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DISCUSSION ON THE REPORT BY THE OCCUPATIONAL PENSIONS BOARD ON PROTECTING PENSIONS — SAFEGUARDING BENEFITS IN A CHANGING ENVIRONMENT — Cm573

Mr A. E. Miller, introducing the discussion, said:—May I start by congratulating the authors of this Report on producing such a readable document within such a tight timescale. So much about pensions these days is written in such impenetrable jargon, that this Report comes as a welcome change.

This review took place just at a time when everyone's attention was fully taken up with the implementation of the 1986 Social Security Act and the Financial Services Act, etc. Resources in the Pensions Industry have been stretched to and sometimes beyond breaking point in the last few years. While I have every sympathy with the desire of this government to maintain its momentum in the area of pensions, I do feel that the imposition on us of this review with its tight deadlines came at a particularly inopportune time. Nevertheless, despite these problems a report was produced and the Board are to be commended on covering so much ground so well and so quickly.

I do not intend to go through the Report in detail nor in fact will I mention all the points that occurred to me as I read it as I am sure many of you will also wish to have your say.

However, before looking at any of the Board's specific proposals, I would like to make one general remark. At several points in the Report, the Board make recommendations about what "GOOD PRACTICE" should be. Unfortunately my experience has been that advocation of good practice, when it involves spending more than is strictly required by law, is just pie in the sky. Many of the companies I speak to are not going to incur greater costs unless they result in a competitive advantage and I do not see the extra costs that could be imposed if all these good practices were effected unilaterally having other than an adverse competitive effect. Therefore, they will not move unless everyone else does and for that legislation will be required.

Looking now at some of the recommendations in more detail . . .

The first is the legal basis of schemes. Although the Board suggested in 1982 that this should be thoroughly reviewed they have now backed away from this view and recommend no change. Apart from the lawyers who no doubt could see hugely profitable employment coming from a major change, I am sure most of us have given a huge sigh of relief when we read this recommendation. I am no legal expert; so I cannot say whether, had we been starting from scratch now, the Trust route would have been the best; but to completely revise the structure of all the tens of thousands of schemes set up under trust would have been a monumental and horrendously expensive task.

The second area covered is revaluation of early leaver benefits which then runs on into the third dealing with the winding-up of schemes. These two really have, I feel, to be considered together. The recommendation starts by saying that the present requirement for revaluation of post 1.1.85 rights should be extended to all accrued rights. Then they go on to say that these valuation rights should form a statutory minimum right on scheme wind-up, with any shortfall of assets over liabilities falling on the employer as a debt.

No doubt many will shout "foul" to all of these recommendations. Why? Extension of preservation backwards is, some would say, a retrospective change in the rules of the game and retrospection is very naughty. The 1985 requirement was imposed on a future basis only, so it enabled schemes to take action (if they wanted to) to restructure to avoid additonal cost. Now they are being asked to find extra funds to cover liabilities which they did not have to take into account at the time the relevant service was done. It is argued that companies will have set up schemes on the basis of an agreed and acceptable level of cost which takes into account the membership profile including its expected turnover. This change would therefore impose extra costs which were not allowed for initially.

The Board argue that in practice this extra cost will be relatively small bearing in mind that by the time this rule is implemented, members will probably have had to have accrued more than 6 years service for it to have any effect. While I do not necessarily agree with this, it is certainly true, especially for contracted-out schemes, that a very large proportion of all accrued benefits is already inflation protected. However, the cost variation has to be put into perspective with other causes of cost variation. Surely it will be minor by comparison with the effect of variation between the main financial assumptions used in setting the funding rate (particularly the real rate of return on the fund) and actual experience.

After all it is only because there is price inflation at all that there is, currently, a cost saving arising from staff turnover. If there were zero inflation (which is not impossible, as West Germany has demonstrated) there would be nothing to save. This is, of course, equally true when pension increases are considered. This just emphasises to me the point that price-protecting preserved benefits does not give rise to *extra* costs—non-protection gives rise to fortuitous profits.

Would it be possible I wonder to come up with a formula for accelerated accrual of the revaluation rights rather than a sudden jump from pre-85 to the lot? This might avoid the discontinuity which will result from the Board's recommendations.

The imposition of inflation-protected preserved benefits as a statutory minimum on wind-up is a more worrying concept when the cost of these minimum benefits is made a debt due from the employer. It is said that this imposition could force some companies into bankruptcy. Frankly I think this is nonsense provided that the new requirements are not imposed suddenly and immediately like some of the bolts from the blue that have appeared on Budget days. I have tried to think out how a company could be forced into liquidation by this requirement. I am not an expert in company finance; but I believe that a company must not continue to trade if the directors know that it is not solvent. While I am sure the vast majority of final salary schemes these days will have more or less sufficient assets to meet this requirement anyway, there are no doubt some companies whose finances are rocky and are trading just on the right side of solvency and who, if they have a scheme, may be running it along funded just sufficiently to meet the current statutory solvency requirements. If such a company saw the new legislation coming and did nothing about it before it bit, it could I suppose be made technically insolvent but what company, knowing its financial state was parlous, is going to act that way and I cannot envisage a company not knowing that its scheme is being funded at a minimum level. If it does not, what on earth has its actuary been up to? He should surely have been making the consequences of the company's funding strategy clear to it. I am sure there will be a breathing space to allow such companies to put their houses in order before the law bites by discontinuing their scheme or changing it into a format more suitable to their circumstances, like money-purchase.

For schemes that are soundly funded, I find it unthinkable that they could go so far off the rails (without realising it) between actuarial valuations that they incur so serious a shortfall that the company's solvency becomes prejudiced. Again I would expect the actuary to be on top of any such situation.

I would just like to throw in another thought on this topic . . .

How far up the chain of preferential creditors will the liability for this minimum funding target fall? Will there still not be the possibility that insufficient funds will be available from the company's assets to meet the minimum requirements? Will the state provide a "last resort" underpin—pigs might fly!!

Now I would like to turn to the area of takeovers, winding-up and transfer.

This is an area that I am sure many of us get involved in from time to time and I am also sure that, in many consultants' minds as soon as it is mentioned by a client, it sets the cash registers ringing. All the negotiations over wordings of sale agreements, bases for the valuation of liabilities, etc., which inevitably have to be carried out at great speed are, I find, very exciting and set the adrenalin flowing.

Basically I have no real criticism to make of the views expressed by the Board in this complex area; but I would like to make a couple of comments on specific points.

Paragraphs 10.25 to 10.27 describe the "past service reserve" approach to bulk transfers as "current good practice" and it is, I am sure, what the actuaries on both sides would recommend *if they had a free hand* but it is of course the sale agreement that sets out the basis and neither party is obliged to pay any attention to his actuary's advice.

It is essential, even if either party does not follow his actuary's recommendations, that the actuary is involved at the earliest possible stage in the negotiations so that the financial consequences of what is finally agreed are fully recognised and understood by all parties.

The thought did occur to me that it might be possible to legislate for scheme rules to require that the scheme assets be split on a "share of fund" basis in the event of a "partial termination" regardless of what a sale agreement might say. It is of course a matter of (actuarial) opinion how a "share of fund" would be calculated, there being several different ways of doing this. The sale agreement would then make provision, as both parties saw fit, for any shortfall of the share of fund from the past service reserve. This would not cover the situation of a sale of a business rather than a company and it is difficult to see how legislation could cover *this* situation, so on reflection I feel that such legislation has to be rejected as impracticable.

In the next few paragraphs the Board put forward the arguments for a requirement that the seller's actuary be required to certify that the package of benefits to be provided by the new scheme is equivalent in value to the package being given up where members' consents are not sought on transfer. In fact many scheme rules do already incorporate a requirement like this although the ones I have seen leave it to the trustees of the selling scheme to form a view without specifically involving an actuary. While obtaining the assistance of an actuary is (always) a sensible thing to do, I do not feel it is necessary to go as far as to require it by statute.

There is of course a weakness to this approach as was demonstrated by a case I came across a couple of years ago. Here everything went effectively as the Board has suggested, with a past service reserve transfer to a broadly equivalent scheme—but—no sooner had the transfer been completed than the buyer made all the transferring employees redundant granting minimum leaving service benefits. There was nothing that the seller could do, although he was understandably upset.

In other words the Board's suggestions could still give rise to a fortuitous profit to the buyer as they do nothing to guarantee that the monies transferred will be used for the sole benefit of the transferring employees. Should the rules proposed not go further and require that at least the past service reserve, member by member, be allocated in such a way as to give some form of money purchase underpin to the benefits promised in the new scheme for service in the old one?

However, I do agree that the Board's recommendations do go generally in the right direction and I think we all accept that there must be a let out of seeking the members' consents where the equivalence requirement cannot or will not be agreed to.

My only detail qualification to this is that the Board propose that the equivalence to be certified by the actuary should not only be of rights (which I would be happy to certify) but also of expectations, about which I would have grave misgivings about certifying. In other words I would be much happier if the words "and expectations" were deleted from paragraph 10.28.

