Private Pensions Simplification

Buck Consultants' Submission to the DWP Simplification Review

Buck Consultants changed their name to the Human Resources & Investor Solutions division of Mellon, on 1 October 2003.

The pensions authority concept featured within this document, has been refined since the publication of this submission.

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Introduction

Buck Consultants Limited welcomes the opportunity to make this submission to the DWP Pensions Simplification Review Committee.

About Buck Consultants

With more than 2,400 staff in 65 locations worldwide, Buck Consultants is one of the largest employee benefit consultancies in the world and is ultimately owned by Mellon Financial Corporation in the United States.

Buck's core activities are most types of actuarial work and pension scheme administration, together with pensions, remuneration and reward, healthcare and investment consulting for a varied client base, which ranges from small family businesses to some of the world's largest multi-national organisations.

In the UK, the firm was founded in 1971 as Martin Paterson Associates Limited. It became part of Buck Consultants in 1987 and at the end of 1996 as part of our expansion plans, Buck Consultants acquired W F Corroon, the employee benefits business of Willis Corroon. At the same time, we established Buck & Willis Healthcare – a partnership in the healthcare sector between Buck Consultants and Willis, the worldwide risk management company.

The acquisition of Buck Consultants by Mellon in 1997 has provided the company with first class support and financial backing while allowing us to remain operationally independent and continue providing impartial advice of the highest quality through a developing, highly motivated and focused consultancy.

Our submission

In making this submission, we have closely studied the consultation paper issued by Alan Pickering to ensure the relevance and feasibility of our recommendations and proposals.

We have therefore looked to:

- identify a package of options for simplification and the reduction of compliance costs
- in making our recommendations, consider the principles behind the legislation as well as the processes and ensure that the law is proportionate to the policy purpose.
- consider the means by which the regulatory framework is enforced.
- ensure that none of our proposals would compromise the overall value of individuals' investments.

Our submission has been compiled with regard to:

- the need to maintain effective and appropriate protection for pension scheme members.
- wider economic and exchequer effects.
- the links with and impacts on tax rules and the Inland Revenue simplification review.
- the separate work to implement the recommendations of the Myners review and to reform the Minimum Funding Requirement.
- the workability and regulatory impact of its proposals.

To seize the opportunity for what might be the last chance to get it right for today's employed, will require a bold and imaginative approach by the Review Committee, and we hope that they will rise to the challenge. Buck Consultants would be pleased to assist in any more detailed proposals where that would be considered helpful.

Signed	………………………..	Signed ………………………..
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Date January 2002

Key Recommendations and Proposals

- Effective change is long overdue. This Review presents an opportunity to make amendments that will put the law governing private sector pension arrangements back to a level where it can complement the design of schemes, rather than stifling them.

- If employers are faced with huge practical difficulties and resultant costs every time change becomes necessary, they will react by closing existing schemes and simply not starting new ones. Indeed, there is evidence that this is already happening. Compulsion is not the answer; many employers would then simply do only the minimum required under the law.

- The practice of adding new rules on top of existing ones has been a feature of private pensions legislation and regulation over that time, and is one of the major contributors to the burden currently borne by those who sponsor and try to administer schemes. To progress, it will be essential to remove old provisions which currently continue to govern benefits earned many years in the past, under regimes very different from that applying today, but which will not be payable for some years to come.

- The burden of inappropriate regulation is not the only factor creating a difficult climate for private pension provision. The cost burdens created by factors such as greater longevity will continue to pose challenges for those seeking to make appropriate provision, but appropriate solutions are more likely to be found in an environment where regulation complements scheme design, rather than driving it.

- We make no apologies for putting at the heart of our response, a proposal to reshape the whole way that Government approaches pensions policy. Only by such a radical new approach will we get a sustainable environment for the long-term and avoid the need for Pickering II in twenty years' time.

- The effective provision of retirement benefits requires a stable environment to be maintained for a considerably longer period than the lifetime of a government or the tenure of office of a particular finance director. Unfortunately, that has not been the experience of the last few decades, and there is currently no sign of the trend easing. Without a change in mindset here, meaningful reform will not occur.

- Employers must regain the confidence and will to commit to establishing new arrangements that they will maintain for the long term, resisting the temptation to tinker in response to relatively short-term changes in circumstances.

- Government must establish a legal and regulatory environment that is cohesive, stable, protected from arbitrary change to fit with political dogma, and flexible enough to enable the majority of employers in the UK to establish and run long-term arrangements with the confidence that they will not be required at some later date to comply with new requirements that will add to their direct costs, or to the cost of administration.

The Key Reform: A New Pensions Authority

- We propose the creation of a Pensions Authority, to regulate the development of pension policy with a light touch. The Pensions Authority should have two main functions. The first would be to initiate, and draft, new legislation governing pensions**.** The second would be the regulation of the law in practice.

- The Authority should be established in such a way and with such powers as to ensure as far as possible that it will remain apolitical, and cannot be influenced by the government of the day – the Bank of England's MPC may be an appropriate model for this.

- Only in this way will it be possible to ensure that pensions will be immune from short-term bias and inappropriate influence, and to gain the confidence of both employers and their employees which will be required if they are to return to making appropriate provision.

Implementation of The New Way

- A large part of the complication (and therefore cost) of current arrangements is directly attributable to the need to maintain past provisions in this way. As new provisions are introduced, so the problem of these past benefits grows. If we are to achieve meaningful reform, we must find a way to remove these past millstones, and to free up employers to start with a clean sheet.

