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The Simplification of Pensions - Pension Green Paper – action on occupational pensions

1 INTRODUCTION

The Government has announced another step towards simplifying occupational pension schemes by publishing its follow up to the December 2002 Green Paper[1]. The latest offering from the Government - "Action on occupational pensions"[2] - takes account of the responses to the Green Paper consultation and announces some key changes in relation to occupational pensions.

To recap, the principal goals and objectives behind the Green Paper included:

- Encouraging more individuals to save for their retirement;
- Greater protection for members;
- Simple and proportionate regulation.

The main points arising from the "Action Paper" are summarised below.

2 IMPROVING MEMBER PROTECTION

2.1 *WINDING-UP – SOLVENT EMPLOYER*

The Green Paper made it clear that the Government intended to strengthen the protection for members whose solvent employer chooses to wind up its scheme. The upshot is that solvent employers who choose to wind up their occupational pension scheme will need to ensure "that there are sufficient funds in the scheme to meet the full costs of the rights accrued by scheme members unless doing so would put the company itself at risk". If the company were to be put at risk,

[1] Simplicity, security and choice: Working and saving for retirement published on 17 December 2002

[2] Simplicity, security and choice: Working and saving for retirement, Action on occupational pensions published on 11 June 2003

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the trustees of the scheme, "exercising their fiduciary duties", will be able to agree a lower amount.

Crucially, the Action Paper states (somewhat ambiguously) that trustees of schemes may use the draft regulations "so that they apply to schemes that are winding up on, or that start to wind up after, the date on which the draft regulations are issued". The draft regulations were published on 11 June 2003 and make it clear that the new buy-out basis only relates to schemes which begin to wind up on or after 11 June 2003. The consultation period ends on 22 July 2003.

The Government also intends to restrict the ability of an employer whose scheme is on-going and in surplus (on its own funding basis) to take a repayment "unless the scheme can meet its pension promise in full".

2.2 *WINDING-UP PRIORITY ORDER*

The Green Paper also set out numerous possible changes to the winding-up priority order so as to try to ensure a fairer sharing of assets where a scheme which is winding up has insufficient assets to meet all of its liabilities. Draft regulations will be published over the summer and the Government intends to afford the greatest protection to those members who have contributed to a scheme for the longest. However, the Action Paper does not make it entirely clear whether such benefits would rank above or below pensioner benefits (although there is a suggestion that they may well rank above). Benefits in respect of non-pensioners will rank above pension increases.

These regulations are likely to be in force by the autumn.

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2.3 *PENSIONS PROTECTION FUND*

A compensation scheme, the "Pensions Protection Fund", is to be introduced to protect members of defined benefit schemes whose employers become insolvent "with unfunded liabilities in their pension scheme". The intention is that this will provide a maximum of 100% compensation in relation to pensions in payment and 90% of benefits for those members who are "still working" (presumably, all non-pensioners) in these circumstances. But this will be subject to a cap "equivalent to the pension expected by those on a final eligible salary of between £40,000 and £60,000".

The financing for the Pensions Protection Fund, which will be run by a statutory body, will come from a combination of a flat-rate levy payable by all employers and a risk-based premium payable by underfunded schemes.

2.4 *BETTER INFORMED AND BETTER TRAINED TRUSTEES*

This is not a new issue as, in response to the Myners review, the Government consulted in 2002 about a proposal to legislate to increase the standard of care required of trustees who make investment decisions to that of someone "familiar with the issues". This was reiterated in the Green Paper. However, the Government proposes to legislate so that trustees are "required to be familiar with the issues or have relevant knowledge across the full range of their responsibilities" (i.e. not just in relation to investments). Guidance on how to satisfy this legal requirement will be set out in Codes of Practice (see paragraph 2.10 below).

2.5 *TRANSFERS OF EMPLOYMENT*

Unlike other contractual terms, the obligation to provide benefits for old age, invalidity or survivors under an occupational pension scheme does not automatically transfer on a business transfer

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under the Transfer of Undertakings (Protection of Employment) Regulations 1981 (TUPE). The Government has, for some time, been keen to bring pensions within the scope of TUPE. Although the Green Paper invited comments on a number of options, the Government now suggests that, following a business transfer, receiving employers will be required to match employee contributions of up to 6% to a stakeholder pension (where those employees previously enjoyed the benefit of pension contributions).

2.6 *BETTER PROTECTION FOR EARLY LEAVERS*

The Government has taken on board the spirit of the proposal in the Pickering report[3] to abolish the current two-year vesting period. Essentially, employees who have been a member of a scheme for at least three months but who leave during a vesting period (which is not specified) will need to be given the choice between a return of contributions (less tax) or a cash equivalent transfer value, which they must transfer out.