Turning now to secion 11, here the Board argue the case for allowing members of schemes which do not guarantee, or generally grant, at least the limited pension increases they support, to opt for a reduced pension which guarantees LPIs. They point out that if a scheme made no promise of increases at all, the starting pension with LPI would be about ⅔rds of the level pension. I am actuary to a scheme which already gives this option and to the best of my knowledge no member has taken it up. Human nature leads inevitably, I think, to a quick mental sum that demonstrates that it takes at least 8 years for the pension with LPI to catch up on the level pension and about 15 years before the total payments are equalised. At 65 this sounds to most people (rightly or wrongly) a pretty poor deal. Thus while I agree with the sentiments expressed and I can see no reason why the option should not be made available, I doubt very much whether there will be much use made of it in practice in schemes which presently do not give any increases. The other situation described by the Board of a scheme which gives ad hoc increases around or perhaps a little lower than LPI on the other hand may get more takers who wish to make their future more certain. Here though the actuary would again be faced with the problem of valuing an expectation which, as I said earlier, is far from an easy prospect for us.

It is important I feel to bear in mind the administration of LPI pensions. Because we now have this requirement for post April 1988 GMPs, all pension payment systems will in future have to cater for every pension being accumulated twice, in parallel as it were—once on the maximum fixed rate and once on the RPI basis, such that at any time the lower of the two be paid (and what happens if the RPI falls?). This must put up the cost of payment of pensions especially as it will, I am sure, require much more elaborate regular explanations to pensioners of where they stand. The fact that the GMP will, as things currently stand, also have to be dealt with at different rates (and in two parts) only makes things even more complicated.

The Report goes on to discuss "Help for the individual", "Trusteeship" and "Investment". I think I have said enough already so I will leave it to others to comment on these topics.

However, as a parting shot I would like to make a plea on behalf of the small scheme. The vast majority of schemes cover very small numbers of members and I just wonder how much thought is really given by government and many of the bodies that are thought to be representative of the "pensions industry" to the administrative cost implications for such schemes of the recommendations and legislation which come forward. Over recent years we have been lumbered with more and more complex, and therefore costly, scheme administration by the successive Acts and standards imposed on us both by law and by other professions. Most of this is reasonably acceptable to the large schemes which can take it in their stride; but scant regard seems to be paid to the effect on the small schemes. These are probably the people who need the most encouragement to provide reasonable retirement benefits for their workers and yet they are finding themselves faced with enormous increases in administration effort and hence cost. While I recognise the difficulties of differentiating between different sizes of scheme I hope that any further changes that arise from this Report can take account of the problems that face the smaller schemes.

Now I look forward to hearing the views of all of you who I am sure are dying to get a word in.

Mr J. Rowe, opening the discussion, said:—Mr Miller covered in a very stimulating and thoughtful manner some of the main points, not all of them, in the OPB Report. I would, therefore, like, in the short time available, to just give you a little bit of background to principles which the Board were looking at in moving to their conclusions and recommendations.

What, first, was our objective? What was the clear common thread in our considerations? The need to ensure that occupational pension schemes serve their purpose of providing security, and peace of mind, amidst the risk and uncertainties of commercial and industrial life, where, in particular, takeovers are a common day occurrence; a pretty topical theme.

What were some of the main principles that we sought to guide us? The first is very simple. We actually wanted to pay due and proper regard to all the evidence that was submitted to us. As you know we had 400 written submissions and in the short time available we were able to follow those up with 16 sessions of verbal evidence. It was not so much used as a statistical analysis of all the views that were expressed to us by members, by pensioners, by organisations, by professional bodies, but rather it presented the discussion of the different problems that come up and the very varied views on how some of those problems should be resolved. In general, we believe that our Report reflects these areas of concern and seeks to address the main issues involved. I think, in fact, just looking back through the particular chapter, there is only one area where our subsequent recommendation did not reflect the basis of evidence, and that was on pensioner trustees. I think we had 143 pensioners writing to us saying that pensioners ought to be trustees, or that they ought to be represented. This was backed up by scheme members, not so much by organisations and bodies. But after very careful thought, we felt that on balance we did not wish to make a recommendation, even in relation to good practice, of pensioners having a place on the Board of Trustees. But that, as far as I can see, is the only case where the recommendations did not reflect the enormous amount of detailed and careful evidence that we got and sought to analyse in a very short time.

Let us move on to the next principle, and one which Mr Miller referred to: the basis of trust law. As he mentioned, we opted for the retention of trust law as the legal basis for pension schemes and made no secret of the fact that this view differed from what we had recommended in 1982 in our last Report. We set out in the Report the various reasons for our present view and, to my mind, the two most important of these are firstly the sheer extent of legislation and legislative change that has taken place since 1982: on disclosure, financial services, insider dealing, statutory supluses, etc., not to mention the new regime on choice. There was need to give these changes a chance to bed down and show their effectiveness before any consideration of further fundamental change was contemplated. This seemed very relevant to the retention of trust law. Secondly we took the purely pragmatic practical point that the particular additional protection that we felt was desirable could, we believed, be accomplished within the existing framework of trust law.

A second principle was in relation to help for the individual. I mentioned the new regime of choice and that has all come about since 1986 and since our last Report. The whole range of private sector pension schemes has been extended through the introduction of Personal Pensions—what is sometimes called the pensions revolution. The individual is now faced with a far wider range of choice and has a greater freedom, and therefore responsibility, for providing for his retirement. This major extension of competition has meant that occupational schemes are having to look to their laurels if they are to retain their memberhsip. To my mind this is wholly beneficial and provides a powerful incentive to employers and trustees to improve their schemes in order to provide improved benefits and greater protection. Greater consumer choice does, however, bring in its train the need for the provision of impartial sources of information, means of seeking advice and methods of conciliation.

I am delighted that we have Margaret Grainger in the audience this evening and, as we did in the Report, the Board would wish to pay tribute to what OPAS has accomplished in this field. But OPAS, as we all know, is financially insecure and cannot cover all the ground. We believe that we should build on what OPAS has achieved to provide a totally independent and impartial information and conciliation service. In addition, to our mind, the evidence was absolutely clear that a means of resolving disputes speedily and at less cost than that presented by the High Court needed to be found. Such a means would be available for the hard core of disputes which could not be resolved through conciliation or, indeed, through misunderstandings. The principle, therefore, of seeking to provide greater help for the individual at a time of wider availability of choice is addressed in Chapter 13 of our Report and has resulted in a series of recommendations in that particular field.

Mr Miller dealt briefly with the difficult question of the imposition of the law as against persuasion through an extension of good practice. In all our recommendations we have sought wherever possible to build on existing good practice and to seek the active support of professional bodies, such as yourselves, in seeking to implement this good practice rather than through the heavy hand of legislation. In fact, we have been accused in some media reports of relying too heavily on the goodwill of the employer. We have, after all, to remember that an employer need now no longer feel morally obliged to set up a pension scheme at all, nor does an employee need to belong to it.

I have spent most of my life in industry as a full-time manager in the brick industry and I believe that the arguments, therefore, for an employer to provide a well-run and funded final pay scheme relate much more to good industrial relations and enhancing the employee benefits than to any lack of a positive alternative. In these circumstances there is every incentive for an employer to provide an attractive package of guaranteed benefits and to publicise these to his employees. It may not be the cheapest option, but it could well be the best. It is only largely in the circumstances of wind-up, and issues related to this, that we believe the force of additional legislative protection is required and here we have had no hesitation in suggesting that the law should be amended through overriding legislation.

In the context of an on-going scheme our aim is to persuade employers and trustees that it is in their interests just as much as those of their employees, to replace, for instance, the practice of discretionary increases with limited guarantees and that this can be achieved in most cases at little additional cost. We have gone on record as saying in effect that the sands of time are running out for discretionary increases, at least to the extent of current practice, and that guarantees or more guarantees should be built in.

Well perhaps on that note one should go on to an absolutely fundamental principle that we sought to guide us, the question of cost. This affected all our consideration. The effect of recent legislation has already increased both the complexity and the cost to the employer of running a company pension scheme and I fully understand what Mr Miller has said in reservation in relation to small schemes. We did actually very much have this in mind. To add to present cost through further legislation designed to provide additional security to the member could prove counter-productive. I have already made the point that an employer does not now need to feel morally obliged to provide a company scheme at all and to push him too far would run the risk of "throwing out the baby with the bath water". We are not in the business of reducing choice. We want to continue to see a build up in well-run occupational schemes and particularly final pay schemes. So all our recommendations, and I do not entirely accept the reservations that Mr Miller has made, all our recommendations have been carefully costed to ensure that their application to the continuing scheme can be achieved without a significant increase in cost. If a scheme is wound up, that is rather different. An employer and trustees at the time they set up an occupational scheme for their employees are not doing it with the intention that it is going to be wound up. Winding-up is a disturbance that crosses a scheme and can affect its members. It is, to our mind, a very special situation where additional protection is required.

