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THE PENSIONS BILL

[A Discussion Meeting, held by the Faculty of Actuaries, 20 February 1995]

INTRODUCTION

1 This short paper has been prepared to draw the attention of members to the more actuarial aspects of the Pensions Bill, and, it is hoped, it will assist in focusing and stimulating discussion on these issues.

2 Although the Bill runs to over 150 pages, it is largely a paving document, giving powers to the Secretary of State for Social Security to regulate, in detail, as he sees fit. It, therefore, represents another step in the development of policy, rather than a fully definitive statement.

MINIMUM SOLVENCY REQUIREMENT (CLAUSES 49–54)

3 The Bill confirms that it is the Government's intention to introduce a Minimum Solvency Requirement on occupational pension schemes. Actuarial valuations will be required within prescribed periods and at prescribed intervals by the trustees of schemes. In addition, Actuarial Solvency Certificates will be required, as well as schedules of contributions detailing the rates of contributions that are to be paid. The rates on the schedules will be those that have been certified by the actuary of the scheme.

4 Although the Bill does not set out the basis or the timescales, the Government has let it be known that for 'large schemes' it is their intention to modify their earlier proposed basis to allow the closed fund for pensioners to invest, in some degree, in equities. The bulk of the benefits within 10 years of retirement will still require a fixed-interest gilt-edged approach to valuation, but an equity approach can be adopted to fund payments due more than 10 years hence. The market level adjustment for the proportion of the liabilities which is assumed to be backed by equities will be related to movements in equity markets. Under this proposal, the proportions of liabilities for pensioners backed by equities would not be permitted to exceed 25%.

5 The Government has also made it be known that they intend, in the Regulations, to extend the correction periods following a fall below the 100% solvency level from 3 years to 5 years, and for schemes falling below the 90% solvency level from 3 months to 1 year.

WINDING UP (CLAUSES 66–70)

6 The Bill makes provision, where a salary-related occupational pension

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scheme is wound up, for the order, in which the available funds of the scheme are to be applied, to satisfy the different liabilities of the scheme.

7 If there are insufficient assets to satisfy all of the liabilities of the scheme, the Bill makes provision for the available funds to be distributed in the following order of priority:

(1) expenses associated with the winding up of the scheme, including any independent trustees' fees;
(2) benefits related to AVCs, where the assets can be identified;
(3) pensions in payment, but ignoring any guaranteed future increases;
(4) cash equivalents covering prospective pension entitlements, excluding guaranteed post-retirement increases; and
(5) rights relating to pension increases on existing and future pensions.

Requisite Benefits Test (Clauses 119–120)

8 The Bill sets out a new basis for salary-related schemes to contract-out from 6 April 1997. The new test for contracting-out will be based on the scheme structure as a whole.

9 To enable a scheme to contract-out on the new basis, the scheme actuary will be required to certify that members and their widows or widowers will receive benefits under the scheme rules broadly equivalent to, or better than, the benefits that would have been provided by the Reference Scheme.

10 The benefits provided by the Reference Scheme are set out in the Bill.

Age-Related Rebates (Clauses 121–124)

11 The Bill sets out new provisions for an age-related rebate to be paid direct to contracted-out money purchase schemes by the Secretary of State for members of those schemes. Provision is also made in the Bill for minimum contributions to be paid to Appropriate Personal Pensions by the Secretary of State, at a rate related to the age of the APP policyholder.

12 The age-related rebates will be introduced from 6 April 1997. No age-related rebate will be in excess of 9% of relevant earnings. The rationale put forward by the Government for this cap is to ensure that a reasonable balance is drawn between encouraging participation in personal pension schemes and protecting those near state pension age, for whom SERPS is likely to offer greater security.

Flexible Annuities (Clauses 126–128)

13 The Bill makes provision for an interim arrangement to be set up, to

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enable protected rights to be paid at any time from age 60 without the purchase of an annuity being compulsory until age 75.

14 The relaxation only applies to personal pensions and not company-sponsored money purchase schemes.

15 The age 75 limitation applies to the member in respect of his own benefits and to the age of a widow or widower where the arrangement provides spouse's benefits.

16 The Bill provides that the theoretical purchase terms should be assessed using factors provided by the Government Actuary.

Whistle Blowing (Clause 41)

17 The Bill places a statutory duty on the pension scheme actuary to give a written report to the Occupational Pensions Regulatory Authority if the actuary has reasonable cause to believe that any irregularities have arisen under the scheme.

18 Failure to comply with this statutory duty can be treated by OPRA as a civil offence, and the appropriate sanctions, as set out in the Bill, for these offences may be invoked by OPRA.

Transfer Value Procedures (Clauses 131–133)

19 The Bill introduces revised procedures which apply to salary-related occupational pension schemes.

20 Following a request by a member of a scheme, the trustees will be obliged to produce a statement of the member's cash equivalent within a prescribed period of the member's request.

21 The cash equivalent will then be guaranteed, if accepted by the member, within a period of three months from the date of the statement.

22 If the member accepts in writing the cash equivalent within the three-month period, the trustees will have to pay the cash equivalent within 6 months of the original statement date. If the member accepts the cash equivalent quotation within the three-month period, then the member will remain entitled to that amount, irrespective of market value movements in the interim.

23 The Bill provides for penalties to apply in the event of non-payment by the deadline.

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ABSTRACT OF THE DISCUSSION

The President (Mr G. M. Murray, C.B.E., F.F.A.): I welcome a number of guests: Mr Adam Ingram, Opposition spokesman for Social Security; Mr Joe Robertson, Casework Director for the Pensions Ombudsman Bureau; Mr David Hill, Occupational Pensions Policy, Department of Social Security; and Mr Gerry Rooney, Scottish Office Industry Department.

Tonight's subject is very topical. The Pensions Bill, currently going through Parliament, is one of the most important pieces of legislation for our profession, our employers and our clients. It is appropriate that we should have the opportunity to discuss such an important piece of legislation.

A short introductory paper, dealing with the actuarial aspects of the Bill, has been circulated. I will ask Mr H.W. Brown, who is Deputy Chairman of the Joint Pensions Board, and who was largely instrumental in producing this paper, to introduce the short paper.

Mr H. W. Brown, F.F.A. (introducing the paper)**:** It was particularly pleasing, having been a member of the Goode Committee, to see that the main recommendations made by that committee were taken on board by the Government in its White Paper, 'Security, Equality, Choice: The Future for Pensions', which was published in June 1994. The Pensions Bill takes the process a stage further, and, although not containing the detail of the White Paper, paves the way for regulations to flesh out the specific requirements.

In carrying out its review, the Goode Committee had regard to the security of pension funds and the rights and interests of members in those funds. We tried to balance this with the need to avoid measures which might discourage employers from continuing to provide good pension schemes. It has been widely accepted that the Goode Committee report achieved such a balance, which has more or less been preserved through the wide consultation process which followed, in the White Paper and now in the Pensions Bill. It is important that this balance is preserved in the final stages of the Bill becoming an Act, and in the resulting regulations. Any material tightening up of the Bill could result in damage to future pension scheme provision. On the other hand, any further weakening of key provisions of the Bill might lessen the security of members' benefits to such an extent that the resulting position becomes misleading and puts the security of members' benefits at risk. This must not be allowed to happen, otherwise all of the hard work that has gone before will surely have been for nothing.

Of all the recommendations in the Goode Committee report, the recommendation of introducing a Minimum Solvency Requirement has, without doubt, stimulated the most interest and discussion within the profession. I still believe that the basis for the Minimum Solvency Requirement strikes the right balance, so long as the safeguards for employers, as set out in the Goode Committee's report, are also adopted.

However, after wide consultation, the profession put forward proposals to the DSS that the basis for the Minimum Solvency Requirement should be modified for pension scheme members more than 10 years from retirement, and should be equity-based, as opposed to bond-based, as put forward by the Goode Committee. Although this constituted a weakening of the basis, this modification has generally been accepted by members of the profession.

