NAPF
Securing the future of pensions

Deregulation Data

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Contents

Executive Summary

This paper summarises two sets of data of relevance to the current deregulation issue: some initial results of an NAPF member survey of private sector DB schemes on deregulation and some early conclusions from an OECD report comparing pension scheme regulation in a number of different countries.

The key findings from the NAPF survey are:

- Overall, when asked what Government could do to encourage employers to maintain DB provision, over half of respondents called for deregulation or for the Government to intervene less. The Government, therefore, has a real opportunity to help rekindle DB pension provision.

- While most of the issues and proposals covered by the External Deregulation Review are thought likely to sustain DB provision, some command more support than others. The two changes topping the poll relate to issues directly affecting the ability of a corporation to operate - the relaxation of section 75 employer debt regulations and making it easier to return a surplus. Both important considerations with today's pensions decision-makers, Finance Directors.

- A second cluster of proposals relate to the adoption of a more flexible regime, notably the adoption of principles-based regulation and the introduction of a statutory override to allow specified changes to the trust deed.

- A third group of proposals considered helpful directly address the original remit of the deregulation initiative, namely rebalancing the costs of providing occupational pensions whilst not placing members' security at risk. Examples include: removing indexation requirements for pensions in payment, lowering the revaluation rule for deferred pensions, and making it easier to change Normal Pension Age.

The OECD data shows that the UK is one of only two countries in the sixteen studied where pensions are required to apply both mandatory indexation of pensions in payment and mandatory revaluation of deferred pensions. It also shows that only three countries (including the UK) require indexation of pensions in payment and less than half of those studied require mandatory revaluation.

1. Introduction

This paper summarises two sets of data of relevance to the Government's current analysis of the deregulation issue: the initial results of an NAPF survey on deregulation; and some of the early findings of some OECD work on DB regulation in different countries.

The aim of the NAPF survey on deregulation was to explore directly with open private sector DB pension schemes what the Government can do to sustain DB pensions. The paper covers three key issues:

- which measures the open private sector DB pension schemes believe are most needed to sustain DB provision into the future; and,
- their assessment of the main issues and proposals considered by the Deregulation Review.

Around 80 NAPF members operating open private sector DB pension funds were surveyed by means of an on-line poll in mid-September 2007. The results below are based on all the responses received to date (25 responses – almost a third of those approached). The final results may change as new responses are received.

The OECD data, which is drawn from a large report on pension scheme regulation due to be completed in December of this year, shows the extent to which OECD countries require mandatory revaluation of deferred pensions and mandatory indexation of pensions in payment.

2. Occupational pension schemes want deregulation and less Government intervention

We asked a sample of open private sector DB pension funds what one thing Government could do to encourage employers to maintain DB schemes. This was a "free form" question which did not prompt respondents with a choice of suggested categories but left it to them to suggest the answers.

Response	Percentage
Deregulate	37
Reduce Government intervention	14
Relax s,75	6
Produce more LPI-linked bonds	6
Allow access to funds before retirement	6
Restore tax relief on investment income	6
It's too late	19

(Responses 15)

Over half of respondents believe that the Government can help employers maintain their DB provision if deregulation or changes to regulation are introduced. Of these, well over a third suggested that the answer lies in deregulation and a sixth suggest that the Government should intervene less. A further portion suggested that relaxation of section 75, also a deregulatory measure, would be of help.

Respondents also suggested a number of other ways of helping sustain provision, such as producing more index-linked bonds, thereby easing the pressure on funding DB pensions or allowing members access to their fund prior to retirement.

3. Which deregulatory measures do schemes want?

We asked which of the issues considered by the External Deregulation Review would help sustain DB pension provision. The results, marked out of 10 (with 10 most likely to help sustain provision) are set out below.

Issue / Proposal	Score
Relaxation of s.75 employer debt regulations in cases of legitimate corporate transactions to allow transactions to take place without additional requirements being placed on the pension scheme.	7
Return of surplus to employer with agreement by trustees	6.5
A move to more principles-based legislation, i.e, where the outcome would be prescribed but not the process	6.5
The introduction of a limited statutory override to allow specific changes to be made where the trust deed and rules may prevent introducing future changes as a result of changes to legislation	5.5
For future accruals, removing the requirement to index pensions in payment	5.5
For future accruals, reducing the requirement to revalue deferred pensions from 5% to 2.5%	5.5
Making it possible to increase NPA for past service as well as future service	5
Amending the requirement for all trustees to have full TKU so that the trustee board as a whole have collective TKU	4
New risk-sharing regime where new schemes would be established under rules which allowed changes to past and future accruals at any time	3

(21 responses)

Of the nine main issues and proposals considered by the External Deregulation Review, seven were considered as likely to encourage DB provision (scores above the mid-point, 5):

1. Relaxation of s75 employer debt regulations in cases of legitimate corporate transactions to allow corporate activity to take place without additional requirements being placed on the pension scheme.