I have already spoken too long. If I may just conclude by saying that, in one of the more complimentary press reviews of our Report, that by John Cunliffe in the March edition of Pensions World, he referred to an ingenious set of recommendations designed to achieve maximum impact with minimum disturbance. That certainly was our aim. But it can only be achieved if we can persuade distinguished and authoritative audiences such as yourselves that it represents a further step forward in the right direction. I hope that after close study and reasoned debate you will feel that this is the case.

Mr H. R. D. Taylor said:—The OPB Report is well written and persuasively argues the case for many of its recommendations. Indeed much of what is contained in the Report is to be commended as quite reasonable.

It recommends maintaining the current legal basis for company schemes—though I doubt whether, given all the recent changes on the U.K. pensions scene, many in the pensions industry would have welcomed further radical reforms including, of course, the SFO and OPB themselves!

It recommends 5% Limited Price Indexing for pensions in payment as a 'bench mark' of good practice. This does not 'sit well' with the 3% LPI for Guaranteed Minimum Pensions built up after April 1988. I wonder therefore if the GMP increase rate may be changed in the future?

I think that 5% LPI may be an over-optimistic target for many small schemes which currently provide low or no pension increases and that few members would welcome a reduction in pension accrual rate to introduce this to the scheme benefit structure on a roughly 'cost neutral basis' to the employer.

I reckon that for similar reasons, the take-up of the "pensioners' option" would be low as most scheme members have built up less than a full pension over their working lifetime and face a substantial reduction to their income on retirement. Given the option of £100 per month with no increases, or a reduced pension of £67 per month with 5% LPI, surely most will take the bigger 'bird in the hand' rather than the smaller but, of course, actuarially equivalent 'bird in the bush' which may some day, through the magic of compound growth, turn out to be two or even more birds.

The Report contains a host of recommendations which should appeal to members, and particularly the consumerist lobby, such as a Tracing Register, Conciliation Body, Tribunal, Limitation on Self-Investment, Employee Trustees, and protection of pension rights on company takeover.

These are the recommendations which could be broadly said to have met my own 'reasonable expectations' of the Report. There are others, however, which have not.

The recommended overriding legislation requiring revaluation of the whole preserved pension for an early leaver creates a precedent by effectively adding an element of retrospection to the 1985 Social Security Act. This may open the door to future 'retrospective' legislation.

I think there is a dangerous sentiment in paragraph 9.12 of the Report that because financial conditions in recent years have generally been favourable to scheme funding levels, it is therefore somehow acceptable to impose legislation which will increase employers' costs. I doubt if experience proves to be unfavourable over the next 5 years there will be corresponding legislation to weaken member rights and so reduce employers' pension costs.

The cost of early leaver benefit improvement quoted as "0.25% of payroll" in the Report will, in fact, be considerably higher for many schemes, especially if, by accident or design, they are funded on a minimal basis or have a high turnover.

The recommendation that any funding deficiency on wind-up of a scheme be a debt of the employer is a fundamental departure from present practice in final salary scheme financing. It removes the one safety valve an employer has on the open-ended nature of his financial commitment to a final salary scheme. That is to say the right to "pay no more" and wind up the scheme. Arguably this bears most heavily on smaller employers because of the inherently greater volatility of the experience with smaller numbers of members.

This recommendation has a number of serious implications. It will affect the credit-worthiness of the employer. This may well put off some employers from installing a new final salary scheme or at worst, could encourage employers to wind up existing final salary schemes which were on a minimal funding basis as a precautionary measure. The prospect of a "beat the deadline" rush to wind up schemes is not attractive. I sincerely hope this recommendation is dropped.

It is also interested to consider the combined effect of the early leaver and the wind-up debt recommendations.

We would effectively have a "minimal funding standard" of the projected unit method, the target being the level of fund required for wind-up liabilities, but I suppose we are already being pushed in that direction by the accounting requirements of SSAP 24. I wonder to what extent the OPB recommendations on wind-up and takeovers have "half an eye" to how much more public the level of funding of the pension scheme will become in company accounts when the requirements of SSAP 24 begin to bite? Companies may become more attractive takeover candidates as a result of a large surplus in the company pension scheme.

In conclusion, it should also be remembered that there are some 11 million employees in the U.K. who have no private pension provision whatsoever. Now admittedly that 11 million includes a number of the very low paid and part-timers, but there are still a substantial number currently relying on the Basic State Pension and a slimmed down version of SERPS who could, and should, do more. The pensions route will be either a personal or a company pension. The take-up rate of Personal Pension is relatively low and the bulk of those written to date for employees have been "rebate only". It has also been estimated that some £8bn of DSS contracting-out payments will go unclaimed, and remember these are for genuine 'no cost' Personal Pensions.

I think therefore for a long time to come, the impetus for employee pension provision will come from employers. They will have the choice between money purchase in the form of a company scheme or group personal pension or, of course, a final salary company scheme. My concern if the recommendations, especially on "early leavers" and "wind-up debt" are put into force is that the final salary route will become a non-starter for new schemes and less attractive for existing schemes. We will have an unnecessary and undesirable distortion in the factors which should be taken into account in planning sensibly the long-term route for employee pension provision.

Mr C. M. Stewart said:—I shall confine my comments to the Board's proposals for securing the interests of *active* members of pension schemes, either in winding-up or when their interests are transferred to another scheme without consent. This has been a somewhat controversial subject in recent years and, in my view, there are shortcomings in what is proposed in the Report.

The sole purpose of putting assets into a separate trust fund is in order to secure the benefits promised in the trust deed and rules. To achieve that purpose, those operating the scheme will adopt a funding target. If that funding target happens to be, say, £20m, and the fund is on target, then it seems to me that the members are entitled to believe that, if their interests were to be transferred to another scheme or, *equally*, if the scheme were to be wound up, £20m is in principle the amount of assets which would be applied towards securing their interests. It does not seem to me to matter whether the £20m is derived as the value of the wind-up benefits in the trust deed or as the amount which would have to be transferred to another scheme. A scheme can have only *one* funding target at a time and I can therefore think of no good reason why, *in either event*, it should not be the intention to apply the whole £20m for the benefit of the members.

The Board apparently do not see it this way. They identify as a good scheme one which guarantees to pay 5% LPI on pensions in payment and which values at least by the projected unit method so as to be able to pay a transfer value on that basis in any bulk transfer arrangement. *The* *funding would therefore allow for future pay increases.* However, if the scheme had to be wound up, there would be no *obligation* to allow for future pay increases; revaluation at only 5% LPI would be required in the period to pension age. The active members' share of the accumulated assets, particularly the younger members, would thus be reduced and part of the £20m would be deemed surplus to requirements. So, even if a scheme had, for the time being, adopted what the Board describe as "good practice" as regards *funding*, the *rights* of the active members in winding up would not be nearly as good. I see this disparity as a serious defect of the Board's proposals.

Why is it that the Board's strategy is aimed at coaxing schemes to fund to the level of the projected unit method? It is clearly because they have been given the impression that it is *only* when the projected unit method is used as the basis for bulk transfer values that the members' interests can be protected. *But this is just not the case.* If two identical schemes with wind-up benefits at the statutory minimum level were funded using the *current unit method*, a transfer value representing past service reserves on *that* basis would enable the receiving scheme to accept the incoming members without financial strain. The same would apply if the two schemes had more generous wind-up benefits, for example, if, instead of the statutory minimum 5% LPI, they promised, let us say, 7% LEI, that is indexation in line with the general level of earnings subject to a maximum of 7% per annum. As it happens, reserves on the current unit method would now be much the *same* as by the projected unit method. It would now be possible to hand over assets corresponding to the accrued liability on the projected unit method but only because members' accrued rights were greater.

The *Board's* approach is to disregard the question of members' accrued rights on winding-up and concentrate on promoting the use of the *projected unit method* for calculating bulk transfer values, irrespective of the wind-up benefits in the scheme rules. They considered making it a statutory requirement for all schemes to use the projected unit method but they tell us in paragraph 10.27 that they could not find suitable words to describe it in legislation. I deduce three things from this paragraph—

1. The Board acknowledge that, *without* such a statutory requirement, each scheme may make its *own* rules as to what a member's accrued rights should be on winding-up or bulk transfer.
2. The Board do not think it really desirable that schemes should *have* this choice.
3. They are nevertheless willing to accept the present position otherwise I would have expected them to have shown more perseverance in their attempt to make it a statutory obligation for *all* schemes to use the projected unit method.

I am surprised, as well as disappointed, that the Board were unable to find a statutory solution to all this because, in my view, that is clearly what is required. There is already a reference to the projected accrued benefit method of valuation in The Pension Scheme Surpluses (Valuation) Regulations and I am sure that that could have been used as a model if the Board had been really determined to impose a single definition of accrued rights on all schemes. I *do* share their misgivings about the extent to which the actuary's techniques and assumptions can affect the *result* when this method is used but, as I have pointed out on a number of occasions, the answer to that is to specify that no allowance should be made for either withdrawal or pay increases on promotion. Making these two compensatory changes would leave much the same total funding target for all members combined, but one less dependent upon the actuary's assumptions and therefore more suitable for the purpose of indicating each member's accrued rights. Indeed, with these two changes the projected unit method would become the *defined* accrued benefit method of valuation, with a statutory requirement for the accrued benefit to be revalued in line with the general level of earnings.