However, the modification put forward has been further amended, as outlined in a letter from Mr Peter Lilley, the Secretary of State for Social Security, to Mr John Butterfill, M.P., Chairman of the Parliamentary Group on Occupational Pensions, and larger occupational pension schemes will now be allowed to calculate up to 25% of their pensioner liabilities by reference to equity returns. The profession has made it very clear that it finds this revision unacceptable as a basis for a solvency test. Indeed, the Pensions Board, with the full endorsement of both the Faculty Council and the Institute Council, has written to Mr Lilley, making it clear that the term 'solvency' is an inappropriate description for this revised test. A more appropriate description for the revised test, if it is to remain, would be a 'minimum funding requirement'.

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In addition, the Pensions Board pointed out that, if the Government decides to set such a funding standard for larger schemes, these schemes should still be required to disclose the extent to which they meet the Minimum Solvency Requirement, even though, for such schemes, the statutory requirement for paying contributions would be based on the failure to meet the Minimum Funding Requirement.

In recent weeks there has been a suggestion put forward for a further modification of the basis of the Minimum Solvency Requirement to allow for overseas equities to be taken into account. In principle, the profession should not be taking any initiative that would result in further weakening of the test. Indeed, given the changes that have extended the periods for achieving the 90% level and the 100% level, and the averaging now allowed in the market value of the assets, I can see little or no justification for such a modification on the grounds of greater stability. I can see strong arguments for the exclusion of foreign equities in a solvency test for U.K. pension schemes, where the liabilities are expressed in sterling terms, which would result in the test not only being dependent on foreign market movements, but also on foreign exchange rates, and which, therefore, is likely to introduce less, rather than more, stability.

I now move to the other test in the Pensions Bill — the requisite benefits test, and the certificate that is to be provided by the scheme actuary if the scheme elects to contract out of the State Earnings Related Pension Scheme (SERPS) from 6 April 1997. A scheme will be allowed to contract out if the scheme actuary certifies that scheme members and their widows or widowers will receive benefits broadly equivalent to, or better than, the benefits that would have been provided by the reference scheme. The benefits provided by that reference scheme are outlined in the Pensions Bill.

The basic problem for a pension scheme actuary, considering whether a certificate can be given, will be to assess the impact of the difference between the scheme definition of final pensionable earnings and the three-year average of 90% of band earnings under the reference scheme. In cases where the pension scheme definition is less generous — for example, restricted to basic salary — then the actuary will need to take a view on the extent to which final band earnings, under the reference scheme, can exceed final pensionable earnings before the requisite benefits test is breached. For example, if final pensionable earnings is a three-year average of basic salary with no offset, and the scheme benefit is one-sixtieth, the total PAYE earnings could exceed basic salary by nearly 50% before a problem would occur. This percentage will clearly depend on the pension accrual rate under the scheme, but, where there is also an earnings offset under the scheme, the percentage will also depend on the actual level of final pensionable earnings in relation to the lower earnings limit.

There are three possible bases that the pension scheme actuary could use for this comparison: a retrospective test on the actual past leavers and retirals under the scheme; a snapshot test, based on the current membership at the date of the test; or a prospective assessment, based on a view as to the future outcomes.

On balance, the Pensions Board feel that the snapshot test is the most appropriate. The level of PAYE earnings versus basic salary can vary for the whole membership over time, due to such factors as the level of overtime and shift allowance, as well as for an individual member. Retrospective views will thus be influenced by the actual level of activity over the period being considered. Prospective views are likely to be too uncertain.

For the test to work effectively, the system would need to be heavily reliant on a statement or certificate from the employer. It might be envisaged that the actuary would calculate the percentage excess of PAYE earnings over basic salary, below which there should not be a problem. This percentage might be called 'the permitted excess'. To cover the effect of the lower earnings limit, the actuary might calculate different percentages at different levels of pensionable salary. The employer might then be required to state, or to certify, that: there are no non-pensionable PAYE earnings; or the non-pensionable PAYE earnings only occur above the upper earnings limit; or non-pensionable PAYE earnings average less than, say, half of the 'permitted excess', and that there is no significant variation in non-pensionable PAYE earnings throughout the workforce; or the employer may not be able to confirm that the permitted excess will not be exceeded. In this final situation, the actuary would need to ask for details of individual members in order to do a more detailed analysis.

It would seem sensible that, if a percentage of the membership is allowed to fail this test, then the

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percentage allowed to fail should not be a group which can be identified in advance. For example, it should not be the lower paid, due to the effect of the lower earnings limit; nor should it be salesmen, due to the effect of non-pensionable commission. No group of members should be expected to fail the test, and any percentage margin that there may be should be there to enable a scheme test to be used, rather than an individual member test. Separate tests should also be required for members' benefits and for spouses' benefits, with no provision to use an excess under one to compensate for a shortfall under the other. Where pension scheme benefits are either payable from a different age than 65 or there is a separate lump sum benefit, the equivalence would need to be assessed using a standard scheme basis, for example, the cash equivalent basis.

Considerable work still needs to be done to resolve some of the above problems, and to enable actuaries to sign appropriate certificates to allow schemes to be able to contract out from April 1997. I hope that the Pensions Board can work closely with the DSS, over the months ahead, to resolve these difficulties and to ensure that future professional guidance notes to assist actuaries in this area will dove-tail with the requirements of the regulations.

The Pensions Bill is a major piece of legislation, which takes most of the recommendations of the Goode Committee one step closer to becoming law, and which, I believe, will result in an improved security of benefits in pension schemes in the United Kingdom.

Mr A. E. Miller, F.F.A. (opening the discussion): Before looking at the Bill in any detail, I begin with two matters which concern me about Acts of Parliament. My colleagues and I are spending a lot of time these days going through contracts, trying to review them in the light of the Unfair Contract Terms Directive. An Act of Parliament is a contract between the people and the Government. When are the parliamentary draftsmen going to write their contracts in plain English?

Also, why can there not be much closer involvement in the drafting of Bills like this by expert professionals from the areas a Bill addresses? Some legislation is politically very sensitive, and it has to be drafted behind closed doors, but there are some that surely need not be, and this Bill must be a prime example. A much better product would have been created at the outset if pensions professionals had been involved throughout its drafting. It is clear from the extremely long, but also excellent, paper produced by the Association of Pensions Lawyers (APL), commenting on the Bill (43 pages of comments on a 93-page Bill), that, even if questions of principle are ignored, there are vast numbers of detailed points which, from a legal point of view, are unclear, imprecise or just plain wrong. For all of these to have to be sorted out by the process of formal amendment in Committee seems a gross waste of resources and parliamentary time. We must be grateful to the APL for the time and care that it has taken in giving the Bill such a thorough going over. Clearly, this Bill leaves a lot to be desired so far as the precision of its drafting is concerned.

The role of the actuary in a scheme is a major issue in the Bill. We have the provision that the scheme actuary cannot be a trustee. This seems a sensible concept, but the detail rather worries me. There are a number of situations where some relaxation of this would be desirable; for example: provision of pensioner trustee and actuarial services to small self administered schemes is one; and the role of the actuary to our own staff schemes is another. I hope that the regulations are framed sensibly in this area.

In Clause 40, the Bill requires an actuary to be appointed by the trustees of 'every trust scheme', although there is provision for regulations to make exceptions. There is currently no requirement for an actuary to be appointed to a money purchase scheme. I was, therefore, pleased to hear that the DSS has indicated that the regulations will exclude money purchase schemes. However, on reflection, should they? There are different types of money purchase schemes. Some variants probably ought to have to appoint an actuary — but which, and how can they be sensibly defined?

On the question of appointment of actuaries, I should like to see the provision for actuaries to be appointed by reference to their employer, if desired, rather than as named individuals. It is interesting to note that, as written, the Bill provides for a firm of auditors to be appointed, but not for a firm of actuaries. Of course, I am suggesting more than this; I would be including life companies as well as actuarial firms. This would certainly make life much easier, especially in a life office environment,

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where there is a constant movement of actuaries from one role to another. Such a change would help to cover the situation where the normal scheme actuary was away for some reason. Too rigid application of the 'one named actuary' principle could be self-defeating.

I now turn to the next concern, whistle blowing. While there have been occasions in the past — just a few — where I should have liked to have had the statutory duty to blow the whistle, I am concerned about three aspects of what the Bill is suggesting. First, a reportable matter is defined as one 'likely to be of material significance'. These days, with the problems that our industry has faced over compliance, I can see me reporting every tiny matter just to be sure that I could not be faulted. Today's watchword, certainly in life insurance companies, seems to be 'be whiter than white at all times'. If the legislation is not going to say more precisely what situations require to be reported, then I must ask that our profession do so by means of guidance notes.

