



Regulation of Pension Schemes

The current chaos in pensions regulation is detrimental to the very people regulation is aimed at protecting.

By Ian Pittaway, Partner

The regulation of pension schemes in this country is leading to lower and fewer pensions for members. How have we got ourselves into this mess?

A man from Mars might say the basic framework looks in good shape. On a voluntary basis many employers have granted generous benefit promises, albeit for their own valid commercial reasons. Millions upon millions of workers, and their dependants, are either already enjoying decent pensions or can look forward to them when they retire. And with in excess of £800bn of assets already put aside, the promises made are by and large covered.

A bit of a success story. But have we got the regulation of it right? Surely the purpose of regulation is to encourage what is good while safeguarding risk in a proportionate way.

Proportionality is critical. It is obviously possible to regulate any activity to such a degree that it suffocates that underlying activity. We have seen with BSE and the railways some of the difficulties of getting this balance right.

I feel very strongly that we have lost that balance in pensions. It is a fundamentally honest industry where the overwhelming majority of pensions are provided in full and always have been even before the current regulatory code. Supporters of regulation will invariably cite the Maxwell case as justification for extensive regulation.

But what happened there was theft of the assets. No regulatory system in the world can provide 100% protection against that; indeed the whole code of regulation introduced by the Pensions Act introduced no specific measures to combat theft of the assets. And we should not forget that the pre-Pensions Act legal position allowed those trustees to recover most of the stolen assets and that most of those affected are receiving their pensions.

Let us look at two specific examples of over-regulation; the minimum funding requirement (MFR) and the complaints mechanism.

What is the mischief the MFR is seeking to protect? Of the £800bn in assets virtually none of it will be stolen from pension funds. And if it is, there is the Compensation Fund. An indication of the level of fraud is that there has only been one successful claim against it of around £40,000; a trivial figure in overall pensions terms.

There will be a slightly larger group of members (but still very small in overall terms) where the employer goes insolvent. Those members will typically still get their share of the £800bn pre-funded assets but this may not be enough to meet the pension promised to them. This might result from an employer not funding the scheme up to an acceptable level (but more likely through the disparity between annuity costs and the MFR).

A deeply flawed MFR

So in order to safeguard this very small group of members we impose the MFR which is universally acknowledged as deeply flawed. But the imposition of this volatile and illogical standard has led to many employers abandoning perfectly good defined benefit schemes. Let's be frank. The defined contribution replacements are often inferior in terms of value going in and always shift the investment risk to the member.

Many more members will receive inferior pensions in the future because of the effect MFR has had than will benefit from its protection.

On this count Myners was a breath of fresh air. I am less bothered about the impact of MFR on distorting investment markets. What irritates me more is when a measure which is designed to protect members harms them.

I would support Myners but go further than him. Abolish MFR but do not replace it or add any further protections. Sure some members will get lower pensions than they might have expected but sometimes the greater good must prevail.

Another area where there is an unbalanced situation is in the area of member complaints. Before the Pensions Act it was too difficult for members to pursue legitimate complaints. But now the pendulum has swung too far the other way.

There is a particular problem with some types of complaint to the pensions ombudsman. The requirement to go through to the Pensions Advisory Service (OPAS) first is a useful sifting mechanism. But even if OPAS does not support a complaint, the member can still persist with it. Even if the claim has little merit, the employer/trustees have no choice but to defend it using management time and often incurring significant legal fees. This is especially so if the complaint is not member-specific but has wider implications for other members or the scheme generally.

Legitimate Complaints

Why not require a member whose complaint has been rejected by OPAS to pay a token fee (say £200) to have their complaint investigated by the Ombudsman? If they win, it will be reimbursed but not if they lose. This would concentrate the minds of members; at present they have nothing to lose in making a complaint and everything to gain. The employer/trustees always lose in terms of cost even if they win.

It will be argued that this would deny complainants justice. But it could be tempered by giving the ombudsman discretion to dispense with the fee if the complainant demonstrated that he or she genuinely couldn't pay it (as opposed to not wanting to pay it).

Am I hopeful that some of the regulations will be cleared away? Sadly not. It would require brave, mature legislators and civil servants willing to re-introduce that proportionality. They would understandably fear criticism if a single member lost out through their relaxation of regulation. It is all too easy to stick with what you have got and ignore the overall long-term damage it is causing.

But perhaps Myners' suggestion to abolish MFR is a straw in the wind. He might even be flying a kite for the Treasury. Let's hope so if only for the members' sake.

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