- Change along the lines we are suggesting may require a degree of *positive discrimination* in respect of some benefits or members, but this should be permitted only in respect of changes which are proven to be necessary or desirable within limits policed by the new Pensions Authority. This would facilitate the clearing out of large amounts of old benefits subject to obscure restrictions, simultaneously enabling schemes to focus on the provision of actual benefits at retirement.

- There must be an immediate block on the introduction of new obligations, such as the enforced introduction of the detailed requirements of the Myners Code, and the new regulations covering anti-franking and member nominated trustees, and where possible, the immediate removal of others which are causing current pain, such as the Minimum Funding Requirement.

Specific Reforms

Contracting out

- Abolish the option for the future.
- Allow reorganisation of accrued contracted-out benefits.
- Transfer all accrued contracted-out benefits to a central fund.

Investment

- Abandon prescriptive aspects of Myners Code and the threat of legislation.
- Reiterate principle that trustees invest for the benefit of their members.

Benefit Limits and Taxation

- Root and branch review, without constraint of need to avoid all tax loss.
- More flexible basis, abandoning concept of preselected normal retirement.
- Abolish the Earnings Cap.
- Reinstate full tax relief on investment income.

Preservation

- Replace detailed regulations with principles.

Transfers

- Simplify by reducing options.
- Replace detailed regulations with principles.

Communication with Members

- Replace detailed regulations with principles.
- Ensure all requirements are contained in the same place.

Advice to Members

- Allow employers to provide basic level pensions-only advice and explanation in clearly-defined circumstances without the need for compliance with full IFA requirements.

The Minimum Funding Requirement

- Suspend immediately.

Accounting Standard FRS 17

- Urgent review required; meanwhile suspend introduction.

Member Nominated Trustees

- Replace detailed regulations with principles.
- Continue to allow employer opt-outs.

Overview

Buck Consultants welcomes the establishment of the Pickering Review. Effective change is long overdue. This Review presents an opportunity to make amendments that will put the law governing private sector pension arrangements back to a level where it can complement the design of schemes, rather than stifling them.

We are encouraged by initial indications that the Review will address a wide range of issues. The Review is the first opportunity since the Goode Review to take a strategic overview of the whole pensions arena, and to make recommendations that will produce a cohesive and effective result. Indeed, by considering all areas, this Review has the opportunity to cast its net even wider than the Goode Committee was able to do

With the rapid and increasing decline in private pension provision by employers, this may be our last chance to get it right for today's employed, since any delay in funding has a significant effect on the level of the final benefits provided. This requires a bold and imaginative approach by the Review Committee, and we hope that they will rise to the challenge.

The Need for Occupational Schemes

Occupational pension schemes remain an effective and relevant method of pension provision. Apart from the benefits of economies of unit costs they allow, they are the only effective medium by which the private sector can provide an element of guarantee to benefits, where that is appropriate. A large number of today's pensioners are direct beneficiaries of the effectiveness of such schemes.

In recent years, a number of factors have combined to exert pressure on occupational schemes. Indirect costs, particularly compliance, have made them more expensive than they need to be.

Employers should see a pension scheme not as an onerous burden, but as a means to attract and retain high-quality employees. Easing the cost of running such schemes will help in this regard. Employers must have the freedom to adapt their ongoing arrangements to changes in economic and other circumstances. If they are faced with huge practical difficulties and resultant costs every time change becomes necessary, they will react by closing existing schemes and simply not starting new ones. Indeed, there is evidence that this is already happening.

Compulsion is not the answer. Many employers would simply only do the minimum required under the law. UK industry has shown itself remarkably adept at producing effective scheme designs to date, to the considerable benefit of large numbers of employees; it would be a disaster if such initiative were to be strangled in future by poorly-targeted and unnecessary regulation.

Ironically, one of the worst culprits in this area is the legislation and resultant regulatory regime created by the Pensions Act 1995. Following on from the Goode Committee recommendations in 1993, the purpose of this legislation is to ensure the security of benefits of scheme members – a purpose that we support wholeheartedly, and made clear in our submission to the Goode Committee. Unfortunately, the practical application of this principle has not been wholly successful. It has resulted in a prescriptive, codified regime, effectively duplicating many of the protections that were already in force under other areas of law. This has added to pressures on sponsoring employers, affecting scheme design in inappropriate ways, and leading in many cases to good schemes being withdrawn. Ironically, the result has been a *reduction* in security for many employees' retirement income.

Of course we recognise that the burden of inappropriate regulation is not the only factor creating a difficult climate for private pension provision. The cost burdens created by factors such as greater longevity will continue to pose challenges for those seeking to make appropriate provision, but appropriate solutions are more likely to be found in an environment where regulation complements scheme design, rather than driving it.

The Burden of Layering

The practice of adding new rules on top of existing ones has been a feature of private pensions legislation and regulation over that time, and is one of the major contributors to the burden currently borne by those who sponsor and try to administer schemes. To progress, it will be essential to remove old provisions which currently continue to govern benefits earned many years in the past, under regimes very different from that applying today, but which will not be payable for some years to come.

Many of the difficulties and resultant costs currently facing administrators of occupational schemes arise from the need to administer these old benefits (many of which, as time passes and inflation continues to apply, are of small value). We recognise that changing these may result in some cases in a reduction in their value, or in their overall security, but believe that the resultant benefit for all of a new simplified system will outweigh these detriments.