The second point is that, if I come across a misdemeanour, I must give a written report to OPRA immediately. There appears to be absolutely no flexibility here for me to take the matter up first with the involved parties to see if immediate steps cannot be taken to put matters to rights. Commonsense says that many problems that could arise could equally easily be resolved by quick action together. The requirement to report, with no flexibility at all, could lead to OPRA being deafened by a continuous blast from actuaries', and auditors', whistles.

Lastly, there are others, besides the scheme actuary and the scheme auditor, who may well be in a position to spot problems — and more quickly. It will be difficult to impose a statutory whistle-blowing duty on an in-house administrator; but remember that the vast majority of schemes (although not, perhaps, of scheme members) are administered by outside parties such as specialist administration companies and life offices. In the Lords debate on second reading, Lord Mackay, speaking for the Government, said: "Anyone involved in a pension fund can blow the whistle; the difference is that actuaries and auditors have a duty imposed on them to blow the whistle. That, of course, is an important duty placed on these people who, I imagine, are closest to the scene of the action in most pension funds". In my view, his imagination is somewhat out of touch with the real world. While actuaries and auditors are certainly close to the scene of the action, it is the administrator who is by far the closest, especially on a day-to-day basis. Further, there is a world of difference between a duty to whistle-blow and blowing the whistle of one's own volition. I would, therefore, urge the Government to consider whether any external parties employed by the trustees for any aspect of the administration or operation of their scheme should have the same statutory duty imposed on them. This would include insurance companies, investment managers, employee benefit consultants and commercial scheme administration companies.

The Minimum Solvency Requirement is clearly a very important issue. Mr Brown has already covered it in some detail in his introduction, and I go along with all the points he said that the Pensions Board are making. In particular, I agree with the Pension Board's strong recommendation that it should be called a Minimum Funding Requirement.

It is clear that, as proposed, a scheme which only just meets the MSR is most unlikely to be able to secure fully all entitlements on wind-up by purchase of deferred or immediate annuities from a life company. To the man on the factory floor, 'solvent' means having enough funds to cover the liabilities. To him 'liabilities' means the benefits he would have been entitled to as a leaver. So, to say such a scheme is solvent is, to my mind, misrepresentation, and will bring our profession into disrepute, even though we are not responsible for the regime. In fact, one such case has already been well publicised.

This leads through to the proposal, in Clause 67, to override the requirement that wind-up rights must be secured by purchase of deferred and immediate annuities by the trustees. A Section 32 buy-out or a transfer to a personal pension is allowed; but these are member options. If the member does not elect them, a deferred pension must be provided. The Bill seems to be turning this on its head, allowing the trustees to discharge their liabilities by paying the cash equivalent to a personal pension of the trustees' choice. If trustees follow such a course and the scheme just meets the MSR, it avoids the problem of having to cut back openly on deferred annuity promises. This is misrepresentation too, and I am not at all happy about the propriety of it. I see that the NAPF is uncomfortable about it as well, and is taking this issue up with its members. I have no real quarrel with the concept; it comes

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back to the terminology, and I add my voice to the clamour for changing to a Minimum Funding Standard.

I am also concerned about the requirement that the actuary is to certify that "the solvency requirements will continue to be met throughout the prescribed period". Unless the prescribed period is no more than an hour, I think I will have great difficulty in giving a certificate of such certainty. There has to be some sort of 'in the normal course of events' qualification, as there is, currently, in the contracting-out solvency certificate. I also wonder what lengths I will be expected to go to in order to enable me to sign such a certificate, and what is the timescale that I will have to do it in. At the Pensions Congress in autumn 1994, the working group I was in spent a long time considering the issues, and found no obvious solution. It seems to me that, where a scheme is hovering around the minimum level, I would not want to sign any certificate on an annual basis without doing a fair amount of investigation, possibly verging on a full valuation. However, I do not see how it can be done within the timescales that the Bill seems to allow.

We cannot yet test our schemes for the MSR, as we do not yet know what basis will be laid down, whether by the Government or by guidance notes from our profession, for calculating the cash equivalents.

It did occur to me that insured schemes which use deferred annuity contracts as their investment vehicle might be better placed to meet the Minimum Solvency Requirement than directly invested ones; but, on reflection, I had to dismiss the idea. Apart from anything else, I get the impression that the new business strain that the statutory valuation basis creates for new deferred annuity business would make many life offices most unwilling to take on huge amounts of such business. This just goes to show the difference between the standards imposed on insurance companies to ensure that they can meet their guarantees and the much weaker ones to be imposed on schemes to meet what, in effect, is the same form of guarantee.

It is also not yet clear how we will be dealing with deferred-annuity with-profits schemes under the new regime. I hope that all this will be covered in detail in the regulations.

An allied point on insured benefits is the way the Bill is proposing to override the priority rules. Pension increases are going to be detached from the current level of pension and given bottom level priority. However, where a scheme which promises a particular level of pension increases insures all its pensions, the insurance will include the increases. As far as I am aware, such contracts have no surrender option or surrender value, so how do the authorities propose to transfer some of their value to meet other priority benefits, if that turns out to be necessary? I see nothing in the Bill which forces life offices to alter their contract terms.

I turn now to transfer values. The proposal that schemes must guarantee transfer values as fixed monetary amounts for three months creates a one way option: heads you win; tails I lose. There is no corresponding requirement that the new contract provider must guarantee unit prices, for example, for three months — or even one day. The actual number of units which can be bought will vary from day to day, and sometimes quite substantially. This variation is likely to be mirrored, although far from precisely, by the assets underlying the scheme the member is leaving, but the trustees are going to be barred from adjusting their transfer value to match. I do not like this, but it is difficult to see a way round it, given the need for some sort of cooling-off period or cancellation substitute for new contracts.

This issue could be solved at a stroke! The solution I propose would be popular with scheme administrators and, I imagine, with the PSO; but it would be unpopular with life office salesmen, and flies in the face of current political dogma. So what should we do? We should go back to the good old days. Transfers from defined benefit to defined contribution should be banned altogether. It seems likely that, with some measure of equity investment creeping into the transfer value basis for younger people, transfer values will, in any event, be lower in future than they are now, other things being equal. Given the extra expense of writing individual policies, it seems to me that the whole effort is self-defeating, and, in the majority of cases, will lead to a poorer result for the ex-scheme member. This is a political hot potato!

The last main issue that I want to touch on is the revision to SERPS, and to age-related rebates. It has taken some time for the message to sink in; but it is quite clear from the Government Actuary's

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paper on the expenditure cost of the Bill's proposals that serious changes are being made to the terms of SERPS. In other words, the Government is taking another axe to this benefit. In real terms, the benefits that will come out of SERPS will, in 50 years' time, be half as much as they would otherwise have been. I am not sure that the real significance of this has yet been realised, and one practical concern is that there will be a very marked discontinuity, because this is not something that is going to be, as it were, for future service only. For everybody who retires after April 2000, the new basis will apply for all their benefit. So, some people retiring just before will get one level of benefit; and some who retire just after will get a lot less.

It is not only SERPS that is being cut; so too are benefits for leavers from contracted-out final salary schemes, because the demise of the GMP for post-1997 service removes the right to fixed-rate revaluation.

Age-related rebates are another aspect of this. Clearly, in future, the rebate will be more or less equally right — or equally wrong — for contracting-out at all ages up to 50-something. On the basis that the Government Actuary sets out in his paper, which he says is hypothetical at this stage, it seems very doubtful to me that the case for contracting-out into individual policy insurance company products will be overwhelming. It will be finely balanced. If the Government wants people to contract-out, then it looks as if it is going to have to go on gilding the lily, as it has in the past, at the taxpayer's expense.

The Bill uses expressions like 'accrued benefits' in various places. When we value we are going to have to know exactly what is meant by 'accrued benefits'. It is absolutely crucial that a clear and unambiguous definition is included in the legislation. At the moment, there does not seem to be such unambiguity.

