Mr. J. Stretton, opening the discussion, said: - One of the fascinations of the actuarial profession is that many of the subjects that we discuss are affected by a mixture of practical, theoretical, moral and political considerations. We must not be shy of the moral and political considerations. Our experience of theory and practice gives us a unique foundation upon which to build our judgments. However, we ought to make it clear whether we are arguing a case logically from theoretical and practical considerations or whether we are expressing personal views. This often gives rise to problems and seldom more so than in discussing the protection of occupational pension rights for early leavers. Because of these problems I am going to start by looking at a few of the underlying concepts from a theoretical point of view.

First, the concept of contributions as deferred pay. One way of putting this idea contained in the report is that all pension costs should be regarded as labour costs. Put in that way there would probably be few disagreements. The difficulties begin when we try to establish an entitlement for each individual employee to a quantifiable element of deferred pay. In the case of a money purchase pension plan this idea of quantifiable deferred pay is totally clear. It is reasonably clear also in an average salary scheme which does not revalue past benefit entitlements. We should not then be too surprised that these types of benefit structure have fairly clear solutions to the questions of equity between members.

Most pension funds now, though, are in final salary form. With this benefit structure there are numerous factors which contribute to inequalities in the amount of pension fund contributions, or deferred pay, between different members of the same fund, for example—late entrants obtain more deferred pay than young entrants—unless pensions are paid to widows of male members but not to widowers of female members, females obtain more deferred pay than males, and the point which we are discussing today, stayers normally obtain more deferred pay than leavers. There are others. Some of these points apply equally to an average salary scheme where we have accepted them without difficulty in arriving at our concept of equity. Others apply only to final salary schemes, in particular the problem of early leavers.

I have looked at the transcripts of the judgments in the cases mentioned in Chapter 1 of the OPB report to see if these cast any light on this imprecise concept of deferred pay. Unfortunately they don’t, so the deductions which follow are my own.

Of the sources of inequalities in deferred pay between members of the same pension fund, two stand out as being arbitrarily imposed and not arising out of the nature of the fund itself. One is the chivalrous habit of
allowing females to retire five years earlier than males. The other is the way in which early leavers benefits are normally calculated. The effect of different retirement ages for males and females is often counteracted by the provision of widows' pensions. There are no mitigating features for early leavers.

Total pension fund contributions can often be in excess of 20% of pay-roll. They certainly form a significant portion of the total reward an employee can obtain for his labour. If a savings scheme were being set up to help employees provide for their old age and the details of that scheme were negotiated between an employer and his employees, it is most improbable that the scheme would allow a difference in treatment between leavers and stayers. I therefore conclude that although the issues are much less clear cut than the use of the words “deferred pay” implies, (1) that becoming a leaver or a stayer is the biggest single cause of radically different treatment between members of the pension fund, (2) the proportion of total reward for employment affected by these differences can be significant, (3) that these differences have not arisen out of the conscious wishes of employer and employees and therefore (4) that this is an area that is ripe for change.

There has grown up since the publication of the OPB report and not, I hasten to add, because of what the report itself contains, an accusatory tone of comment implying that pension funds have deliberately set out to take advantage of early leavers. This is most certainly untrue. Pension funds have evolved very rapidly but the treatment of early leavers is in my view one aspect of fund design which remained unchanged in the form dictated by average salary scheme parentage. The evolutionary pressures on this form of behaviour have been small. Most scheme members, whether because we have failed to educate them or whether for other reasons, have not valued improved benefits for early leavers very highly.

I will return to the subject of pressure from pension fund members later but before I do so I would like to apply a theoretical approach to some of the other points raised by this report. Apart from the argument of natural justice and apart from the Government’s statement that job mobility should not be allowed to undermine occupational pension schemes as a major form of provision for retirement, another argument which has been used to support change has been the idea that job mobility might be increased if early leavers were given higher pension benefits. This aspect has been given much greater prominence in subsequent discussion than it was given in the OPB report. However, I think analysis throws grave doubt on whether it can be admitted as a sound proposition. There isn’t any reliable evidence on attitudes of employees considering a change of job. However, theory can help a little. If we consider an entrant to a final salary pension fund at age 25 and assume that his salary will increase at a constant annual rate through to retirement at 65 we can calculate at what age a change of employment has the most severe effects on his total pension at retirement. This is of course using the traditional method of calculating paid-up pensions. I am assuming here that a change of employment produces no discontinuity in salary and that it results in him joining a precisely similar final salary pension fund to that of his first employer.

An early change has little effect on total pension because he earns almost a full pension in his second employment. Similarly, a late change has little effect because the value of his first pension has only a short time in which to decay. The worst age to change jobs is not very sensitive to the rate of increase in salary we assume and for rates between 6% and 15% per annum lies in the range 50 to 53.
Of course, many employees joined their current employer at ages greater than 25 and for them the worst age to change is older than 50 to 53. It is probably fair then in respect of all people currently in employment to talk of the age range where greatest exposure to loss of pension occurs as being 45 to 60. Not only is this the age range where changing employment has greatest effect, this is also the age range where, as I remember one series of advertisements pointed out, we start to worry about our pensions. One would therefore expect that if the pattern of pension provision was a significant factor acting to distort the labour market we would see evidence of unsatisfied demand for workers over the age 45. It is not what we find and it was not what we found even before unemployment climbed to its current levels. This is a slightly condensed version of the necessary reasoning but I think it would be totally wrong to expect noticeable freeing of the labour market to be brought about by improving the pension provision for early leavers.

Having talked so far about the reasons for change, I would now like to move on to the proposed changes themselves. First, a brief comment on the use of the words "open-ended commitment". If a pension fund accepts a liability which can grow in a manner which is unforecastable and which is out of the control of the suppliers of finance to the pension fund and if the liability is absolute (that is come what may the fund must meet that liability) then it has accepted an open-ended commitment. This is what we all feared in the early considerations of guaranteed minimum pensions. Index-linking pensions of early leavers need not be like that, though, provided these benefits are not given better security than that attaching to continuing members' benefits. That is to say that the fund must be allowed to cut back benefits alike for early leavers and stayers should it become necessary to terminate the fund in a state of insolvency. Provided this is allowed, the problems of index-linking early leavers' benefits become first and most powerfully very high cost and secondly the possibility that early leavers can, especially in declining industries, get better treatment than stayers. But the risk involved is akin to that for members still in service. Perhaps a better way of putting it is that the liability is open-ended (as is the liability to provide final salary pensions for stayers) but it is not a commitment, merely an expression of intent.

Next, Inland Revenue limits. With active encouragement being given by the OPB to the inflation proofing of preserved benefits there arises the possibility of an employee with one or more changes of employment qualifying for a total pension of up to 49/60ths of final salary. And this without any of the funds of which he had been a member giving benefits in excess of 60ths. This seems unreasonable in view of the restriction to 40/60ths for members who don't change employment. It also seems unreasonable that the final employer should have a duty to monitor restrictions on total pensions. There are other similar problems which emerge over the issue of annuity contracts under Section 32 of the 1981 Finance Act. To make this workable the OPB should make representation to the SFO for the removal of limits on those benefits which emerge from a pension fund in taxable form.

Thirdly, the recommendation of the OPB report for legislation and the minimum basis which was proposed for the protection of early leavers' pensions. At this point I would like to return to my early comments about the lack of pressure from members of pension funds for improved benefits for leavers. The OPB report contains the statement that "trade unions have in the past been concerned mainly in negotiating with employers
on behalf of their members currently in the employer’s service who by definition were not yet early leavers”. This is a true statement, but members currently in the employer’s service are by definition not yet pensioners either, and trade unions have negotiated tenaciously and successfully for improvements in pensions.

There can be no doubt that the mechanisms exist by which employees can exert pressure for improvements to their pension funds. We cannot tell whether the fact that these mechanisms have not been brought into action to secure improved benefits for early leavers has been due to ignorance among unions and employees of the problem or to an expression of priority for forms of benefit other that leavers’ benefits. However, now the spotlight has been turned on the problem of leavers' benefits we should leave time for a true expression of the wishes of pension fund members to emerge.