Elsewhere in this submission, we propose a series of specific regulatory reforms. However, such reform is likely to be short-term and overtaken by further ill-thought-out regulation in years to come. So we make no apologies for putting at the heart of our response a proposal to reshape the whole way that Government approaches pensions policy. Only by such a radical new approach will we get a sustainable environment for the long-term and avoid the need for Pickering II in twenty years' time.

A Package of Principles

If reform is to be effective, it must result in a cohesive structure - a package of principles that fit together. The law and regulations governing private sector pension provision in the UK has suffered from being built up in a piecemeal fashion over many decades, with contributions made to the effort by a large number of organisations and government departments, each with their own discreet area of interest.

Thus, pensions have to cope with the rules of the Treasury (principles, which are implemented and regulated through rules and practice developed by the IR SPSS and also by other branches of the Inland Revenue), the relevant Social Security Department in existence from time to time, OPRA, the Pensions Ombudsman, and the FSA or its predecessors.

Then there are the burgeoning regulations imposed by employment legislation, and the influence of the European Union, which already affects pensions through employment rules, and whose influence is growing rapidly in other areas such as taxation and social security generally.

It is in the administration of an arrangement that the problems crystallise. Administrators are faced with a complex and muddled collection of rules built up over time in response to the conflicting demands of different parties, and often containing irreconcilable inconsistencies.

We are not suggesting that legislation has been deliberately or even negligently misdrafted. Many of the current difficulties arise from provisions that were designed as a genuine attempt to address or allieviate particular problems, often prompted by the pensions industry itself! However, these result in the imposition of further complications, which would not be necessary in the first place if the underlying system itself were not so complex.

One example of an area where this approach has resulted in additional problems is in the difference in the compliance requirements, such as for disclosure of information to members imposed upon "defined benefit" and "defined contribution" schemes. One problem that results is in respect of schemes where both defined benefit and defined contribution benefits are provided under the same trust, in identifying which of the requirements need to be complied with by the scheme.

This is the result of unclear thinking, combined with a prescriptive underlying regulatory regime. If the requirements for defined benefit schemes were not so onerous in the first place, there would be no need for easements for defined contribution schemes.

But the rulemakers are not the only blameworthy parties. Many schemes suffer from excessive complexity of design, which has been changed frequently over a number of years. Some of this has been due to the need to comply with developing legislative and other regulatory demands, and where the scheme design features a strong element of interaction with the benefits provided by the State, that will have matched changes in the State arrangements.

However, many scheme designers have allowed themselves to be influenced into making frequent changes in order to achieve a short-term financial gain to the sponsoring employer (such as to take advantage of financially advantageous contracting-out rebates) or to address a short-term financial or employment problem experienced by the employer.

And it is this short-term approach that has contributed to many of the problems associated with retirement benefit planning in the UK today. The effective provision of retirement benefits requires monies to be built up over the working lifetime of the individual – already a long time, and likely to get even longer as a result of demographic pressures and continuing improvements in longevity. This requires a stable environment to be maintained for a considerably longer period than the lifetime of a government or the tenure of office of a particular finance director. Unfortunately, that has not been the experience of the last few decades, and there is currently no sign of the trend easing. Without a change in mindset here, meaningful reform will not occur.

There must be a partnership between employers and government to establish and run retirement benefit arrangements for the benefit of the end consumer – the employee.

Employers must regain the confidence and will to commit to establishing new arrangements that they will maintain for the long term, resisting the temptation to tinker in response to relatively short-term changes in circumstances.

Government must establish a legal and regulatory environment that is cohesive, stable, protected from arbitrary change to fit with political dogma, and flexible enough to enable the majority of employers in the UK to establish and run long-term arrangements with the confidence that they will not be required at some later date to comply with new requirements that will add to their direct costs, or to the cost of administration.

The Key Reform: A New Pensions Authority

Parliament is currently debating a Bill to introduce Ofcom to regulate the communications industries. The new authority will amalgamate five different regulators, and will explicitly operate with a light touch. This is because the Government recognises that the communications industry is fast-moving and changing and unsuitable for prescriptive legislation.

Similarly, the Government has entrusted the stewardship of a key economic tool – interest rates – to an independent committee.

With these two examples in mind, we propose the creation of a Pensions Authority, to regulate the development of pension policy with a light touch.

The Pensions Authority should have two main functions.

The **first** would be to initiate, and draft, new legislation governing pensions. This would begin with the new simplified legislative framework that we are proposing, and would continue to ensure that any new proposed legislation or extension of regulation was tested against the new governing principles.

The **second** would be the regulation of the law in practice. This will require a sensitive approach to regulation, assessing arrangements and the actions of those running them against what will be a less clearly-defined set of principles, rather than the present "box-ticking" regulatory approach.

This will require a broad band of experience to be represented on the governing body of the new Authority, following a similar format to that employed for OPRA. The Authority's constitution should include a requirement that its governing body and all its officers must continually adhere to the overriding principles of practicality and proportionality.

The Authority should be established in such a way and with such powers as to ensure as far as possible that it will remain apolitical, and cannot be influenced by the government of the day – the Bank of England's MPC may be an appropriate model for this. It would also be helpful if as far as possible its authority were clear and wide enough to avoid the need to refer often to the courts for determination of issues.