I do not think enough attention is paid in the Bill to the different considerations that should apply to insured schemes. It is difficult, I know, to come up with a suitably water-tight definition, but surely some way can be found of simplifying some of the issues for such schemes. I know the ABI are working on this, but I am concerned that, if no special provisions are made, that the proverbial camel's back has really had it.

I do not like the let out for personal pensions, other than APPs, not to have to provide LPI on the resulting pension. We must have a level playing field here. Practical experience shows that, almost without exception, where a pensioner is offered a higher, but level, pension or a lower, but increasing, one, the choice will be the level one, on the 'pound in my pocket' argument. Human nature is to do the wrong thing. All pension arrangements, at least where there is an employer contribution, should be required to pay LPI increasing pensions.

I think that the decision in 1987, to bar compulsory scheme membership, was dogma driven and wrong. It is clear that large numbers of so-called opt outs did not, 'do their own thing'; they did nothing at all. I do not accept Lord Vinson's argument that every man or woman is perfectly capable of planning properly for his or her retirement. It is patently obvious that this is nonsense. The man in the factory needs to be protected against himself. I would like to see the ban on compulsory membership rescinded or that we should have some minimum level of enforced contribution, as I understand is now the case in Australia. I understand that the NAPF is putting forward a similar view.

Mr I. M. Aitken, F.F.A.: As we all know, the Bill is currently being debated in the House of Lords, and both Government and Opposition peers are proposing amendments to it. Consequently, with this debate, the actuarial profession has a real opportunity of clarifying many of the actuarial issues that are in the Bill. I would like to make a plea to the DSS officials who are here, and ask them to take on board the comments that we make, and pass them back to Ministers. The pensions industry made many salient comments on personal pensions and voluntary membership in the mid-1980s, but I think that those comments seemed to fall on deaf ears.

From the actuarial point of view, one of the central planks of this legislation is the Minimum Solvency Requirement, and the Bill makes reference to it without really defining what it is. I think it is very important that it is very clearly defined. If we look in the White Paper, in ¶1.21, it says: "... in the case of pensioner liabilities, allowing a margin to account for the administration costs of

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providing pensions that would be purchased by a scheme if it were to become a closed scheme....". From this statement, it appears that the Minimum Solvency Requirement is the liability on the basis that the scheme continues as a closed scheme.

On 8 December 1994, the Secretary of State for Social Security, Mr Peter Lilley, wrote to Mr John Butterfill and said, "If the sponsoring employer were to cease trading, and the scheme be wound up, benefits could be secured through the purchase of insurance annuities. This remains an appropriate basis for valuing the liabilities of small and medium sized pension schemes". From this statement, it appears that the Minimum Solvency Requirement in respect of pensioners is the liability on the basis that annuities are purchased from a life office.

Clause 67 of the Bill says: "This Section applies, where a salary related occupational pension scheme to which Section 49 applies,...is being wound-up." The important phrase is "is being wound-up."

The Minimum Solvency Requirement is a theoretical calculation that we are going to have to make every year, and actuarial assumptions are going to be based on the closed scheme concept, because the scheme is not being wound-up. There is a very big difference between the liabilities on the basis of a closed scheme and the basis of purchasing annuities from a life office. From my own experience, the difference in mortality assumptions alone can add 10% to the liabilities. If you add the difference in interest assumptions, that could be another 10%, so actuaries must have it clarified what exactly they are working on.

I should like to reiterate what both Mr Brown and the opener said about the terminology. To the scheme members, the Minimum Solvency Requirement conjures up a vision of solvency, and they believe that they will get their pensions with complete certainty. I think that the members have every right to assume that their scheme is solvent and that it will provide them with a pension if we continue to call it a Minimum Solvency Requirement. Of course, if we go down the route of these assumptions, the members may not get their pensions. Take, for example, the difference in gilts yields at 31 December 1994 and a year earlier. In December 1994, U.K. gilts yields were 8.82%, and the index-linked gilts yields were 3.84% A year earlier they were 2% less — 6.61% and 2.86% respectively. I suspect that many schemes may have been able to purchase annuities in 1994, but they would not have been able to do so a year earlier. It is essential that we change this description to a Minimum Funding Requirement.

I turn now to the suggestion that we should make special allowance for overseas equities. Any trustees who decide to invest in overseas equities are doing so because they believe that they are going to get a better return, when taking into account the performance of these shares and also fluctuations in the currency market. Therefore, if they are expecting to be better off by taking this line of action, no allowance should be made for overseas equities in the basis for the Minimum Funding Requirement.

Mr M. R. Slack, F.I.A.: I am a member of the Pensions Board and Chairman of the Current Issues Committee of that board. On the Minimum Solvency Requirement I want to raise one technical issue, and then comment on how we might see the profession moving forward towards the process of defining the actual calculation that has to be made.

The technical issue relates primarily to the question of the schedule of contributions which will require to be certified to confirm that, whatever the position of the scheme on the valuation day, it will remain in a fully 100% Minimum Solvency Requirement position over the prescribed period. There are some real difficulties here. It is going to be difficult enough to agree a procedure for deciding whether or not a scheme met its Minimum Solvency Requirement in doing a snapshot test on the valuation day. Trying to define what contributions should be required to maintain 100%, or to recover a 100% position if less than 100%, is much more complex. We have to decide what actuaries will have to take into account, and issues such as mismatching reserves begin to raise their heads.

Those of you who are familiar with some of the requirements for Appointed Actuaries of insurance companies will know what work has to be done on mismatching. It is not difficult to see similar calculations being required if we are to have sufficient confidence that the solvency position will be maintained over the prescribed period.

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I now comment on the procedure over the next 12 months or so, for moving towards the final resolution of the calculation procedure to enable actuaries to give certificates of the Minimum Solvency Requirement and the schedule of contributions. Clearly what we are looking for is some sensible parallel development of regulations and guidance notes. We are, as a profession, in discussion with the DSS to try to find a happy medium between what might be in the regulations and what might be in the guidance note. We hope that the two will be published on the same day, but I think that is almost certainly unattainable. We will have to find some compromise.

We will be looking for the regulations to state the basic principles. There are certainly some principles for which the profession cannot, and would not, want to take responsibility. For example, the discussion about the element of equities that might be included, both in the calculation for people who have not yet retired, and for those who have. We have already seen that there is no single view within the profession as to what the right answer might be, and it depends on whether you are looking at this as a solvency requirement or a funding requirement. Given all the uncertainty, it is virtually inevitable that we have to look to the Government to tell us what they want, and the most likely way that they will tell us is by putting it in regulations.

What the guidance note will be looking at are issues such as the assumptions and some of the more technical details of the method of calculation. What we are expecting is that it would be a fairly prescribed calculation. Indeed, we may be hoping that, if two actuaries did the same sum for the same scheme, they might actually get the same answer. That must be a unique event, and, if we can achieve that, I think we deserve some credit. There is going to be very little scope for professional judgement in this particular calculation. Perhaps it is a regressive step for the profession's development, but it seems to be virtually unavoidable in this area.

Within the next two to three months — possibly a little earlier — the Pensions Board will try to introduce an exposure document, setting out its thoughts on the way that the MSR should be calculated. This would not be a draft guidance note, but would essentially be the material that would subsequently find its way into a guidance note.

We recognise that we need to consult with members, both north and south of the border, to make sure that we have overall support and that what we are trying to do is likely to work. There is much more technical detail still to be considered. The issue of overseas equities is an example where there is no single view. The Pensions Board will be working to resolve such issues.

Moving on to requisite benefits, I have nothing to add to Mr Brown's comments, which essentially express the current position of the Pensions Board. The area we have at the back of our minds is that we need to make sure that there is some protection for the actuary who has given a certificate stating that the scheme benefits are expected to be adequate to produce benefits which exceed the requisite benefits. On the basis of that certificate, an individual is contracted-out and loses his SERPS benefit. There could be a situation where the scheme benefit turns out to be less than the SERPS would have been if the member had not been contracted-out, and it does not take too much imagination to see an aggrieved member, who happens to have worked out that particular calculation, then saying, "Ah! but the actuary certified that it would not happen. It is the actuary's fault that I have lost out," and the member might contemplate taking some action against that actuary. Clearly, we do not want that to happen. We do not want any individual to be in such a position, but inevitably some will, and we need to make sure that, when it does happen, the actuary has adequate protection for the certificate that was given.

