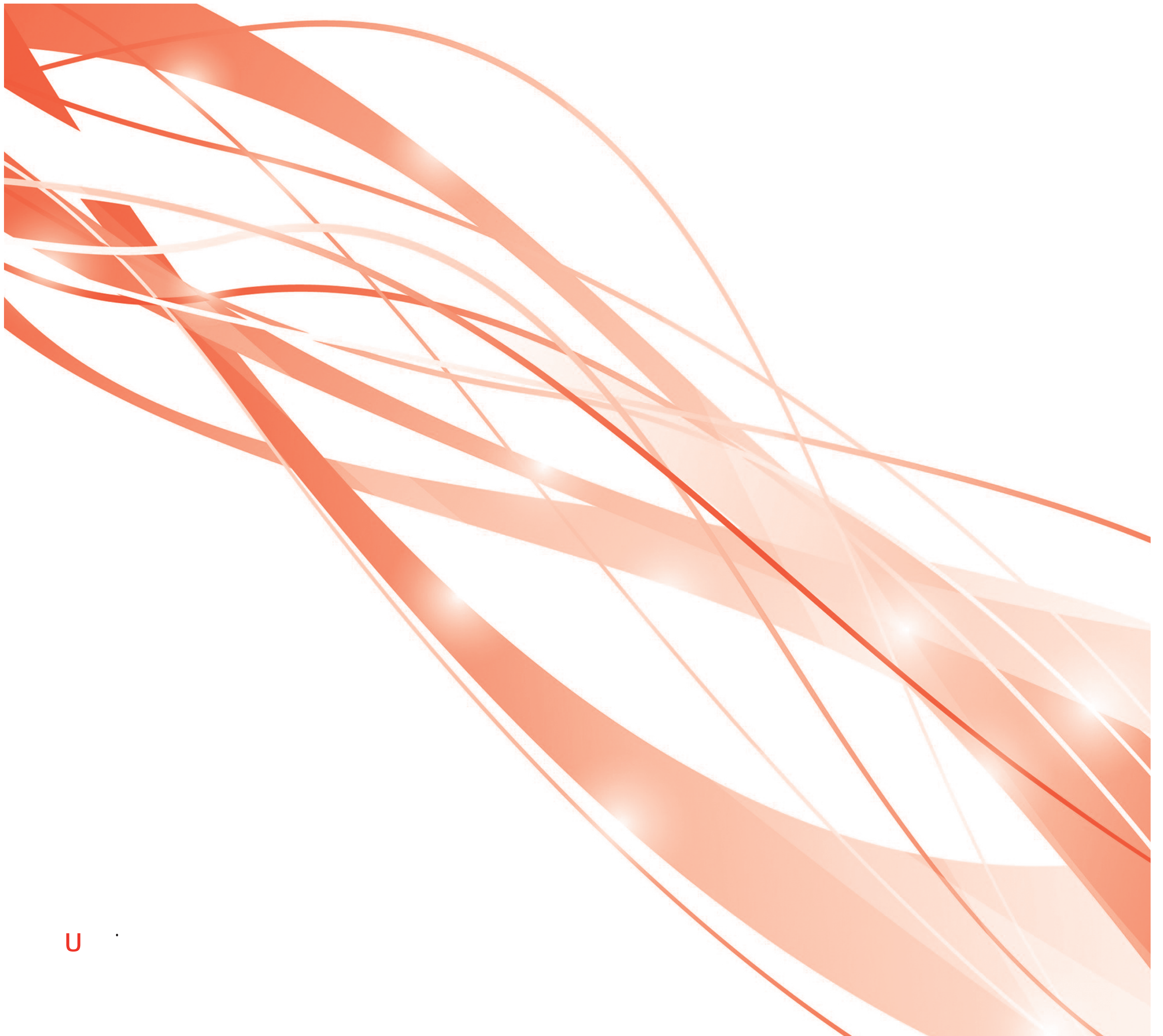
NAPF

Securing the future of pensions

Spotlight on pensions:

NAPF response



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EXECUTIVE SUMMARY

The NAPF welcomes the Government's focus on cutting red tape on pensions as part of its wider drive to modernise and reinvigorate private pensions. We have long argued for a more principles-based and less prescriptive regulatory regime that encourages employers to offer good, sustainable workplace pensions that can better balance the risks of pension saving between scheme members and their employers. The regulatory system for pensions in the UK has had to evolve over time as successive Governments have reacted to pensions crises and scandals, to economic and demographic challenges, and to new developments in the pensions market. The complexity of the pensions landscape is reflected in the scope of the Red Tape Challenge itself – with the areas of pensions tax and financial services regulation both excluded from the 'pensions spotlight' as they do not fall under the remit of either the Department for Work and Pensions or the Pensions Regulator.

The aim of the Red Tape Challenge must be to identify where streamlining regulation can foster the efficient operation of workplace pensions, for the benefit of members, sponsors, and trustees, without putting at risk scheme member protection. However, much of the UK regulation around workplace pensions appears to have been drafted on a supposition of non-compliance, prescribing down to the very detail how employers, trustees, pension scheme managers and professionals must go about their business. This has led to increasingly onerous, time consuming and costly requirements, most recently with the regulation around auto-enrolment (deemed out of scope for the Red Tape Challenge) which will be binding on the largest employers from later this year. Hardwiring and gold-plating of employer's pension promises over time, including through legislative specification of exactly what must be provided by a Defined Benefit scheme, has also ramped up liabilities and running costs, to the point that many employers feel the goalposts have moved so irrecoverably that they have no choice but to close their scheme.

