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A DISCUSSION ON THE REPORT OF THE PENSION LAW REVIEW COMMITTEE (THE GOODE COMMITTEE)

(A Discussion at the Faculty of Actuaries on 15 November 1993)

The President - Good Afternoon, Ladies and Gentlemen. It is a great pleasure for me to welcome you all to this, our second, Sessional Meeting and, in particular, to welcome our official guests, Professor Roy Goode (of whom more anon) and Mr Bob Lusk, Controller of the Inland Revenue Pension Schemes Office.

Before we move on to the main part of the meeting, I have a pleasant duty to perform and one which I am sure will bring pleasure to many of you. One of our students, having recently completed the examinations, has acted with sufficient alacrity to get his Application for Fellowship to Council before today's meeting and I am pleased to say that his application has been approved. I am talking of Mr John R Gemmell, who is the son of one of our Fellows. Admission to our Fellowship is always a landmark in any young person's career and it gives me very great pleasure to ask Mr Gemmell to come forward now to receive his Diploma.

[Mr Gemmell was then presented with his Fellowship Diploma.]

The main purpose of our meeting this afternoon is to discuss the report of the Pension Law Review Committee. We have gathered a panel of four of our Fellows who are distinguished in the pensions field. We are particularly pleased to welcome them and equally pleased to welcome the Chairman of the Pension Law Review Committee. Professor Goode must have seen his name in print more in the last few weeks than almost any other person, except possibly the Prime Minister, so he will be known to you all. Probably most of you will know of his career, but perhaps I could take a few minutes to fill in some of the blanks.

He is Norton Rose Professor of English Law in the University of Oxford, where he is a Fellow of St John's College. He was admitted a solicitor in 1955 and became a partner in a distinguished firm in the city. He became Professor of Law at London University and was subsequently called to the bar by the Inner Temple, of which he is now an Honorary Bencher. He is a Queen's Counsel. His intellectual distinction is reflected in the fact that he was elected to the Fellowship of the British Academy. He has published many articles, papers, and books on wide aspects of law - with particular reference to commercial law.

It is particularly pleasing to us that Professor Goode agreed so willingly to come and talk to us here in Edinburgh.

Professor Roy Goode First of all, may I say what a very great pleasure it is to be here. My instructions are very clear, to speak for no more than five minutes but be sure to cover all 218 recommendations in full! Of course, I am particularly pleased to be filling this spot because all the hard questions are going to be dealt with by the very expert panel.

I should also like to just say how much my Committee was indebted to the actuarial profession including, I would imagine, most if not all of the firms represented here today who helped us enormously on some very complex problems. I also have to admit to being frightened out of my life - to be a lawyer standing here before so many actuaries is for me a most alarming experience!

Our report was essentially focused on two key issues: fair play and security for pension entitlements. We wanted, so far as the fair play aspect was concerned, to ensure that meaning was given to the pension promise; in other words that the pension promise was identified and was written into the statute as a responsibility on the employer and that there was fairness as between the employer and the scheme members. That reflected itself in the recommendations on the one hand that the pension promise should not be able to be watered down as regards accrued service - in particular, that scheme rules would not be allowed to provide for the forfeiture or adverse amendment of rights accrued by service - and, on the other hand as far as the employer is concerned, that it should be free to reduce or even terminate its obligations as regards future service and thus control its future financial viability.

Ensuring that the pension promise is defined and cannot be taken away by amendment or confiscation under the scheme rules is one way of protecting the pension promise. The other is to make the promise secure. That led us to the conclusion that there should be a minimum funding standard, a minimum solvency requirement, 100% funding. This has engendered a mild degree of discussion within the actuarial profession. Under our proposals, schemes might be able to dip below the planned 100% target but, if they did dip below that 100%, then a business plan would have to be submitted to the Regulator, whom we recommended should be in place, showing how the 100% solvency level would be restored within three years. Moreover, there should be a base level of 90% below which, in principle, the assets should never fall, with three months leeway for making good any deficiency.

The minimum solvency standard should be geared to ensuring that legal liabilities would be fully satisfied if one were to assume a discontinuance of the scheme. That has given rise to a certain amount of debate.

The minimum solvency requirement should largely help to ensure that the integrity of the pension promise is maintained. The fall-back position, but only covering loss through fraud, theft or other misappropriation, is a statutory compensation scheme. Where there is a deficiency because of fraud, theft or other misappropriation, then there should be a statutory compensation scheme providing for up to 90% of the loss of assets or 90% of the scheme deficiency, whichever was the lower.

These measures, together with increased monitoring and a significantly increased rôle for the scheme actuary and the scheme auditor, should help to ensure that, if any losses do occur in the future, they will be fairly minimal, so that we could largely avoid the problems and hardships that have arisen from the Maxwell affair.

The President I indicated that we had a distinguished panel. Its members are probably known to almost everyone here, but lest there be any present who are not entirely familiar with the panel I will identify them to you.

We have Mr Ian Aitken who is President of the Pensions Management Institute, Mr Ron Amy who is Chairman of the National Association of Pension Funds, Mr David Berridge who was a member of the Pension Law Review Committee, and Mr Harvie Brown who was also a member of Professor Goode's Committee.

I said that they were particularly distinguished and I think the rôles I have mentioned bear that out. Another thing that distinguishes them is that I wonder when last Harvie Brown was alphabetically at the end of any panel of four on which he served. We must aim for four letter As at our next panel session!

I understand the panel members have agreed among themselves certain aspects of the Report which each will highlight for us. After we have heard the panel I will invite another of our Fellows who has attained distinction in the pensions field, Mr Roger Westwood, the President of the Society of Pension Consultants, to open the discussion.

Mr I. M. Aitken Professor Goode's Committee makes many recommendations in its report. From the many discussions that have taken place during the past six weeks, I believe that the recommendation which has been most widely debated, and is certainly contentious, is that regarding the introduction of a minimum solvency standard.

In its report, the Committee stresses the importance of protecting members' accrued rights and consequently the Committee proposes a statutory minimum solvency standard which will be a test of a scheme's ability to provide the accrued rights of its members if it were discontinued. At first sight, this test might not appear to be particularly onerous but, in practice, it may have major funding implications.

Today a pension scheme may be comfortably funded on an ongoing basis but have insufficient resources to secure accrued rights on discontinuance by the purchase of annuities, particularly where significant levels of pension increases are provided as a right rather than on a discretionary basis. This is no more than a reflection of the wide gap between the expected investment return on a largely equity orientated portfolio of an ongoing scheme and investment yield implicit in annuity terms available from insurance companies.

It is necessary to address the major problem, namely the difference between solvency of an earnings-related scheme on an ongoing basis and solvency on a discontinuance basis. In the United Kingdom, most earnings-related pension schemes are funded and valued on an ongoing basis as the funding objectives are directed towards providing the benefits which are likely to emerge if a scheme continues rather than the accrued rights of members in the event of discontinuance.

A typical funding objective is that the resources of the scheme should be sufficient to meet the projected benefits in respect of service to date. This objective includes provision for future expected salary increases and makes provision for increases to pensions in payment and during deferment. Consequently, the benefits for which provision is made generally exceed the accrued rights of employees concerned if a scheme were to be wound up. In the past, this margin has been substantial and most schemes fully funded on an ongoing basis were comfortably over 100% funded in the event of immediate discontinuance with non-profit annuities and deferred annuities being purchased. However, this margin has been eroded by the statutory revaluation of deferred pensions and the recent trend towards consolidating discretionary pension increases into benefit promises. At the same time, there has been a widening of the gap between the level of returns to be expected from the equity-based portfolio of an ongoing pension scheme and fixed-interest and index-linked investment returns which determine the terms on which an insurance company will be prepared to write annuity business.

The result of these developments is that schemes which are comfortably funded on an ongoing basis may well have insufficient assets to meet discontinuous liabilities by the purchase of annuities. In an ongoing pension scheme, any fluctuations in the value at which shares stand in the market are of little significance as the assessed value of a pension scheme is based on an anticipated income stream from a notional portfolio over the expected future life of that scheme. However, the cost of purchasing annuities is not responsive to variations in the market value of an equity portfolio. A good example of this is the stockmarket crash in October 1987 when, at that time, most pension fund values fell by some 25% but there was little change in annuity rates.

Professor Goode and his Committee considered this point and they concluded that it would be wrong to stipulate that a minimum solvency should be based on the purchase of deferred annuities. I quote from the report: "It could force intrinsically healthy schemes to reduce benefits and increase contributions substantially in order to meet liabilities on a hypothetical discontinuance which in an ordinary way would be very unlikely to occur. A scheme's investment managers might feel constrained to move from an equity base to a fixed-interest or index-linked portfolio so as to be certain of covering its wind-up liabilities." Thus the Committee recommends that, for the purposes of a minimum solvency standard, schemes should be required to have resources so that cash equivalents can be provided in respect of active and deferred members.

How is this cash equivalent to be calculated? At the present time, there is a dichotomy of views in the actuarial profession. Some actuaries believe the cash equivalent should anticipate an investment return no greater than that which can be expected from risk-free investments in Government fixed-interest and index-linked gilts. Other actuaries take the view that the calculation of the cash equivalent should reflect investment returns from investments held by the scheme. This means that, from the Trustees point of view, the cash equivalent is a financially neutral option.

Under the first approach, based on fixed-interest investments, cash equivalents would vary in amount according to the yield available on Government stocks rather than in line with the market values of the Scheme's investments. Under the second approach, cash equivalents would normally be lower than under the first approach since they would reflect the higher expected returns on an equity orientated portfolio and they would be more sympathetic to changes in the market value of the scheme's assets.

For the purposes of a minimum solvency standard which applies to the entire scheme, it is essential that the cash equivalent is based on the rate of return obtained from the portfolio of investments actually held by the scheme. It cannot be based on the hypothetical portfolio as this would provide no comfort to the members.