There isn't any agreed set of tests which must be passed before legislation is adopted as the solution for a problem but if I had to formulate my own they would include—legislation must produce either a more satisfactory solution than would arise in its absence, or it must achieve a solution more quickly than would otherwise occur—and it must be possible to formulate legislation which not only imposes a solution to the problem but which can be understood by those to whom it applies.

In my view the OPB's proposals for legislation on benefits for early leavers fail both these tests. The maximum loss of pension on a single change of employment occurs for a man aged about 50 after about 26 years' service. The proposed basis for legislation will provide partial protection in the form of 5% annual increases for all of his pension on changing jobs at A day plus 26 years. If this problem demands legislation, is it consistent that the worst manifestation of the problem takes that long for the legislation to provide its partial solution. And in view of the rapid improvements that have taken place over the last 15 years won't natural evolution solve the problem at least as quickly? Then understanding, perhaps I am wrong—the OPB clearly think I am and maybe others here this evening will think so too. However with the benefit of considerable experience of talking with a wide variety of trustees and pension fund members I don't think the calculation methods described in paragraph 7.17 will be understood. Imagine answering the direct question “Is my paid-up pension now inflation proof?” in front of a staff meeting. The first word would have to be “No” which is always a bad start and a full answer would go on to talk about GMP revalued at 8.5% but fully inflation proofed by the State, the balance of the pension entitlement being split pre- and post-A day, the latter being increased by 5% per annum from leaving to retirement age. There would also be adjustments to cover partial returns of contributions, benefits secured as a result of previous transfer values paid into the fund and voluntary contributions. All of this being dependent on the employer maintaining his fund in full force throughout. I doubt if this will inspire much confidence that early leavers are being protected. I also very much doubt if one member in a hundred, given all the necessary figures, could correctly calculate his pension at normal retirement assuming immediate cessation of employment.

I hope I make my point here entirely clear. I am in favour of change. But the proposed legislation would add to the administrative complexity of pension funds, it might encourage the acceptance of the minimum basis proposed, it would not be understood by pension fund members and without all pension funds taking action well in excess of the required minimum it would not solve the problem it addresses.
In conclusion, I welcome the OPB's report, particularly for drawing out from comparative obscurity an issue which I feel hasn't until now received the attention that is due. I hope though that changes to pension fund design will occur in response to educated pressure from members and their unions and not through legislation.

Mr. A. Neill:—I have been particularly intrigued on what this OPB report would say as I had the privilege of being involved with the drafting of the Faculty-written evidence and I, with the then President and Past President, gave oral evidence on behalf of the Faculty. One of the problems of oral questions is to guess at what the consensus of the Fellows' view will be on any point raised rather than expressing one's own view. However, tonight there are no such inhibitions and one can express one's own view.

I realise why the OPB prepared this report but I think one also asks why is it that this one feature of benefit design has become so important. It is all very well to say they reported because they were asked to—anybody who has watched "Yes, Minister" is aware that they could easily arrange to get asked to make reports if they wanted to.

Presumably it is because a particularly glaring inequity has been caused by the customary practice or the statutory minimum requirement—probably these are much the same—and while this may well be, I would myself think that there are plenty of other aspects of benefit design which could equally well be looked at. It seems strange, for example, that the Government and the OPB seem to take no real interest in the fact that an employer can set up benefits for himself and/or for his senior executives and ignore completely the remainder of the staff, or can have considerably higher benefits for themselves.

Again a final salary scheme does seem intrinsically to be a desirable type of benefit structure but for those who are given a considerable increase in salary quite close to retirement, perhaps from promotion, it seems strange that they should be given a much higher benefit during all the time of their retirement because of a higher salary which they may have received for only a short time. This may happen for example in the Armed Forces where a General or Admiral will only be such for, say, two years and yet will retire on a considerably higher pension than a Lieutenant-General or a Vice-Admiral whose pension is itself considerably greater than a Major-General or Rear-Admiral. I have a feeling that average salary benefits revalued (in some way) are really faire—although administratively a problem.

When considering leavers' benefits the OPB also seem to take a carefree view when transfer values become involved. Whereas a scheme itself which provides a widow's pension must provide as a preserved benefit a pension and a widow's pension once a transfer value or, apparently, a payment to an Insurance Company is made under this new Section 32 of the Finance Act (although this has still to be clarified) the type of benefit can be changed completely, and in these circumstances I feel that a widow may have a very reasonable cause for complaint against the trustees of the scheme, and the OPB, if she loses out.

You can have a properly funded scheme where the assets representing the directors' benefits are transferred into one of these small self-administered schemes which can seemingly make some pretty dodgy investments, and the security of the benefits could be considerably reduced. This doesn't seem to worry the OPB but I feel it should. Again a transfer out from a proper fund could be made into a unit-linked type policy and the units
chosen could be invested in some pretty chancy shares but the OPB do not seem to be worried.

It is sometimes said that because rates of interest have for some years been high, and higher than the rate of interest assumed in the funding assumptions for the pension arrangements, that considerable excess interest has been generated and that if a scheme does not increase pensions' payment they are being robbed. I accept that this is one way of looking at the investments and income of a pension scheme but my own view is that due to the requirements of matching, the assets of the scheme are theoretically in separate parts—one part of the assets for the pensions in payment, one for deferred pensions and one for the active members. When a member reaches retirement then the assets representing his pension entitlement according to the rules of the scheme should really be matched with the likely outgo of pension and as the pension is paid, at least theoretically, there is a sale of these investments to meet the payments of pension. If in fact there are high rates of interest then this has no effect if the investments have been properly matched to the outgo, and if they have not been properly matched and are invested longer then in fact high rates of interest, because of depreciation, will mean that the investments will not actually meet the pension in payment.

Much the same argument I think also applies to the investments for deferred payments, the entitlement for pension being established at the time the person leaves and the investments made for these so that it is only really the possibly higher rate of interest earned by the reinvestment of the income from these investments that will give a higher investment return on the assets held for the deferred pensioners, it is not the interest income itself.

However I wouldn’t like my comments to be understood as being unsympathetic to leavers. In fact I feel particularly sympathetic to those who suffer redundancy. I am also, though, sympathetic towards employers who may feel upset about a valued employee leaving, perhaps to a competitor, without also having to grant a generous preserved benefit.

I have a feeling that redundancies are really the State's responsibility, particularly on the liquidation of an employer, and that there should be some way that the State should make up the preserved benefits for those made redundant due to excessive rises in the cost of living which are basically the State's fault.

Incidentally I liked, though I don’t really agree with, Mr. Peter Shore’s phrase last week at the NAPF conference when he accused the pensions industry of providing "lightly sugared" rather than "preserved" benefits.

One of the things that bothers me is that the apparent equity of money purchase schemes and the way they seemingly solve the problems of early leavers may persuade some employers to change to this type of benefit which I would see as a retrogressive step.

I think that one of the problems if schemes voluntarily increase deferred pensions is that if a scheme does take this seriously and changes the rules of the scheme and then when legislation comes along in a year or two they will then have to be sure that the amendments they have already made comply with whatever the legislation is and it may well be that in some minor point this does not occur. Frankly I don’t really see many schemes voluntarily increasing the benefits with or without the threat of legislation particularly at a time when funds are limited—it is really the employers who are going to have to find the extra money. It is really a political
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decision and if it is desirable for deferred pensioners to be given bigger
benefits even at the expense of stayers and pensioners then let the govern-
ment legislate.

Two points to end with—I don't really see why franking and relatively
high employee's contributions for low benefits were allowed in the first
place; and on one other point I think the report is too cautious. This is in
suggesting that somebody who retires early from his last scheme should
have any preserved benefits from other schemes also paid early but that
this should not be obligatory—I think it should be.