Alternatively, the Board could have adopted the suggestion made by David McLeish and myself in our evidence to them, namely that the *defined* accrued benefit method should be substituted for the somewhat indefinite *projected* accrued benefit method in the regulations, but *without* any requirement as to revaluation beyond the statutory minimum for early leavers. This would limit each scheme's tax relief to the benefits promised in the rules and would thus use the tax incentive to encourage schemes to tighten up their rules and to provide equal security in winding-up and on transfer. This would be more effective in making accrued benefits secure than coaxing schemes to fund by the projected unit method without earmarking the resulting assets for the members if it ever came to winding up.

It seems to me that the Board's pre-occupation with past service reserves in a continuing scheme has blinded them to the possibility of *defining* the accrued benefits and in that way making them secure whether the members' interests are transferred or not.

However, leaving on one side what I think the Board *should* have proposed, I would make two comments on their recommendations as they stand. Their *main* recommendation for securing the interests of those transferring is that the actuary should certify that the members would be given broadly equivalent rights and expectations in the receiving scheme. I agree with this recommendation, subject to one proviso. The receiving scheme should be required to give a written undertaking that the *same* method of valuation would be used *again* if any of those transferring were to be involved in any subsequent transfer without consent. This should not be taken for granted as it is at present where schemes follow the Board's "current good practice" of calculating the transfer value by the projected unit method.

I hope that the guidance from the Faculty and Institute will make this a requirement because I would not personally feel able to *give* an unqualified certificate without such a commitment on behalf of the receiving scheme. Perhaps, too, such a requirement would encourage those schemes which follow the Board's "good practice" to give the same undertaking in respect of *all* their members, thus bringing the accrued rights of the members into line with the scheme's funding practice.

However, even that would not secure the accrued benefits on winding-up unless the recommendation in paragraph 10.9 were to be amended so that the first charge on surplus became to improve the accrued rights of active members up to the level of, let us say, 7% LEI, i.e., indexation in line with the general level of earnings with an upper limit of 7% per annum.

Mr C. W. F. Low said:—Whilst congratulating the OPB on an eminently readable Report and, indeed, one which in many aspects I regard as eminently sensible, there are two aspects of it which concern me. I believe there is the likelihood of the government introducing legislation, possibly directly at a Bill stage without a White Paper, and Mr Miller pointed out, rightly in my opinion, that exhortation to good practice has little effect on many employers and I believe the government may see it that way.

I am very concerned at the prospect of a deficiency in accrued benefits becoming a debt of the employer. Mr Miller mentioned that he thought it would have relatively little effect at this point of time and would be unlikely to put any employer into bankruptcy. I do not disagree with his views at all. But I do believe we should look to the future and the lack of flexibility which this might give employers in the improvement of pensions. It may well be that we think many schemes are improved to a level beyond which further improvements are unlikely beyond the current sixtieths and half widows' pensions. But we do not know how in the future state pension ages might be equalised. If government surplus allowed state pension age to be equalised at a younger age there would be pressure on occupational schemes to follow. Many employers in the past have not taken the minimum route of making improvements in benefit only accrue over the future but have given retrospective improvements. That I believe would be impossible if the Board's proposition was enforced. While the accountants have allowed, under Standard Accounting Practice 24, deficiencies to be paid off over the future average working lifetime of the current workforce, if there was an immediate deficiency then that is going to show on the balance sheet of the employer and if it is going to be enforced as a debt, it will affect his borrowing powers immediately.

The second point which concerns me is of less importance, but it is still, I believe, important. It is in the pensioners' option. True the Board have only recommended it as good practice but I believe it is not at all unlikely that it might be legislated on. There, then, is the proposition that on a subsequent takeover the pensioner would have the right of exercising the option retrospectively. I believe that if that is to be the case then the actuarial profession should be relied upon, as they are in certifying transfer values under Guidance Note 11, that a fair pensioners' option would be given following the takeover, which was fair in the then circumstances of the scheme. Obviously the Board are concerned to protect scheme members against a takeover raider. I believe that all the scheme members also require protection against severely changed financial conditions, either in respect of that scheme not caused by the takeover raider but possibly by unfortunate investments, or changed financial conditions in general, by severe fluctuation in interest rates. The imposition of the previous year's pensioners' options could be totally inappropriate.

Dr L. W. G. Tutt said:—I have listened with intense interest to the most commendable remarks of previous speakers. May I endorse that there is, perhaps, one word which permeates actuarial involvement in pensions affairs namely, security, an aspect so well emphasised by Mr Rowe this evening. It is a word which takes a prior position in our thoughts when, for example, we are certifying, completing a valuation statement, and, indeed, at any time when we put forward a recommended contribution rate. For us, therefore, it seems to me to be most gratifying that the OPB in its excellent Report so valuably highlights many aspects of desirable security to scheme members of benefits promised to them under final salary arrangements.

I regard it as implicit, when a promise is made of a pension related to final pay, that such promise is in real not fictitious terms. Pay to active employees is, overall, related to the full earnings index and deferred pay to retired employees logically should correspond. The OPB's recommendation in this respect does not go as far as this but as far as it does go it is to be welcomed as a first step. A pension ostensibly of, for example, two-thirds of final pay which depreciates in value year by year, often to a mere nominal amount in real terms in later life, does not seem to me to conform with security of pension promises as actuarially perceived. There is, of course, the question of cost but promises should be related to realism. No one, as far as I know, has been given authority to dangle false expectations in front of others.

And again, as regards winding-up the OPB is right to direct attention to the unsatisfactory state of affairs which presently can arise in some circumstances. The proposals, to rectify the unsatisfactory position, which it puts forward, including overriding legislation to prescribe minimum winding-up benefits with a deficiency in preserved rights being a debt to the company, are valuable and constructive. Their proposals with regard to transfers following a takeover or other company reorganisation seem to me to involve delicate technical problems but such problems need to be tackled because this is yet another area where security of benefits to members is deficient.

The sections in the Report dealing with financing principles are to be regarded as especially apposite to actuaries. Here we have shunned, for the private sector, assessmentism as practised, for example, in France, and book reserves as practised, for example, in West Germany. We have pinned our faith on a system under which assets are accumulated external to the sponsoring employer's business, under trusteeship. We have claimed that it is this system, as practically adopted here in Great Britain, which best provides security of benefits to members. The OPB's Report is particularly interesting in this connection. It points out that under the current British system substantial self-investment can be permitted in failing companies and that this, in the past, has in practice proved disastrous to the finances of the schemes concerned; moreover, that there are situations in which employers in financial difficulty have used their pension funds as lenders of last resort usually without the consent of the members. It is, of course, generally appreciated that the continued good fortunes of the employing company and the build up of pension accruals under an associated pension scheme go hand-in-hand. But perhaps some members of pension schemes are not over keen on such hand-in-hand principles being taken to quite such lengths.

The consequent recommendation of the OPB is that should scheme assets, net of self-investment, not cover winding-up liability, there should normally be a maximum on self-investment of 5% of scheme assets, with provisions for dispensations in appropriate cases. All in all I submit that this recommendation of the OPB seems to be inadequate.

For such a proportion of a scheme's assets to be allowed to fluctuate in accordance with the fortunes of the employing company, without safeguards, does not seem to me to be altogether appropriate. If self-investment of this order is to continue to be permitted then a system of credit insurance against the possible failure of the employer's business seems indicated. Forms of such a system do operate in West Germany and the U.S.A. I appreciate that there are some minus points including that credit insurance can necessitate some state intervention. But surely continuation of the disastrous results to which the OPB Report draws attention is highly undesirable. Should we not attempt to play our part to have matters rectified? May I suggest that a system of credit insurance, on the lines of that provided by the Pensions Benefit Guarantee Corporation in the U.S.A., be considered for recommendation by the profession as a possible means of preventing the possibility of future further pension scheme financial disasters of the type indicated by the OPB in its Report.

Mr G. G. Bannerman said:—I want to address myself particularly to two points. The first is the one which other members have mentioned, the question of the priority claim for revaluation of benefits on a wind-up or transfer. On the one hand I feel that there should possibly be some form of protection for the employer. It might be right, for instance, where an employer has undertaken to provide back service rights, the back service period has not yet been completed and the scheme is therefore in a deficiency as far as total benefits are concerned, that the employer might have some degree of protection against this prior claim if it can be shown that the contributions that he has paid have been fully in accordance with the recommendations of the actuary. Where, however, there has been a holding back of money then in those cases I feel it is very proper for there to be an additional claim on behalf of the employees.

The other thing which worries me about the revaluation suggestion is again in the situation where back service is being paid for. We have a preservation rule which says that people have to get the proportionate part of their benefits, although at present it is subject to the fund being adequate. In future when we get to a wind-up we may have the situation that some individuals have very long service, but because of the shortness of the period during which the scheme has been in operation, are only entitled to a low proportion of benefits even relatively close to retirement. Had they actually retired they would have priority rights in full but they are losing out on benefits. I think in place of an inflexible statutory preservation with revaluation, there ought to be discretionary powers to the trustees to re-spread the available assets to members where it seems appropriate for them to do so.