The Authority could also be entrusted with the task of designing State pensions. Certainly it would possess the appropriate expertise, and its apolitical constitution would enable it to ensure that appropriate design criteria were always applied, and that necessary stability was maintained. Of course, such a move would not be popular with politicians, but since they have consistently failed to achieve consensus over any aspect of pensions issues for the last two decades, with the result that pensions have been reduced to a game of political football, they have shown that they are incapable of maintaining the level of stability which is vital to the effective provision of retirement benefits for the UK's population. It is imperative for the achievement of stability for this issue to transcend party political dogma.

There would obviously be a concern that the new Authority would, in time, start to extend its power and influence beyond that originally envisaged at its creation. This possibility can however be minimized by careful drafting of its constitution, including its powers and the overriding principles to which it and any pensions law must always adhere, and by providing that its governing body must always comprise a specified number of individuals drawn from representative pensions bodies.

The principle of the Sovereignty of Parliament means that there is no way of creating a body that is *guaranteed* to survive over the longer term, to ensure the continuation of the new apolitical, stable and appropriate pensions environment. It is therefore imperative that the Man on the Clapham Omnibus buys into this New Way, and then influences his political representatives to act accordingly. This will require a significant increase in the level of pensions understanding

generally – something which again will not be achieved without considerable simplification of the system.

Only in this way will it be possible to ensure that pensions will be immune from short-term bias and inappropriate influence, and to gain the confidence of both employers and their employees which will be required if they are to return to making appropriate provision.

The New Way – Simplicity Above All

The driver behind the success of the reform package will be **simplicity**. Every piece of legislation should have a clear retirement benefits purpose, be restricted to the minimum possible to achieve that purpose, and fit within a framework of high-level principles that allow genuine flexibility in individual scheme design, combined with a light regulatory touch. Simplification of the system, involving the removal of most of the prescriptive detail, will enable many helpful consequences to flow through. It will also enable many of the direct links with other areas of the law to be broken (such as the overly-complicated taxation system), as a result of which the number of parties who become involved in generating further legislation affecting occupational pensions should reduce.

This therefore rules out prescriptive legislation of the type much in evidence in regulations written under the Pensions Act 1995, in favour of a system of higher level principles to which schemes must adhere. The new framework must allow for scheme designs to be created that will endure through future social and economic changes – both anticipated, and as far as possible, unanticipated – and that will enable as many as possible of the pounds invested in the arrangement to be used directly for the provision of retirement benefits for the member.

Opponents of this approach in the past have cited a lack of certainty as the inevitable – and, they say unwanted – result. However, experience has shown that once a process of prescriptive legislation has been embarked upon, it actually *increases* uncertainty in practice, since more questions arise around the edges of the law that is prescribed and certain, questions which require yet further legislation and judicial intervention to resolve. The whole process feeds upon itself and rapidly grows out of control, in the process losing touch with the intentions behind the original legislation.

We can understand the attraction to the legislator of prescriptive legislation of the type that now prevails in the pensions area. Although as we noted earlier, much of the current member protection legislation effectively duplicates rules that already existed elsewhere, it does at least introduce a level of certainty, to which penalties can be attached for non-compliance. One of the perceived difficulties connected with the existing legal principles was the difficulty and expense to an aggrieved member of trying to enforce them against a more powerful party. However, we feel that our proposals, including those for the new Pensions Authority described above, will enable justice to be maintained, without the need for prescriptive legislation.

Implementation of The New Way

We identify later in this submission the current main problem areas, and propose some practical ideas as to how the New Way might be achieved. There will be many more detailed reforms that will flow from them. In considering these, it would be easy to follow the approach of legislators in the past and fall into the trap of looking only at future benefit accrual, believing that what has happened in the past has to be ringfenced and preserved. However, a large part of the complication (and therefore cost) of current arrangements is directly attributable to the need to maintain past provisions in this way. As new provisions are introduced, so the problem of these past benefits grows. If we are to achieve meaningful reform, we must find a way to remove these past millstones, and to free up employers to start with a clean sheet.

This has two immediate implications.

Minimise Loss of Accrued Rights

The **first** is that a way has to be found to minimise any possible loss of rights to members who have accrued rights and benefits under past regimes, and crucially to protect where possible the *value* of those rights. It has to be recognised that it will not be possible to retain all these rights. This will result in some individual pain, but if it can be kept to a minimum, it will be more than offset by the overall gain. The prize of a new long-term stable order will be worth some additional effort and cost now. As long as people have justified confidence that this current reform really will be long-lasting, and that the proposed simplification will help them to understand – perhaps for the first time, we believe that they will accept these effects.

Acceptance of, and confidence in, the New Way by employees is a crucial issue. With their freedom to participate in pension arrangements or not, as they choose, they must be convinced that it is in their interests to do so. A number of events over recent years which have generated bad publicity for pension arrangements, combined with an inability to understand the complexities of what is on offer, result too often in a mistrust of pensions arrangements generally. Where that results in no provision being undertaken, then we all are potential sufferers.

One major implication of such change however, is the likely contravention of section 67 of the Pensions Act 1995. This particular provision (ironically on its face a very good example of simple, non-prescriptive legislation, but which in its application in the current legislative environment of mixed prescriptive and non-prescriptive rules is causing practical problems) is currently a bar to many practical and commonsense proposals to simplify present arrangements. We support the principle that benefits which have already accrued should be protected, but we consider that there is already sufficient protection under trust law and consequently there is no need for a further statutory provision specifically for pension schemes.