Turning now to pensioners, the recommendation is that the minimum solvency standard should be the cost of buying immediate annuities. Large pension schemes do not purchase annuities in the normal course of events. Indeed, they could not do so. The assets of some of our larger pension schemes in the United Kingdom are larger than the assets of some life offices. The life assurance market does not have the capacity to provide annuities to all pensioners in many of our larger schemes.

As mentioned in the report, "it is a hypothetical discontinuance which in an ordinary way would be very unlikely to occur". Why do we have to make the suggestion to have this? It is interesting to note that the funding implications of this particular recommendation are not addressed by the Committee even although pensioner liabilities represent a substantial and a growing proportion of total liability.

Even although a scheme is 100% funded on an ongoing basis, it seems probable that events will occur from time to time in the future which will take the funding of that scheme to below the base level of 90%. A recent example is the invasion of Kuwait where markets fell by up to 20% but at the same time gilt yields changed by much less than this with the consequence that annuity rates changed by a very small percentage.

If a valuation had been carried out at the time of the stockmarket fall, the actuary would have been suggesting very substantial cash injections into a pension scheme within a three month period. I suggest that such an injection of cash would have been unacceptable to most companies and would quickly have proved to have been totally unnecessary. I would like to suggest that, in the circumstances where there is an overall fall in stockmarket values which is not accompanied by a change in interest rates, the actuary should be permitted to carry out a further solvency test in three months' time to re-test the scheme's level of solvency. Only at that time, if the level of solvency remains below the base level of 90%, should it be necessary to take corrective action.

I started by saying I believe the introduction of a minimum solvency standard to be a contentious recommendation. We must ensure that this subject is given adequate debate and thought through thoroughly. If not, the actuarial profession and U.K. industry may regret it.

Mr R. J. Amy It is my task this evening to give an overview of the sections of the report which deal with interests in the pension fund and surpluses and early leaving.

Scheme surpluses topped the polls as the issue with the largest number of responses to the Committee's questionnaire. Over 55% of respondents made comments. The Lucas case in the High Court confirms that the ownership of surplus assets continues to be one of the most emotive issues for pension schemes. Fortunately, both the report and the High Court came up with the right answer.

The report recognises the members' direct interest in the assets of a money purchase scheme and so most of Chapter 4.3 is devoted to considering the identification and the application of surplus in an earnings-related scheme. A fundamental distinction is drawn between an ongoing fund and a fund on winding up. The report states that a surplus in an ongoing fund is purely notional with no beneficiary having any interest in particular assets. The existence of surplus cannot be fully determined except at the point when a scheme is wound up. As well as being notional, it is argued that, given the wide range of different assumptions which the actuary has to make, a surplus cannot be accurately identified by a valuation on an ongoing basis. The report contends that a surplus in an ongoing scheme is somewhat ephemeral, its existence could be disputed and a substantial surplus at a particular time may rapidly be transferred into a deficit. Against this background, the report considered the laws governing reduction or elimination of surplus in an ongoing fund.

Ownership of surplus does not arise in legal terms. The real question is what powers, if any, are given to the Trustees to deal with the application of surplus including payments to the employer and the considerations to which the Trustees must have regard in exercising their powers. Members do have a legitimate interest in a surplus - not in terms of legal entitlement but because of the degree of security which surplus assets provide and because the members carry the risk that they eventually may not receive their full benefit entitlement.

The report's recommendations, therefore, focus on slowing down any reduction in surpluses in ongoing schemes by limiting payments to employers to strictly defined circumstances and subject to the approval of the Regulator in all cases, by not allowing contribution holidays for employers or employees which would take the value of the assets below the 100% minimum solvency level, (to be effective, this restriction would also need to apply to contribution reductions as well as contribution holidays) and by extending the Revenue's five year period for eliminating excess surplus to the average length of future service subject to a maximum of 15 years. In addition, it is recommended that the Inland Revenue surplus regulations should apply to insured schemes and it should be made clear that any tax charge on excess surplus should only apply to the surplus in excess of 105% after taking account of proposals for the reduction in the surplus.

On winding up, the report considers the various arguments for surplus being used for the benefit of members, being paid to the employer or being shared in some way. The Committee comes to the conclusion that the question is not easy to resolve and that surplus should generally be dealt with in accordance with the scheme rules. If the rules are silent, it is recommended that the Trustees should be given a statutory discretion as to the application of surplus. This is not entirely satisfactory to members. It might be better in these circumstances to require the rules to be amended to make clear how the surplus will be used.

If the scheme rules prohibit payment to the employer, it is recommended the Trustees should augment benefits first by limited price indexation and then to those Inland Revenue benefit limits which apply. Any balance would be allocated as the Trustees think fit subject to the approval of the Regulator. Prescribing a basis for augmentation has its dangers. It may not prove equitable or best meet the needs of the beneficiaries, particularly when you think of three different regimes of Inland Revenue limits. An alternative approach would be to require the approval of the Regulator for the whole package of proposals.

Turning now to my second subject, early leaving. The first main issue which the Committee addressed was the revaluation of deferred pensions under final salary schemes. Is limited price indexation capped at 5% adequate or should some form of earnings indexation be used? The recommendation in this area was apparently one of only two out of the 218 on which the Committee was not unanimous. The arguments for and against each basis are clearly set out in the report and, while the Committee's members' views on what is fair and practical differed, it was recognised that a statutory basis of earnings indexation for deferred pensions might cause employers to reduce benefits, move to money purchase and even shut down their schemes. No recommendation for a change from price indexation to earnings indexation was therefore made.

The qualitative survey which makes very good reading and is reproduced in Volume II of the report, states that virtually every actual problem experienced by employees was rooted in one way or another in difficulties with transfers. One of the major issues was delay. The Committee has recommended that the Regulator should have the power to impose a penalty on the scheme administrator if a transfer value is not paid within 12 months. The Committee also recommended that communications on transfers should be improved. The Regulator should produce a clear and simple leaflet which explains how the transfer process works and which should be made available to all scheme members. As many employers still seem to be concerned that they might be in breach of the Financial Services Act, SIB is going to be asked to prepare a statement of guidance about the provision of general advice to scheme members by employers.

Another area of concern with individual transfers is the wide range of possible values produced by actuaries under GN11. The Committee is recommending that the profession should tighten the bases under this Guidance Note, although it recognises that the answer should not be a standardised basis for all schemes. If the profession does not produce a satisfactory solution to this problem, my view is that the Government will impose a standard basis.

A further recommendation would require an individual transfer value to be calculated on a basis which is at least as favourable as the basis used to assess minimum solvency. This appears to recognise the possibility of some difference between the cash equivalent bases for individual transfers and solvency, whereas recommendation 27 on solvency implies that they should be the same. Is the difference that an allowance for discretionary benefits built into cash equivalents can be excluded for solvency purposes? Perhaps this point can be clarified in the discussion.

The inclusion or not of discretionary benefits in transfer values is considered at some length in the report. The Committee came to the conclusion that the Trustees should retain the right to decide. However, it considers it an abuse for an employer to give a clear indication of an intention to exercise its discretion to grant non-reduced early retirement pensions but not to allow the actuary to reflect this in the calculation of transfer values. The important point not made clear in the report is that it is discretions in relation to preserved benefits and not active members that should be taken into account in transfer values as reflected in GN11. Discretions must continue to be capable of being exercised differently for active and for deferred members.

Finally, a few words about bulk transfers and mergers. The report concludes that the actuary's certificate provides adequate protection for members whose consent is not sought to a bulk transfer. However, it recommends that the certification requirements should be extended to mergers which are just a special case of a bulk transfer within the same employment. That has to make sense. However, I would suggest that too much reliance is placed on member consent. All bulk transfers and mergers should, in my view, be subject to actuarial certification with the need to obtain members' consent incorporated in a code of best practice.

My task has been made relatively easy tonight because, in general, I welcome the Committee's recommendations on surpluses and early leaving. My support for the line taken by the report will not necessarily be echoed by opposition politicians, the media and the general public because these are both emotive areas. It is vital that, throughout the period of consultation and the parliamentary process, the pensions industry continues to argue strongly for the principles that underly the Committee's recommendations in these important areas of public interest.

Mr D. A. Berridge I have been asked to speak briefly on aspects of the recommendations concerning protection for members in the event of insolvency of the sponsoring employer.

For some, this will suggest a discussion on compensation but, in practice, the primary protection for members derives from the prudent management of pension funds already practised by many and which will be strengthened in many ways if our proposals are accepted.

In particular, the proposals materially strengthen the employer's benefit promise but in a way which the evidence to date suggests most employers will find acceptable. Although most schemes meet their promises, confusion often arises because the promise is in practice inadequately defined. Furthermore, in the final analysis, a promise is no more than that and circumstances can and do frustrate its delivery. The proposals are designed to improve the clarity and delivery of promises.

The strengthening derives to a major extent from the proposed obligation to fund promises with all that that implies in terms of monitored minimum solvency and in terms of the obligation on the employer to make good a deficiency arising for any reason whilst he or she is financially able to do so. Minimum solvency is an integral part of a coherent package of measures and I fully accept Mr Aitken's point that a contribution from the profession is vital in this area before bases are finalised. We have asked the profession to do a lot but it is surely better that than the PLRC asking someone else to do actuarial work for us.

The employer's obligation will lead to even greater focus by directors on the financial impact of the schemes that they are sponsoring. The combined effects of proposals on the rôles and responsibilities of the actuary and the auditor, the appointment of a Regulator, the new disclosure proposals and the composition of Trustee Boards will give financial monitoring more publicity and lead, I believe, to major benefits in terms of improved understanding and security.

Beyond all of that, the proposed compensation scheme is of secondary importance but it will have great significance, despite that. It will be seen as a measure of the effectiveness of regulation and of those professionally involved in this area. An indirect effect of the compensation scheme may be pressure from the best schemes and from the actuarial and accounting professions contributing to a general improvement in standards and in security. The PLRC proposals without being unnecessarily prescriptive create the framework within which that can happen. If a scheme does not meet standards with regard to security, then the actuary and auditor would be expected to take action to seek to have the position remedied and, if necessary, provide publicity to Trustees, members, the Regulator and shareholders.