Mr. R. J. Amy:—Members of Occupational Pensions Schemes can be split
into two distinct categories, active members, and members who are no
longer active whose benefit rights have been established. I would argue
that equity is best served if the second category of members, which consists
of pensioners and deferred pensioners, is considered as a whole. Why
should the fact that the benefit is in payment be significant, particularly as
it is common practice for Trustees to permit deferred pensioners to draw
their pensions at any time after the age of 50?

The OPB in their report have considered the lack of protection of
pension rights for employees who change jobs. This is one aspect of the
more general problem that U.K. occupational pension schemes do not
adequately protect against inflation, pension rights which have been
established. By addressing themselves to only half the problem the OPB
have in my view given insufficient emphasis to the implications of their
recommendations.

The Board have compared early leavers with stayers considering them all
as "active workers who are building up pension rights for their retire-
ment through differing career paths". This approach leads to the
recommendation that final salary schemes should aim at increasing
preserved benefits broadly in line with the movement of national average
earnings. However, early leavers cease to be active as far as their former
employers are concerned, and in this respect are no different from pen-
sioners. It would seem to me more logical to encourage final salary schemes
to fully maintain the purchasing power of deferred pensions by increasing
them in line with the movement of prices. This would be consistent with
public sector index-linking and I would suggest that the differentials which
are likely to be maintained between stayers and leavers would make the
protection of deferred pensions more acceptable to employers and active
members.

I cannot support the OPB's recommendation for statutory revaluation
at 5% on the grounds that it is totally unacceptable to provide a more
generous level of protection for deferred pensions than for pensions in
payment. To extend the guarantee to pensions in payment could be
prohibitively expensive if schemes felt obliged to protect existing pensions
and deferred pensions and service before A-day for future leavers.

It is difficult, however, for early leavers to apply pressure on former
employers, and I believe that some legislation is necessary as a contribution
towards a solution of the early leaver problem. A sensible initial approach
would be to extend the preservation requirements to ensure that if a
scheme provides protection for pensions in payment then the same increases
must apply to deferred pensions and vice versa. Such legislation combined
with the abolition of franking would provide a good foundation for volun-
tary action.
Mr. C. W. F. Low:—There are two issues in the OPB report to which I would like to refer—one being basic preservation for early leavers and the other franking as already referred to by Mr Neill. I regret to say that I disagree with Mr. Neill in his comments regretting that franking was allowed in the first place. I think we should remember that both in 1978 and now the pensions industry has a lot to be proud of in having persuaded employers to bring in voluntarily a substantial level of retirement income. As I understand it, the State Scheme introduced in 1978 was to provide a reasonable degree of retirement income for those employees unfortunate enough not to be provided for already by their employer. We cannot expect employers to provide the best parts of both occupational and State Scheme. I therefore strongly disagree with the OPB recommendation that franking should not be allowed and, more strongly, that it should be done away with retrospectively. If there was a time for this argument, then it was in 1978 or, more accurately, in 1975 before contracting-out started in 1978. The contracting-out terms which were then given by Government and agreed to by the pensions industry were that if you had a scheme which was good enough, you were allowed to contract-out, and all that you had to provide was an underlying guarantee that at no point of time would the terms of your scheme be worse than the State Scheme. I therefore contend that any retrospective alteration to these terms by means of any anti-franking legislation which is retrospective is contrary to the assurance that the then Government gave that there would be no retrospective alteration to the contracting out terms.

Turning now to the early leaver and the 5% revaluation. Surely we should also remember that before preservation was introduced in 1973, it was virtually universal for pension schemes to grant preserved benefits to the involuntary leaver—not just those over age 26 or with five years service—but preservation right down to the ground for those dismissed through no fault of their own. I do not think it is a coincidence that it is during a time of high unemployment and a severe rise in the number of redundancies that attention has turned to the problem of the early leaver. These problems arise principally from the involuntary early leaver. In 1973 the Social Security Act took away the differential between the voluntary leaver and the involuntary leaver by giving the voluntary leaver preserved rights. I am sure that employers, when they can afford to do it—and admittedly now is not the time—will be prepared to grant some form of revaluation to the extent they can afford for the involuntary leaver. I therefore strongly disagree with the OPB's contention that they cannot differentiate between these two categories. I know that there are severe practical difficulties in the differentiation area—more often than not the employer will err on the side of generosity. I think employers will take this action with their eyes open, seeing that having granted revaluation on preserved benefits to the involuntary leaver, and actuaries having funded in case all leavers are involuntary, the media and others would be able to say that in not granting revaluation on the preserved benefits of the voluntary leaver, something was being taken away. Let us all be prepared to take a stand and say “no, something is not being taken away—we are merely protecting those who leave involuntarily”.

Mr. G. M. Murray:—A person changing jobs generally does so because there is some advantage for him, not necessarily financial, and the new employer is generally seeking something special that the new employee has to offer, such as experience. I therefore find the solution to the preservation problem set out in the OPB's report quite hard to accept. May I say here,
however, that my criticism of the proposals relates only to voluntary leavers; like Mr. Low, in the case of involuntary leavers I would go along with the OPB report—in fact I would prefer preservation in line with pension increases for the relevant scheme, which may be more generous than the OPB report.

The case of voluntary leavers, I think, is quite different. I do not believe that job mobility has been significantly hampered by present arrangements, and so the suggestion that mobility would be improved by placing an uncalled for burden on the old employer to me is quite inequitable, however much it eases any administrative problem. I think the figures and statements from Mr. Stretton earlier in the discussion were quite important in this light, showing that the majority of leavers will arise at an age where the pension problems will probably be insignificant. Nevertheless I am sure many employees do consider the effect on their pensions when changing jobs but, in order to be certain, I would go along with the suggestion in the report that would make it a standard procedure at the time of a move that pension benefits become part of the negotiations—partly with a view to placing more of the burden on the new employer. I find it inconceivable that leavers around the age of 50, which Mr. Stretton also referred to, wouldn’t consider pension rights, but once again in order to be on the safe side I think they should be forced to consider them even though other factors will come into the scene. As I said earlier, the new employer is acquiring skills where the training has been paid for by someone else and some form of transfer fee is justifiable. In principle I would place the burden of preservation on the new employer. He should grant back service benefits in terms of his own scheme equal to any years of back service entitlement that the person joining has already built up in the previous employer’s scheme. A transfer value in terms of the other scheme’s valuation basis should be compulsory with a full allowance for any under-funding but the ability to pay the transfer value, or at least the under-funded portion, over a period of years—say ten. I know I have not had to deal with drawing up the full details of such a scheme, but in spite of what is suggested in the report I am sure it could be done in a way which, although not perfect, would be much more equitable and generally acceptable than the proposed solution. As an aside, I was astonished that, in spite of the extensive survey of other countries, none of which seemed to place the burden of the problem on the old employer, the report skated over this. There may well be historical and other reasons why the previous employer was so favourably treated, but I’m quite sure equity was an influence.

Mr. R. K. Sloan:—The report of the Occupational Pensions Board deals with the rights and expectations of early leavers, but I believe that the problems discussed apply much more generally than would appear to be suggested in the narrow classification of “early” leaver, in that loss of expectations can occur after periods of pensionable service of 25 years or more. Mr. Stretton made this point himself in his opening remarks. My hackles were rising rapidly at the remarks of Messrs. Low and Murray, so I would include all leavers in my subsequent remarks. I see no reason to discriminate in favour of redundancy. If we take it that the term “Rights” equates to the promises made in the Scheme Rules, then I would like to begin by quoting from some remarks made recently by the U.K. pension manager of a large multi-national company.

“If we accept that there is generally no failure to meet the promise, the question we must ask ourselves is, therefore, has there been a failure to fulfil
expectation? Or, put another way, are expectations different from the promises or have levels of expectation risen, or been allowed to rise, above the promises made and kept? In my view this is a critical point, for there can be no doubt that failure to fulfil expectations leads inevitably to bitterness and frustration and a feeling of being cheated; and, like it or not, it is on this, as much as on the ability to deliver the promised benefit, that our pension plans will tend to be judged by the employees and their families."