The other point in which I am very interested is the Board's suggestion of a wind-up trustee. I have had some experience of this situation quite recently and there is one feature where I think we need to build on the Board's recommendations. I feel it is very desirable because with people departing, you find you cannot get the necessary signatures. An interesting point here is the question of when a wind-up trustee can say he is clear of responsibility. A wind-up trustee often will come in at the time of the liquidation or even after it. He will find that a lot of the staff who have been running the pension scheme have departed and the records are in a bit of a mess but he has to pick up the bits. He is going to do his best to trace all the people who have left service and to establish the rights of individuals but at the end of the day there may be someone who turns up years later and says 'I have got rights under this scheme.' Now a gratuitous trustee may be protected under the Trust Deed from further claims if he has done his best. A paid trustee does not have the same protection and may have difficulty in proving he was right. There should be statutory provision for a final discharge of a wind-up Trustee. There is a precedent for this sort of situation where a solicitor or someone is looking after a person's affairs (the Scots law term being a curator bonis). He can go to the court and get a discharge at the end of the day. I would suggest to the OPB that they could build on this suggestion and provide for something like this.

Mr A. Neill said:—I think perhaps first I might say where I stand with regard to pension provision in general. As I think I have said several times before in this Hall my ideal is, in fact, a career average or average salary re-valued scheme. The nearest thing to this is probably actually SERPS, surprisingly enough. I accept, however, that final salary schemes are the practical alternative. I do not despise money purchase schemes, although I worry about the variation in pension, particularly due to market conditions at the time of retirement.

The second thing I might say is that I think in general this Report is a pretty good effort. It is clearly a good idea for schemes to add on escalation of pensions in payment, particularly as this will put a life office's premium income up. But I wonder how many employers can really afford it? And I wonder whether any employees will really be interested in the LPI alternative already mentioned? In fact, my office has offered the index-linked pension, with no 5% restriction by the way because it is easier to match the investment, as an alternative for all our pension schemes, and out of the thousands of people who retired last year two people took advantage of that choice.

Incidentally everybody gets concerned about people in final salary schemes not always getting increases in retirement. But who is looking after the people in money purchase schemes? In the final salary versus money purchase argument I do not hear the proponents of the latter mentioning this problem.

When contracting-out started there was a liability on the employer for accrued rights premiums on a termination of a scheme if the trustees did not have enough assets. This, in fact, was one of the things that worried some of us when we considered whether to recommend schemes to contract out. Later this provision was deleted in a tidy up apparently because it had never, or rarely, been used mainly, presumably, because the investment returns for that period had been pretty good, and our profession was to be trusted in the future to make sure the funding was adequate.

As mentioned by Mr Low we now have this question of employers being liable for the solvency of a scheme in a slightly different context. On the winding-up of a scheme the employer is to make good any deficiency, and with some retrospective liabilities shortly to be added. This all seems a bit odd to me in practice because, as Mr Miller said, if the debt on insolvency is given a low priority none, or not very much of it, is actually going to be paid, whereas if it were given a high priority somebody like a bank, who is asked to give a loan to keep an employer going, is going to become very interested in the state of funding of the pension scheme before it makes a loan that would have a lower priority than any of its own debts.

One of the things that bothers me about this Report is that I am not clear on which aspects the Report is actually making recommendations which cover money purchase schemes as well as the fairly large final salary schemes. Various people have already mentioned this question of the smaller schemes. The example I keep using is my golf club, which has a scheme for its Secretary, the Club Master and the Professional. Now going to get the funds to pay some large fee to be registered is going to be difficult and if (what a calamity) the actual employer went bust, where is the money going to come from to pay this independent trustee? And why is he needed if the scheme is insured? Is it going to come from a reduction in the benefits? Maybe it is the employer rather than the trustees who are paying this fee and if that is the case again we come to the question of adding to the priority liabilities of the employer. I had a similar thought to Mr Bannerman and I wondered if these independent trustees were going to have to pay quite a lot for professional indemnity insurance?

Just a few odd thoughts now. Suddenly without a preamble Personal Pension schemes suddenly get into the act in the Pensions Tribunal in paragraph 13.17.

I find it very difficult to decide who should be the trustee of a small money purchase scheme. I do not really want the employer to be it but I cannot think of anybody better and certainly I am completely against some life offices which act as trustees on their own policies, which seems to me to be completely unsatisfactory: who keeps the life office in line?

I welcome the recognition of the problem of unwilling, or disappeared, trustees in paragraphs 14.20 and 14.21.

Finally I am intrigued as to whether my own letter was treated as group B in paragraph 7.3 or was I promoted to C(1)?

Mr A. U. Lyburn said:—Concern has been expressed tonight, and already elsewhere, over in particular the terms for bulk transfers and the pensioners' option and the corresponding responsibilities of the actuary, which if the OPB recommendations become enshrined in legislation, place further legislative responsibilities on the actuarial profession. It is an onerous responsibility which we should not shirk. First I will explain why in my opinion it is onerous and second why it should not be shirked.

The first point is relatively simple—if the terms of the pensioners' option and probably the far more complex terms for bulk transfers without consent are to be left to the profession, the profession has to understand and accept that we are in fact legislating. Now we are not elected Members of Parliament and, understandably so, MPs are extremely reluctant to subrogate their responsibilities and indeed their power. In a limited way they have already done so with The Occupational Pension Schemes (Transfer Values) Regulations Statutory Instrument 1985/No.

1931. In short these regulations lay down that cash equivalents are to be calculated, etc., by an actuary in accordance with Guidance Note 11 (originally the note current on the date the regulations came into force and I will come back to this). Before that, however, let me quote the regulation verbatim—

> "In a case where it is the established custom of the trustees of the scheme to award additional benefits at their discretion, the cash equivalent shall be increased to take account of any such additional benefits as will accrue to the member in question if the custom continues unaltered unless the trustees direct otherwise."

and 3.3 of GN11 refers specially to this regulation.

However, 10 days ago I was at a conference in London centred round the Report we are discussing this evening and I was horrified to learn that there are not just a few cases where trustees were directing otherwise. This is not in the spirit of the legislation and it brings home the sad fact that there are still many cases where the trustees are far from sympathetic if not hostile to the voluntary early leaver. I believe the regulation was originally so drawn because it was felt that the actuary could not determine far less quantify the discretionary policy of the trustees and also because to insist on discretionary increases being taken into account is looking very far into the future to a time possibly when members then becoming pensioners would not be so well treated. For the pensioners' option, however, it is clearly easier to justify taking current discretionary practice fully into account.

It was also felt that there was a transfer value "safeguard" in paragraph 3.4 of the Guidance Note which reads:

> "In cases where the trustees, in accordance with paragraph 3.3, have given a general direction to the actuary that discretionary increases should *not* be taken into account, then the same principles should be applied to the calculation of the benefits in respect of incoming transfer values so as to maintain consistency between the basis for incoming and outgoing transfer values."

Unfortunately this safeguard does not appear to be as strong as anticipated as I understand that, where transfer values out are calculated not taking into account discretionary increases, transfer values in are not accepted for defined benefits but may be accepted on a money purchase basis. Clearly a change will be required and unfortunately it seems as if it will have to be a legislative change. Had the regulations been drawn putting the entire decision in the actuary's powers then the necessary change could I reckon have been introduced within a few weeks. Perhaps I should emphasise that the regulations I have been talking about were in fact only laid before Parliament once the Guidance Note had been produced. Referring back to an earlier comment it is important to note that the regulations have subsequently been changed to specify the Guidance Notes in force at the date of calculation. Put in a nutshell, for practical reasons, we have been given more legislative authority which is a mark of the respect in which the profession is held. It is up to us to continue to justify this trust and we shall be I hope cooperating very fully with the DSS on future legislation emanating from the OPB Report. I think it is very important that as much of the detail as possible should be left to us because it is so technical and from past experience we have found that while Parliamentary draftsmen may believe they understand what pension technicians advise is required they have frequently been unsuccessful, certainly at the first attempt, in producing legislation which achieves the objective—even where the legislation can be understood. There is no doubt, particularly I think in the case of bulk transfers, that we shall have to learn by experience. That is why I hope the actuarial profession is left to produce guidance which can be modified quickly in the light of experience.

Perhaps I should add that I do have some reservations about the production of Guidance Notes but these are personal. When the OPB Report was being produced I had no hesitation in backing the guidance route thinking that by the time the notes had to be produced I would be safely releieved of my responsibilities as Chairman of the Pension Standards Joint Committee and that all would be left to my successors.

Unfortunately the timetable appears to be such that I may not get off quite as easily as I had thought!

Mr J. H. Devine said:—I shall restrict my comments to one or two matters of principle.

Throughout the Report there are quite rightly constant references to the rights of members contrasted with their expectations.