In conclusion, a clearer understanding through more explicit financial reporting of the employer's financial obligation is the key to all of this and seems bound to lead to closer attention to aspects of security. The actuary is in a central position and can do much to ensure the employer, the Trustees, the members and the shareholders have the information they need and to help raise standards where necessary.

Mr H. W. Brown I should like to speak briefly on the expanded rôle of the actuary to occupational pension schemes as outlined in the Goode Committee report.

At present, the actuary plays a central rôle in providing advice for the financial management of pension schemes, through regular actuarial valuations and the providing of statements and Certificates to the Occupational Pensions Board and the Pensions Schemes Office of the Inland Revenue. The Goode report envisages that the existing rôle of the actuary should continue but that it should be extended. I think that this should be welcomed by the profession.

The report has made it clear that the pension scheme actuary should be appointed by the Trustees of the pension scheme. The pension scheme actuary's primary responsibilities will therefore be to the Trustees but, as is currently required by our professional guidance, the actuary will, in giving this advice, need to have regard to the interests of others, for example pension scheme members may rely on this advice given.

The report does not prevent the pension scheme actuary from also giving advice to the employer so long as there are no conflicts of interest. Normally the commonality of interest should avoid this. However, when the pension scheme actuary is advising the employer it should be made clear in these circumstances that it is the employer who is the actuary's principal. As is required by our professional guidance, if the actuary considers there is a conflict of interest, the extent of that conflict must be disclosed and if the conflict makes it improper for the actuary to act for the employer, the actuary needs to advise the employer accordingly or needs to resign as the pension scheme actuary.

It is recommended in the report that it should be required by law that all occupational pension schemes have an appointed scheme actuary. To recognise the importance of the involvement of the actuary, the Goode Committee have said that if the Trustees fail to appoint an actuary to the pension scheme, this should be treated under the proposed regulatory structure as a criminal offence.

The statutory duties of the pension scheme actuary are recommended to be extended to include reporting irregularities in pension scheme management to the pensions Regulator. This is a new rôle for the actuary who will have the right, under law and in the case of serious or persistent irregularities, the statutory duty under law, to report any such apparent irregularities to the pensions Regulator. The actuary, in whistle-blowing to the Regulator in good faith, should be exempt from any legal liability that might otherwise be incurred. Since this is a new responsibility for actuaries, the profession should assist members in this area by providing professional guidance to enable them to comply properly with this additional requirement.

The report envisages the continuing rôle of the actuary in the financial supervision of pension schemes. It identifies from evidence received that for the actuary to carry out properly and effectively the various actuarial functions for a pension scheme, the actuary depends heavily on the timely receipt of, or access to, information concerning the scheme, the contributions, the assets and the liabilities. To assist the actuary in this matter, the report recommends that there should be a statutory requirement on Trustees to provide information to the actuary with appropriate sanctions for default. There should be a corresponding statutory duty on the employer to provide the Trustees with any information they require for this purpose. This should assist the actuary greatly in receiving proper information and in carrying out his expanded rôle.

The report envisages the financial supervisory rôle of the actuary being extended to providing the Trustees with an annual certificate stating that the market value of the scheme assets is not less than 100% of its liabilities on a minimum solvency level basis. If the value of the assets is below this level, the actuary's certificate would need to quantify the solvency level and the amount of any lump sum contribution required to bring the scheme up to the 90% level.

The actuary will also need to help the Trustees to put together a three year business plan to the pensions Regulator detailing how the funding level of less than 100% will be restored to the 100% level. The scheme actuary would be under a statutory duty to report to the pensions Regulator any shortfall, whether in the 100% level or the 90% level, as soon as he or she becomes aware of it. Additional professional guidance for our members will be required in this area.

As well as there being a requirement for a pension scheme actuary to a final salary scheme, money purchase schemes will also need to appoint a pension scheme actuary. The envisaged rôle of the actuary in money purchase schemes will be to provide advice on levels of contributions to be paid to achieve targeted benefits, to carry out periodic actuarial valuation reports for the Pensions Schemes Office of the Inland Revenue for approval or continuing approval purposes and to provide certificates on over-funding required by the surplus regulations. In addition, the actuary to a money purchase scheme should assist in providing scheme members with clear and realistic indications of the levels of benefits their scheme may provide along the lines outlined in the report.

The report does not give the actuary the statutory responsibility to agree the investment strategy adopted by the scheme. This is reserved for the Trustees in consultation with the employer and having regard to the statutory prudent investment standard that has been recommended in the report. The report requires there to be a statement given by the Trustees in each year's annual report that the Trustees are satisfied that the investments conform to the statutory criteria. However, I envisage that the actuary's advice will be sought by the Trustees before they give this annual statement.

In addition, the actuary should also have a professional responsibility when providing a minimum solvency certificate to point out to the Trustees if he or she is of the opinion that the investment strategy being adopted, having regard to the funding level of the scheme, is inappropriate for the profile of the liabilities. A mismatched approach might, of course, not be inappropriate if there is a sufficient cushion of assets above the minimum solvency level. I suggest that such a requirement should become part of our professional guidance similar to the current position under our Guidance Note GN9 on actuarial valuation reports.

Mr R. M. Westwood This evening is the first major debate in the actuarial profession on the excellent report of the Pension Law Review Committee. We should put it in the context of a situation where the public perception of occupational pension schemes is tarnished. Pension plans are often regarded by their members and by those eligible to join them with some degree of suspicion, if not outright distrust. This is partly because we, in the actuarial profession, and others in the industry have failed to communicate adequately the merits of occupational pensions. Indeed, I think we have developed an almost insane expertise in detail and complexity. The intricate web of DSS and Inland Revenue legislation, theoretically perfect but difficult to describe benefit structures and legally inspired communication literature - all conspire to force employees to base their opinion of occupational pensions on some instinctive level of trust (or otherwise).

I am therefore very pleased to note the central theme of the Committee's recommendation and I quote: "Employees belonging to occupational pension schemes have certain reasonable expectations that the law should protect. These include the expectation that rights will accrue with service and, once accrued, will be protected and that benefits will be provided in accordance with the scheme rules and any legal requirements. These reasonable expectations form the core of what may be termed the "pension promise". It is this promise that the law should seek to protect, particularly in respect of accrued rights."

Many duties, some old, some new, will fall to actuaries. But I would urge all of us in the profession to remember that, whilst the recommended pension law reform will enhance the security of employees' expectations, those employees will need to understand what is going on much better than they do today. Only then can their suspicion of pension schemes be reduced. It is time for all of us to drive unnecessary complexity out of the system. We must bring transparency into our methodology.

I am particularly pleased to have the opportunity to open this debate at a time when I serve as President of the Society of Pension Consultants. It gives me just cause to take a much broader view of the actuarial aspects of the report.

I wholeheartedly support the introduction of a Pensions Act to provide the statutory framework for occupational pension schemes. Clearly the Regulator will have great power and responsibility but, even if there is a streamlined procedure for smaller schemes, effective supervision will require a substantial operation. I have heard it suggested that it may involve several thousand staff. It is certainly a large and ongoing cost. If that is to be borne by Government, and I doubt whether it will be, then we should expect rigorous prescription of rules, methods and procedures. If it is not, then occupational schemes must bear the costs either directly or indirectly. But let us not allow any sort of double-whammy to hit us of pension schemes paying for more complexity which, in turn, adds further to the cost of administration and probably adds further to levels of employee suspicion. But whoever pays for regulation, there is an important new rôle for actuaries. As we have heard, we will be appointed by Trustees. We shall have statutory responsibilities. Like it or not, we shall be in the front line of regulation.

Many of you here this evening have concerns about these new responsibilities. I would say that if we stand back from these responsibilities, then someone else will certainly fill the vacuum which the Pensions Act will create. It seems to me that whilst the scheme auditor will be responsible for the accounts and other things, the proposal is for the appointed actuary to provide all the necessary advice on actuarial matters, to oversee regulation on the spot and, in particular, to opine on the ability of the scheme to meet minimum solvency requirements.

A whole raft of issues arise of which the following are the ones which I believe to be most important:

1. If the Institute and Faculty of Actuaries Guidance Notes are to take on an increasingly important quasi legislative character, then the profession will need to consult more widely than hitherto on relevant Guidance Notes. It will not suffice to consult within the membership of the Faculty and Institute alone. An Actuarial Standards Board may be needed.

2. The legal responsibilities of an appointed actuary need to be considered and perhaps codified within the Pensions Act or otherwise we shall either have a raft of test litigation against actuaries or, more likely, actuarial advice which is so heavily qualified that its usefulness to Trustees will be severely diminished.

3. The different requirements of Trustees and the company will inevitably lead to occasional conflict. I can foresee the possibility of an actuary working for the employer and so with no statutory responsibility being able, quite properly, to advocate a less prudent approach than would be acceptable to the appointed actuary (who will have at least one eye, I think, on his professional indemnity policy!). Investment strategy may be a particular area where this debate could emerge.
4. We must ensure that we do not create conflict between the very rôle of the appointed actuary and those minimum solvency standards. After all, if the appointed actuary is to be truly responsible for advising on the actuarial health of the fund, then is it appropriate for the actuary to be constrained by external solvency standards? More particularly, if minimum solvency were to be on a basis which the appointed actuary would not normally consider appropriate to the circumstances of a particular scheme, then what should the actuary do? In my view, it is better to have true responsibility resting with the actuary even if this necessitates more flexibility in the range of methods than some commentators might wish to see.
5. I am concerned that the development of a streamlined regulatory procedure for small schemes should not reduce the security which members of those small schemes might otherwise have. I understand the practical issues involved but I notice, and I am going to quote from Paragraph 4.19.8 of the report, that the Regulator "should be empowered to establish streamlined regulatory and compensation procedures for small schemes administered by insurance companies or other regulated service providers willing to assume direct responsibility for administration or supervision and to be answerable for any defaults that might occur." What does that mean? What defaults? What is the impact on compensation arrangements? What is the impact on the security of those members?
6. What about whistle-blowing? I am of the view that it is absolutely right for the appointed actuary to have a statutory duty to report irregularities. But what if things are going on of which the actuary is not aware? How much of a responsibility should the actuary have to seek problems? My tongue is in my cheek when I ask, "Should the actuary have the power to make dawn raids on pension managers' offices?"