Change along the lines we are suggesting therefore, may require a degree of *positive discrimination* in respect of some benefits or members, but this should be permitted only in respect of changes

which are proven to be necessary or desirable within limits policed by the new Pensions Authority. This would facilitate the clearing out of large amounts of old benefits subject to obscure restrictions, simultaneously enabling schemes to focus on the provision of actual benefits at retirement.

Embargo on New Obligations

The **second** implication concerns legislation and other regulatory changes that are currently being, or are shortly to be, introduced. If we are to move to a new, simplified, regime, these provisions must be retested against the new principles and abandoned or amended appropriately. This means that there must be an immediate block on the introduction of new obligations, such as the enforced introduction of the detailed requirements of the Myners Code, and the new regulations covering anti-franking and member nominated trustees, and where possible, the immediate removal of others which are causing current pain, such as the Minimum Funding Requirement.

Specific Reforms

In the next section of this submission, we identify a number of areas where particular barriers to effective pension provision exist. At this stage, these are necessarily addressed at a fairly high strategic level.

Many of the detailed provisions causing difficulties within these areas would automatically disappear with the implementation of the strategic reforms proposed. Those that would not, and any new detailed provisions that might be needed under the proposed new strategic regime, would have to be formulated later.

Contracting-out

- ***Abolish the option for the future***
- ***Allow reorganisation of accrued contracted-out benefits***
- ***Transfer all accrued contracted-out benefits to a central fund***

We believe that the State should always provide a safety net, at a level that is affordable over the long term, and to which a further level of benefit is added for those not able to arrange a reasonable level of retirement income for themselves. The level of any combined State-sponsored provision however should not be any more generous than is absolutely necessary, in order to comply with the overriding principles of freedom and the flexibility to tailor arrangements to individual needs. Based on this premise, we ask why it is thought necessary even to offer an option to contract-out of any part of State provision.

Once that has been accepted, there is no need to devise elaborate ways to permit alternative methods for partial replacement by private sector arrangements. Contracting-out would therefore not be needed. Its abolition would also remove the need for other related legislation, such as anti-franking.

Dealing with the Past

As a result of the perceived need to ensure the maximum possible security for contracted-out benefits, the regulations that govern those schemes that have taken on the responsibility have left a legacy of bureaucracy and cost which may possibly last into the next century.

The process has been made worse by the fact that as an adjunct to State planning, this is a prime area for political intervention, which has resulted in a number of different regimes to be complied with. Each regime has its own peculiarities, which successive governments have refused to address. A key example of this is the need to find a way to "equalise" GMPs in order to comply with the rulings of the European Court of Justice. Schemes which hold GMPs are in breach of the rulings because of the failure of successive governments to allow GMPs to be payable from the same ages for both men and women.

The most effective solution to deal with the legacy of bureaucracy strangling schemes from past contracting-out would involve the transfer of accrued GMPs to another funded arrangement, outside of the control or responsibility of employers and occupational scheme trustees. For other contracted-out benefits, there should be a softening of the regulations governing their retention within their present schemes, and the introduction of greater flexibility in the form in which they may be paid.

One reason often given for the decision to contract out is the desire to avoid exposing accrued State benefit to reduction by future governments keen to divert money to other projects with a higher short-term profile. This lack of trust in government to maintain benefits is unfortunately, a product of past experience.

One possible solution to this which we feel would be worthy of careful consideration are the proposals of the **Pensions Reform Group**, published in their work **"Universal Protected Pension: Modernising Pensions for the Millennium"**. Their proposals for a funded second tier State scheme have much to recommend them. More thought and debate is needed on some aspects of the detail, including the level of benefits to be provided and the governance of the funds. However, the principle of creating a fund, which would grant property rights to citizens in respect of their State pensions, would significantly increase the security of those pensions by reducing the ability of any future government to alter them.

The concept would also satisfy another traditional driver behind contracting-out, that of the desire by governments to rid themselves of the responsibility for significant future pension liabilities, which are currently unfunded, and which has been principally achieved by enhancing the National Insurance rebates paid to schemes that contract-out. This in turn encouraged employers to design their schemes to contract-out, simply to obtain short-term financial advantage. While perhaps understandable in the circumstances, this was by itself, not an appropriate reason to make such a fundamental design change, and the resulting administrative legacy remaining after the evaporation of short-term financial benefit has left many employers with a long-term headache.

The establishment of a funded second tier scheme would therefore address the issue of future liabilities, and remove the need to offer a contracting-out option in future. It would also provide a vehicle into which all current GMPs would be transferred, while at the same time providing the opportunity to simplify the regulations to which all contracted-out benefits are currently subject, in return for a guarantee that their accrued value would not be reduced.

Investment

- ***Abandon prescriptive aspects of Myners Code and the threat of legislation***
- ***Reiterate principle that trustees invest for the benefit of their members***

This is an area that has produced a lot of regulatory interest recently, most notably in the form of the Myners Review of Institutional Investment, leading in the case of pension schemes, to the Myners Code. We have already publicly explained why we are opposed to a number of aspects of this Code, but the main thrust of our objections is that it constitutes a further significant increase in the level of bureaucracy and unnecessary prescription on those running pension schemes.

We believe that the costs of compliance with the Code will add new impetus to the demise of occupational schemes under trust. Whilst we support a number of the underlying principles aimed at ensuring that trustees take a professional approach to their responsibilities in respect of the funds under their control, we see no reason for a further set of prescriptive regulations, principally designed to fit only with civil servants' idea of the perfect (large) pension scheme.