Having identified that the expectations of members are often greater than their rights the Report sets about suggesting how these expectations can be satisfied, basically by improving the benefits under the scheme. Why? Why does the OPB not concentrate on the reasons for expectations being greater than rights namely, as they themselves say in paragraph 8.3, the legal position is "confused and unsatisfactory"? Where there could be confusion, make it clear in the Rules what should happen.

For example, on takeovers and mergers, it says in paragraph 10.3 that "the package of benefits offered may well involve expectations as well as rights". The solution proposed is that the actuary to the transferring scheme should certify that the rights *and expectations* in the new scheme are *broadly equivalent to the rights and expectations in the original scheme for service to date*. What *are* the expectations of those members? Surely only each individual member knows his own views? The Report says in paragraph 10.29 that "it should be possible for the actuary to the transferring scheme to form an opinion on whether the expectations acquired in the receiving scheme are broadly equivalent". Of course it is possible to form an opinion but would the actuary be right? An actuarial professional guidance note is suggested but would the actuarial profession be any more right?

The OPB have not come up with a solution to the problem of expectations being greater than rights. They have just shuffled the problem along to the actuary so that he can try to play God with these expectations. It is not a suggestion which the profession should endorse. The solution to the problem is to address the confusion in the Trust Deed and Rules and other literature available to the member so that it is absolutely clear in all circumstances, especially on takeovers and mergers, what rights the member has, so that expectations get closer to rights—that *may* mean increasing rights to meet expectations but it could mean reducing expectations to meet rights. Each individual employer and each set of trustees should decide which way they want to go.

The reason the OPB has come up with their suggested solution is, I believe, because the Board has been over-influenced by funding considerations and actuarial methods of valuation. For example in paragraphs 10.25 and 10.26 it states that trustees *require* a transfer amount called the "past service reserve" (which allows for expected future pay increases) if they are to grant pension credits which allow for rights and expectations based on eventual final pay. Every actuary knows that is not so. The trustees do not require it; they may want it but they do not require it. If the receiving scheme is valued by a different method the receipt of this past service reserve will still throw up a surplus, or a deficiency, even with the same assumptions in the transferring and receiving schemes. There is nothing wrong with that. The trustees of the receiving scheme can be instructed by the employer that full past service rights are being granted to the transferring members irrespective of the transfer amount. If the trustees are unhappy about the financing of the liabilities they should talk to the employer, not the trustees of the transferring scheme.

Transfer of the past service reserve is described as "current good practice"—it may be current practice but I question whether it is automatically "good". Why not specify the accrued rights awarded on takeover or merger and calculate the transfer amount to cover these rights? The accrued rights could be at the leaving service benefit level, or higher, perhaps allowing for future salary increases. The employer should decide at the outset what he wants for his fund and then have it set out clearly in the Rules. The OPB should have concentrated on benefits, the reasons for the current difference between rights and expectations, putting greater stress on the use of disclosure rather than being so heavily influenced by funding considerations. Define the benefits to apply in all circumstances and let the actuary in consultation with his client decide how these benefits should be funded.

The suggestion of a minimum funding requirement on discontinuance is initially appealing but potentially dangerous. Of course it seems reasonable to expect that active members should receive at least leaving service benefits on discontinuance and hopefully better than that. But the employer's reasons for the discontinuance could be to cut costs to survive (which would keep the members in work and they may even support the discontinuance). Perhaps the poor trading position is associated with rampant inflation, collapsing equity prices but without a significant corresponding reduction in the cost of deferred and immediate annuities which would be bought on discontinuance. The employer then finds that he has to pump more money into the fund which helps kill off his business. At the moment there is a safety valve for the employer, which is more psychological than real, that he can discontinue his fund without having to consider putting any more money into it.

I know the OPB have very laudable objectives in mind with this suggestion and that there could be other discontinuance circumstances. In fact I believe most employers want to fund above the minimum and would want to build in a cushion to make it more unlikely that there would ever be a shortfall on discontinuance. But what is now being proposed for them? Well, if there are surplus assets after providing leaving service benefits for the active member then they are to be used to provide pension increases at 5% p.a. before there is ever any question of there being surplus to be disposed. Are these pension increases what the employer had in mind? If not then maybe he should fund meanly.

Why has the OPB suggested legislation in this area? Attention could be drawn to the desirability of pension increases at 5% p.a. and greater use could be made of disclosure to show whether the assets would be likely on a theoretical discontinuance to be able to provide these increases—if the surplus were to be used in that direction. This pressure I believe would be likely to encourage employers to have 5% p.a. pension increases while the scheme continues as well as on discontinuance—and to put it in the Rules as a right. At the moment the OPB's suggestion could make pensioners better off if only they could engineer a discontinuance.

The Report is excellent in many respects but I believe that the OPB have missed one or two opportunities. They should have concentrated more on the benefits combined with disclosure and clarity in Trust Deeds and Rules, and should not have been influenced so much by funding considerations.

Mr R. K. Sloan said:—Tempting though it is to be drawn into further discussion on some of the points that have already been raised in this Hall tonight, I will confine myself to comments on four specific points.

First of all, I fully support the OPB's second recommendation regarding statutory revaluation of the *whole* of a preserved pension, rather than this being limited only to pension earned from 1 January 1985. Since before the time of the 1984 Government Inquiry, I have regarded this as an anomaly which militates against long-serving employees, and I am glad that the overall financial, and funding, climate now seems to be such that this recommendation will probably be accepted.

After the first point of agreement, I am afraid my secoind point is to disagree with the "pensioners' option" in the limited form proposed. I quote from paragraph 11.18 of the Report itself, where the OPB state that "improvement in benefits implies increase in costs, and since we are seeking to avoid the imposition of extra costs, we have considered a method of introducing LPI (Limited Price-Indexing) which would be financially neutral on schemes". In other words, the proposed option to exchange a 4% escalating pension of (say) 100 per annum for a 5% escalating pension of only 92 per annum is *not* seen as a benefit improvement.

Taking Mr Miller's point, I believe a scheme member would also be *un*impressed, since it would be likely to take more than 20 years before the cumulative shortfall in his lower 92% pension catches up. However, if the option were to be extended to the purchase of a *fully* price-indexed pension of say 83%, then I believe this *would* have some real merit because of the genuine protection that this would afford, regardless of the vicissitudes of future inflation. I am surprised at the low 2% take-up.

I think the OPB have become so accustomed to thinking in terms of defined benefit schemes that they have not fully grasped the implications of the essentially money purchase nature of the proposed pensioners' option. The conversion terms are akin to an open market option, and effectively place a capital value on the member's pension entitlement.

It would therefore seem equally logical to give the pensioner the option to exchange his 100 of 4% escalating pension for a *higher fixed* rate pension which, based on the example in the Report, would be 137%. This would still be cost-neutral to the scheme trustees and would keep the pensioner ahead on a cumulative basis for well over 20 years—undoubtedly the option I would recommend.

My third point is prompted by the reference to funding levels in paragraph 15.14. Here the Report suggests that the funds of employer A's scheme may amount to only 90% of the funds of the otherwise identical scheme of employer B. What they fail to state, however, is that this relationship remains wholly true only if the scheme membership profile of both schemes is also identical, which seems extremely unlikely.

I therefore make no apology for remounting my hobbyhorse about the way in which funding levels are communicated, both within our profession and outside. My own preferred approach is to calcuate the rate of future revaluation on accrued benefits that can be supported by the existing assets, giving rise to the measure that I call the pre-funded rate of revaluation, or PFR for short. The PFR takes full account of the age, sex and salary distribution of the scheme membership, whereas a straightforward asset/liability ratio such as 90% does not.

If we take an admittedly extreme example of scheme A with only one employee aged 35, and scheme B with one employee aged 60, then *90% funded* on the statutory 8.5% interest/7% salary growth would be equivalent, on a wind-up basis giving 5% revaluation, to *158%* funded for scheme A's 35 year old but to only *99%* funded for scheme B's 60 year old. By comparison, the PFR approach would combine both sets of results in the form of a rate of revaluation of 6.6% for the 35 year old and 4.8% for the 60 years old, which I believe to be a much simpler, and clearer, presentation in practical terms.

My brief mention a few moments ago of money purchase brings me to my fourth and final point. In Appendix 3, the Report explains the detailed provisions for contracting-out of SERPS, with paragraph 9 describing the GMP approach of a final salary scheme, and paragraph 10 the protected rights approach of an Appropriate Personal Pension or COMP scheme. However, these two definitions are *not* mutually exclusive, in that money purchase schemes can also be used to contract-out on the *GMP* test, which in fact has much to commend it.

The OPB is not the only body to overlook this important facility, since most of the Joint Office Memoranda likewise tend to assume that all money purchase schemes are contracted-out on the *Protected Rights* basis. Perhaps what is needed is yet another acronym to distinguish between contracted-out *money purchase* schemes and money purchase *contracted-out* schemes.