And so to minimum solvency, a concept which has my wholehearted support. Much is going to be said on this subject in the debate which follows so I am going to concentrate on just three broad comments:

1. This is the sharp tip of the proposed legislation as far as the financial protection of employees' expectations are concerned. Clearly, the absolute level of protection is a measure of the risk which employees have in receiving their expected level of benefit. It seems reasonable to some of us here tonight that if there is a high risk because levels of protection are low, then the reward for employees should be a stronger claim to ownership of any surplus should it exist. On the other hand, if solvency standards are high and therefore employees' risks are low, then so too should be their claim for ownership of any surplus. I, personally, prefer the low risk, low reward approach.
2. When we look at solvency in detail, I would urge that we stand back from time to time as we debate the actuarial theory and look at the problem from the perspective of scheme members. Their existing suspicion of pension funds will be heightened if we end up having to make statements like, and we nearly heard it earlier on, "Cash equivalent solvency standards have been met, albeit there are insufficient funds available to purchase accrued rights by way of deferred and immediate annuities.". It would be particularly difficult to explain to members of an insured scheme. It may be true, but difficult to explain.
3. There is a great variety of pension schemes to be dealt with and let none of us think narrowly, as we try to deal. Let none of us concentrate, for instance, on the problems of small insured schemes or the problems of large self-invested or our own existing funding basis, which may fall short of proposed minimum solvency standards. A broad debate is essential if we are to rise to the challenge which lies before us and that is to recommend a set of solvency standards which are robust enough to satisfy scheme members and the legislators, but which retain sufficient flexibility to allow actuaries to deal with specific circumstances of specific schemes. If we fail, we will surely get prescriptive methods laid down by statute and, in my view, that would be a great blow to the actuarial profession.

A word on the proposed compensation scheme which offers further scope for criticism by scheme members. Loss of pension means loss of pension whatever the cause. In my view, if a tough regulatory regime and strong minimum solvency standards are imposed on the pensions industry, then there is scope to offer a much broader definition of compensation, perhaps even without any significant increase in the cost burden. But whatever the costs, just remember that a compensation scheme which does not compensate will do little to remove the levels of suspicion which currently fall on the pensions industry.

I am particularly concerned that the practical application of the recommended compensation scheme might produce some difficulties. Where does the boundary lie between a fraudulent and a thoroughly inadvisable investment? If payments are to be made from the compensation scheme to make good losses arising from fraud or theft, how can the payments be made quickly when the legal process to prove fraud or theft is so tortuously slow?

If compensation is to be funded by means of post-event levies on all schemes in proportion to the value of the liabilities which they are required to fund for the purposes of minimum solvency requirements, then I foresee vast opportunities for actuarial fees but with no real gains to the pension schemes. There should be better ways to fund a compensation scheme. I have said on another occasion that I believe there is just as strong a community of interest between employers at large as between pension schemes at large.

There are so many other areas on which I would like to comment. I feel many of you will want to say something, so time is very much against me. I would like to finish by saying, despite my strong comments in some areas, in overall terms the Committee's recommended package is a good one and Government should be urged to implement it as a whole, no cherry picking, and quickly.

The actuarial profession should also work quickly and publicly to produce the necessary guidance in such a way that scheme members will not be given further opportunity to be suspicious of occupational pensions. Let our recommendations be both transparent and intelligible to non-actuaries.

Mr P. N. Thornton F.I.A. The Pensions Joint Committee is meeting tomorrow and a number of its members are here and will be very interested to hear the views expressed later on. I am going to restrict myself to just a couple of brief points. Although the PJC is meeting tomorrow, various working parties have been meeting in the meantime to consider, first of all, the initial responses from the profession. We welcomed Professor Goode's report which does not, of course, mean that we accept every detail or that we won't have some suggestions to make. Secondly, we have been considering the minimum solvency standard and thirdly we have been considering transfer values. These various working parties will be reporting to the PJC tomorrow and there will be a lively discussion there I have no doubt.

Apart from minimum solvency and transfer values, the rôle of the scheme actuary is obviously going to need some very careful consideration.

On solvency, the working party is concerned about the implications of the proposals for schemes providing limited price indexation (LPI) or index-linked increases in particular - and there is, of course, no difference in a low inflation environment between LPI and index-linking - and also particularly about those schemes with a high proportion of pensioners.

The profession's submission to the Committee drew attention to the need to look at another approach than buy-out for immediate pensioners, perhaps to look at them on a closed fund basis, and also drew attention to the need to look at cash equivalents on a basis which reflected the ongoing investment strategy of a typical scheme. So the working party believes that, in this context, the profession's rôle should be to alert the Government to the implications of what has been proposed as it may affect investment strategy, funding levels and costs for employers.

I accept fully the point that Mr Westwood was making about the risk/reward trade-off and I think, at the end of the day, it is a political decision for the Government as to where on the risk/reward spectrum it wishes to legislate. In other words, how much pain employers should have to bear in order to achieve a desired level of security for members.

So the proposal which the working party is asking the PJC to consider is that we should review for the benefit of the Government, and others, not only the proposal the Goode Committee has made but also the various alternatives which have been mooted which would include buying-out all the liabilities with annuities, a central discontinuance fund, a closed fund for pensioners, cash equivalents on various bases, cash equivalents for pensioners and some degree of prescription of ongoing funding standards; in other words, the whole spectrum of possibilities.

On transfer values, the working party is putting up for consideration the possibility of a prescribed basis for minimum cash equivalents, that is excluding discretionary increases. Incidentally, I have seen a letter, which answers Mr Amy's question, from Professor Goode which makes it clear that the intention was to exclude discretionary benefits from the cash equivalents for the purposes of the solvency test, thus making a distinction between minimum cash equivalents and transfer values, which would reflect discretionary increases and would be calculated on a basis determined by the actuary. Now these are ideas at a very early stage of consideration but I mention them for your benefit because we will be very interested to hear any views you might have on them and, as I have said before, many members of the PJC are here tonight and will be listening out.

Mr A. Neill When I gave my Presidential Address two years and one month ago - a month before pensions became a top item in the media - I asked if we were happy with the legal structure of pension arrangements. Did we need a Pensions Scheme Act? My answer was "Yes", in particular saying that spasmodic case law is just not good enough.

Surprisingly, to me anyway, "The Times" noticed the Press Release and their leader said "Mr Neill argues that a Pensions Scheme Act is needed. He is right." Incidentally, I also commented on the Barber case; wondering how we had managed to become part of a legal system which leaves such uncertainty as to what the benefits in a scheme are, and what the law is, for so long. It was then 16 months, it is now 3½ years.

Has this Review then given what I want? Briefly and generally; yes. Much of it I would have written myself had I more energy and skill. I have in the past expressed doubts about why there were different methods of funding and assumptions, and, as a member of the original working party which drafted GN11, I have been disappointed that there has not been more consistency.

I, perhaps, would have some different emphasis but I am glad to see one suggestion particularly, the suggestion of sanctions. Last year, I gave evidence to Frank Field's Select Committee and tried to make the point that some people should be going to prison, for example for embezzling employee contributions, but rather lost my audience by saying that some people should be sent to Saughton. Nobody knew where that was. I should have said Barlinnie or Pentonville.

The main point I want to make this evening follows on from my criticism of two years ago of the debt on the employer legislation, because in a time of high inflation the employer has to increase pay and this means a very big increase in the previous service liability of the scheme. The same point arises with the suggestion in the report about keeping up the funding to 90% or 100%. This does seem sensible but the proviso in the report that exceptions can, grudgingly I think, be made is vital. I have a feeling, however, that the Committee have been thinking of an individual company. As an example, I advised an employer at one time who went on to 7-day, 3-shift working. This meant huge increases in pay and the previous service liability almost doubled.

What happens when there is a significantly high salary inflation for one or a few years, much greater than that assumed in the actuarial assumptions? The liability increases significantly, the assets change little. Every scheme in the country is going to be affected and all will have to make huge payments to their funds in a few months. It is rather similar but much much worse than mortgage indemnity insurance where there are few losses until a change in the market and then huge losses that affect everybody, and all at the same time. If the answer is that we will never again have such significant inflation, I just don't believe that. I suggest that more attention has to be paid to when the regulations are not going to be applied and plan accordingly. Ideas that seem sensible in settled times must be tested in more extreme circumstances.

Mr C. M. Stewart C.B., F.I.A. I shall limit my remarks to accrued rights and funding and, in doing so, I may betray the fact that I was at one time engaged in Government service in the supervision of insurance companies.

Naturally, I support the Committee's conclusion that members' accrued rights at any particular point of time are to those benefits which would crystallise for all members if the scheme were to be wound up on that date and that the minimum solvency standard should therefore be related to what it would cost to secure the accrued benefits. Mr A D McLeish and I have been saying exactly that for some years.

I am out of touch these days but it seems to be generally agreed that, because of the demise of the deferred annuity market, our defined accrued benefit method of valuation is no longer suitable and the defined benefit must now be replaced by its cash equivalent. It seems a pity to deprive members of the right to a defined benefit but if it really is unavoidable then so be it. However, it would surely be necessary for the new legislation to over-ride scheme rules so that the less expensive cash equivalent was substituted for the defined benefit. I certainly would not recommend any Government to give legislative force to a minimum funding requirement which it was known would be inadequate to cover the accrued rights, whatever those rights were.