2.7 *COMPULSORY MEMBERSHIP*

There are no current plans to allow employers, on a voluntary basis, to make membership of their occupational pension schemes compulsory. However, the Action Paper suggests that "there may be scope for the new Pensions Regulator to issue general guidance that employers should ordinarily include employees in their pension scheme unless they actively choose to opt out of it".

2.8 *CHANGES IN BENEFITS – CONSULTATION WITH EMPLOYEES*

A consultation paper will be published over the summer introducing a requirement for employers to consult their employees, employee

[3] Alan Pickering, A simpler way to better pensions – An independent report

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representatives or both prior to any pension scheme changes being made. (A new EU Directive on consultation is due to be implemented by March 2005.)

2.9 *A NEW REGULATOR*

A recent report[4] has criticised Opra (the Occupational Pensions Regulatory Authority) for focusing on "trivial" regulatory breaches instead of addressing major risks posed to occupational pension schemes. It is also a widely held view that Opra's original mandate was too restrictive. In line with the Pickering report (and as outlined in the Green Paper), the Government intends to establish a new "Pensions Regulator" which will "focus on tackling fraud, bad governance and poor administration, and will encourage best practice through an increased education and guidance role". The Pensions Regulator will have "statutory objectives that set a clear framework" and, as well as the power to sanction, will be able to carry out compliance visits.

The Green Paper indicated that the Pensions Regulator would be funded, as now, through a scheme levy.

2.10 *SIMPLIFIED LEGISLATION AND CODES OF PRACTICE*

The Green Paper specifically recognised the complexity of existing pensions legislation. The Action Paper reiterates its aim to "restructure and simplify pensions legislation" so that the "level of prescription will be based on the risk to the benefits of scheme members". As part of this process, the Pensions Regulator will be given power to issue Codes of Practice. However, although only breaches of the legislation itself will be subject to sanction, Codes of Practice will have "evidential value" in

[4] Public Accounts Committee – Fifteenth Report: Opra tackling the risks to pension scheme members (HC 589)

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proceedings, say, before the Pensions Ombudsman.

3 MAKING PENSION PROVISION EASIER FOR EMPLOYERS

3.1 SCHEME-SPECIFIC FUNDING

This has been on the cards since the Government announced in March 2001 that it was going to replace the Minimum Funding Requirement with a scheme-specific one. The "key elements" of the new requirement will entail:

- the trustees drawing up a "Statement of Funding Principles";
- following each actuarial valuation (at least every three years as now), the trustees putting a Schedule of Contributions in place;
- the trustees sending members information on the funding position of the scheme each year (this is consistent with the "likely requirement" under the EU Occupational Pensions Directive).

If trustees and employers cannot agree on "issues fundamental to the funding of the scheme", the trustees will be able to freeze or wind up the scheme "as a last resort".

The scheme actuary's duty of care towards scheme members will also be clarified

3.2 *MODIFYING ACCRUED RIGHTS*

In the Green Paper, the Government stated that it would allow accrued rights to be modified "in certain circumstances and within well-defined limits" so as to lessen the current burden when modifying schemes imposed by section 67 of the Pensions Act. The proposals now set out in the Action Paper are based on those made by the Pickering Report

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and will allow schemes to change scheme rules if:

- there is a power in the rules to do so and the trustees consent to the change;
- the changes do "not involve converting defined benefit rights into defined contribution rights";
- "the total actuarial value of members' accrued rights at the point of any change is maintained";
- there is no reduction of pensions in payment; and
- members are consulted before changes are made.

3.3 *CONTRACTING-OUT AND INDEXATION*

3.3.1 *Survivors' benefits and indexation*

The Government has decided not to abolish survivors' benefits (which was one of Alan Pickering's more controversial proposals) but is to relax the requirements relating to indexation by requiring schemes to increase pensions in payment only by inflation, capped at 2.5% each year. Pensions in payment will not be affected by this relaxation; however, the precise effect on other scheme members' benefits accrued up to the date of change is unclear.

3.3.2 *Scheme Reference Test*

A "package of measures" will be put forward to simplify contracting-out which will include:

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- relaxing "some restrictions" on contracted-out benefits being commuted (taken as part of the tax-free lump sum) and contracted-out benefits being taken at the same time as other scheme benefits;

- increasing the level at which small contracted-out benefits can be commuted.

In the light of the responses to consultation, the Government has abandoned its intention to abolish COMBS (Contracted-out Mixed Benefit Schemes).