2. Permitting the return of surplus to the employer with the agreement of the trustees.

3. A move to a principles-based regulatory regime, where the outcome would be prescribed but trustees and sponsors would have flexibility in applying the process.

4. The introduction of a limited statutory override to allow specific changes to be made where the trust deed and rules may prevent changes being made.

5. For future accruals, moving to a system of conditional increases to pensions in payment.

6. For future accruals, reducing the requirement to revalue deferred pensions from 5% to 2.5% a year.

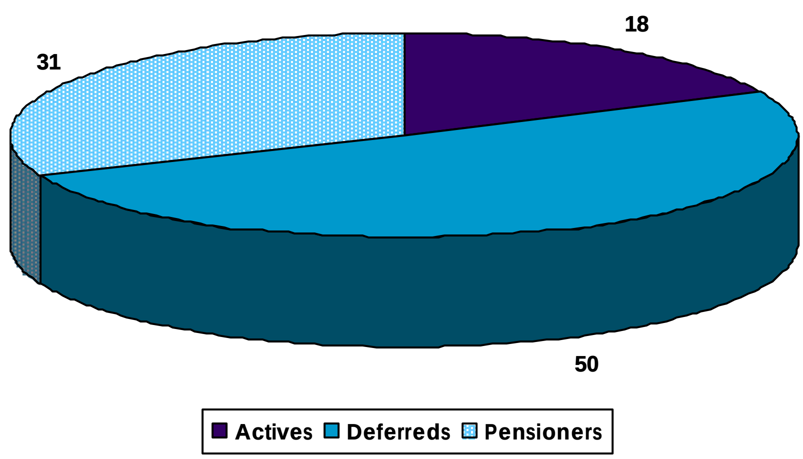
7. Making it easier for schemes to raise the Normal Pension Age for past as well as future service.

The first two do little to reduce the costs of running schemes, but they send important messages to the Finance Directors who are taking decisions about DB pensions today that they can control their own destiny. In an era when employers are questioning their commitment to DB, changes in these areas should not be underestimated.

Items 3 and 4 should provide trustees and scheme sponsors with the flexibility they need to apply rules in a way that suits them.

Items 5, 6 and 7 start to get to the heart of the matter and really address the terms of the Government's deregulation review announced in the May 2006 White Paper, namely rebalancing the costs of providing occupational pensions whilst not placing at risk members' security. Moving to the Dutch system of conditional indexation for pensions in payment would help reduce scheme costs by around 16%. Reducing the ceiling on revaluation of deferred pensions would reduce schemes' costs by around 11%, an important consideration, given the high number of deferred members in each scheme (see below).

Membership in a typical private sector DB pension



A new risk-sharing regulatory regime did not score highly on NAPF members' list of priorities. Perhaps reflecting the immediacy of their needs and the pressures they are facing.

4. OECD report on pension scheme regulation

The table below shows the regulatory requirements for DB pension schemes as recorded in a study of 16 OECD countries to be published in December 2007.

Country	**Revaluation of Deferred Pensions**	**Indexation of Pensions in Payment**
Austria	None	None
Belgium	Min. Return	None
Canada	None	None
Denmark	Min. Return	None
Finland	CPI-wages (20-80%)	CPI – wages (80%-20%)
Germany	None	Inflation
Ireland	CPI up to 4% ceiling	None
Japan	None	None
Netherlands	None	None
Norway	None	None
Portugal	None	None
Spain	Inflation	None
Sweden	None	None
Switzerland	Min. Return	None
UK	CPI up to 5% ceiling	CPI up to 2.5% ceiling
USA	None	None

Source: OECD 2007

The report found that the UK is one of only two countries in the sixteen OECD countries studied to have mandatory requirements for both the revaluation of deferred pensions and indexation of pensions in payment. Nine of the sixteen countries have no requirements at all for either revaluation or indexation.

The majority of OECD schemes studied do not have any revaluation requirement. Of the counties that do, the UK appears to have the third most generous / costly requirements after Spain and Finland.

Finally, only three of the sixteen OECD countries studied, Germany, Finland and the UK, have any sort of requirement to index-link pensions in payment. The vast majority set no requirements.

5. Conclusions

Respondents showed a range of reactions to the proposals under consideration. Relaxation of section 75 and provisions to make a return of surplus were considered most likely to help sustain DB provision. The adoption of a more principles-based approach, and changes likely to reduce the cost of providing a good pension, such as removing the requirement to index pensions in payment and reducing the revaluation requirements on deferred pensions, were also rated highly. In contrast, respondents did not think that the introduction of a new risk-sharing regime would help keep today's DB pensions open.

The OECD's report suggests that UK regulation is rigid and burdensome compared to that in many other developed countries. Mandatory requirements for indexation of pensions in payment and revaluation of deferred pensions are rare outside the UK. No wonder, perhaps, that open DB schemes need, and are calling for, deregulation.

In our view, no single measure will be enough to support good DB provision. However, a package of measures, comprising longer terms reform to the regulatory environment, and shorter term rule changes to reduce costs now, may together be enough to sustain the remainder of the UK's DB provision.

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