I also believe that it would be inadvisable for any Government to introduce a funding requirement based on variable cash equivalents before it had decided how much variation would be acceptable and was satisfied that the actuarial profession would, indeed, be able to narrow the present wide variation to the desired extent. After all, Parliament and the public will have to be persuaded that the change proposed is going to be for the benefit of members and this would not be easy if it were known that some schemes' cash equivalents were going to be 10% or 20% lower than others.

In an ongoing scheme, such a difference would not matter to the members because their pensions and other benefits would be unaffected by the level of funding, but employers might be concerned. Under the new regime, the scheme actuary is to be appointed by the Trustees but the employer would surely have a legitimate interest in knowing whether the funding target he was being asked to adopt was higher than it would have been with a different actuary, and how much higher. Would the actuarial profession be expected to prevent an employer from finding this out by preventing any of its members from providing a second opinion and thus intruding on the scheme actuary's preserve, or would the employer be allowed to get a second opinion, in which case would the new Regulator pay any regard to the result or simply rule it out of order? These are matters of some importance to the actuarial profession.

I well understand the concerns which have led the Committee to recommend that the scheme actuaries should in future be appointed by the Trustees but I would be less apprehensive about the practical implications of this if it had also been able to recommend that there should be a standard basis for the new minimum funding requirement rather than a variable one.

As I am on record as saying that a statutory basis would be both desirable and feasible, I was disappointed that the Committee apparently came to the opposite conclusion. However, it appears from its report that what it had in fact pronounced unworkable was the proposition that there should be a statutory set of assumptions to be used in calculating the future contribution rate irrespective of the valuation method used and the scheme's own experience. I accept that that would be both unworkable and undesirable but, with respect, that is not the issue. Contribution rates and different valuation methods do not come in to it. We are testing to see whether or not, at the valuation date, the assets would have realised sufficient cash to enable the Trustees to purchase immediate annuities for those already retired and personal pensions for the others which could be regarded as a satisfactory substitute for the defined accrued benefits. I believe a statutory basis could be derived for the latter so long as we look outward at what the policy proceeds might be and don't insist on the cash equivalent varying so as to reflect what each actuary thought the scheme's own experience might have been if it had not been winding up. I hope the Government will look at this again.

My final point concerns the need for a solvency margin. At the very least, the new minimum ought to include provision for meeting the Trustees' expenses. Also, it would not surprise me if the President of the Board of Trade has already been on the telephone to the Secretary of State pointing out, in his capacity as regulator of insurance companies, that he has both a solvency margin and a policyholders' compensation scheme in his regime and was surprised to see neither suggested for pension schemes. I am personally in favour of having a pensioners' compensation scheme but, if that is ruled out, then there is surely all the more need to have a solvency margin. The Committee take the view that schemes generally will ignore the new minimum and aim higher, so that there will be surplus assets available. I do not think the Government should rely on that. I would expect employers generally, and hard-up employers in particular, to show considerable interest in knowing where they were in relation to the new minimum and to resist if asked to aim much higher, but whether the Committee are right or not, I believe the statutory requirement itself should include a solvency margin of 10 per cent or so.

Dr L. W. G. Tutt It is stated in the report under consideration this evening that no regulatory system can provide total security but it suggests that members need to feel that their future benefits are secure. Accordingly, the Committee makes recommendations to appease that feeling. It proposes a compensation scheme under which one employer may be required indirectly to compensate for the fraud of another employer. Furthermore, the basis and method for calculating a minimum funding rate under the Committee's minimum solvency standard differ from those as presently required for calculating a maximum funding rate. Problems attendant on that inconsistency might arise. Perhaps the Committee could have focused even rather more attention than it did on possible desirable modifications to the existing surplus regulations.

As a further factor, if employers are to be forced to fund, broadly speaking to a minimum level of 100% and to be constrained to a maximum level of 105%, could it have been seen as a token of encouragement to employers to continue to run good occupational schemes by suggesting consideration of a book reserve system of funding subject, of course, to the necessary associated insurance.

Much emphasis is placed by the Committee on the word 'security' but is there the question as to what association there can be between theoretical security on the one hand and practical sustainability on the other? Indeed, has the Committee been constrained unduly by its terms of reference? For example, the Committee states in its report that it has not involved itself in fiscal policies but is there the question of whether a fiscal policy largely centred around a continuous and highly significant debasement of the national currency affects the security of pensions payable in pounds sterling in real terms relatively or absolutely?

Is security of pensions within an economy dependent on the maintenance of an adequate demographic dependency ratio and when such is not being pursued are individuals choosing to undermine the security of their own pensions in favour of other delights? Indeed, as regards security in general, are pensioners dependent on the willingness of the current working population to provide their pensions? According to the then British Government Actuary, speaking in Helsinki in 1988, if the working population chooses to push the pensioners down the priority ladder then down they go whether they be in assessment schemes or in funded schemes and, indeed, such has been, at times in the recent past, a feature of British society.

Apposite in these important regards, is the Committee's statement that it has no recommendations to make on the indexation of pensions in payment. Numerous factors impinge on pensions security. There are those so valuably considered by the Committee in its report which constitutes such a significant contribution to progress and there are many other factors. Perhaps all should be kept in proper perspective.

Mr R. E. Brimblecombe C.B.E., F.I.A. Tonight I want to comment on just two points -firstly the question of solvency and the related issue of transfer values and secondly the question of the pension scheme actuary.

I want to talk about the question of solvency, firstly from the point of view of public perception. Whether we in the actuarial profession like it or not, the Pension Law Review Committee did arise out of Maxwell and similar "scandals" and the report has to be seen in that context. There is a public perception that something needs to be done and, indeed, public expectation that something will be done. Since the report was published, much has been said by actuaries on the question of additional burdens on employers, the unsuitability of the proposed solvency standard and so on. I do not think we bring the profession much credit if we concentrate solely on those particular issues. Not because they are not perceived to be important, but because we have seemed to have overlooked the interests of that other important ingredient of pension schemes, namely pension scheme members and pensioners.

The actuarial profession has an enviable position in being able to give completely independent views on various issues such as pensions and I believe that, in so doing, we must be seen to be taking into account all the parties involved - employers, members and pensioners. If we are not careful, to rephrase Mr Aitken's comments, it is pension scheme members and pensioners and the actuarial profession who may have cause to regret.

Mr Peter Lilley in his comments in the House of Commons on the Committee's report said: "We must make sure that we do not impose such burdens on employers that they cease to run pension funds, that would be to kill the goose that laid the golden egg. Equally, we must provide security; we must not trade off security to secure lower burdens on businesses." Balancing those two, I believe, is something that the actuarial profession can do and that is a very important issue that we should be seeking to address over the coming weeks.

On the question of the actual proposal for solvency levels, I would like to point out that there is one major recommendation not in the report - the dog that did not bark. There is the question of discretionary benefits and discretionary pension increases which have been mentioned tonight. In its evidence the profession made great play of discretionary benefits, especially where they were pre-funded and disclosed. It recommends the disclosure of solvency levels which included discretionary benefits, allowing for discretionary benefits in transfer values, only allowing employers to have the equitable right to surplus after allowing for discretionary benefits and so on. The report, however, comes down very heavily in support of considering the solvency position excluding these. Given this cushion, as well as other factors, there is a margin in well-funded schemes. It is for this reason, as well as the fact that cash equivalents are, of all the alternatives, the least difficult for a member of the public to understand (because they relate to the amount he can transfer to another scheme or to a personal pension if he leaves service) that I believe that the actuarial profession should give the proposed standard a fair wind bearing in mind the balance of interests of all parties. Clearly that proposal needs refining. We must look at our transfer value bases as we have been asked to do and we need to consider such problems as buying-out annuities for large schemes, the question of the period before the proposed solvency standard comes into play and so on. Nevertheless, we should not throw out the baby with the bath water by rejecting the general proposal without detailed consideration.

I will only speak briefly on the scheme actuary. I think we as a profession must not underestimate the amount of involvement in preparing ourselves for this important rôle which I believe we should welcome. The question of professional guidance, technical issues, education, continuing professional development and practising certificates all have to be considered and we need to bear in mind that whilst there are only about 150 appointed actuaries for insurance companies we have over 150,000 pension schemes which will, in future, require pension scheme actuaries.

Mr C. D. Daykin C.B., F.I.A. I am grateful for the opportunity to make a few remarks in my own right, rather than speaking on behalf of the Government, the DSS or the Government Actuary's Department.

I want to focus on the recommendations for the minimum solvency requirement. There are three essential criteria by which I would judge such a requirement. Firstly: does it provide a clear-cut process for triggering regulatory intervention of an appropriate nature? Secondly: does it offer an adequate degree of security to members when supervisory action is triggered? Thirdly: does it avoid creating spurious alarms and triggering inappropriate regulatory intervention? To these one might add a number of desirable objectives such as ease of operation, minimum burdens on Trustees and employers, transparency vis-à-vis members and so on.

From the point of view of the members, a desirable criterion for minimum solvency is that the accrued rights should be capable of being bought out and their defined benefits continued. However, in practice we know that a buy-out with an insurance company is relatively expensive relative to funding the pension scheme on a continuing basis, largely because the pension promise is being replaced by a guarantee, requiring matched investment policy and margins appropriate to such a guarantee.

The Committee recommendation is that 100% of cash equivalents for active members and deferreds, and buy-outs for pensioners, should form the basis of the minimum solvency requirement. Cash equivalents reflect only the value of the early leaver benefits and are usually significantly below the value of accrued rights if the latter are taken to include the promise of benefits at retirement age linked to final earnings, and subsequent pension increases. The cash equivalent is also often based on a relatively optimistic assumption about the future, so as not to be over-generous to early leavers relative to the security offered to those who stay. Linking the cash equivalent to gilt yields, as has been argued by some actuaries, may be appropriate for determining a transfer value but it does not seem very appropriate for looking at the solvency of a whole scheme and would potentially generate a fundamentally mismatched situation unless the scheme restructured its investment policy into the matching assets. This is not necessarily an appropriate result of the regulatory regime. Similar issues arise with the requirement to look at buy-outs for immediate annuities in respect of pensions in payment.