Mr P. D. G. Tompkins, F.I.A.: The Pensions Bill is no mean feat of drafting. It implements not, just one White Paper, but two. There is the White Paper, 'Security, Equality, Choice: the Future for Pensions', but there is also the earlier paper 'Equality in State Pension Age', which is being put into effect through the changes which will lead to a state pension age of 65 for men and women.

I draw attention to the fact that the later of these White Papers emphasises the choice that the Government wishes to give to people. There is a lack of choice in the response of the Government to the equality debate for state pensions. It is proposed that we will have a state pension age, by the year 2020, which is 65 for men and women, with no facility for that pension to be taken before that age.

During the consultation period on the issues of state pension age, almost all the pension industry

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bodies responded by saying that, ultimately, they could accept the fact that the Government may be pointed towards a pension age of 65, but that, in practice, because of the many different practices of businesses and in company schemes, a flexible approach to state pension age would be appropriate. They argued for the facility for pensions to be drawn early from the state when people's pensions go into payment from their company scheme and they are fully retired from work. I am sorry to see that a rather inflexible approach was adopted by the Government.

We are not talking about extra cost. It does not need a great deal of imagination to design appropriate arrangements whereby the Government's total cost remains unchanged. It is simply a question of timing, and when people receive their benefits. As I say, employers and occupational schemes operate schemes with a variety of retirement ages. The most common age is 65, now that we have had equality imposed on us through the European Court of Justice decisions. However, 60 is also a common age at which many businesses find it is convenient to set retirement ages, and that will continue to be the case. It is not just a matter of the demographics determining that people must work longer when the demographic time bomb draws on the diminishing employment resources in the second quarter of the next century. It is also a matter for company policy and the best way of running the business in question.

In this day and age, I do not think that it is really a matter for the Government to be indicating the ages at which it believes people should be stopping work. When people stop working early, as many do, they also stop contributing. I do not see a good reason why they should not be able to draw their benefits early at a reduced rate.

Lord Boyd-Carpenter, speaking in the House of Lords debate on the Second Reading of the Bill, said that he was sorry that he failed to deal with the issue when he was Minister. He was very pleased to see that the Government was now doing so. I am, too. He pleaded with the Opposition to confirm that it would not change the details in the Bill when it becomes an Act, if they form a future Government. I would not endorse that plea.

The level of state pensions is something which it is for the Government to decide from time to time. The level will depend on economic performance and on the Government's approach to distribution of transfer payments within the economy. It is also a matter for the Government to decide on the payment terms, the timing, and the possibility of reductions for early payment. We need to deal with the mismatch between a lot of employment practices and the legislation we expect to have for state pension ages. I hope that this issue will continue to be thought about. I also hope that there will be opportunities to introduce some choice in equality in the state pension age.

Mr J. Forrest, F.F.A.: I assume that an insured scheme — that is, any scheme whose only long-term asset is an insurance policy — will be exempt from the compensation arrangements described in the Bill. Clause 74 of the Bill states that compensation is only to be awarded where there are reasonable grounds for believing that a reduction in the scheme assets was "attributable to an act or omission constituting a prescribed offence". Of course, an insurance policy can reduce in value, but, for such a reduction to be attributable to a prescribed offence, this means, surely, that the insurance company must be in some sense culpable. The obvious route for the trustees to seek compensation would be through the Policyholders Protection Act or, perhaps, through the courts. A levy on other schemes would seem to be quite inappropriate.

I agree with the concern of the opener about the common practice in insured schemes of guaranteeing increases, funding for them and actually buying them out by means of an annuity at retirement. It is a perfectly sound practice, and it can make actuarial, administrative and financial sense for schemes. However, if Clause 66 is enacted, it will leave the trustees of such schemes with a non-escalating priority liability and a mismatched escalating asset.

I have read in the trade press calls for the abolition of SERPS, on the grounds that projected benefits under SERPS are too low, and the whole scheme is too complex to administer. In my opinion, the Bill does not make things simpler, and certainly reduces the value of SERPS benefits further, since SERPS benefits will cease to accrue for anyone who has contracted out under the new provisions mentioned in the Bill.

While there is no doubt that SERPS is complicated, its complexities are almost trivial when

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compared with the complexity surrounding contracting-out of SERPS. Perhaps what we should be looking at is the abolition of contracting out rather than the abolition of SERPS. For those of us who are employed, at least partially, administering the complexities of contracting-out requirements, abolition of contracting out, with its attendant reduction of work for actuaries, is not a wholly pleasant prospect. I have not considered the full implications, particularly for benefit design.

In addition to the easing of the administrative burden, two other aspects come to mind. Firstly, for the Government, there are fiscal attractions because of the boost to Government finances through the payment of full rate national insurance contributions. There might also be payment of state scheme premiums, if trustees decide to extinguish existing GMP liabilities. Secondly, contracting out can be seen as a partial privatisation of SERPS, and a Government of a different political persuasion to the current one might see political attractions in de-privatising or re-nationalising SERPS. So, while pension scheme actuaries might view the abolition of contracting out as the worst idea since personal pensions, the absence of contracting out would certainly simplify pension scheme administration, and it might have fiscal and political attractions for a new government.

Mr I. A. Farr, F.F.A.: I should like to support a couple of points made by the opener, particularly as, in many ways, we are from such completely different backgrounds.

Cash equivalents and the three-month guarantee

Clauses 132 and 133 of the Pensions Bill, as drafted, will give the member a statutory right which could, in certain circumstances, be seriously damaging to the scheme. If investment values fluctuate significantly, particularly where large numbers of cash equivalents or large individual cases are pending, the scheme's finances could be materially adversely affected. Because the member cannot be compelled to take his guaranteed cash equivalent, the trustees would not normally sell investments in advance to meet the amount payable; if they did so, they would be exposed to the risk of investment movements in the event that the member declined to take the cash equivalent. This would be an option which could be systematically exploited — for example, following the departure of a group of employees or during the course of a winding up.

It would seem more appropriate for the Pension Schemes Act 1993 simply to require a statement of the cash equivalent at a particular date, together with an explanation of how it might vary with investment conditions over a short period thereafter.

The requirement to appoint an individual as the actuary

Clause 40 of the Pensions Bill requires an individual to be appointed as actuary. It might be preferable to allow a firm to be appointed. Not only would it ease the change of responsibility from one actuary within the firm to another, but it would also make the whistle blowing requirements more effective. For example, as the Bill is currently drafted, if another member of the firm became aware of an event which justified a report to the authority, that other member could not make such a report in the absence of the named actuary, since the protection of Clause 41 would not apply. If the firm were appointed as actuary this problem is resolved.

Furthermore, requiring the actuary to be an individual could introduce uncertainty as to the status of any advice obtained by the trustees from a colleague or partner of the appointed individual, possibly making it difficult for them to operate in the absence of the named individual.

Mr G. G. Bannerman, F.F.A.: I am one of those people who, looking at orthodox words, say, "Why?". Some of the things which have come into this discussion make me even more inclined to say, "Why?". We have a system which requires the pension fund auditor to be independent of the company, which I think is right, but the fund auditor must also be independent of the auditors of the company itself, and the actuary must be independent. In other words, everyone has to look at things separately.

I believe that, if you have the same auditors dealing with the pension fund as are dealing with the company accounts, the possible disadvantage of the company leaning on the pension fund auditors is outweighed, because the company's auditors have a direct responsibility to see that things are done

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properly. If you have the same auditors, they see the money in both sets of accounts. They can also see that the pension fund contributions, as paid, bear a sensible relationship to the salaries, and that the salaries, as recorded in the pension fund, bear a sensible relation to the salary bill.

I move on to the question of the administrator not being a whistle-blower. I have always thought, for instance, that the protection given to our profession by the Appointed Actuary having a duty, which overrides any duty to the board, of telling the Government Actuary or the Department of Trade and Industry of any infringement, is, in turn, a protection for the actuary.

If the scheme administrator is an employee of the company, and does not have a positive duty to blow the whistle when something seems to be going wrong, the administrator's own job is put on the line. In such a case the administrator ought to have protection. There should not be an insistence on absolute compartmentalisation of responsibilities, but there should be an acceptance that, if one firm takes on several responsibilities, then the firm may be in jeopardy from two or three sources at the same time.