Mr E. Rogers said:—May I first repeat Mr Rowe's thanks to you for inviting us to attend this extremely interesting discussion. I must say I found it particularly encouraging because, although it was hardly to be expected that people would agree with everything that we said, nevertheless enough people seem to think that we have got a lot of things right and I find that very encouraging. I do not think that we expected to get everything right because, although I have seen it reported that we had 8 months to decide what we were going to do, we did in fact take what was, I think, the reasonable view that we wanted to analyse the evidence before trying to reach conclusions. The evidence came in August and we needed a month to analyse it. So we really had September, October and November to decide what to do and I am sure that we did not get everything right. In fact the main purpose of this consultation exercise is obviously so that people such as yourselves can point out where the recommendations could, and should, be improved.

I must not try to do the closer's job for him so I think in the very limited time I have available all I should do is comment very briefly on one or two points of concern expressed by speakers and try to explain how we got to where we did.

First, retrospection. Could I remind you of the history of preservation legislation? The first government body ever to be set up to consider the problem of preservation was in the 1950's when many other countries in Europe already had their preservation legislation in place. That committee was pretty high-powered with people like Frank Redington involved. In the end they decided that the time was not right for compulsion and that exhortation was the preferable route. That did not work and 20 years later we got the 1973 Act which was the first retrospective legislation. Our recommendation is not a precedent because the 1973 Act required preservation to apply to all service. The problem was that inflation took off just about the time the legislation came in, so since then there has been an urgent need for revaluation. Again there has been the same problem that the good employers have made progress in this area but others have not. I have heard estimates from leading consultants that up to 80% of their clients already give 5% revaluation on all service and not just post '85 service, but it is the back-sliders who create the problems. All the time we were having to try to strike some sort of balance, not going so far that we pushed people away from maintaining their pension schemes, but just trying to make sure that people went a little further along the road that the good employers have already taken.

Next, the proposal for an employer's deficiency debt on wind-up seemed to worry you quite a lot. I think that employees who are given a Rule Book think that the employer has promised them the benefits that are promised by that Rule Book in whatever circumstances they leave service, including wind-up. In fact the employees' view may not be so far out because the legal situation is indeed very unclear. We pointed that out in this Report, and we pointed it out in our previous report. It is possible that there is, in fact, an obligation on the employer to provide the benefits promised by the pension fund rules whether or not the assets are there and we said in both reports that this legal draft ought to be cleared up as a matter of urgency. However, all we are doing in recommending that any deficiency should be a debt is again trying to give a little push along the road to those employers who, putting it bluntly, are welching on their obligations. I should say that we do not suggest in the Report that the debt should be a priority claim. We simply suggest that it should be part of the general creditors' claim on the employer. Of course, not all wind-ups occur through insolvency. There are occasions where employers deliberately seek to cream off surplus through wind-up. It is not fortunately very common but it does happen.

Now transfers. I think this is clearly, along with pension increases, the two most difficult problems we had to cope with and I do not think that there are perfect solutions. If there are we certainly were not going to find them in 3 months' discussion. Again we adopted our general approach of not wanting to interfere with arrangements that were working well. I know from my own professional experience many examples where between two employers of good faith a transfer of rights and expectations through the use of past service reserves works perfectly well. By that approach we avoid all the complication of the share of fund approach and the immensely complicated calculations that can arise out of it. We have deliberately put, or sought to put, a much greater obligation on the actuary for the reasons discussed by Mr Lyburn. We think that it is an area that would not lend itself to legislation which would be complicated and obscure. On the other hand I do not share the opener's confidence in the even-handedness of trustees. Maybe that is a cynical view coming out of my experience of the OPB. We meet some shocking trustees. So I support very strongly Mr Lyburn's point that I think the right approach is to make this area the professional responsibility of the actuary with the best support the profession can provide in the way of actuarial guidance. I very much hope that the Faculty and the Institute will go along with that view point.

The pensioners' option is a very difficult area. My own view on this, perhaps held more strongly than by some other members of the Board, is that what I really want to see is employers guaranteeing pension increases up to the level they think they can afford. I think they greatly over-estimate the risks in giving such guarantees, simply because they have not really thought the problem through, and I hope actuaries and other professional advisers will be putting their weight behind encouraging employers to see a little straighter on this issue. I agree the pensioners' option is complicated and likely to be used very much as a second best but it is in my view better than nothing, particularly perhaps in situations where a predator is on the horizon. I think it would have a real value there.

On self-investment there was a suggestion that the Report did not go far enough. I should explain that when we were talking in the Report about dispensations we were talking about very extreme situations indeed; in particular situations in which unusual funds are operated with the full consent of the members involved. For example, the most extreme situation we came across is where a pension fund owns the whole of the parent company. There are a few situations like that that you cannot just stop overnight, and I am talking of situations where the employees fully understand the situation. There are just a few of these very special situations that are acceptable but in the main I would hope that there would be a very tough line taken on self-investment.

On credit insurance, a subject after my own heart, I prefer the German approach to the American approach. In other words insuring against the insolvency of the employer, with the pension promise a direct obligation of the employer, rather than the American approach of insuring against insufficiency in the pension fund. I think the German system has a great deal going for it. We covered it very fully in our previous report and rather less fully this time. Possibly it has a future in this country sometime but we did not think that if we recommended such a dramatic change at this stage we would make much progress.

Obviously I cannot try to cover everybody's points. I think that in the very limited time there is not much more that I can say except to repeat that I have greatly enjoyed the discussion.

Mr T. M. Ross closing the discussion, said:—The discussion this evening has covered a range of issues. It has addressed the broader question of whether the Board's recommendations will achieve the objectives which Mr Rowe outlined, together with a series of rather more particular points, some of which will affect us professionally. I will attempt to cover both the broader consequence of the recommendations and some of the detail.

To begin with, I think it is necessary to view the Board's recommendations in a world which is changing, where the employer's attitude to the operation of an occupational pension scheme is moving away from what I might call benign paternalism towards a harder brand of financial control. This change is reflected, for example, in a shift of the corporate responsibility for pension funds away from the personnel function towards the finance function. I believe that, as more external constraints are placed on the funding of pension schemes, (for example surplus regulation, accounting standards, minimum funding standards and so forth), and as the sheer size of pension funds grows ever larger in relation to both employee payrolls and the market capitalisation of the employer, this shift in attitude will continue. That makes me have some doubts about the sustainability of trust law in the long run as a satisfactory basis for pension schemes. Some employers are beginning to feel uncomfortable about the traditional approach of funding conservatively and leaving the trustees to deal with the surplus as it emerges. It is not, I think, that employers are becoming less generous in their attitudes towards their employees or towards their pensioners. But I do think that employers today see a much greater need than hitherto to control the level of protection given to employees and pensioners and how it is paid for and to retain a significant degree of flexibility in the operation of their pension schemes.

The Report appears to be written against a background of the traditional paternalistic approach. However, I believe that we should view it against a rather different scenario where employers' attitudes to pensions are changing. We must also bear in mind that the Board's proposals are primarily aimed at specific dislocations of the circumstances of employees and pensioners—that is, a winding-up or a takeover in whole or in part of an employing company with a pension scheme. There are very many more employees who do not face these dislocations and we should judge the impact of the Board's proposals on them. These wider considerations may give cause for some concern.

Now let me turn to some of the detail. A number of speakers referred to the pensioners' option. Clearly the terms of the pensioners' option will depend on the level of discretionary pension increases which is allowed for in the calculation. I believe that there is a very close link, as indeed has been suggested by My Lyburn, with the transfer value regulations and the provisions of GN11. I find it difficult to see how a different allowance for discretionary pension increases can be made in the pensioners' option calculation from that which is made for the purpose of calculating transfer values. My own experience accords with My Lyburn's in relation to transfer values. The level of discretion which is being allowed for is less than that which is funded for and less than that which has been granted in practice. I do not regard that as weakness of the actuarial profession. Such decisions are quite properly the province of the trustees and the employer.

Many of you will be aware that the Pension Standards Joint Committee of the Institute and Faculty has carried out surveys on the transfer value bases which are used by actuaries. Unfortunately the questions asked have not made it possible to evaluate the extent to which discretionary pension increases are being assumed. I suspect it is very little and I would hope that future surveys will provide better information on this important question. In my view therefore, the transfer value regulations, far from encouraging better transfer values, have alerted employers and trustees to the generosity of previous practices (and here I come back to my earlier point about changing attitudes) with the result that transfer values have actually decreased as a result of the legislation.

The reaction to the transfer value regulations perhaps gives a clue to how employers will react to the pensioners' option. I am inclined to think that the option will either not be offered at all or, if it is, it will be offered with relatively minor levels of discretionary pension increases being allowed for. This will make the option unattractive to the member. I think that employees would be reluctant to accept a significantly lower pension in return for long-term increases and I am interested that there is already evidence of this where such an option has been offered by schemes.

A worrying technical aspect of the option, which has been touched on by Mr Low, is the element of hindsight inherent in the ability of the pensioner to elect last year's terms if this year's terms have been worsened. Clearly this is intended to protect the pensioner from an employer who decides to reduce or cancel pension increases. But I can visualise, as can Mr Low, other circumstances, of an actuarial rather than a commercial nature, where the terms of the option would have to change. A change in medium to long-term interest rates is one example. It goes against the principles of actuarial thought that changes in the terms for these reasons should not be allowed to take immediate effect. All in all I think that the pensioners' option adds an additional layer of complexity to final salary pension schemes which will not be helpful.