I suggest that the cash equivalent which we need for the purposes of a minimum solvency requirement should be different from that which we have developed so far for transfer values. It needs to be responsive to market movements and it should apply to the sort of assets in which pension funds are invested for long term strategy. It should be calculated on moderately pessimistic assumptions and there should be some constraint on the degree of optimism permitted. This would not necessarily be a statutory basis as such but might impose some limits on what assumptions can be made, so as not to leave the determination of the statutory minimum solvency requirement entirely to the discretion of individual actuaries, who might be subjected to intolerable pressures from Trustees or from employers of ailing businesses.

There should, furthermore, be some trigger for initial regulatory action at a level such that the problems can be addressed and satisfactorily resolved in the majority of cases, without the funding level dipping below the minimum solvency requirement. If the ultimate regulatory action is required and the scheme has to be discontinued, then there should generally be sufficient resources to achieve a run off or buy-out with a fairly high level of accrued rights being secured. I wonder whether we need to look at some alternatives if this situation arises, rather than requiring immediate injections of cash. Maybe there is a need to look at letters of credit, charges secured on the employer's business or even external insolvency insurance in the case of some under-funding.

I look forward to a vigorous debate within the profession on these issues, so that we can find an effective way of improving the security of scheme members.

Mr J. R. Bowman F.I.A. I am delighted to have the opportunity as a visitor to speak at this meeting. Tonight I am speaking as Chairman of the Pensions Committee of the ABI.

The ABI broadly welcomes the recommendations of the Pension Law Review Committee and congratulates Professor Goode on producing such a comprehensive and readable report. We are currently looking at the detail, particularly in those areas of interest to insurers where the Committee has indicated that further work needs to be undertaken by others.

We believe it is important to recognise that Professor Goode has produced a unanimous report with only limited exceptions. This is without doubt a most impressive achievement and adds considerable weight to the 218 recommendations. Not 218 individual and separate recommendations, but 218 closely inter-related recommendations which, together, make a coherent set of proposals. It would not therefore be proper for the ABI, or I suggest anyone else, to consider the recommendations piecemeal. As Mr Westwood said, we should not cherry-pick.

Although many of the recommendations are in line with the approach suggested by ABI's evidence, we were, however, disappointed that the Committee concluded that all pension schemes, including insured schemes, should come within the proposed new compensation scheme. Despite our disappointment, we welcomed the fact that the Committee recognised the extra security which is inherent in insured schemes. The report said that: "We accept that the risk of fraud in respect of funds invested in insurance policies should be less than that in respect of funds invested directly.". However, the Committee did not feel it was appropriate to draw a distinction on these grounds between insured and other schemes. The Committee recommended, however, that the Regulator should be empowered to establish streamlined regulatory and compensation procedures for small schemes administered by insurance companies willing to assume direct responsibility for administration of supervision and to be answerable for any defaults that might occur. This is one of the main issues being considered by ABI. We will be putting forward constructive proposals for carrying forward the Committee's ideas. We recognise that our proposals will, of course, have to achieve equivalent protection to that offered by non-insured schemes.

We heartily welcome the emphasis placed by the Committee on the importance of making law clearer, simpler and more accessible to those who use it. We agree that the present law is over-prescriptive and unnecessarily complex and, moreover, costly to administer with all the consequences for scheme members and employers. We are concerned that any new legislation should not impose undue additional burdens and costs on pensions providers and in any way limit the choice available.

We are concerned about the minimum solvency requirements and we do suggest that they need further detailed work. The ABI looks forward with interest to the views of the actuarial profession in this respect. We do, however, believe it is essential that whatever does emerge on solvency is capable of widespread understanding, especially by scheme members, else the debate may prove to be no more than academic.

The ABI is committed to the need to re-establish confidence in occupational pension schemes and believes that the recommendations of the Committee taken as a package, and subject to the further consultations already outlined by the Secretary of State, will achieve just this. The ABI looks forward to playing a vigorous rôle in helping to establish the new legal framework.

Mr C. W. F. Low I wish to address one point only and that is the minimum solvency standard and the aspect of it I wish to address is the public perception of the actuary or, more importantly, the probable future public perception of the actuary.

We can talk in this hall about the need for cash equivalents and to have painless definitions of solvency. I think we should recognise that the public will put this to the test when schemes in fact go insolvent.

My employer is involved as independent Trustee in winding up large numbers of schemes at present and in many cases the situation exists, as Mr Westwood aptly described, where the scheme was solvent on a cash equivalent basis but deferred annuities could not be purchased. I believe we should recognise now, and not wait for Parliament to do it either now or in a few years' time, as I believe they would then find us wanting, that the definition of solvency should be the purchase of deferred annuities.

Mr Aitken quite rightly pointed out that for large schemes, of course, the need to purchase deferred annuities could well be 20 years or more down the track after discontinuance. That I think should be the benchmark but how do we apply it? We have got to make it quite clear to public opinion and to backbenchers that that is a large additional benefit and it does not come for free. We are misleading people if we think we can find a solvency definition which comes for free. If we had that definition in, as we have been reminded, there would need to be a change in investment policy, there would be much lower yields and returns available and so higher costs for pensions. Who will meet this cost? A few employers might, most would not. Therefore, if the public, as represented by backbenchers in Parliament, want that degree of protection they have to pay for it by reduced expectations and I think we should make it quite clear that perhaps the pension promise only represents the basic benefit and all future increases are mere expectations or hopes. Perhaps, indeed, the basic promise will only be 80ths and the difference from 80ths to 60ths are mere expectations or hopes. I believe that that would be a more informative way of presentation to the general public. It would be very simplistic for this audience here but this audience is not the constituency which will make the final political decision.

Mr D. C. Mason I believe that it is important that we remember that the Committee was established as a result of the recommendations from the House of Commons Social Security Committee in its report "The Operation of Pension Funds". I would like to quote Paragraph 126 of that report.

"Actuaries do not seem to be concerned in their reporting to members of a pension fund with an overview of whether or not the pension fund to which they lend their names as professional persons is operating in a fit and proper manner in terms of administration, appropriateness and custody arrangements for investments, meetings of Trustees, consideration of all contributor interests, management operation and control. We recommend that this broadening of the actuaries' rôle should take place either by raising the profession's current standards or with the support of legislation."

We should be very appreciative that, whilst the Social Security Committee was implicitly criticising us for taking a narrow view of our responsibilities, it believed that we should be encouraged to take a much fuller rôle. The Goode Committee has now endorsed this. Thus I believe that it behoves us:

(i) to look widely and openly at the service that we are providing;

(ii) to remember that our ultimate customer is really the pension scheme member irrespective of who pays our fee; and

(iii) to structure our advice and help in such a way that it is understandable to that scheme member.

This view may make it more difficult for us to reach decisions on what we see as the controversial parts of the Committee's report which we are discussing this evening but if we remember that focus I believe it will concentrate our minds on what are the true important issues for the profession.

With the background of the Maxwell affair, the proposed office of the Pensions Regulator has come out of the report as having a legal bias. I hope that the Regulator can be much more open and thus much more important than this. When I first worked in the pensions field 25 years ago, what attracted me was the sense of partnership that prevailed. Employers, trade union representatives, professional advisers were all then working to the same end - to better the lot of the employee by the provision of a good pension. As Mr Westwood said in his opening remarks, that sense of partnership has now been lost. I believe that the next few years gives both our profession and the office of the Regulator a unique opportunity to regenerate that partnership. With the demographic trends that we are facing, it is very important that we do so. Private pension provision, in all forms, needs to be encouraged.

The proposed Pensions Act and the rulings from the European Court of Justice will remove many areas of debate. We may not like the rulings but the uncertainty has gone. The report acknowledges that the great majority of pension schemes in the United Kingdom are well operated. Many here tonight assist OPAS and know that the cases that come before that body are generated by misunderstanding or poor communication rather than by any suggestion of malice. The need for harmony is great. The Regulator will have a unique opportunity to give leadership and we as a profession must encourage whoever is appointed in it.

The section of the report on introducing a minimum solvency standard has brought out areas that we have been debating in the profession for a few years. As regards the appropriateness of the assets held in relation to the pension scheme liabilities, we as pension actuaries should look to the appointed actuary system of life office supervision. There any incompatibility between the assets and liabilities shows up in the mismatching reserve. Provided there are sufficient free assets, the reserve is covered and the investment strategy can be followed. A similar philosophy should apply to pension funds valuation. The motives for the mismatching are the same and the pensions scheme actuary should be willing to do some resilience testing to understand the scope for incompatible changes between assets and liabilities in the scheme under consideration.

Mr T. M. Ross I wish to address the vexed question of a minimum solvency standard and I think it is helpful to start with three fundamental points.

The first one is that investing in equities to meet pensions in payment involves a higher level of risk than would investment in gilt-edged stocks. Second, equity, that is equity in the sense of fairness or as Professor Goode put it in his introductory remarks "fair play", dictates that those who stand to lose when risks turn out badly should stand to reap the rewards when they turn out well. Thirdly, there is no such thing as an absolute pension guarantee.

Now how do defined benefit schemes currently measure up in relation to these three points? Well, mismatching of assets and liabilities has indeed occurred and on a massive scale, particularly in mature schemes. The level of investment in equities is now not far short of 90%. However, with the benefit of hindsight, this mismatching though risky has been beneficial. Members have had discretionary benefit improvements and employers have had contribution holidays, even in some cases surplus refunds. But we must not allow the generosity of many employers to disguise the fact that if hard choices had had to be made then it is the employers who would have had the benefit of the surpluses in the past not the members. Put another way, if the mismatching had gone disastrously wrong, in the ultimate it is the members who would have paid the price.