Expectation on the part of scheme members is therefore very much subjective or perceived. It is sometimes further reinforced by use of the term "deferred pay", an expression much loved by trade union negotiators. However, I would suggest that the principle of deferred pay, again as referred to by Mr. Stretton, is nowadays a fairly meaningless concept in the context of final salary pension schemes where company contributions are allocated only in aggregate, rather than separately on behalf of individual members. Despite this, the notion of deferred pay continues to be fostered by expressions such as "you may be granted the pension secured by the company's contributions" which appear in members' explanatory booklets.

The idea of deferred pay suggests the concept of the money purchase approach as an alternative to final salary schemes. Although it is frequently argued that money purchase arrangements cannot hope to achieve realistic benefits in times of inflation, we nevertheless all know that no scheme can provide, in total, over the longer term, benefits greater than are supportable by the funding contributions plus interest. We are therefore faced with the question of how best to allocate the finite resources available. I for one do not accept that a final salary scheme is necessarily the only answer.

It is possible to operate a money purchase scheme with clearly defined final salary benefit objectives, with individual funding rates calculated for each employee. If overall experience proves to be adverse, then the benefit expectation will tend to diminish unless further resources can be made available. This contrasts with the final salary approach where the employer must apparently make good the deficiency, leading perhaps to the current situation where insufficient resources are available to maintain the real value of pensions in payment, let alone to consider the plight of early leavers.

This leads me to quote again from the lips of the same U.K. pension manager mentioned before, who says:

"Whatever the amount of money available, the benefit structure of the plan is merely the instrument of distribution of this available resource among the members. At present this resource is applied through benefit structures that raise the expectations of the members while apparently failing to fulfil this expectation for those who have changed jobs and for those whose fixed retirement pension is whittled away by the savage effects of inflation. If there is not sufficient resource to improve existing benefit structures to the point where expectation is more nearly fulfilled, would it not be more realistic to reshape our plan so that the target, and hence the expectation of the members, is lowered but at the same time to apply a greater share of the total available to improve both the benefits for those who change jobs and the real value of the pensions in payment, albeit on a lower target benefit."

I seriously believe that pensions have, in general, been oversold in this country in nominal terms in the past. For example, if we take the case of a married male employee with 40 years potential service in a typical 60ths non-integrated final salary scheme, then even at a pay level of about 1.5
times national average earnings or, say £9,500, he is likely to receive overall net pay replacement in retirement of about 100% of his current income in employment net of tax, national insurance and pension contributions. It is, of course, often argued that few employees achieve 40 years pensionable service, but this is surely no justification for a badly designed benefit formula. Also, it is ironic that several million public servants are provided with potentially excessive benefits on this scale, thereby lending added point to the U.K. pension manager's earlier remarks regarding a lower target benefit.

Next, franking of revalued GMP. Here I would agree very strongly with Mr. Neill and disagree most vehemently with Mr. Low. I think the practice of franking can only be described as iniquitous. Although it has not yet proved to be too great a problem, it will become so increasingly as the proportionate value of GMP grows. The extent of this potential problem is well illustrated by the case of a 60ths final salary scheme which this time integrates with the single person's basic State pension. My calculations indicate that for members aged under about 40 in 1978, who leave service before the age of about 50, the majority would probably have been better off had their private pension scheme been wound up completely in 1978. In other words, their revalued GMP earned after April 1978 is likely to absorb more than the full scheme benefit earned in respect of service going back anything up to 15 years or more prior to 1978.

I of course appreciate that full franking of this kind is not universally practised. Nevertheless, an industry that is prepared if not exactly to recommend, but certainly thus far to condone, this practice, has hardly demonstrated its right to be allowed to apply self regulation in anything approaching a responsible manner. I therefore regret to conclude that legislation would seem to be essential to protect the rights of pension scheme members, not necessarily in the precise form proposed in the report.

Finally, if I have perhaps seemed fairly liberal in my criticism, then I should in fairness also offer a possible solution to some of the problems exercising our minds tonight. As one who is a member of a final salary occupational pension scheme financed by a company of which I am a major shareholder, I am only too well aware of the various potentially conflicting interests that can arise. Briefly, our own policy is to award increases to pensions in payment for retired employees on an ad hoc basis, taking account of the inflationary needs of the retired pensioner and also the resources of our pension scheme and our company. We have then agreed to provide increases on deferred pensions for ex-employees at two-thirds of the rate awarded to our retired pensioners, although without any commitment as to the extent of any future increases. This is a variation of what was suggested earlier by Mr. Amy. I believe this to be an equitable and realistic solution which does not impose open-ended financial obligations on the employer and yet satisfies some of the worst fears of the many of us who are potential early leavers.

Mr. J. M. MacLaren:—Mr. President, I am sorry to begin on a discordant note by accepting the main recommendation of the OPB but in recommending limited statutory revaluation, I feel that the Board has given the only sensible answer. Without legislation there is no likelihood of schemes generally making the necessary improvement. The majority of the Board have chosen 5% as the upper limit of mandatory revaluation to ensure that the cost is reasonable and this makes their recommendation an immediately practical one. As I see it, no new principle is involved—simply a significant extension of the 1973 Act requirements. The burden of revaluation has to
Lie with the old employer's scheme because it is unrealistic to expect a new employer not to be influenced in his recruitment policy by any requirement to revalue pension from a former employment. Also, of course, there may be no new employer. Transfer values should always represent realistic valuations of the benefit that the fund would otherwise pay but the idea of compulsory transfers of normal reserves is much too costly to be taken seriously.

I should, nevertheless, like to voice disagreement with some of the report's proposals. For example, I feel the retention of age 26 as the minimum age is sensible because by limiting numbers it reduces administration and of course it avoids preserving pensions for those who can qualify for full pension in a new employment.

Of somewhat greater moment is the Board's view that escalation should be limited to leavers after A-day. This unfortunately fails to tackle the major injustice of the current situation. It would, I agree, be unrealistic to make funds shoulder retroactive increases but on balance I believe it would be reasonable to require increases in existing 1973 Act preserved pensions in respect of the period between A-day and retirement.

My most serious disagreement with the Board is on the question of franking. There is, I believe, no good reason for schemes to be required to revalue part of the scale benefit at 5% and the other part, the GMP, at 8.5%. The GMP after all is somewhat capricious in its amount being most favourable to those who happen to stay close to 1.5 times national average earnings. Provided the scale pension revalued at 5% exceeds the GMP escalated at 8.5%, there seems no reason to introduce the inequity inherent in the GMP. Furthermore, by removing this unnecessary luxury from the Board's proposals, there will be a significant saving in the comparatively small increase in contribution otherwise needed. This idea would be helpful in allaying the doubts of those who regard even limited revaluation as too costly.

Much has been made by the opposition to legislation of the so-called "knock-on" effect. This in my view is a fallacy. There need be no knock-on effect at all. The fact that the typical job changer may now receive perhaps 85% of the stayer's pension, instead of 75%, is no reason for altering the present arrangements after pension age. It is entirely logical to regard the rates of increase as completely independent. The fact that some schemes may not be able to afford 5% increases in pensions in possession is not a valid reason for perpetuating substantial inequalities between leavers and stayers.

Mr. President, we now have a new Secretary of State for Social Services and I hope the message from our profession will be "go ahead with legislation—not at some indeterminate future time, but now!"

Mr. C. M. Stewart:—I think we might usefully ask ourselves why it is that the expectations of early leavers are not being satisfied, which has led the Occupational Pensions Board to recommend legislation to cure the trouble. I would agree with the Board and with others who have suggested that legislation will be necessary because it is the employer who foots the bill for pension schemes and employers are very hard pressed at present. I do not think there will be a great rush to volunteer to improve this or other aspects of pension schemes in the present difficult times.