3.3.3 *Guaranteed Minimum Pensions (GMPs)*

Rather disappointingly, the Government's only substantive comment about GMPs is that it is "continuing to explore options" for simplifying their administration.

3.4 *OTHER SIMPLIFICATIONS*

A number of other proposals (some old, some new) will also be taken forward:

- to "rationalise the rules governing the way occupational schemes communicate with members";

- to require all schemes to have at least one-third member-nominated trustees but without having an overly prescribed procedure for achieving this;

- to streamline procedures for dealing with scheme disputes;

- to remove the requirement that schemes provide facilities for members to make Additional Voluntary Contributions, although a scheme may continue to do so. A scheme member who wishes to make additional contributions will be able to do so through a stakeholder arrangement;

- to abolish safeguarded rights in relation to pensions on divorce so as to allow greater flexibility when implementing a pension share;

- to clarify the Pensions Ombudsman's jurisdiction so that "maladministration by an occupational or personal pension scheme [falls] clearly within his remit".

Finally, the Government has invited the NAPF (National Association of Pension Funds) to work in conjunction with the Inland Revenue "to find a simple, workable solution to one final difficulty…cross-subsidy between unconnected employers".

4. CHOICE FOR ALL – PLANNING FOR RETIREMENT

4.1 *MAKING CHOICES AND PLANNING FOR RETIREMENT*

One of the messages emerging from the consultation process is the importance of providing individuals with the right personalised information so that they can plan for retirement. Key plans here include that:

- members of defined benefit schemes will need to receive an annual benefit statement (this is already the case for defined contribution schemes);

- employers will be encouraged to provide combined pension forecasts (which cover both state and occupational benefits) on a voluntary basis (but the Government will legislate to allow it to require regular forecasts to be issued if it feels it necessary in the future to do so).

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4.2 *WORKING WITH EMPLOYERS*

Many respondents to the Green Paper share the Government's view that employers "have a pivotal role to play" in promoting pension provision and providing information. Therefore, the Government is to pursue "a pilot scheme" so that it can evaluate the effectiveness of providing employees with access to pensions information and advice in the workplace. If the pilot scheme proves a success, the Government may well then legislate.

4.3 *REALISING THE POTENTIAL OF ODER WORKERS*

I terms of initiatives for older workers:

- the option contained in the Green Paper to allow employees to continue to work for their employer whilst drawing pension has been widely welcomed, but the trade-off for this will be that the earliest age from which pension may be taken will be age 55 from 2010 (up from 50);
- there will be further consultation over the summer on the EU Directive on age discrimination, which needs to be implemented in the UK by December 2006.

5. OTHER BODIES INVOLVED IN THE NEW PENSIONS FRAMEWORK

5.1 *EMPLOYER TASK FORCE*

The Government has now established an employer task force which includes both employers and trade unions. The aim of the task force

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(which was set out in the Green Paper) is to promote the employers' role in pension provision, developing best practice and encouraging employee saving (for example, by increased take-up of pensions).

5.2 *THE PENSIONS COMMISSION*

The Pensions Commission was established in the wake of the Green Paper "to monitor and keep under review the system of private pensions and long-term savings". It is believed that an interim report by the Commission outlining "the present situation, current trends, and the challenges which need to be met" will be published in 2004.

6. TAX

Whilst the tax simplification review is not specifically dealt with in the Action Paper, Andrew Smith, the Secretary of State for Work and Pensions, also announced on 11 June 2003 that the new implementation date for the tax simplification proposals put forward in the Inland Revenue's December 2002 Consultation Paper[5] will be April 2005. It was originally intended that these proposals would be put in place from April 2004 but this has been delayed in order to allow the industry more "time to prepare for the radical new simplified regime".

The next phase in this particular consultation will take place in the autumn.

7. TAKING THE AGENDA FORWARD

The Action Paper sets out a fairly detailed and useful timetable for introducing the changes discussed. Over the summer we can expect consultation on

[5] Simplifying the taxation of pensions: increasing choice and flexibility for all

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changes as diverse as winding-up priorities and age discrimination. However, the bulk of the reforms will be introduced, at the earliest, in Spring 2005.

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8. CONCLUSION

The Government has quite clearly listened to the pensions industry on some issues (such as reforming section 67) but we continue to remain in the dark regarding solutions to other long-standing problem areas such as GMPs. The Government has, however, taken steps to address the critical issues of ensuring that pension schemes are adequately funded and of how to deal with cases where pension schemes are wound up when underfunded. Not all of these steps will be welcomed by employers, who are likely to be faced with even greater financial obligations.

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