The other piece of orthodoxy is apparent in the pensions industry. People say that we ought to have a flexible retirement age, the implication being that someone retiring early can have a lower pension. That is appropriate, because it is drawn for longer and it has the same value. People are saying that it is just a question of the timing of the payments, not the value. The problem comes when the early retirement pension is below the level at which the state feels it necessary to provide supplementary benefit so that the pensioner stays alive. Therefore, it is going to cost far more. The orthodoxy does not add up, to my way of thinking.

It may be that companies want to change the contracting-out rules to allow earlier payment of contracted-out pensions. In order to permit early retirement, the company may have to guarantee extra pension equal to the shortfall in the state pension. I doubt whether companies would like such a condition.

Mr D. J. Henry, F.F.A.: One aspect which has received surprisingly little comment is the changes to the contracting-out terms proposed in the Bill. In the interests of facilitating equality between members of contracted-out schemes, it is proposed to 'break the link with SERPS' for members who are contracted out after April 1997. Contributors will no longer earn accrued SERPS benefit in respect of contracted-out earnings after that date. This means that all existing inflation protection for contracted-out members is to be swept away.

SERPS will no longer provide for excess inflation on GMPs after retirement — there will be no GMPs after 1997. There will be no fixed or limited revaluation for early leavers, and there will be no buy back terms into the state scheme for terminating pension schemes in the form of ARPs. All state scheme premiums are to disappear with the exception of CEPs. The full brunt of inflation will fall upon the individual who is contracted out of SERPS.

Of course LPI is to be provided from 1997, both for deferred pensions and for pensions in payment. We know that the past is not necessarily a reliable guide to the future, but, if we look back to 1978, when SERPS was first introduced, inflation since that time has averaged 6.7% p.a. Thus, a deferred pension receiving only LPI would have depreciated by about 25% in real terms since 1978. A pension in payment with a less generous definition of LPI, which restricts increases to 5% on a year-by-year basis, would have lost one third of its value over the same period.

When we look back to the discussions on contracting out in March 1975, and again in October 1976, one of the main concerns of the profession was that sufficient protection against inflation should be given to contracted-out schemes. Of course inflation had peaked at 26.9% in mid 1975, whereas now year-on-year inflation is a mere 3.3%, but how long will that last? There was also a difference of emphasis. The open-ended commitment to cover inflation then fell to the sponsoring employer. Now the loss from any inflation (in excess of 5%) will fall directly on the individual who has been contracted out. Thus, this Bill, which seeks to provide increased security in other areas, will remove an important element of protection for individual scheme members who are contracted out of SERPS.

On a different, but related topic, it is interesting to look at the calculation of assumed age-related rebates in the report by the Government Actuary on the financial provisions of the Bill. Consider the assumptions used to calculate rebates, and regard them as a premium basis offered by the state, and

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available to anyone wishing to invest their national insurance rebate. The assumptions are 2% p.a. in excess of earnings inflation before retirement, guaranteed; 3.5% p.a. in excess of price inflation after retirement, guaranteed; expenses of 6% of the rebate plus 2% of the annuity purchase price and a further yield deduction of 0.8% p.a. for Appropriate Personal Pensions Schemes: or 0.5% for Contracted-Out Money Purchase Schemes. Moreover, population mortality is used, rather than the more expensive pensioners' mortality, in the calculation of annuity costs. If this basis persists, then I think I would exercise my choice by contracting in.

Mr D. G. Ballantyne, F.F.A.: What concerns me about the Bill is the interaction between the new provisions relating to flexible annuities — which have been covered mainly in the Finance Bill, but which are picked up in the Pensions Bill, to some extent — and the implementation of LPI from April 1997. The differential treatment between what is proposed for personal pension arrangements on these aspects is likely to be detrimental to all other forms of pension provision. This discrimination will be exacerbated if the cash equivalent transfer values from defined benefits schemes have to be pitched at too high a level because of an inappropriate linkage to the Minimum Solvency Requirements.

Briefly, the new flexible annuities are to be available to personal pensions, but not to retirement annuity contracts, nor to occupational pension schemes, although the Inland Revenue has indicated that some sweeteners may be on the way. The LPI is to be enforced on the whole of an occupational pension, but only on the rebate part of personal pensions. These changes open up the opportunity for some exploitation and manipulation by transferring pension rights from a defined benefit regime to a personal pension shortly before retirement. The different tax treatment, the different levels of death benefit and the greater flexibility allowed to the form and timing of personal pensions arrangements, all give the commission-driven salesmen some real advantages to market as well as all the spurious advantages which we are used to hearing from them. Since the transfer value is at its highest just before retirement, there is a considerable financial incentive to encourage this process. I would offer this as my candidate for the next fiasco in personal pensions mis-selling. I have a number of suggestions for improvement:

(a) Obviously, you could not mirror exactly what is in personal pensions, but you could certainly introduce greater flexibilities into the occupational pension side.
(b) You could enforce the LPI on all pension arrangements.
(c) You could restrict cash equivalents two years before normal pension age rather than one year; or preferably you could ban them altogether.
(d) If comparable flexibilities are introduced into occupational pensions arrangements with, perhaps, a maximum voluntary pension age of 75, then the cash equivalent transfer values could be determined on the basis of an 'all-gilt' approach at age 75, with the equity content being tapered in 10 years before that age. There would then be a better match with the real risks involved, and with the type of benefits structure that would be envisaged when there is a flexible arrangement.

Without steps being taken to reduce the extent of discrimination, I think there is going to be an opportunity for mis-selling. Obviously, it is never possible for the playing fields between two such radically different animals to be level, but, if the field is tilted too much in one direction, all the players end up in a muddy morass at the bottom of the pitch.

Mr A. Ingram, M.P. (a visitor): I am the Member of Parliament for East Kilbride and am Opposition spokesperson on pensions.

There was a plea, earlier, asking for the profession to be more involved in non-controversial legislation and also related regulations. I am broadly in favour, as is Mr Donald Dewar, the Shadow Secretary of State for Social Security. However, in order to be effective, there has to be unanimity of purpose and objectives. I have heard variations in this discussion on some of the things which are sought from this legislation. I do not know who will speak for the profession and how you come to your democratic decision, but it seems that you have a long way ahead of you before you come to that unanimity, by which time the Bill will be on the Statute Book. Please agree some clear definitions, since these assist Opposition spokespersons of all parties, and indeed back-bench

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Conservative MPs who serve on the Bill in Committee. It helps us to put forward reasoned and reasonable amendments to the legislation.

The introducer made a point about further tightening of the legislation not being desirable for various reasons, and a further weakening being damaging. I agree with the latter comment. Any further weakening of legislation in this area would make a mockery of why we are here in the first place — that is, to avoid some of the excesses which take place, not just in Maxwell-type examples, but in other occupational pension schemes, and over the whole of the pension industry. We need proper regulation which is carefully thought out and delivered. On the subject of tightening the legislation, I would say that one person's further tightening is another person's improvement.

The role of the regulator is one where we feel there needs to be a much tighter definition, together with guidance on whether the regulator is proactive or reactive. It is the view of the Opposition — and there is a general view around as well — that the way in which the role of regulator has been defined is not wholly adequate to deal with some of the excesses which could apply in the future.

There is also the question of the funding of the regulator. There is debate about whether it should be funded by the industry itself or by the state. We are now in a world of regulation across a whole sector of public utilities. They are financed by the taxpayer, that is, by the state. We, therefore, have a useful model to build upon. If it is correct for public utilities and other areas of interest affecting many, many millions of our fellow citizens, then why not in the pension field as well?

The Government are suggesting that members form one-third of the number of trustees of occupational pension schemes. Many within the broader Labour and Trade Union movement are arguing that there should be a majority of members, although this is not a view taken by the Opposition Front Bench. We are arguing in the House of Lords, and will be arguing in the Commons, that 50-50 seems about right. We also need to tighten up the role of independent chairmen, and how the chairmen are appointed in some of the larger schemes.

Importantly, within that, there is the question of protection for trustees. In the same way as you argue for protection for actuaries, clearly trustees also have to be protected. I recall to mind one of the trustees of the Maxwell pension fund, who raised many areas of concern about what was happening within that fund. He was dismissed, not from the scheme initially, but from his job. That was the way Maxwell removed him, and there was nearly a major strike as a consequence. It was resolved in a different way. That man ended up out of a job. The whistle blower on the scheme was very quietly disposed of.