Views on retrospection in relation to the provision of improved protection for early leavers' benefits seemed to vary quite widely. For my own part I would accept that the costs for a continuing scheme are on the whole likely to be modest and I would also accept that retrospection is not a precedent given the original preservation legislation. I was interested to hear more than one speaker tonight suggest that some insured schemes would not be discontinuance funded if allowance was made for the proposed improvement in withdrawal benefits. This might not matter so long as the scheme did not discontinue, but what if it did? I think that Mr Bannerman makes a good point when he suggests that there need to be some safeguards if the winding-up proposals incorporating a debt on the employer become enshrined in legislation.

It has also been said by another speaker that it is all very well to say that schemes can afford the proposals because times are good, but these benefits cannot be taken away if financial conditions turn out to be less favourable. I believe that we have to be very careful in these days of strong legislative control of pension funds that seemingly minor changes of this kind do not become financial millstones.

Very closely allied to the retrospection issue on early leavers' benefits is, of course, that on winding-up. It seems to be widely felt that the debt which an employer would suffer could be a deterrent, at the margin, to the creation of new final salary pension schemes and to improvements to past service benefits under existing schemes. Others felt that, with proper actuarial control, the risk of discontinuance insolvency of the fund would not be significant. I believe that Mr Neill was among them. He felt, however, that the idea of there being a debt on the employer was unacceptable, and that it should be the responsibility of the actuary to make sure that insolvency did not occur. I was relieved, as I am sure many others of you were, that he did not go on to say that, if the actuary got it wrong, then the debt should fall on him or her. At least I do not think he said that!

When schemes are reasonably well funded, perhaps on a projected final salary basis, it is perfectly possible that some employees and former employees would be better off on a winding-up than if the scheme had continued. This would be particularly true of pensioners and deferred pensioners, given the release of reserves from salary-related benefits which would be converted into 5% per annum, or up to 5% per annum, pension increases. Mr Stewart said that this problem only arises because a fund which exceeds the value of the wind-up benefits is larger than it should be. It would perhaps be inappropriate this evening to repeat the arguments about funding objectives, but suffice it to say that, in my own experience, employers have many reasons, other than simply covering discontinuance benefits, for building up pension funds to particular levels. I am not comfortable with Mr Stewart's suggestion that the provision of salary-related benefits for active members should take priority over pension increases if the funding of the scheme accords with that concept. The fact is that the wind-up of the scheme immediately alters the circumstances of the active members, who are not active members any more and should not therefore remain entitled to active member benefits. Often they will no longer be working for the employer. Why should they get better benefits than those employees who happened to leave the employer the year before? A pension scheme is similar to a business. It is sensible to run it as a going concern, fully recognising that the financial figures would be totally different if by change the business were to break up or discontinue.

I think that the practical effect of the winding-up proposals will be weaker funding—and weaker funding is likely to mean a lower level of discretionary benefits, both in continuing schemes and also, possibly, in some instances of winding-up and takeover.

Turning to pension increase guarantees, the Board are of the view that employers tend to overestimate the risks of giving partial guarantees. I fear that this may miss the point and that the Board may be underestimating the desire of employers to retain flexibility. Of course it should be accepted that a guarantee is a good thing for pensioners if, in the absence of such a guarantee, discretionary practices change for the worse. However my concern about the guarantee on pension increases is that the proposals have been put forward at a time relatively low inflation coupled with unprecedentedly high real investment returns. Although the Report does not state it, it has been said by both Mr Rowe and Mr Rogers that the costs of providing these guarantees might be relatively modest. Mr Neill, on the other hand, threw in a word of caution, with which I agree. I know that, at the present time, even in a good sixtieths scheme there are substantial parts of the pension which would not have to be increased. The GMP does not have to be increased, nor does the part which is commuted. However, in the current political climate these two elements could well decrease or even disappear leaving the whole pension subject to increases. Certainly it is advisable, when considering providing such a guarantee, to calculate the cost assuming that there are no deductions for commutation or for GMP's. Perhaps the actuarial basis should be rather stronger than some of those which are found at the present time, driven as they are by the very high real returns of recent years. If the employer is then happy with the cost, by all means proceed.

In my view the Board have underestimated the employee relations problems associated with a cut in accrual rates as a way of paying for pension increase guarantees. We have heard, in relation to the pensioners' option, how unpopular reduced benefits would be with the members of schemes.

I might also say in passing that the type of guarantee being suggested by the Board could be regarded as tackling the wrong slice of inflation. It is not the first few percentage points of RPI increases which hurt the pensioner. Rather, it is the massive increases above that level which occurred, for example, in the 1970's. If there has to be a guarantee I would suggest that something more along the lines of RPI less 2% with quite a high ceiling in RPI such as 10% might fit benefits rather closer to needs, while still to some reasonable degree safeguarding the finances of the fund.

Turning to bulk transfers, there are some aspects of the proposals which are somewhat puzzling and I note that I am not the only one who has had difficulty in this area. Mr Stewart mentioned the desirability of the receiving scheme undertaking to use the same valuation basis on a subsequent transfer without consent and I agree with him. But the fact remains that while discretion rather than guarantees continues to be preferred, there is little control over how bulk transfer values will be used. Even when employees are asked for their consent, I wonder how fully they understand the relative values of the options before them and it has to be said that this is one of the serious drawbacks of final salary schemes. There is a need for a high level of professional knowledge in order properly to evaluate even relatively simple options in a final salary scheme. The lay member has a formidable task to choose correctly. Moreover, future actions by the employer and the trustees could well undermine even the most carefully thought out decision.

It should be noted that the proposed benefits on wind-up will often be worth more, perhaps much more, than the early leaver benefits and they could also be worth more than the benefits offered in the new scheme. This may put the trustees of the exporting scheme in a difficult position. Could they reasonably ask the employee to consent to a transfer where the benefit would be less than he would get in his existing scheme were it to be wound-up? If they decided they should ask him for consent and he declined, how comfortable would they feel about giving him just early leaving benefits from the existing scheme? I think that the Board's intentions regarding the circumstances when the partial wind-up option in chapter 10 paragraph 31 comes into play, need to be clarified. If the members were required to be given the best benefits, partial wind-up might be the relevant option more often than may be thought. In an ideal world where pension increases are guaranteed, which is what the Board would like, these sorts of anomalies would not arise, but I fear that the world may not be ideal.

What is the broad effect of the proposals on pensioning likely to be? Firstly they will not do very much for the continued expansion of final salary pension schemes. At the margin I think that employers will be deterred from implementing such schemes. This view has been expressed by Mr Taylor and others tonight. I think that we, or rather the politicians, need to decide whether we want a pension system in the U.K. which does provide full protection for the privileged few who are members of it, or whether we want a pension system which may have shortcomings at the margin but on the basis that, for many of the 11 million who are not members of schemes, half a loaf is better than no bread.

For my own part I think that the Board's exhortations on pension increase guarantees will not work. They will not lead to higher pension increase guarantees, but I think that there is likely to be a movement to lower funding objectives because of the wind-up provisions and this will reinforce the unfortunate trend which started off, I think, with the surplus regulations and by the fear of corporate predators. The result of weakened funding is bound to be some lowering, on average, of the increases enjoyed by the pensioner population as a whole. If the Board really believes that pension increase guarantees are important then I think that they should have recommended that they should be required by legislation in continuing schemes. I fear that a web of indirect coercion based on moral pressure will be counter-productive. Those employers who would have given RPI up to 5% will do so anyway. The others, I suspect, will give less, not more.

For some employees caught up in takeovers and wind-ups the proposals will certainly improve their position, and if that is the Board's main objective, I think it will be achieved. In fairness, the Board did not state that one of their objectives was to make recommendations which would widen the coverage of pension schemes. Certainly their recommendations will have the opposite effect.

Let me leave you with a thought which was touched on by Mr Tutt and which, for me, is prompted by the interaction of weaker external funding with the new accounting standard SSAP24 and with the restrictions in pensionable salary introduced in the recent Budget. I think that many employers do see merit in final salary schemes. They fit their own employment objectives. But flexibility for employers is vitally important. I can therefore visualise that external funding as we know it is going to be aimed at covering only non-discretionary approved benefits—and at a comparatively weak level—but the accounting standard will make sure that there are balance sheet provisions to make up the difference. So we could, for different reasons than Mr Tutt's, arrive at the West German book reserve system. We are taking a step in that direction in my view, through the recommendations before us tonight. I agree that it is then essential that we have appropriate credit insurance to cover the potential losses arising from the insolvency of employers.

That said, it remains to be proved that the German pensioner and the German economy as a whole have been disadvantaged by the system in force in that country. Consequently it would be inappropriate to put a value judgment, good or bad, on this possible impact of the proposals. But I do feel that the proposals could have more far-reaching consequences, in the longer term, than the Board intended.