Now, how did these difficulties arise? When the final salary scheme was invented it seemed a good arrangement providing a level of pension or deferred pension reasonable in relation to the final salary. Its value was not subsequently eroded by inflation and the contribution rate was tolerable, calculated as it was on a 3% or 4% interest basis. The effect of
inflation has been that for those whose final salary is still to come the expected pension is still reasonable although, for many employees in the public and the private sector whose earnings are falling behind, the outlook is not all that rosy but at least the position is clear as far ahead as retirement. This is more than can be said for those whose final salary is somewhere in the past, where prospects are both poor and uncertain.

Inflation does not, of itself, increase the cost of a pension scheme—this happens as a result of protecting the values of pensions and deferred pensions which is the general rule in the public sector and not infrequent in parts of the private sector. The effect of the Board’s proposals for early leavers will be to increase the cost of pension schemes to employers, significantly so for schemes in the private sector where similar increases are not already the custom for pensioners. Is there any alternative? As I see it there isn’t, if the rights of early leavers (and pensioners) are to be improved to meet expectations and, until they are improved, the final salary scheme will be a less than satisfactory instrument for providing pensions.

It may be that if employers have great difficulty in meeting those extra costs this can be interpreted as indicating that, as a nation, we are setting our sights too high in aiming to provide fully preserved and inflation-proofed pensions of two-thirds of final salary at a time when the real rate of return on investment is inadequate for this to be done at reasonable cost. If we sought to avoid the extra cost, as one speaker has suggested, by cutting the target pension to something lower than two-thirds of final salary, I don’t think that would be popular. In my view it still would not diminish the need for legislation to improve the benefits of early leavers.

As the Board chose the evolutionary road rather than one which would disturb the present arrangements they propose only straightforward amendments to the rules of final salary pension schemes, which it seems to me must always tend to apply such resources as the employer makes available in securing first the benefits of those on whom the employer’s business depends. However, if the concept of pension rights as deferred pay were to be accepted and the joint contributions regarded as belonging to the individual employee and credited to him whether he was a stayer or an early leaver, then this would at least remove the contest between the early leaver and the stayer which the latter must always win if the employer is the paymaster. The individual would no longer have the apparent security of building up rights defined in terms of final salary yet to come but if that were thought to be a serious loss, illustrations of the accrued rights could be given without much difficulty and those rights would be the same whether an employee chose to stay or to go and if at the end of his working life the amount standing to the employee’s credit was not enough to purchase a fully inflation-proofed pension, at least he would know what it would purchase which in my view would be better than the present uncertainty for people retiring. Moreover, with a first tier of pension provided by the State, including the additional component, fully preserved and inflation proofed, topped up by an occupational pension which reflected what money invested would buy, the total pension would never be wholly unreasonable.

Mr. President, this is not really the occasion for me to dwell on these wider considerations and to describe for example how I would see the public sector fitting in with remarks which might appear to apply more directly to the private sector but I have personally felt for some time that we are gradually being forced into a fundamental reappraisal of the methods of providing pensions in this country and the controversy over the Board’s proposals for early leavers reinforces me in that view.
Mr. P. J. F. Taylor:—I work for a nationalised industry and most of our employees are members of pension funds which provide for benefits to be index linked from the point of leaving our employment; in other words whether the pension is in payment or not. On the face of it, we might seem to have nothing to fear in any compulsory benefit uprating which may result from the OPB’s report. Unfortunately it is quite possible for the method chosen by the OPB, namely Section 21 Orders subject to a maximum of 5%, to give a bigger answer than the method that was chosen by us quite a long time ago, namely retail prices index with no maximum. Thus what could happen is an extra layer of complication, an extra layer of red tape and wasteful administration could be forced on us. And this is despite the fact that, in principle, we already provide for benefit uprating for our leavers at a reasonable and I believe logical level. I think there is a lesson in this. It is a typical example of what is likely to happen if nothing is done by the pensions industry of its own volition and eventually something is forced on us by statute. We have already had a warning in the complicated "preservation" legislation, which required several statutory instruments in addition to the original Act to sort the thing out. We have had to digest enough legislation in the least ten years so let us not invite any more. I urge the pensions industry to take voluntary action to protect early leavers before it is too late. It worries me that many of the articles I have seen in the press and other places have concentrated on the perfectly good reasons why nothing can be done for the time being. That I suggest, Mr. President, is the way to inflexible, bureaucratic compulsion.

Protection against inflation is expensive of course and if it is true that no further resources are available then the answer may well be to provide 80ths with some form of inflation protection instead of 60ths with none. In my industry we provide 60ths but fully integrated with the basic state pension and I very much doubt if this costs much, if any, more than the non-integrated 60ths with no inflation protection which one often sees in the private sector. There may be resistance to what is seen as a nominal cut in benefits but cuts in future service accrual have happened in the past, even in the public sector. Given the choice myself I would certainly choose the smaller starting pension plus inflation protection. In that I should be joined by many trade unionists whom I know, and also I believe by many fund members whom I do not know but who voted with their feet when they elected to transfer from a scheme which gave 60ths with no inflation protection to the scheme I mentioned giving the integrated 60ths with full protection (although I should say that there were other considerations involved).

On a slightly different tack may I make a plea against setting an arbitrary fixed limit on inflation protection? There are many schemes which provide 3% or 5% increases irrespective of inflation. In the report a 5% maximum is canvassed. Inflation has been 20% in the past and I see no reason to suppose it will never reach that sort of figure in the future. It does not take long with that sort of inflation to make inflation protection at the 5% level little better than no protection at all. If we must have a maximum then let it be related to the investment yield. For example, the maximum might be 3% less than the investment return. Obviously the phrase "investment return" in this context would need to be defined and the figure of 3% is obviously negotiable. I do not propose to go into the possibilities this evening. However, I believe the principle is a sound one.

If I may summarise, I believe that consideration should be given to reducing future service accrual to pay for some sort of inflation protection. I suggest that the job should be done properly and that we should not have
an arbitrary limit on this inflation protection. Lastly, and most importantly, I believe action should be taken voluntarily before it is forced on us.

Mr. C. B. Russell:—Several speakers have mentioned that the problem of preservation is thrown most sharply into focus by final salary schemes. I believe that final salary schemes themselves are an absurdity and are inequitable. What more absurd situation could there be than that where an employee works for a lifetime, contributes for a lifetime and yet his pension is entirely based on his earnings during a period when he has no negotiating power because of impending retirement. That is, I believe, the true situation. Now that might sound rather theoretical but I have recently dealt with a scheme where no salary scale was built in, the previous actuary using a single percentage to cover both salary inflation and salary scale, so I thought it would be right to consider putting in a salary scale. So I worked out the experience and the salaries reduced quite substantially as pension age approached. I believe that employers, whether consciously or not, do allow salaries to drift below inflation as retirement approaches and I do not believe that voluntary change is possible. In most big companies even now people reach senior positions fairly late in life and it is entirely in their interest to maintain continuance of the present situation. I believe, therefore, that some form of statutory intervention is necessary.

The OPB have made a start, however small, and I believe that if we do reach a situation where preserved pensions are based on the accrued with some reasonable degree of inflation protection, then final salary schemes will die out in favour of inflation-linked average salary schemes because employees will be in a position to build their own average salary schemes by changing jobs.

I now turn to a particular question which has been discussed very little outside this Hall but I am pleased to see that it has been mentioned a great deal tonight and that is the question of franking of GMP increases against accrued benefits. Like some previous speakers, but not all, I believe the present situation is totally inequitable. It is argued by those who say that legislation should be avoided, that pension schemes are voluntary and if there is too much legislation there will be less pension provision. There are many people now leaving pension schemes who would be in a better position had the schemes not existed. This can arise because an employee may well have paid a significant contribution rate perhaps for seven or eight years and end up with no more pension than the contracted-out benefits for which he would have paid 2.5% since 1978 had the private scheme not existed.

