is an independent trustee.

Finance Act 2004

- The burdens placed on schemes before small amounts of pension can be trivially commuted should be relaxed.

Regulations

The Employment Equality (Age) Regulations 2006

- It would be helpful if the regulations clarified what is meant by “more nearly equal” in relation to age related contributions.
- Regulations should clarify whether an offset of up to 1.5 times the lower earnings limit can be made to contributions (as it can be when calculating benefits).
- Regulations should clarify whether occupational pension schemes must allow members to take their benefits while still working.

Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006

- Consultation should not be required:
 - where there is a change of scheme but no change in their employer or benefits accruing in the future;
 - where there is no detrimental effect on members benefits;
 - where an employer is simply switching from one stakeholder pension scheme to an equivalent stakeholder scheme, or
 - in advance of termination of participation in a scheme as a result of a sale of the shares of a subsidiary or the transfer of its business to a third party.

- Regulations should clarify the reference in Regulation 8(3) to the rate of future accrual of benefits.
- The fixed period for consultation should be replaced with a “reasonable period”.

The Occupational Pension Schemes (Contracting-out) Regulations 1996

- The restrictions in Regulation 20 on what authorised lump sums can be paid should be changed to line up with the Finance Act 2004.

The Occupational Pension Schemes (Cross-Border Activities) Regulations 2005

- The definition of “European Employer” should be changed to make clear that it does not include an employer located in the UK.

The Occupational Pension Schemes (Disclosure of Information) Regulations 1996

- Schemes should be allowed to deliver all or some communications by electronic means.
- Current disclosure requirements should be reduced so that providers can produce more clear and closely targeted information.

The Occupational Pension Scheme (Employer Debt) Regulations 2005

- Schedule 1A, para 2(3)(b), which requires that the guarantor under a withdrawal agreement be more likely to meet the debt than the ceding employer (as opposed to as likely to meet the debt) should be amended or removed.
- Regulation 5 should allow the actuary to estimate the cost of providing benefits in the manner the actuary considers appropriate in circumstances of the case.
- The regulations should clarify that the use of contingent assets in scheme funding arrangements is acceptable, and where it is possible to interpret regulations to preclude such arrangements, they should be amended.
- Regulation 6 should be revisited:
 - the definition of employer cessation event should be clarified so that it does not encompass so many situations in which the effect on the scheme is minimal;
 - the liabilities of the scheme should not include liabilities in respect of money purchase benefits;
 - how benefits from service with a previous employer are treated should be clarified;
 - the definition of “employer debt” should be changed so that it does not preclude use of contingent assets in scheme funding arrangements, and
- Schedule 1A should be amended to remove the requirements for trustee consent and for the arrangement to be exclusively subject to the law of England and Wales; and to clarify the timing of withdrawal agreements in relation to cessation events.

The Occupational Pension Schemes (Investment) Regulations 2000

- Regulation 12, which would, under the present definition of an employer-related loan, prohibit the use of a contingent asset (which would come within the definition when the contingency is satisfied) in a funding arrangement.

The Occupational Pension Schemes (Levies) Regulations 2005

- Levies charged on DC schemes are not proportionate to the risk and should be based on the size of fund rather than the number of members.

The Occupational Pension Schemes (Modification of Schemes) Regulations 2006

- In paid up schemes where the employer no longer exists, schemes often cannot be amended because the employer's consent is required under the scheme documentation. Regulation 6 should be amended to allow trustees to amend scheme rules by resolution where the employer is no longer in existence.

The Occupational Pension Schemes (Preservation of Benefit) Regulations 1991

- Transfers should be allowed between all employer schemes, occupational or personal, without member consent, subject to appropriate safeguards. (This would also require changes to the Protected Rights (Transfer Payment) Regulations 1996).

The Occupational Pensions (Regulatory Own Funds) Regulations 2005

- These regulations should be amended or removed.

The Occupational Pension Schemes (Scheme Administration) Regulations 1996

- The rules on the appointment of professional advisers (Regulation 5) and on the types of records to be kept by trustees (Regulation 12) should be covered in a code of practice issued by the Regulator rather than in regulations.
- The requirements relating to the information to be recorded following a trustee meeting (Regulation 13) should be removed.

The Pension Protection Fund (Multi-employer schemes)(Modification) Regulations 2005

- The definition of "employer" in Regulation 1(3) should be changed because it can prevent a scheme from entering the PPF because an employer that no longer participates in the scheme has not suffered an insolvency event.
- The requirement that "the value of the assets of the scheme or section was such that" should be removed from Condition D.
- It needs to be clear that entry to the PPF is secure if all surviving employers have suffered a qualifying insolvency event.

The Pension Sharing (Pension Credit Benefit) Regulations 2000

- The restriction on payment of pension credit benefits under Regulation 7(3) should be removed and pension credit rights should be treated in the same way as non-pension credit rights.

The Pension Sharing (Safeguarded Rights) Regulations 2000

- Safeguarded rights are an unnecessary area of complication and should be abolished.
- Safeguarded rights should be taken in a manner consistent with protected rights.

The Personal Pension Schemes (Disclosure of Information) Regulations 1987

- Schemes should also be allowed to deliver all or some communications by electronic means.