There is also within the Bill a need to look at the question of the disposal of matrimonial property on divorce. We need a proper definition. Furthermore, there is the whole question of equal treatment. I understand that the Government is prepared to look again at some aspects of the application of equal treatment. We will push very firmly at Report stage in the House of Lords, and in the House of Commons, in relation to E.U. decisions.

I hesitate to mention the Minimum Solvency Requirement, because it is one of the areas where there is not an easy solution. Nonetheless, we will be looking at ways in which it can be made much better for those contributing to the scheme, both employer, and employee more importantly. The Opposition position on this is that we look at pensions as a form of deferred pay, and therefore the contributors, that is the employees, who pay a considerable part towards the pension scheme, should have proper protection.

There are many anxieties about the abandonment of the GMP. The underlying principle of the Bill is to give more emphasis to the personal pensions sector, rather than the occupational pensions sector, and, therefore, it is subject to criticism from the Opposition Front Bench and elsewhere. Of further concern is that SERPS benefits have already been halved since they were first put in place. They are going to be halved again as a result of this legislation, if it is passed in the way proposed in the Bill. Such a proposal cannot be good news for many lower earners and people with intermittent work patterns.

On the flexible decade of retirement issue, the Labour Party have expressed a strong point of view. Government Actuary statistics and those who have looked at this matter say that age 63 is fiscally neutral, and the Labour Party is nothing if not fiscally neutral these days! There is a genuine point here. We believe that to go to 65 is no great benefit to our society. The arguments which are

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advanced are dependent upon the assumptions made. We are advancing age 63 as part of the wider debate, and we hold firmly to it. When we are in government we will have to look again at the pension age, and we may want to propose different assumptions.

Mr R. K. Sloan, F.F.A.: Transfer values arose in response to frozen deferred pensions and to give people the opportunity of improving on their frozen pension. The consultation took place under Mr Norman Fowler's Inquiry in 1983. In my submission to that Inquiry, I recommended that a right to transfer value be granted only in respect of any accrued pension that was not revalued. It seems a remarkably sensible thing to have said! As the opener said, a defined benefit is a defined benefit, and we are in terrible danger of allowing people to try to improve on what is a good benefit, and one which is now largely revalued. There could, therefore, be some merit in no longer permitting transfers as of right.

Next the Requisite Benefits Test; it is 17 years since the whole business started in 1978. For the first $8\frac{1}{2}$ years we had a Requisite Benefits Test. We are now $8\frac{1}{2}$ years on from that, and we want to bring it back again. This is crazy. Mr Brown described the minutiae of how actuaries can certify whether the arithmetic stacks up or not in all these cases. I suggest that this is not an actuarial matter; it is simply detailed arithmetic and is rather an absurd test.

One of our members wrote an article in *Pensions World* this month, highlighting the ridiculous way in which the sums can work out. I, too, have done some calculations; for example, pre-1989 scheme members, on the old regime, could be in the position, under the new rules where, by taking maximum cash, they could end up with a residual pension which is a lot less than GMP. The Government seems to have lost its sense of proportion by giving up tax on pensions through a disproportionately high degree of tax-free cash.

My final point is a plea for retaining GMP. Some comments have already been made to this effect, and I agree with Mr Henry's comments. I have been trying to think of a suitable analogy: the fable of the hare and the tortoise is, perhaps, stretching credulity a bit, but consider final salary as the hare and money purchase as the tortoise. The hare is no longer being allowed to enter the pensions marathon, unless it can do a time of less than $2\frac{1}{2}$ hours. That is the quality test. However, I am a money purchase tortoise, a jogger. Although I can get there in $3\frac{1}{2}$ hours, I am not to be allowed to enter the same race, because the GMP omnibus is to be withdrawn. The GMP omnibus used to come along the route behind us to pick up the stragglers. This applied, even if we used a money purchase scheme with a GMP test; but now the joggers are having to go by a different route. Money purchase schemes will have to use the Protected Rights Contribution Test, without any GMP underpin. I therefore make the plea, save our GMP. Let us keep the GMP test, and not revert back to the Requisite Benefits Test, which was abandoned in 1986.

Mr J. S. R. Ritchie, F.F.A.: I am the Chairman of the Insurance Committee reporting to the Pensions Board. In that capacity, I have been involved in negotiations with Government departments on the subject of flexible annuities, both for personal pensions and also for occupational pensions. There are significant dangers in flexible annuities. People who read the *Daily Telegraph* will be aware that I have stated there that one of the priorities is that we get agreement with the regulators as to what is required in this area.

Having said that, it must also be true to say that, as the years go by, there will be more and more people who have higher and higher levels of pension provision; whether it is occupational or personal, to some extent, is beside the point. The more pension provision that they have, and indeed the more other wealth that they have, then the more important it is, and the more valuable it will be to them, to have the freedom to plan both their pension assets and their non-pension assets into retirement.

It is a very significant development that they will have the ability to defer annuity purchase, whether it is in an occupational pension regime or a personal pension regime; and, indeed, if it is best advice for them to switch between one regime and the other, then so be it. Clearly there is a risk here, but it is a risk that can be managed. The ideal people to manage that risk are members of the actuarial profession. Think about the interaction between investment risk, mortality risk and the movement in immediate annuity rates. These are ideal areas for actuaries to be commenting upon. I do not think

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we should shy away from that, particularly when one remembers that an annuity is insurance against living too long.

My other comment refers to something which Mr Aitken said concerning the exclusion of international equities from any calculation of cash equivalents for the purposes of statutory minimum solvency or, as we hope, statutory minimum funding. I understand the argument which is that you are excluding international equities because trustees are only going to invest in them in the hope of gain. Exactly the same argument applies when you compare U.K. equities with U.K. gilts. The conclusion would be to have the test based on gilts alone. I am not saying that I necessarily agree with the conclusion; I am saying that I think that the two arguments are identical.

Mr A. C. Martin, F.F.A.: I address you this evening as a consulting actuary, but also as an independent trustee appointed under Section 119 of the Pension Scheme Act 1993. Because of that, I want to relate an important part in my trustee life: explaining to people why they are not getting all their pension.

Trustees may have the pleasure of paying out 105% of cash equivalent transfer values, but I am afraid that that only equates, at the moment, to 70% of benefits if you buy a deferred annuity. Trustees, therefore, have to tell lay people that they should forget what they have seen for years in their final salary benefit statements. They should forget the formula that they have in mind from their final salary scheme booklet, giving a leaving service benefit related to earnings at leaving plus revaluation. Trustees have to tell members to forget other things that they have heard about, for example, regulations about a 'debt on the employer' in the event of there not being enough money. Such debts relate only to cash equivalents. They should forget this nebulous element of minimum funding or minimum solvency which also relates to cash equivalents. They should forget the compensation, which will give you only 90% of cash equivalents, and they should forget competition in the insurance market. Deferred annuities currently cost something of the order of 40% more than most cash equivalents being certified by actuaries.

My point is that this Bill greatly accelerates the trend away from final salary or defined benefit promises by giving us a new GMP. Quite simply, when things really matter, all we are giving is 'Guaranteed Money Purchase'. All we are giving is cash equivalents.

I, therefore, suggest that everybody concentrates their minds on redrafting clauses in their pension scheme deeds, for example, something along the lines of saying that, on leaving service for whatever reason, a final salary scheme, possibly discontinued by the employer, will give only a money purchase benefit. That is, in effect, what this Bill greatly accelerates.

Mr C. W. F. Low, F.F.A. (closing the discussion): As could be expected, we have had a long and varied discussion. Mr Martin highlighted very graphically what minimum solvency is all about. There was almost unanimous feeling that the terminology of solvency is just not appropriate, given the methods and the approach which the Government is taking in the Bill. Indeed, an official letter has gone from the Chairman and Deputy Chairman of the Pensions Board, duly authorised by both Councils, to the Secretary of State, stating that the profession could not be associated in any way with advice which thought that minimum solvency was the correct term. The letter also said that we could not be associated with any weakening of standards which we had previously discussed, both with Ministers and with Civil Servants. In effect, only a gilts-based solvency test should apply as far as pensions in course of payment are concerned.