Finally, Mr. President, can I put to you a small personal, professional and ethical dilemma which arose? What happens if the employee, an actuary, approaches a new employer and knowing the preservation situation makes demands as to his pension. The employer asks for the actuary’s advice as to whether he would be a wise employer to grant the demands and what it would cost. It is well known that a professional man in giving advice has a duty of care to any person who may be affected by that advice. In this situation the third party is himself. Is his duty of care greater to that third party, namely himself, or to the second party, namely the potential employer?

Mr. E. Short:—Mr. President, first of all I would like to thank you very much for the official invitation to this meeting and secondly I would like to emphasise I am speaking as a member of the Press and not as a Fellow of the Institute. This is the first discussion I have attended on the OPB report in which widespread and vitriolic “press bashing” has not taken place.
On my part I promise not to use the words "pensions swindle". I came here tonight seeking answers to two questions with which actuaries are fully qualified to deal and I am disappointed that so far they have not been dealt with. The OPB report specifically referred to cost—cost to employers—deducing the famous 1-2% of salary. Your colleagues in other sections of the pension movement have bitterly attacked that figure as a gross underestimate since the knock-on effect must be taken into account. The OPB has not, to my mind, fully justified its figure. Instead it refers the calculation back to the Government Actuaries Department, which in turn disclaims the ultimate responsibility.

Secondly, nobody has answered the question as to what funding rate employers should pay—what assumptions should be made in calculating that funding rate. The questions the Press have tried to ask, in between all the rhetoric, is what funding rate would have been paid if there were no early leavers at all; if somebody stayed in his job for the whole of his working life. Then should not this full funding rate be charged and allow the surplus to emerge when a person is an early leaver. Because if this was so, then to my non-actuarial mind, the problem of cost is solved; the employer knows at the outset what the cost of providing his pensions are and the early leaver profit is a bonanza. Nobody has yet answered that question in spite of all pleas to the contrary.

Finally, I am very pleased to see that one actuary in the Hall supports my view that the whole pension scheme system needs to be revalued and looked at afresh. I said this when I first wrote on the OPB report and I was taken to bits—very scathingly—by a leading member of the pension movement who said I was most unrealistic. We are back to the situation in the old Irish joke—if I was going to a certain place I wouldn't start from here. The fact is that we have final salary schemes, whether we like it or not and we cannot change that. But I would only re-echo a warning given by Ken Thomas of the Public Service Union at another meeting discussing this report. He emphasised that if the pensions industry did not solve the twin problems of revaluing pensions in payment and those of early leavers then employees will look for other solutions—possibly an enlarged State Scheme.

Mr G. G. Bannerman:—I have rather a rag-bag collection of points which I feel have not been made in the discussion so far. The first is that a number of speakers have adopted the basic premise that inflation proofing is a necessary thing in a pension scheme and that, having accepted this, all that is necessary is to discuss how to implement it. I would beg to differ on this point. It may be that it must be done—if it is accepted that inflation proofing is itself necessary but here we have a circular argument.

I seem to remember some years ago in a completely different context, the report of the Chief Registrar of Friendly Societies (who was, I suppose, the original Insurance Ombudsman as far as industrial insurance is concerned) contained the rather nice comment that "the difference between the terms of a policy and what the insured thought the terms were seemed to be in proportion to the number of years which had elapsed since the policy was taken out". The bearing of this on tonight's discussion is that an employee's expectation is one of a pension in money terms—at least it is at the point of leaving service. He may have a picture in his mind of what that money will give him but if he has a long time to go before retirement he may well have forgotten what his expectation really was.

Certainly most of the examples which I have seen take the case of an
employee going from one job to another, and possibly to another after that, seeking promotion each time, and then saying that, had he stayed with the first employer all the time (and had been given the promotion, which he was not going to get and which was why he left in the first place) then he would have finished up with a much higher pension. This, I would suggest, is not going to be fulfilled by going to the OPB report basis and I do not think there is any justification in anyone expecting that sort of expectation to be fulfilled.

Turning to the next of my rag-bag of points, Mr. Sloan referred to the question of people under forty not being able to get anything out of a contracted-out scheme if they left before 50. I would certainly confirm this and indeed if you have a new scheme starting from scratch the position can be much much worse. I have investigated some figures where a 24-year-old would not get anything until he was 51—this was in a scheme where the contribution rate for the employee was 6%, compared with what he would have paid to the State Scheme, so he is certainly much worse off there. If the entry age was about 45 the break-even point before considering contributions went up to about 58. Looking at the various figures, if you have a 60th scheme an employee who joins at, say, 24 and leaves in 12 years' time at age 36 would have a pension of 20% of which the GMP might be about 8%. On leaving at 36 the value-for-money factor for 6% contribution might be about 35% or 40% already just about double the scale benefit but the GMP is 65%. If you give him what I have recommended in some of the schemes with which I deal, the minimum should be the GMP plus value-for-money of the excess employee contributions over the contracted-out level you are up to about 80% or more. If you give the full OPB recommendations, then an employee leaving after 12 years' service at about age 36 would need to get a pension of 120% of his leaving salary.

Now all of this is just application of compound interest. It must be applied if the pensions are to mean anything at the end of the day but can we really imagine employers accepting the idea that an employee leaving at age 36 should be guaranteed a pension 20% higher than his leaving salary?

On the question of cost, we have the famous "one or two per cent" mentioned in the OPB report. I think the answer is very obvious from the report itself where it is stated that 75% of leavers have less than 5 years' service and would never qualify for preservation anyway. If this is so, the OPB report—and all the fuss that has been made of it—is again not going to fulfil the expectations of employees. I think that this is one area where, if something does come in, the real knock-on effect will take place in a different area from that envisaged—the preservation period will become shorter and shorter and the cost correspondingly greater.

I would go on, however, on this question of expectation. We have talked about the employee's expectation but the employer also has expectations which are not fulfilled when an employee leaves and these are completely ignored. I would go along with Mr. Low and others who have said that they have the utmost sympathy for employees who leave in cases of ill-health, or redundancy, or no fault and, while I would support a measure of inflation-proofing for such cases, I do not support to the same extent inflation-proofing for the voluntary leaver.

Mr. A. U. Lyburn:—While I have not kept a count of those for or against legislation as recommended in the Report my impression is that those for are in the majority. I would like to record a vote against—at least for the time being—on practical grounds. First, I understand the Government has
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stated that there is little prospect of legislation on this topic in the present Parliament. We therefore have two years, perhaps quite a bit longer, for the pensions industry to put its house in order to the extent that the majority consider is necessary. The second practical point is that of complications as already mentioned by Mr. Taylor and by Mr. Bannerman. May I add to their warnings by reading from a telex I have received from Canada today. An Ontario legislative taskforce on pensions has just reported and one recommendation is “the employee’s share of benefits on termination should be at least 50%”. All right so far, but it goes on “a terminating employee should also have the right to transfer at least 50% of the total benefit to a retirement benefit plan of his own choice”—something like the section 32 provision in our 1981 Finance Act. That however is not all, the recommendation continues “any benefits left in the plan should be augmented by interest earnings in excess of some unstipulated rate”. The implementation of that would certainly add to our problems.

On the question of franking I would like to try and redress the image that some are creating. In my opinion franking was not given sufficient consideration in the run-up to 1978. I think it has crept up on us and with the benefit of hindsight many of us would have been given different advice. That does not mean however that franking should necessarily be abolished. What I would concede at present is that there is no justification for franking which impinges on benefits secured by employee’s contributions in excess of the employee’s contracting-out reduction.