Now Professor Goode and his colleagues have recognised this unbalanced state of affairs and they have recognised it sensibly. They have concluded that employers should have the reward through the very substantial control of surpluses in ongoing schemes but at the price of having to back a meaningful solvency standard. Bearing in mind, the substantial level of control of surpluses in ongoing schemes endowed on employers, it is hard to avoid the conclusion that the solvency standard should remove as far as possible the risk that members will not receive their pension so I do not therefore see how a standard which takes substantial recognition of the higher expected returns from equities, except perhaps where young active members are concerned, can be supported without a re-examination of the question of control of surplus and I am slightly disappointed that those advocating a rather weaker solvency standard than Professor Goode and his Committee envisaged have not at the same time addressed this question of control of surplus.

I therefore believe that as a profession we need to do three things in relation to the minimum solvency standard. First, we should recognise the direct link between the strength of the standard and the right to control and benefit from surplus. Second, we should seek the Government's view on the balance it wishes to be achieved, either that which Professor Goode and his Committee envisaged or something different. Thirdly, then and only then, should we develop a solvency standard in the knowledge of the objectives it is seeking to meet.

Prof A. D. Wilkie I am speaking as Chairman of the Investment Joint Committee of the Institute and the Faculty and I welcome what Mr Neill and Mr Daykin said in relation to the wider consequences of implementing the Committee's recommendations.

It seems to me that the consequences for the investment world of implementing the recommendations on solvency are two-fold. Trustees of pension funds will need to make a substantial switch from ordinary shares to fixed interest stock, either conventional or index-linked, in their investment portfolios; and firms will need to increase the contributions made to pension funds in future or else reduce the benefits. A third possibility for some schemes would be to increase the funds considerably and maintain the equity proportion, but this would not be generally possible.

I want to concentrate on the first of these problems. My colleagues have estimated that, for all United Kingdom pension funds, the likely switch would be of the order of £150 billion, that is £150,000 million, from shares to bonds. Who is willing to switch this amount in the other direction from bonds to shares? Over recent years, the Government has sold shares in the form of privatisation issues rather than selling Government stocks. I haven't counted up the total market value of the privatisation issues but it might well be of the order of £100 billion to £150 billion. But I don't think it is likely that the present Government will reverse its privatisation process, re-nationalise BT, British Gas and all the others, and issue £150 billion of Government stock instead.

Companies themselves could do the switch. They could buy in a fraction of their shares, up to 20% of them, and issue loan stock in its place; but would the other shareholders want this? Would it make the companies any more solvent or would it not be more likely to increase the chance of the companies themselves becoming insolvent? There would then be those who would say that the Committee's proposals were all the more necessary, but that is missing the point.

Are there any other U.K. investors that could do the switch? Is the general public willing to withdraw £150 billion from building societies to buy shares from pension funds and are the pension funds then happy to deposit the money in building society deposits? That is not the sort of matching asset that one would normally recommend.

What about overseas investors? American investors are said to be enthusiastic to buy what for them are overseas shares. Are they likely to be willing to buy them in such quantities and are pension funds willing to replace U.K. shares with foreign bonds? I don't think that is the matching policy that we would be recommending.

There are those, including some actuaries, who have suggested that a switch in the underlying assets would not be necessary because it can all be done by pension funds buying put options on the shares. I think there would be no problem in doing this with perhaps £150 million of shares but not for the £150,000 million that would be necessary. Someone on the other side needs to write the put options and, in effect, promise to buy shares at today's prices whatever they have fallen to in the meantime. All the banks in the world are not going to take on that sort of commitment.

There is another way out. Share prices could drop so that by market value their percentage contribution to pension fund investment diminished enormously. Pension funds would then be in deficit according to the proposals, companies would have to top up their pension funds to maintain their solvency, which could then only be done at the expense of profits and dividends, thus justifying the fall in the market value of shares and producing a corresponding fall in the actuarial assessed values too!

Before embarking on any implementation of the Committee's proposals, I suggest that the Government, possibly aided by the profession, should look very carefully at the macro economic consequences of what is proposed.

How did we get here? Over recent years pension funds have been pushed towards making stronger and stronger guarantees. First, we have had the limited price indexation of deferred pensions, then formal LPI of pensions in payment, then cash equivalents of deferred benefits on a market-related basis and now the Committee's proposals for the minimum solvency requirements. Step by step these may seem reasonable but, in aggregate, I think they are ending up at the wrong place.

Many people in this hall come from life offices. It has always been thought reasonable for a life office to ensure that the valuation reserve for each policy exceeded the surrender value, or rather that the surrender value basis was weaker than the valuation basis. Consider the following line of development.

Policyholders' reasonable expectations become interpreted as maintenance of the current rate of bonus. When premiums cease and policies are made up, the current rate of bonus in future years has to become guaranteed and the policy shifts from with profits to without profits on this enhanced basis. It is then decreed that the surrender value has to be the fair market value for paid-up benefits. It is then argued that the fair market value is the single premium quoted by other life offices for purchasing these benefits, not for surrendering them. Life offices are then required to calculate valuation reserves on the assumption that all policies are immediately paid-up and surrendered on this basis. This is not the perfect analogy but it gives some idea of the shift that is taking place in thoughts about pensions.

Mr J. S. R. Ritchie I restrict my remarks to one crucial area, namely the method and assumptions for calculating cash equivalents for defined benefits under GN11 on which many people have already commented tonight.

The fundamental objective must be to produce a transfer value which is seen to be fair by the member. I am not convinced that this is currently the position. Defined benefit schemes were brought into disrepute 10 years ago by their past treatment of early leavers and the threat that they now face from Personal Pensions may be traced back directly to that issue.

Let us not compound that mistake by now calculating cash equivalents which transfer value analysis systems show to require yields in excess of 11% per annum at a time when long gilts are yielding less than 7½% and price inflation is around 3%. I understand the concern that a gilt basis for GN11 may threaten the statutory solvency of a scheme heavily invested in equities. Mr Daykin, and I think Mr Low, have suggested that a different basis for statutory minimum solvency should be used than that of GN11 for individual transfer values. I have sympathy with that but, on the other hand, whenever a divergence arises between the statutory minimum solvency basis and the individual transfer value basis, then you have a credibility gap. Whichever way it is, it is going to have to be bridged and there will be a lot of explaining to do even if it is actually thoroughly justified in practice. So, from the members' point of view, I am concerned about that.

Perhaps we should look at the precedent of Accrued Rights Premiums for buying back into SERPS. If for GN11 we had a table of basic rates which were adjusted for market values by reference to a basket of specific assets, this surely could be constructed to be fair and to be seen to be fair. Clearly, the choice of constituents for the basket is very important and there will inevitably be implications for the scheme's investment policy especially if the solvency position is tight to start with. I do not envy the Pensions Joint Committee its task of revising GN11 but I do ask it to keep in mind the need for the new basis to be demonstrably fair in the eyes of the member.

Mr A. E. Miller One or two practical things have come into my mind while all this talk has been going on on the theory.

Several speakers have talked about the members' perceptions having to be recognised. I am concerned about the timing of solvency statements and the like. We have seen one or two examples already described of markets moving very rapidly. We will not be producing solvency statements on the day to which the accounts relate. We will be producing them months afterwards but they will be for a set of published accounts and Trustees reports as at a particular day. Things could be desperately bad on that particular day and have recovered two days later or vice versa. I am concerned that we could look rather silly, producing a statement nine months after the valuation date which, by that time, has been rendered completely out of date.

Another concern I have is on the practicalities of the appointment of an actuary to each money purchase scheme. The vast majority of money purchase schemes that I am familiar with are small schemes where the employer is putting in 3% or 4% of salary and the employee is putting in something similar. There is no final salary benefit whatsoever, there is no GMP, there is nothing else of that nature whatsoever. There is no need for actuarial involvement in schemes of that nature. I appreciate that it is very difficult to draw the line between which money purchase schemes should have, and which should not have, actuarial involvement but there are a very large number which should not have.

Mr R. A. Scott As a member of the Pension Management Institute's Working Group on Pensions and Divorce, I am well aware of the problems of getting majority consensus let alone unanimity on pensions issues from a group with diverse professional interests and expertise. I thought that our task was hard but, if I could use a rugby analogy, it was like taking on Spain or Italy whereas the Goode Committee had the All Blacks themselves to contend with. Whilst the Committee might not have routed the All Blacks, they have certainly sent a few homewards to think again!

I will restrict my comments to the proposals on the treatment of pension rights on divorce. The Committee has generally endorsed the proposals subject to some further clarification on certain issues and whilst this might seem a minor matter within the overall report, it is nonetheless a very important issue for divorcing couples (around 150,000 a year). It is also a very important issue for the legal profession who are crying out for some guidance on this subject sooner rather than later. I would therefore urge the Committee and the profession to progress this matter with the same urgency as the other proposals. Certainly, I would be happy to discuss any grey areas with the Committee or the profession.

Replying to the discussion:

Professor Roy Goode I wouldn't dream of uttering any thoughts on actuarial matters because there is a huge volume of expertise in this hall which I could not possibly hope to match.

First of all, I would just like to say how much I was heartened by the strong measure of overall support for the package as a whole. Obviously there will be points to be worked out. I was also very pleased to listen to various speakers advocating that the actuarial profession should be involved in detailed work and in debate because we as a Committee could not investigate every detail. We hope that we got the balance about right.

The one thing I would like to emphasise in all of this is the fundamental importance to scheme members of confidence that when they come to retire their pensions will be paid. That was the fundamental thing that drove us and, it may be that benefits have to be slightly reduced or contributions have to go up somewhat. Our view would be that it is better that that should happen than that people should discover when they come to retire that they are not going to get paid the pension that they thought they were going to receive and on which they will have to depend for living. They have organised their affairs on that basis, they have worked for 20, 30, 40 years perhaps to earn that pension and to us the integrity of the pension promise was of utmost importance. So that was the driving force and I am sure that the expertise in the actuarial profession will enable us to go forward broadly along the lines that we have recommended as a Committee in a unanimous report.