A mismatch in assets, appropriate to a continuing fund by comparison to a discontinuing fund, is inherent in pensions business. We should not be suggesting to politicians or to members of schemes that one can have solvency for free. Solvency is conditional. Mr Brown, introducing the paper, made the point that we should have a rigid standard for solvency of schemes, and that all schemes should have to disclose their position against it. We should not forget the special position of very large schemes. Mismatching will occur, quite properly, so long as the additional reserves are there to allow such mismatching.

We have heard a majority supporting the fact that overseas equities, for example, should not form part of the minimum solvency, or funding, test. There is no suggestion that overseas equities are not

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a very proper investment, and a very proper diversification, merely that the actuary has to take into account the expected variance in their value in U.K. sterling terms when approaching the solvency calculations. The opener also supported the funding terminology, and mentioned the fact that buy-out from an insurance company was the only real solvency test. He mentioned the problems facing the actuary in giving any certification over a future period, which we understand may well be five years, and suggested that the traditional words we are used to in Certificate A — 'in the normal course of events' — may well be required. Such a wording is a practical necessity if the Government insists on continuing with the solvency definition.

Mr Slack emphasised the nature of the regulatory process that we now find ourselves in, and Mr Ingram also commented on this area. The profession has a history, quite properly, of using its specialist skills to advise Government, whether invited to or not, about the likely consequences of their proposals. I believe that we would be failing in our duty as a profession if we did not do so. It may well be that certain members of the profession, while in employment in commercial circumstances, may well be involved in blatant commercial lobbying. This is quite proper in a democracy, but not to be confused with a professional stance. Once, however, the democratic process has run full course, and Parliament has decided what the basic principles are going to be by enacting an Act, we would ask the DSS officials and Members of Parliament to recognise that our position then changes. We then use our professional skills to advise Ministers and Civil Servants as to how best their decisions can be put into practice by means of regulation. We want to help in this way, even if our advice before enactment has been rejected. I hope we will be allowed to do so this time.

It is interesting that some of the points raised in seminars, which the Pensions Board have held round the country, have not been repeated in this discussion; in particular the balance between regulation and professional guidance. We are duty bound to publicise our draft guidance to allow members and others to comment, bearing in mind the public interest. There is a major point of principle in the fundamental changes being proposed under the whistle-blowing procedures concerning the relationship between actuaries and their clients. Formally, the actuary is an adviser, but at the same time he or she is a policeman.

Practical difficulties have been raised by two speakers, from different corporate entity styles, about whether protection should be extended past the individual scheme actuary. We certainly need to retain the individual scheme actuary position, as that is how our professional guidance and discipline is written. I hope, however, that the DSS will take on board the fact that close colleagues of that individual should be able to act in the individual's absence and have the same statutory protection for that temporary period. It would not be appropriate, on that one point, to move all our professional disciplinary procedures from individuals to firms. That would take too long and is far too big a job. I have heard no good reason why that should be so other than this one, essentially practical, point.

We have had quite a few speakers on the subjects of contracting-out, the requisite benefit test and age-related rebates. Here there is a very major change for the profession. We have to recognise that, by the nature of what we are being asked to do, there will be a percentage of people who are worse off, and who will naturally feel they have good cause to complain against the actuary. If it were not so, then effectively the Government would be retaining the administrative complications of GMPs, because we would be certifying that no individual member in any circumstance could be worse off. However, the intention behind the Government's Bill in this area is simplification. Our job is to try to find a sensible way of looking at this. The essential element of Mr Brown's comments is that those people who are going to be worse off — and there will be some — should not be able to be anticipated in advance, otherwise we will have not done our job properly. This will be a very thorny problem.

We had little mention of the equalisation problem surrounding contracting out and GMPs. Certainly the profession has said, right from the outset of our evidence to the Goode Committee, that the protracted response of the Government in responding to Europe and the maintenance of non-equal state pension ages, and thereby non-equal ages for payment for GMPs, have imposed an impossible burden on pension schemes trying to get equalised benefits.

A recent European Court of Justice decision said that, if you accept a transfer value in, you expose yourself to the liabilities of the failure to equalise for all previous schemes. This decision should

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logically draw a complete halt to a transfer market, which is totally against the Government's intention. As Mr Sloan reminded us, preservation, revaluation and personal pensions all started from people being locked into schemes with frozen benefits. There are, I know, some submissions being made to Government as to how this might be put right. We can only hope that the Government will listen; otherwise, the non-equalised position of GMPs, and thereby also occupational schemes, will remain with us for a decade or two yet in respect of pre-1997 service.

The opener, Mr Farr and Mr Sloan mentioned the position of transfer values. The three-month guarantee on transfer values seems like a very quickly thought-up solution which does not look through the problem. There is absolutely no point in saying to a member, "Here is a three-month guarantee of the amount out in cash terms", when what you can transfer it into is moving up and down daily, if not hourly, with the markets. It is a total illusion as to what a guarantee might be worth, although, of course, it is a guarantee. Mr Farr mentioned the fact that the scheme cannot, therefore, match its liabilities for both its outstanding guarantees and for the long-term position of the fund. It will, indeed, be ironic if, in certain circumstances, a scheme fails the solvency test merely because of having outstanding guarantees which were taken up — by no means an impossible situation.

It may be not surprising that the majority of the debate was on purely actuarial matters as they affect occupational pension schemes, where the majority of us in the pensions industry obtain our living. Four people spoke about the public interest in the revision of SERPS, and reminded us of the dramatic figures which, if politicians realise, they do not publicise too much. The changes to SERPS will, over what is, in pension terms, a relatively short period of 50 years, reduce the value of the benefits by one half.

Mr Tompkins highlighted the total irrationality of the two sections of the Bill introducing yet further choice in occupational schemes, while refusing any choice whatever in the state pension scheme. This is a major point, which does not seem to have been picked up by many commentators.

Mr Aitken speculated about the dangers of personal pensions which this profession had clearly warned the Government about in the 1980s. It is sad that the remarks were then not listened to, since we would not then have had the current SIB review into the personal pension scandal.

Mr Ritchie's point about the dangers of flexible annuities should be taken on board by the DSS in the same context. He illustrated where this profession can be of great value to the individual with a flexible annuity. I suspect, given the complexities of professional advice, only those with very large flexible annuities will be able to avail themselves of the advice necessary to consider the delicate balance between mortality, and their own mortality in particular, against contract terms, against rates of interest, both long-term and short-term, and the terms in the immediate annuity market.

It is, perhaps, a sign of the direction in which the profession is having to go as politicians make, for apparently very good social reasons, the operation of group pension schemes ever more complicated. We are already seeing signs that some employers are saying that enough is enough, and switching a final salary scheme to group personal pensions. A lot of what we have heard has been about the transfer of risk from employers to individuals, and how much the individual should be made aware of that risk. It may well be that, indeed, we are talking about 'Guaranteed Money Purchase' in the end.

The President (Mr G. M. Murray, C.B.E., F.F.A.) : I am sure you will all agree that we have had a wide-ranging and useful discussion on many aspects of the Pensions Bill. The Bill is presently at committee stage, and I am certain that it would be helpful to all the parties concerned if our debate could be taken on board by those who are considering the issues. As a profession we have to be extremely concerned and interested in how the Bill works its way through the legislative process. We must have concern about the professional issues, particularly those relating to solvency.

It is important that it is understood that the issues surrounding solvency are more than just playing with words; there are fundamental issues involved. It is important that the actuarial association with pensions and solvency is seen in a proper light. If, in our view, solvency has one interpretation and funding has another, then we must get this message across. The difference is the cost of guarantees.

There was some discussion on the whistle-blowing aspects of the Bill. As a profession, we have a

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balance to maintain between clients' interests and the public interest, and, bearing these in mind, it is perfectly appropriate that we should be prepared to whistle blow. I agree that it should be a level playing field as far as possible, and everyone in ethical issues should be playing to similar standards. Nevertheless we are a profession, and, therefore, we must take on board what is appropriate in whistle-blowing terms.

I thank everyone for their contribution to the discussion, and I am sure you would all like to join me in particularly thanking Mr Brown, Mr Miller and Mr Low for their considered contributions.

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