Mr. E. James:—I am Report Secretary of the Occupational Pensions Board and I have been very interested in listening to all this feedback on the report which I must admit that I drafted. I am to that extent a biased observer but of course I must emphasise that I must simply describe and try to interpret the views of a board of 14 people. This is an independent board with 14 people drawn from many different walks of life and representing the trade unions and the occupational pensions industry; actuaries, lawyers, people from big schemes and small insured schemes, so what we have here is not a Civil Service view—it is a view of one or two representative groups of people, not a random sample, but people who represent a broad range of views and so must be taken seriously as an expression of fairly authoritative opinion. I must admit too that although I am a civil servant I have a certain emotional involvement in this because I am myself an early leaver, having only joined the Civil Service a few months ago. In fact I joined after all the research had been done on the report and I was simply involved in writing it up. I am thus very conscious of the fact that it is very difficult to say who is a voluntary early leaver and who is an involuntary early leaver. People change jobs for a wide variety of reasons. They often have pressures upon them because of the children’s schooling or because of relatives or all sorts of other reasons that they may have for changing jobs and what may look like a voluntary change from the employer’s point of view may be a rather reluctant change from the point of view of the employee. Also our report was specifically not only about people changing jobs.

The remit given by the Secretary of State talked about changes of employment but the Board deliberately referred to any people leaving employment for whatever reason before retirement age and this includes, for instance, women leaving work to set up a family. In fact in the Guardian this was referred to particularly as a report on rights of women. We hadn’t thought of it particularly in this way but this is the way that the public saw it. This report also covered people giving up work to take
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further training as well as people who left for other employment or because they were unemployed. So it covers a huge range of reasons for leaving a particular employment and for this reason we felt that it would be invidious to try to classify who was the involuntary and who was the voluntary leaver or to put it in another way who left for a laudable reason and who left for a frivolous reason. These things would be so difficult that we were not attracted to the line of trying to discriminate between deserving and less deserving early leavers. The main object of the report was, as the report says, to focus attention on this issue and to prompt action and the major action was to be left, hopefully, to voluntary initiative. Remember that the Board recommended that schemes should revalue early leavers' benefits up to section 21 orders by voluntary means and the statutory coercion should only be up to a level of 5%. So it's mainly on voluntary action that the majority of the Board pin their hopes. They also accept that there is unlikely to be legislation within the term of this Government. The Government have expressed their full support for the objectives of the OPB report but it seems clear that they are not at the moment contemplating legislation; so to some extent recommending legislation would not have been productive of immediate action because the Government clearly wasn't sympathetic with this. But even so, the Board's objectives are being realised by events such as this tonight and events that have taken place like this in other halls throughout the United Kingdom. The Board has focussed attention on the problem of the early leaver and tried to create a situation where for future discussion and in particular negotiation on pensions the early leaver aspect cannot be left out of account as it has been in the past. But I think if we had not recommended any form of legislation you would not have had the same discussion and debate and to some extent by merely mentioning legislation you get the talk going in a way in which simply referring the matter to voluntary action might not have done. Also the Board did have the general view that a certain level of legislative coercion was necessary. Legislation is rather like Heineken beer—it gets to the parts that other action cannot reach—and we repeat particularly to the more obscure corners of the pensions world where there is less sympathy for the early leaver and more attempt to take the scheme at the lowest possible cost without worrying too much about the equity of the spread of benefits.

I have been very much struck by the fact that almost everybody watches "Yes, Minister"—it has been mentioned to me in a number of telephone calls I have had and it seems to be believed that the OPB can choose the topics of its own reports. If you watched last Tuesday's episode you would see it was the Government manipulating the independent enquiry not vice versa. The Board is not in a position to choose what remits are given to them. They are a body which can speak when it is spoken to and doesn't have any standing otherwise. They happened to be given a report on early leavers and were expected to produce this report within three years and so they produced this report on early leavers. They did not produce a report on pensioners because they were not asked to give a report on pensioners. However, simultaneously or almost simultaneously with the early leaver report they were also asked to produce a report on the security of members' benefits or rather security of members' rights and expectations in occupational schemes. This was a longer term remit and accordingly most of my time is now spent working with the Board on preparing this report which should see the light of day next summer, roughly the anniversary of the present report. This will indeed cover a wide range of topics such as the problems of schemes that wind up with insufficient resources, the problems of maintaining the real purchasing power of benefits in
payment and quite a range of other things which the Board has been criticised for not commenting on the last time. So I can assure you that there is another instalment coming and before you have got tired of talking about this report, you will have another report to consider.

The Board has been accused of not giving simple answers but in fact a lot of the problems of explaining the Board’s proposals to scheme members arise from the complexities of occupational schemes themselves and we are faced with a situation where there is a guaranteed minimum pension which exists within the wider shell of total pension rights and there are problems about transfer values and this sort of thing which the pensions industry must sort out itself. The Board I think has tried to take the simplest solutions about transfer values. Largely because the whole problem of working out equity in transfer values seems to be so daunting they fell back upon the idea that if you improved the right to a preserved pension then transfer values should automatically improve as well—the transfer value usually reflects the value of the benefit that would otherwise be paid by the scheme. It might in fact be much more equitable to have a system of obligatory transfer values and oblige the transfer value to take account of the years of service—but I think this would eventually be a much greater burden on the old employer than merely a limited revaluation of the preserved pension rights and it would be much more difficult to legislate for. It would bring us into the area of setting actuarial assumptions, fundings standards etc.

On the matter of costs, the castings of 1-2% are based upon the experience of one large scheme in the private sector of which the Board has some knowledge and the calculations were made by the Government Actuaries Dept.—it came between 1 and 2% and that is the figure that was published. If the arithmetic is challenged it is the G.A.D’s arithmetic. I think that the scheme in question is not an unusual scheme. It has in fact a slightly higher early leaver rate than the average for large schemes but of course it is simply a model scheme and every scheme will be different. The cost will depend upon the age at which people normally join the scheme and the sex structure of the scheme or the types of benefits that are given within the scheme. Finally as regards more radical solutions the report has a chapter on more radical solutions, some overseas schemes were described because they were examples of more radical solutions and moreover examples where there has been much greater co-ordination of occupational pension schemes, much greater centralised control either through Government or by, in the Swedish case, the equivalent of a combination of the CBI and the TUC. The Board said that unless the problem of early leavers could be resolved there was a strong case for introducing much more control and co-ordination of occupational pension schemes, either by Government or some other agency and that the present autonomy enjoyed by occupational pension schemes in this country could not persist. What the Board recommended was a minimum action which they thought was compatible with justice for the early leaver and without a major disturbance in the present structure of occupational pension schemes. It was left as an option that if this was not sufficient then a more thorough look at the way schemes are run might be required and we might move towards some of the solutions favoured in the countries listed in the Appendix—Scandinavia and France in particular. The report therefore concludes with a mild warning of what might eventually happen if the problem is not resolved.

Mr. T. Young:—It is very difficult, if not impossible, to summarise a discussion comprehensively particularly if your writing is illegible and I
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hope I can be forgiven if I concentrate on what I see as the main issues. But before I do so I would like to touch on some general observations that have been made, in particular observations made by Mr. Bannerman and Mr. Sloan in connection with expectations. It seems that paragraph 1.4 comes perilously close to accepting the principle that a contractual arrangement has two elements. Firstly the rights set out in the contract and secondly the rights in respect of one of the party’s expectations which are not set out in the contract. Now expectations are objective as has been said and can vary from one extreme to another and some of the early commentators were individuals whose expectations were of the most heroic proportions.

Next, Mr. Short referred to the absence of “press bashing”. Perhaps I will be able to make good that deficiency. We, the public, were belaboured by phrases such as “Legalised Robbery”, “The Great Pensions Scandal” and one writer likened changing jobs to giving away your house to someone you meet in the street; even the Secretary of State has talked of people put in thrall to their employers by their pension scheme.

Several articles expressed confidence—and here I found Mr. Sloan agreed with them—that stayers would accept a reduction in benefits so that leavers could have more benefits. Common sense suggests such an acceptance would be most unlikely. One does get a feeling that what we saw was in fact a somewhat crude lobby and that the case for those who would have to pay to have benefits reduced went largely by default and even the report itself, although striving to be evenhanded, does have that same feel. Essentially the setting up of a pension scheme is a voluntary act and the imposition of any statutory constraints which raise the cost of such an act could be self-defeating by inhibiting both new schemes and the improvement of existing schemes. This statutory process started with preservation. We are now faced with the possibility of revaluation of leavers’ benefits and on the horizon we have solvency requirements—this was touched on by Mr. James.