Personal Pension Schemes (Appropriate Schemes) Regulations 1997

- The restrictions on the types of vehicles in which protected rights can be invested should be removed to allow investment in SIPPs.
- Protected rights should have the same flexibility regarding payment of death benefits as non-protected rights.

Personal and Occupational Pension Schemes (Protected Rights) Regulations 1996

- Protected rights should be allowed the same guarantee periods as non-protected rights.
- The conditions in Regulation 4(9) should be replaced with a requirement that if a pension for a surviving widow(er) or civil partner was secured at retirement, the guarantee payments should be paid to that person. If not, the payments should be payable to any person.
- Regulation 6(c) should be amended to cover charities and to enable the deceased's legal representatives to nominate a charity where someone dies aged 75 or over.
- Regulation 6(c) and 12(2) (and regulation 6(9) of the Pension Sharing (Safeguarded Rights) Regulations 2000) should be further simplified to require that protected and safeguarded rights must be used to provide authorised payments or, if that is not possible, to meet the scheme's administrative expenses.
- The provisions relating to limits on the pension commencement lump sum in Regulation 8(1D)(b) should simply refer to circumstances permitted under the Finance Act 2004.
- The requirement to hold protected rights separately from other pension money should be removed.

The Protected Rights (Transfer Payment) Regulations 1996

- The need to keep records of pre/post 1997 protected rights should be removed.
- Requirements for widow(er) or civil partner consent to drawdown to drawdown transfer should be rationalised so that they apply only where member consent would be required.

The Stakeholder Pension Schemes Regulations 2000

- If a member is transferred to another stakeholder pension scheme when his scheme winds up any regular contribution mandates should continue. This should also apply on windup of AVCs.
- The requirement for a termination statement under Regulation 18(2)(b) should be removed.
- Stakeholder providers should be required to report any breach where an internal audit finds that the charge has exceeded the statutory maximum charge.

The Transfer of Undertakings (Pension Protection) Regulations 2006

- The references to 6% matching requirements should be clarified to take account of matching by way of salary sacrifice.

Annex C – List of questions

Risk sharing

- 1) Do you consider that the interests of employees will be served by the presence of more risk sharing schemes? What risks do you believe are most appropriately shared?
- 2) Do you believe that employers are interested in supporting schemes in which the risks taken by employers and employees are balanced differently than under traditional money purchase or defined benefit schemes?
- 3) Are you aware of situations in which the present framework has prevented the implementation of an arrangement under which risks were shared between the employer and the member in a novel way? Can you describe what specifically prevented implementation?
- 4) What do you believe to be the main obstructions to creativity in scheme design? Do you believe that they should be removed?
- 5) Would you favour an approach under which specific forms of shared risk schemes are recognised, along with appropriate safeguards, or would you prefer that current regulations be loosened to allow a variety of approaches?
- 6) What challenges do you see in the effective disclosure to members of the nature of the risks they are running and how their benefits may be affected in risk sharing schemes?
- 7) What should the role of the PPF be in risk sharing schemes? Are there changes to the present legislation pertaining to the levy and treatment of schemes on wind-up that would be necessary in order to fairly regulate these schemes?

Limited price indexation of pensions in payment

- 1) How likely are schemes to remove the promise of LPI for pension accruals going forward if they were allowed to do so?
- 2) Would employers be more likely to continue defined benefit plans if LPI were made optional?
- 3) Would employers be more likely to establish risk sharing schemes if LPI were made optional?
- 4) Do you have any information on the impact that optional LPI would have on scheme costs?
- 5) Are there particular approaches to LPI (see paragraph 30) that appeal to you? Why?
- 6) Do you believe that the cost savings to pension schemes if LPI is no longer mandatory outweighs the reduction of benefits to members?

Revaluation of deferred pensions

- 1) How likely are schemes to implement a reduction in revaluation if the cap on mandatory revaluation is reduced for accruals after 2008?
- 2) Do you think that reducing the cap would maintain a fair balance between stayers and leavers in defined benefit schemes?
- 3) Do you think that a reduced cap would have a significant impact on labour mobility?
- 4) Do you have any information on the impact that this change would have on scheme costs?
- 5) Would there be any impact on long term funding strategy if liabilities are measured based on a 2.5% cap?
- 6) Would employers be more likely to continue defined benefit plans if revaluation is reduced?
- 7) Would employers be more likely to implement risk-sharing schemes if the cap on revaluation is reduced?
- 8) Do you believe that the cost savings to schemes that would result from reduced revaluation outweighs the loss of benefit to members?

Normal pension age

- 1) Do you believe that an NPA set to a longevity index is feasible (leaving aside any application to past accruals)? Why or why not? What changes to present laws and procedures would be required?
- 2) If you believe that an NPA set to a longevity index is feasible, would changes to present regulation of pensions be necessary? What changes would be required?
- 3) Do you believe that established pension schemes should be allowed to set NPA to a longevity index, or to change NPA, in regard to the entire period of scheme membership? Why is this your view?
- 4) If your answer to question (3) is "yes", should there be statutory protection for members in respect of these changes? What sorts of protection would be appropriate? For example, should members nearing retirement be allowed to keep a lower NPA?
- 5) If your answer to question (3) is yes, would this be only under particular circumstances? What circumstances? Should a rise in NPA be allowed even for schemes that are closed?
- 6) Do you have any information on savings and costs in relation to your responses to the questions above?