As the position currently stands, although the government has stated that compliance with the Code is voluntary, the criteria by which schemes generally will be judged in 2003 to have complied with the requirements make it inevitable that the threatened legislation will follow. This has been reiterated by recent statements on behalf of the government, although not consistently by Paul Myners himself.

The other driver behind the Myners Code is the desire of the present government to divert some of the considerable assets currently held by pension funds to other uses, such as venture capital, and to encourage greater participation in the running of companies. With such large sums currently belonging to pension arrangements (currently estimated at over £750bn) it is perhaps not surprising that governments take an interest in how they are invested. However, if these are truly problem areas, then they should be tackled from a different direction.

Pension funds are invested where they are today because in the current environment that is the most appropriate place for them to be. As the recent actions of the trustees of the Boots Pension Scheme have demonstrated, trustees will move funds in response to new challenges on their schemes when they consider it to be appropriate to do so. If there is perceived to be a need for new funding for parts of UK plc, then it is up to markets to create new investment vehicles that will satisfy the needs of pension funds, or if necessary for the government to create the environment where such new vehicles may prosper.

The problem should not be addressed by imposing new arbitrary requirements on pension schemes. In this respect, we support the arguments for trustees to go through an appropriate process of instigating, and keeping under regular review, their investment strategy and the selected investment

media, assisted where appropriate by their properly-qualified advisers, and which is applicable to the circumstances of their particular scheme.

Trustees of pension funds have clear duties to act in the interests of their beneficiaries as a whole. That is as it should be. The trust system is wholly appropriate for the purpose of providing secure retirement benefits for members, and trustees should be left alone to get on with the job without being diverted by constraints dictated by outside issues.

Accordingly, we believe the Myners Code should not be imposed in its present form.

Benefit Limits and Taxation

- ***Root and branch review, without constraint of need to avoid all tax loss***
- ***More flexible basis, abandoning concept of preselected normal retirement***
- ***Abolish the Earnings Cap***
- ***Reinstate full tax relief on investment income***

Although we understand the purpose behind benefit limits, we consider that they are no longer relevant in their present form. They impose a large administrative burden on schemes, when the benefits for the vast majority of members will never come close to the limits, let alone exceed them. They are subdivided into three (arguably four) regimes, and contain a number of irritating and irrelevant restrictions that pose a significant bar to the efficient administration of schemes.

We know that the Inland Revenue are currently conducting a review of these limits. Given our understanding that currently, the overriding restriction on that review is that it must not result in a diminution in the amount of tax revenue, we have severe reservations about its ability to deliver meaningful reform. We therefore recommend that Inland Revenue limits be included as part of this Review.

The limits themselves require a fundamental reappraisal. Gearing pre-1989 benefits to a preselected normal retirment date is outdated, requiring a large number of additional rules to deal specifically with retirement before and after that date, and with leaving pensionable service (which we address later under "preservation"). The concept of a fixed date for commencement of benefit payments also runs contrary to both the need for a flexible workforce in a modern complex economy, and to the need to address the challenges posed by an ageing population.

Given that benefits taken in the form of an annuity are subject to income tax on the same basis as earned income, there should be no need for the Inland Revenue to impose such limits.

For benefits provided on a defined contribution basis, restrictions should only apply to contributions, with emerging benefits being unrestricted. This is currently the case in respect of schemes approved under Chapter IV of Part XIV Income and Corporation Taxes Act 1988. The fact that schemes can choose different bases of approval is itself an unnecessary complication, and an example of the muddled thinking that allows multiple, incompatible types of arrangements to coexist, and then seeks to try to somehow put all of the arrangements on a level footing relative to each other, and allow transfer options between them all.

There should be one, simple, approval basis for defined benefit schemes. The restrictions should be in the form of a limit on the fraction of remuneration which can be made pensionable in respect of each year of service completed – regardless of when it is paid. However, we do accept that some of the present sophistication to cater for late entrants with insufficient accrued benefits, or members

who move to a highly-paid job in late career, is useful, and its continuation should not unduly affect the simplified rules for those of whom it is not appropriate.

In the cause of simplicity, and bearing in mind our comments on the taxation basis of pensions in payment, we also believe that the Earnings Cap is an irrelevance and should be abolished, certainly in respect of pensions. As far as its continued application to tax-free cash sums is concerned, that debate should be had against the background of accurate figures illustrating the cost to the Exchequer of its removal. If at all possible, it should be removed altogether.

Finally, on the subject of taxation, we believe that there should be tax incentives to encourage saving for retirement. We consider that the reduction, and then the removal of ACT (Advanced Corporation Tax) credits on pension funds was ill-considered, and we are only now seeing the effects of that on private pension provision. When added to all the other pressures on employers, we believe that this measure alone is responsible for a significant proportion of the reduction in benefits, including those hidden in a reduced contribution rate which often accompanies a move from defined benefit to defined contribution. Accordingly it should be reversed.

Preservation

- ***Replace detailed regulations with principles***

One of the areas which produces the most work for schemes is that of compliance with the Preservation regulations.

As a matter of principle, employers who enter into contractual agreements voluntarily with their employees in good faith and on a specific basis, should not then have their costs increased by government requiring them to provide further benefits; relative to their competitors, they are being penalised for their original generosity. This is effectively what has occurred in respect of Preservation regulations. The new Authority should be restricted to ensure that such action cannot be repeated.