So it only remains, Mr President, to thank you and to thank your colleagues for the welcome that you have given and to say that I am extremely grateful to you for the format of this session which meant that each of us was allowed to say a few words without any of us being called upon to answer any questions!

Mr I. M. Aitken On the problem of solvency, I get the feeling there is a consensus. It should be based on the purchase of deferred annuities and immediate annuities. This may be so but I would still like to ask the question "Can British industry afford it?". It is no use saying to our members there is this wonderful level of solvency, you are guaranteed your benefits, if this puts the employer into liquidation.

The proposed level of solvency will mean that pension schemes are forced in one of two directions. First, to increase their assets so that fluctuations in market values are such that they always are above the 90% base level. In this scenario, I estimate that pension schemes will require to have assets approximating to 110% of the 100% solvency level. This means increasing their reserves by some £40 billion. The alternative, as suggested this evening, is they should change the investment strategy and invest more in fixed interest and index-linked gilts. That, in turn, will mean reduced returns to pension schemes and, in turn, this will mean increasing contributions. I estimate the increase in contributions will be about 10%, in other words 1% of payroll. That is equivalent to an extra £1½ billion every year.

In either scenario, this is additional money that an employer has to put into the pension fund which otherwise would be available for investment in new plant, research and development. It is no use going down this route if this puts major companies into liquidation. I believe the proposed standard for solvency, as outlined in the Committee's report, will be crippling to British industry and it is essential that the Government considers these points further.

Mr R. J. Amy Let me say just a few words on minimum solvency as everyone else has and as I wasn't allowed to earlier! Let me talk from the practical perspective of a large company where any suggestion that discontinuance is likely would be heretical. Straightaway you are talking about an issue that is regarded as a remote possibility by management.

This is not the time for extreme solutions. Too extreme and you will turn employers, even big employers, off running final salary schemes and Professor Goode and his Committee took that as a fundamental guiding point in writing their report. We believe in final salary schemes. We believe there is a future for them and that they have an important rôle to play. We must not undermine that.

We have also got to take into account that, if you go into any large company and start talking about surplus, management do want to have a large say in the control of that surplus and, as Mr Ross has said, they can't have it both ways. They can't have control of the surplus on the one hand and not provide security on the other. So what we are trying to get at here is some form of equilibrium and there are forces tugging in different directions. We have got to try and achieve a balance. We can't let one string pull too far in one direction and weaken the rights of members and pensioners, nor can we pull too far the other way and make employers stop running schemes and it is the rôle of the profession to steer Government towards a balanced solution.

I like the concept that Mr Mason introduced of mismatching reserves. In other words, you recognise that if you are funding a scheme and you want the benefit of equity returns that you do have to maintain a margin and that seems to me a productive route to follow. Mr Ritchie is absolutely right that we have got to be seen to be fair in our transfer values and in our standards of solvency. So we have a very difficult task to walk this tightrope while being pulled in opposite directions, but we have got to try.

Mr D. A. Berridge I offer a brief comment on minimum solvency.

I think the profession is being challenged here to come up with a basis for minimum solvency which will work. I believe we can do so. I don't think the more extreme conclusions put forward by some will necessarily arise provided the basis is chosen wisely.

Mr Daykin put the point very well when he said that the difficulty arises from the thought that the promise should be replaced by a guarantee whereas what we really need is to replace the promise by an equivalent promise.

Mr Stewart was on the right line in saying think outward as you are thinking about this process. It is really back to the profession. I think we can come up with a practical basis, but everyone must recognise that demonstrating solvency does have a cost.

Mr H. W. Brown I wouldn't want to break the trend by not speaking about minimum solvency. I was amazed at some of the figures that have been bandied around tonight.

One of the areas that I have looked at is some surveys that have been carried out on the minimum solvency requirement that the Committee has put forward compared with the ongoing funding of a pension scheme. Indeed, a number of my colleagues who have carried this through have looked at SSAP24 assumptions published in various surveys. Having regard to those and a scheme that is funded on a 100% basis and using 100% equities, over the last 30 years there is only once that those schemes would have had any problem in meeting the minimum solvency requirement. That was in 1974, no not 1987, 1974 and the stockmarket crash then. At that time such a scheme would have dipped below the 90% level for only 5 months.

The Committee in its recommendations was very concerned about this specific area where the markets might crash and schemes could find themselves insolvent and be required within a three month period to put cash in to the pension fund and as a safety net they make it quite clear in the report that the pensions Regulator would, under those circumstances, have the power to be able to extend that three month period. I would have hoped that would have given most people reasonable comfort that what is being recommended as a minimum, and to provide greater security for members, is something that we, as a profession, can live with.

Subsequent to the meeting:

Mr A. C. Martin *(a written contribution)* I contribute initially as an independent trustee appointed under section 57, Social Security Act 1975. On the funding front there is unfortunately a common problem of having a solvent scheme on the basis of paying cash equivalents but an insolvent scheme on the basis of having to buy out immediate and, particularly, deferred annuities.

For those who are not just about to retire, I believe securing deferred entitlements on a guaranteed basis via insurance company policies is an outmoded concept and totally inappropriate for the general circumstances of the members. We now live in an environment where index linked and variable immediate annuities are sold.

We also live in a world where individual members quite freely and frequently uplift leaving service (or scheme) transfer values in lieu of defined benefits to secure money purchase entitlements with few if any guarantees. I would like to see the requirement to secure entitlements via guaranteed buy-out policies removed for all but the very oldest members.

Like Mr Scott I contributed to the PMI Working Group on Pensions and Divorce. The working group chose cash equivalents as the basis of "value" of members entitlements. I understand consideration is being given to removing discretionary benefits from the calculation of cash equivalents for solvency tests. I believe there are dangers in creating more than one cash equivalent. I do not feel one cash equivalent can be used for solvency purposes and another cash equivalent be paid in practice. People will simply not understand it.

Emerging from some recent Scottish divorce cases is the associated problem of including or excluding the value of spouse's entitlements in transfer value payments. With the debate on unisex annuity rates, I regret a potentially greater difficulty might be ignored - marital status. Transfer values do not vary significantly (when spouses' entitlements are included) by sex, however, the thorny problem of unistatus will have to be tackled, not least for those emotive situations when in future split transfer values may be paid to divorcing spouses.

My only regret in reading the report is that the conflicts of interest for those acting as advisers and trustees did not extend to the inevitable problems of those acting as administrators and trustees. I believe the committee did not "get off the fence" in connection with this aspect, merely leaving it to the ramifications of a best practice regime.

Mr I. A. Farr *(a written contribution)* I should like to make a few comments on the minimum solvency standard proposed by the Committee.

It is proposed that the standard will be introduced with full retrospective effect, after a short transitional period. As a result, the statutory framework within which occupational pension schemes operate in the U.K. will be changed significantly. For example, if the minimum solvency standard, as proposed, had been in force for some years, it is my belief that many employers who have introduced guaranteed increases to pensions in payment would not have done so. More likely, the increases granted to pensions in payment, whilst in practice being exactly the same, would have been made on a discretionary basis.

In current conditions, the ongoing funding levels of many schemes will be around their funding target and the amount of the assets in the trust fund will probably be similar to that required to meet the proposed minimum solvency standard, provided a significant proportion of their liabilities is not in respect of pensions in payment. If there is an excess of assets, it is likely to be modest. Thus the cost to many employers of pensions already accrued could be increased - because if the proposals are implemented, many trustees will choose to invest a significantly larger proportion of the trust's assets in fixed interest securities than previously in order that the funding level of the scheme moves more in sympathy with the minimum solvency standard. If an increase in the cost of pension provision is to be avoided, a major transfer of resource is likely to be required from the company to the trust fund in order to raise the funding level of the scheme comfortably above that required by the proposed minimum solvency standard. Whilst employers will not be able to change the pensions accrued for past service, despite the retrospective nature of the proposed standard, they may feel unable to afford, and hence wish to change, their pension promise in respect of employees' future service - but at what price, in terms of staff relations and management resource?

In my view, if the standard is to be retrospective, the cash equivalents in respect of active members and deferred pensioners will have to be allowed to be calculated on a basis consistent with a scheme's ongoing investment policy. If the ongoing investment policy is equity-orientated, as will be highly likely in order to maximise the cost effectiveness of ongoing pension provision, the cash equivalent calculated for the purpose of the standard will be based on a realistic future expected return from such a portfolio and its amount will move in sympathy with the appropriate market levels.

The retrospective nature of the standard leads logically to this cash equivalent approach being extended to pensions in payment, the pension and guaranteed future increases being capitalised on a basis consistent with the scheme's ongoing investment policy, which typically will be equity-orientated. On the winding-up of the scheme, the cash equivalent in respect of a pension in payment could be used to purchase an annuity from an insurance company at whatever rate of guaranteed increase could be secured. Alternatively, the annuity could be purchased without future increases, other than those required by statute on the GMP, the pensioners being paid an enhanced level annuity - or a with profits annuity could be purchased, the market for which could be developed if such an option were available to offer contracts with different levels of reversionary bonus. In other words, there would be a choice, in much the same way as there is intended to be a choice for the active member and the deferred pensioner.

There would be a minimum requirement, however, that the cash equivalent should be of an amount sufficient to secure from an insurance company a level annuity of at least the amount of pension in payment at the time of the winding-up of the scheme. Thus the cost of an immediate annuity would still be a part of the standard but that cost would be a minimum requirement which would not take into account any future pension increases, whether guaranteed or not. Such a minimum requirement would result in a higher minimum solvency standard being imposed on schemes with no pension increases in their benefit structure, which in my view would be quite justifiable.

The vast majority of employers in the U.K. have a record of pension provision of which they can be justly proud - in many respects leading the world. We know, from his statements, that Professor Goode does not want to impose greater financial burdens on employers as a result of his Committee's proposals. Unless a more radical solution is embraced, the minimum solvency standard as proposed needs modifying if final salary schemes are going to continue to be a major source of income for the retired population in this country.