Legislative override

- 1) Would a statutory override to provisions in scheme trust deeds and rules that prevent changes to rights attributable to future service be appropriate? If it would be appropriate only in some circumstances, what would those circumstances be?
- 2) Do you believe that a statutory override to provisions in scheme trust deeds and rules that would prevent changes to rights already accrued would be appropriate? If it would be appropriate only in some circumstances, what would those circumstances be?
- 3) What form do you think any appropriate statutory override should take?

Principles based regulation

- 1) Do you think a principles based approach would be appropriate for pensions regulation? Why or why not?
- 2) Are there particular areas of existing legislation that you consider particularly suitable for a principle based approach? If there are, why?
- 3) Do you believe there would be cost savings arising from a principles based approach? To whom would they accrue?
- 4) What steps could be taken to allay concerns about the lack of certainty that is inherent in a principles based approach?
- 5) Do you believe that a principles based approach will have any impact on member protection? If so, would this impact be positive or negative?
- 6) What impact do you consider this may have on the running costs of the regulatory authority?
- 7) If a principles based approach were adopted do you think there would be a continuing need for codes of practice and guidance notes to supplement primary and secondary legislation?
- 8) What impact do you consider this may have on the levels of skills, knowledge and understanding of trustees, employers and their advisers?

Disclosure

- 1) Do you think that a principles based approach to disclosure would work?
- 2) If the answer to question (1) is “yes”, do you feel that any of the approaches outlined above (or an alternative to those approaches) would be most appropriate and why?
- 3) If the answer to question (1) is “no” are there any other changes that should be made to improve the current disclosure regime?
- 4) Do you think there are circumstances in which members and/or trustees should be required to consult with or get the permission of spouses and civil partners –

for example, where changes to scheme rules reduce their contingent benefits, or when the member is choosing a single life pension?

- 5) Do you agree that there are particular disclosure issues in relation to risk sharing schemes? How should these issues be handled?
- 6) Do you think that trustees should be required to provide more information at the point of retirement? What sorts of information should they provide?

Trustees

- 1) Is it more difficult to find and retain suitable volunteers for trustee positions? If so, why do you think this is the case?
- 2) If conflict of interest is an issue, do you believe that conflicts are inevitable, or are there specific aspects of regulation that are causing individuals to be needlessly concerned that they may be compromised?
- 3) If personal liability is an issue, are there steps that could be taken under the law that would protect both the trustees and the members' interests? Would a statutory exemption of trustees from all or most liabilities incurred in the course of their functions be advisable?
- 4) Do you believe that the current focus on trustee knowledge and understanding is discouraging individuals who have valuable expertise from volunteering to serve as trustees?
- 5) Would your answers to any of the above questions depend in part on whether the trustee involved is a professional trustee, paid for his or her services to the scheme?
- 6) What would the impact of any change in this area be on scheme liabilities?
- 7) Do you think moving to principles based regulation would have an impact on retaining or recruiting trustees?
- 8) What bearing do your views in relation to the above bring to the proposal that at least 50% of trustee boards should be member trustees?

Return of surplus to employer

- 1) Do you believe that the current legislation discourages employers from agreeing to appropriate contribution levels due to concerns that any funding surplus would not be returned, should it arise?
- 2) If the answer to question 1 is "yes", is your concern that the threshold at which a payment to the employer may be considered by the trustees is inappropriate? Is there a threshold to better balance interests of employers and members?
- 3) If the answer to question 1 is "yes", is your concern the ability of the trustees to block return of surplus where they do not believe it to be in members' interests?
- 4) Do you agree that a refund should be payable on request to an employer once a scheme's funding level reaches a certain threshold? If so, what level should that be?

Section 67 Pensions Act 1995

- 1) Does section 67 as currently drafted continue to stop trustees from making small changes that would help their schemes run more efficiently?
- 2) Are the procedures set out in Section 67 too complex and, if so, how should they be simplified?
- 3) Under what circumstances do you think an exemption from section 67 – whether or not it retains its current form – would be justified?
- 4) Do you believe that it would be useful to allow some leeway for changes in actuarial value? To what degree?
- 5) Would it be helpful to define the “subsisting rights” in more detail? How would you define them?

Employer Debt

- 1) Do you believe that the operation of present section 75 and its regulations create unnecessary problems? When and why do these problems arise?
- 2) Are there ways in which the present legislation could be amended to minimise these problems, keeping in mind their purpose to protect members of the scheme and minimise calls on the PPF? For example, should the circumstances under which a section 75 debt is triggered in multi-employer schemes be changed?
- 3) Are present requirements or procedures relating to withdrawal arrangements too onerous? Which requirements and in what way?

FRS 17

- 1) Do you consider FRS17 has had an impact on defined benefit pension provision by employers?
- 2) If your answer is yes, please explain whether this impact has been good or bad, and why.