We agree with the need to ensure that members of schemes receive the value of the benefits that they have earned from their employment with the employer, however once the basis of calculation of such benefits is settled, there should be no later additions imposed on schemes.

As far as Preservation regulations as a whole are concerned, we recommend that the detailed regulations be replaced instead with a set of clear principles. Each individual scheme would then be responsible for its own compliance, subject to review by the new Authority. The overriding principle would be that the value of the accrued benefit must be maintained, but its shape could be amended to fit with the scheme in which it is held (whether that be the scheme in which it accrued or any arrangement to which it may be transferred).

Finally, to further reduce the amount of regulation to which schemes are subject in respect of deferred members, an option would be to allow schemes to require the transfer (without consent, if necessary) of such a member's accrued benefits to another scheme, or to a buy-out policy. However, this may not be to the member's benefit in all cases, and if the Preservation regulations were simplified to the level of a collection of principles that provide individual schemes with considerable freedom in their application, such a provision may not be necessary.

Transfers

- ***Simplify by reducing options***
- ***Replace detailed regulations with principles***

This is an area that involves considerable complexity. Regulations exist to protect both the value and integrity of the benefits being transferred, and to ensure that tax relief given is not abused. These rules are the responsibility of different government departments, with interests which at times conflict, so that further rules are necessary to decide whose rules take priority!

In many cases, transfers of accrued benefits by early leavers are not really necessary or even particularly desirable. In those that are, the rules that apply should be straightforward and kept to a minimum and should simply ensure the value of the benefit being transferred is protected, and that the receiving arrangement is tax approved. As with the Preservation regulations, the rules should essentially consist only of a series of principles that have to be observed by transferring and receiving schemes respectively.

Communication with Members

- ***Replace detailed regulations with principles***
- ***Ensure all requirements are contained in the same place***

No one can reasonably object to the principle that a member of a pension scheme needs to be given relevant information about that scheme and his or her interest in it. However, this basic principle has once again been expanded and translated into a series of detailed prescriptive regulations that not only dictate the types of information to be provided, but also the frequency, and in some instances even the precise format in which it must be presented. With more recent regulations, these rules have spread out so that they are now not all in one place. This makes it more difficult for scheme administrators to comply with the requirements, and increases the possibility of breaches occurring.

This is another key area where the thought process behind the legislation is flawed. It starts with the premise that members' interests are best served by giving them large amounts of written information, from which if they were pensions experts, they could extract sufficient information to assess the state of their retirement funds from time to time.

However, this ignores two fundamental truths. The first is that the pensions system is so complicated that no one but an expert (and not even all of those!) can fully understand all the ramifications of the information provided. The second is that, even if it were straightforward and easily understood, most people are not interested in reading about the details until quite late in their lives – and certainly too late to make any appreciable corrections if they are unhappy with their current arrangements. Simply providing more information is not the answer; the result too often is that it goes unread.

The current prescriptive approach requires complex detailed regulations to cope with the many variations in scheme design that currently exist. It follows that every time a new design emerges, the regulations will need to be reviewed and possibly added to in order to cover the new design variant.

Once again, we would advocate a series of principles to which schemes must adhere – with their detailed application being left to individual schemes to devise, in keeping with their own particular circumstances, but nevertheless designed to achieve the highest possible level of real communication with members.

Advice to Members

- ***Allow employers to provide basic level pensions-only advice and explanation in clearly-defined circumstances without the need for compliance with full IFA requirements***

We have frequently referred in this submission to problems caused to employers by the complexity of the system. However, members can also be adversely affected. In the introduction, we referred to the need to allow employers flexibility to adopt scheme designs that complement their financial positions, and to change those designs when necessary.

Although it benefits all parties to keep scheme design as straightforward as possible, it is necessary at times for employers to adopt some fairly sophisticated designs, for various financial, as well as other reasons. Current thinking in this area is to utilise at least an element of defined contribution, where members need to take decisions in the areas of investment choice and the level of contribution. The complexities inherent in these areas necessarily require a high level of understanding, which unfortunately is not generally present in most employees. The position is exacerbated by the unnecessary legislative complexities already referred to.

It is apparent from this therefore that most employees will at times be in need of good advice, much of it probably at a fairly basic level, and much of that would simply be explanation on a one-to-one basis. However, the current regulatory system governing the provision of advice, whilst attempting to ensure that when it is provided it is of the highest standard, ironically has a negative effect by cutting off most employees from it altogether. Employees' attention is usually drawn to the desirability of obtaining independent financial advice, but there is usually a cost, which most members are reluctant to pay. Part of this cost would be generated by the need to undertake formal fact-finds which are not necessary to provide the basic level of pensions advice required. Attempts are made to fill this gap by providing increasing amounts of information on paper, but as we explained earlier, this is not the answer. The information is in many cases simply not understood, assuming it is even read in the first place.

There are two innovations that would help.

The **first** is to simplify the options available. This will necessitate the loss of some potential choice for members such as for example, the facility in certain circumstances to have concurrent membership of both an occupational scheme and a stakeholder arrangement. However in practice, this will not be a problem, since due to a fundamental lack of understanding in most cases, these options are not currently being taken up. Complications such as this would not arise in an environment, where the need to have a number of incompatible schemes all competing with each other, would be eliminated.