I now come to the main elements in the report. The first element is “do leavers lose vis-à-vis stayers?” The second, “if they do, is it right or wrong?” Thirdly, if it is wrong, what should be done?

So we start by referring to Chapter 5 which discusses the question “do leavers lose vis-à-vis stayers?” and various reasons are listed. It does no harm to point out that transfers in themselves are not necessarily a cause of loss.

We now come to the question of franking and clearly there are several views on this. The point that Mr. Low made was that franking was in fact part of the contracting-out terms and if franking is going to be disallowed then some adjustment will have to be made to allow for it in the contribution reductions for contracted-out schemes. Mr. Lyburn disliked franking, Mr. Neill disliked franking, and Mr. Low, although I don’t know whether he disliked or liked it, made the point about the fact that it is part of the contracting-out package. Mr. Sloan definitely disliked franking. Mr. Russell criticised final salary schemes and Mr. Stretton discussed final salary schemes versus other types.

The most obvious difficulties regarding leavers versus stayers arise in the context of final salary schemes and these difficulties are, by and large, caused by inflation and some criticism has been directed at final salary schemes when the real problem is in fact inflation. Whatever else people can find to blame on pension schemes, I don’t think inflation is one of them. Mr. Sloan favoured a non-final salary type of scheme. Final salary schemes are basically designed, or were developed, not to deal with inflation but to deal with progressive salary structures. Non-final salary schemes may not
favour stayers vis-à-vis leavers but they are vulnerable to many other criticisms. However, I think there can be little argument against the conclusion that leavers are, in general, worse off than stayers.

Now is this right or wrong? Mr. Stretton has deduced that mobility is arguably not adversely affected by poor leaving benefits. The Bill itself argues otherwise namely that the effectiveness of a scheme is undermined by job mobility. But what of those people who move to better-paid positions? What of those who have received their training or acquired expertise and then left? This point was made by Mr. Bannerman. And should leavers not consider the implications of their leaving? Surely the reason for leaving is relevant to the question. I am convinced there is a significant body of opinion—and several of the speakers tonight referred to this point—that forced leavers, such as redundancies, have a much stronger case for favourable treatment than those who leave of their own volition. Mr. Neill made this point; Mr. Low agreed with it; Mr. Murray made the same point; Mr Bannerman agreed; Mr Sloan disagreed.

Paragraph 5.19, discussed by Mr. Neill, raises the question of inflation and the cross subsidy effect of high rates of interest. Perhaps this could be dealt with by a more equitable distribution of interest surplus rather than by legislation. The difficulties that pensioners experience in times of high inflation are acknowledged but put aside by the report as another problem; Mr. James referred to this and Mr. Amy said that you cannot push such a problem aside. It has long been established that pensioners take a high priority position and the legislation proposed in this report would act against that principle. This point was also raised by Mr. Stretton. Pensioners might find themselves behind leavers if assets are insufficient and it is not beyond the bounds of possibility that in certain circumstances leavers could move right to the head of the priority queue, moving in front of pensioners and stayers.

Paragraph 5.22 deals with the many changes in pensions legislation that we have seen in recent years and suggests that these changes have been absorbed and are now behind us. This should bring a smile through gritted teeth to anyone who has any dealings with the S.F.O. and who is faced with horrendous backlogs of work. These complications were referred to by Mr. Lyburn, Mr. Taylor was very worried about them and Mr. Stretton suggested that legislation (because you couldn’t enforce too much via legislation) would take a long time to work through—and in fact voluntary action would probably act just as quickly without all the complications and difficulties which legislation will give rise to. It’s simply not realistic to say that the industry (however resilient it has been and I have no doubt will continue to be), can adjust without undue administrative strain particularly when rising administrative costs are a cause of very real concern to the industry at large. In dealing with the problems of a weak economy the report argues that the inequity which they claim exists takes precedence over financial considerations and, by limiting action to future accrual, they presumably hope to avoid piling the last straw on the camel’s back. Let us hope they are right. The report argues that schemes should be neutral in their influence on mobility and stability and Mr. Murray has made the point, and I am sure many will agree with him, that in fact the weight of opinion should favour stability rather than mobility. In any event, the report concludes that there is a problem which should be solved, i.e. leavers lose vis-à-vis stayers and this is wrong. Now what should be done?

Paragraphs 6.4 and 6.5 correctly point out that transfers by themselves solve nothing but unfortunately a certain amount of misunderstanding has arisen as a result of transfer values which have a value greater than the
value of the preserved benefit given up. Alteration of the preservation requirements may be unexceptionable but please let us have identical requirements for preservation as for GMP's. Let us also be grateful that the report does not recommend preservation of death in service benefits.

The report then goes on to discuss three main approaches to improving preserved benefits. Paragraph 6.16 raises a possible method which to my simple mind does not belong to the real world and fortunately the next two paragraphs demolish such a method. The next paragraphs, 6.20-6.22, also lacked real credibility for occupational schemes with differing concepts and levels of funding. Of the three possible methods only the third offers a practical and meaningful solution provided, of course, that one accepts the solution is considered desirable. This proposed solution is the revaluation of leaver's benefits.

In Chapter 7 the report discusses the various methods of revaluation. Paragraphs 7.1-7.5 reject the use of a price-index and ends up recommending the use of an earnings index, but I cannot find any reference to the possibility that stayers may not have earnings raised in line with the national average thus putting a stayer at a disadvantage vis-à-vis the leavers. This anomaly could even arise at 5%—witness British Leyland!

Paragraphs 7.6-7.11 recommend a 5% per annum ceiling (which Mr. MacLaren agreed with) over the period of deferment. There was a warm-hearted minority who wanted no limit. The report is probably optimistic, as Mr. Neill suggested, in thinking that schemes, other than a very small minority, will revalue at a rate higher than any statutory minimum.

I have already referred to the cessation of franking as a change in the contracting-out terms. If this does come into operation surely as a result it should be made possible to buy back individual leavers into the State Scheme.

Mr. Stewart seemed to favour non-final salary schemes and they are discussed in the report and clearly offer the employers a means of avoiding some of the difficulties of leavers versus stayers but such schemes are not suitable for contracting out and hence if an employer wishes to contract out, he would not be able to escape statutory revaluation. Mr. Short referred to the dubiety of the costs of the legislation and the report itself quite correctly concludes that costs will rise since reducing benefits is not a practical possibility. Mr. Stewart agreed with this point but Mr. Taylor thought in fact you couldn't reduce benefits. So, was the report correct in concluding that leavers were unfairly untreated? Was the report reasonable in its conclusion as to the rate of revaluation? Mr. Stretton has said that legislation cannot impose too great a burden and hence it will take a very long time to work through.

Should the new employer not shoulder some of the cost of revaluation? This is a point made by Mr. Murray although Mr. MacLaren disagreed and thought that the cost should fall on the old employer. Should occupations with high mobility not organise their schemes accordingly? Will anyone understand the legislation? Mr. Stretton had grave doubts although Mr. Russell certainly supported legislation.

At another time—a more prosperous and confident time—the answer would be "yes" but at the moment the priorities are viability and survival for without these we may all become early leavers and the assets will certainly not cover our revaluation. In today's climate, costs are all important. Statutory revaluation could in these circumstances cause some employers to terminate schemes. We might see the re-emergence of unsatisfactory types of schemes. The recent discovery of average salary or money purchase schemes by some writers looks like the pensions equivalent
of inventing the wheel. A breathing space before legislation may well be a good thing.

Finally, Mr. President, it would be ungracious not to thank the authors for a very clear and very-well-written report; Mr. Stretton for his thoughtful remarks and all the contributors. Whatever happens, their efforts are worthy of our gratitude.