The **second** is to make a limited form of advice available at the workplace, where it is going to be of most value. Those of the employer's staff who work on his scheme are well placed to give a basic level of advice and explanation to members with little risk of misleading them. At the moment however, they cannot do so without effectively becoming pensions professionals, passing examinations and undertaking regular updating courses, which have little relevance to their main work.

Clearly, the extent to which such advice can be given will have to be carefully defined, to avoid such "advisers" stepping over the line and giving advice in areas that are outside their expertise. On paper, such a relaxation in the rules would represent a reduction in the security of members but in practice, if it is going to be the only access most employees will have to advice, it is a compromise which on balance, is worth making – and may be the only way that many members will actually get advice. It is also relevant to note that some relaxations to the current regulatory system in respect of retail products are being proposed by the Financial Services Authority. Close liason with the FSA as it develops its new regime should help to ensure a welcome degree of consistency in this difficult area.

If this proposal is to be accepted, the question of appropriate protection for those giving the advice will need to be addressed. In today's litigious society, where if a person suffers a disadvantage he often looks for someone else to blame, there is a clear danger that this basic level advice could be made the subject of legal action in the event that the recipient did not like the final outcome at retirement. Concern over this potential liability could prevent even basic level advice being given at all.

Consequently, some form of statutory protection would need to be effected. One possible approach would be that currently provided to statutory whistleblowers under the Pensions Act 1995. The legal profession should be asked to consider the effectiveness of such a provision in this context, and to suggest alternatives if that is not deemed appropriate.

The Minimum Funding Requirement

- ***Suspend immediately***

This hugely complex piece of legislation is inappropriate and is now causing significant and unnecessary pain for a number of employers with defined benefit occupational schemes.

Although this fact has been recognised, and a decision has been taken to replace it, the requirement itself is still in force, and is causing severe difficulties for a number of employers. Given the current recognition that it is not a valid test of the security of funding for benefits, interim measures should be taken as a matter of urgency to relieve its worst effects on a temporary basis.

Certain affected employers will have to endure the painful experience of having to comply with the MFR regulations some time after having voluntarily set up a scheme. In the event that they find the residue of the MFR requires them to fund at a higher level in respect of benefits accrued to date, they may well decide to opt out of future provision altogether, unless they can be reassured that the experience will not be repeated. Consequently, it is imperative that they have confidence that whatever follows will not cause their business further severe problems in the future.

Accounting Standard FRS17

- ***Urgent review required; meanwhile suspend introduction***

This new standard, like the MFR, is causing significant concern amongst employers with defined benefit occupational schemes. Many such employers have genuine fears that it will have significant and detrimental impact upon their business, and their ability to pay dividends to shareholders, and to raise necessary finance. Indeed, early results from some large companies who have produced their accounts on the FRS17 basis seem to bear this out although some have found the opposite.

Companies have been reporting results on the current basis, apparently without any general or obvious problems to date. A new arbitrary accounting method, which is by no means universally accepted as a true indication of the worth of a company, essentially discriminates between two companies that, apart from their pension arrangements, are otherwise very similar.

Whether or not it generally produces effects as marked as those feared, the mere existence of the standard at a time when there are already so many pressures on employers to abandon pension provision makes it inappropriate.

The standard should therefore be reviewed as a matter of urgency, and its implementation halted pending the result of that review. Given the reluctance of the Accounting Standards Board to review it voluntarily, the government should override the ASB on this matter.

Member Nominated Trustees

- ***Replace detailed regulations with principles***
- ***Continue to allow employer opt-outs***

Although from one perspective, we understand the reasoning behind these provisions, we consider that the thought process behind them is flawed; furthermore, the resulting regulations are unnecessarily onerous. As a matter of principle, the requirement for a proportion of the trustee board to be appointed by the members encourages a devisive approach to trusteeship. Trustees are encouraged by the provisions to consider themselves as "representatives" of the constituency that nominated them. Pension schemes should be run on a consensus basis, recognising and balancing the legitimate interests of a number of parties, including the employer.

Although we have not seen many examples of this potential problem to date, we believe that it remains a real threat for the future, since most schemes currently operate under the "employer opt-out" procedure allowed under the original MNT regulations. When the new regulations, which outlaw this option start to bite, with most reviews next occurring in 2003, the problem is likely to start appearing.

Most schemes currently operate perfectly satisfactorily under a procedure whereby the employer appoints all the trustees, but in many cases, will bear in mind the desirability of having a widely-drawn trustee board. Given the real danger that could arise, we therefore see no reason for a continuation of the requirement that all trustee boards should comply with a regimented perception of an ideal.

Conclusion

We are firmly convinced of the need for considerable simplification of the existing system. It is clear that we are not alone in that view.

However, we also firmly believe that if occupational provision is to survive, it is essential that the whole system is re-thought from scratch, with the objective of becoming a fully integrated pensions system, without interference from inappropriate outside influences. The existing system suffers from having been developed in a piecemeal fashion over a long period, by different coloured governments, different Civil Service departments and other organisations. Currently, there is no sign of that process changing, and we would urge the Review Committee to press for this to happen as a matter of priority.

Our proposals in this submission cover only some of the issues that need review, however, we think that they are the most important. Some of our recommendations are necessarily at a strategic level while others have been kept deliberately brief. We would be happy to expand on some or all of them if this would be beneficial.

If the basic parts of an integrated system, installed and administered by a single organisation, can be put in place, many more worthwhile reforms will follow. In that situation, we would be pleased to assist in any more detailed proposals where that would be considered helpful.