The NAPF believes that there is an opportunity to lighten the load of regulation going forward, and to shift the balance back towards 'trusting the trustee' or those responsible for making decisions about pension schemes on behalf of the employer and members. This freeing up, combined with a regulatory regime that can better accommodate pension schemes that are neither pure Defined Benefit (DB) or pure Defined Contribution (DC), and that encourages scale and good governance through the promotion of Super Trusts, should help to drive the Pension Minister's vision around 'Defined Ambition' and the Government's underlying objectives to secure good member outcomes and adequate incomes in retirement. Other legislative steps to modernise pensions could be considered alongside the Government's planned reforms to state pensions – in particular considering what statutory overrides may allow employers and trustees to consolidate or refresh their pension offering, or how legislation might allow workplace pensions to be more robust and better equipped to deal with future challenges (for example, by allowing scheme's normal pension ages to also be explicitly linked to longevity increases and the State Pension Age).

To ensure our members could fully engage with the Red Tape Challenge, the NAPF issued a Call for Evidence[1] at the beginning of February to inform our own response and to encourage contributions and case studies from our members. Our response to the Pensions Spotlight is based on written responses to the Call for Evidence, and has been informed by our regular visits with NAPF members, as well as by discussions at NAPF working groups and forums. We have also drawn on the pension scheme representatives and business

[1] Better Regulation: Responding to the Red Tape Challenge

member expertise on the NAPF Retirement Policy Council, our NAPF Legal Panel, evidence from our previous policy consultations and other published documents.

The specific recommendations raised in this document cover areas both in and out of scope of the Government's pensions spotlight, and are based on our Call for Evidence and discussions with fund and business members, and include:

Areas within scope of the Pensions Spotlight

Indexation of Benefits: The NAPF recommends that the Government removes the statutory requirement for future accrued rights in DB schemes to be indexed for pensions in payment, and considers the case for removing other statutory requirements on the structure of benefits.

Section 67 and Modifications to Schemes: The NAPF recommends that Section 67 should be removed or amended as it is superfluous to existing fiduciary duties and creates a high technical, and process driven, hurdle for trustees when considering changes to their scheme. If Section 67 is kept, an easement should be introduced so that schemes can make changes that have only minimal detrimental impacts on individual members and do not reduce the overall liabilities of the scheme.

Section 75 and employer debt: A Section 75 debt can currently be triggered by a corporate restructuring even where no value has left the corporate group. This could be simplified by relying on The Pensions Regulator's (TPR) increased powers to intervene and take action against any company within a group rather than crystallising the deficit.

Scheme administration and interactions with TPR and the PPF: The burdens around compliance and governance were felt to be onerous and disproportionate, particularly for smaller schemes. Particular issues were raised around the time and effort spent on record keeping, and around data exchange and appeals processes, especially for multi-employer schemes. DWP and TPR should review where the processes around scheme record keeping and data exchange can be further streamlined to reduce the burdens on individual schemes.

Disclosure and Communications: The current requirements were described as overly prescriptive, complex and unhelpful for members. The NAPF recommends that more focus should be placed on the principles of what information should be provided and on 'trusting the trustee' or the pension scheme manager to determine how to best communicate with their members. Aligning the requirements for trust-based and contract-based pension schemes from 2013 should help to streamline the regulations in this area, provided it does not lead to overlaying of prescription and a levelling up of information requirements.

Areas out of scope of the Pensions Spotlight

The regulatory framework for pensions: The NAPF recommends that the regulation for workplace pensions should be brought under the remit of one regulator, the Pensions Regulator, which should have a new statutory objective to ensure the longevity and health of workplace pensions.

State Pensions: The NAPF welcomes the progress the Government has made towards introducing a Foundation Pension, and recommends that the Government sets out concrete plans and workable timetables as soon as possible, with a consideration for employers who will face upheaval from the abolition of contracting out and who will need to manage the transitional costs of restructuring their schemes.

GMP Equalisation: The NAPF recommends that the DWP should withdraw its proposed new Regulations on equalisation of Guaranteed Minimum Pensions (GMPs) and should conduct a full assessment of the impact on pension schemes, including public sector schemes. The DWP should also disclose the legal advice it received to increase transparency and to give schemes more certainty.

Automatic Enrolment: The NAPF recommends that with only five months to go, no further changes are made to automatic enrolment. However, it seems crucial to keep the process under review as the regulations are rolled out to smaller employers and to iron out any pressing implementation problems identified by early adopters of auto-enrolment before the next major review in 2017.

Pensions Tax Regime and Simplification: As a first step, HMRC should review the delivery of its services and the costs the pensions tax relief regime is placing on pension schemes, with a view to improving the way it communicates and interacts with those running pension schemes and the professionals advising them. In addition, the NAPF recommends that the Office for Tax Simplification conducts a separate review to identify opportunities to streamline and simplify pensions tax legislation.

Of all the areas raised above, the single biggest priority raised by members in the Call for Evidence around Guaranteed Minimum Pension equalisation and the £13 billion cost (and £300m administration cost) this is expected to impose on employers who, according to the Government's latest legal advice, may need to further level up benefits within their schemes. This new burden alone, which is believed by many in the industry to be gold-plating EU legislation, could wipe out at a stroke any benefits delivered by the Red Tape Challenge, and would undermine the Government's deregulatory agenda on pensions. We have raised this issue, and issues around the auto-enrolment regulations and the operation of the pensions tax relief regime, in the hope that they receive attention through the Red Tape Challenge and can be addressed by the relevant Government departments and regulatory authorities in due course.

CHAPTER 1: INTRODUCTION

The Government's Red Tape Challenge

The NAPF welcomes the Government's ambitions to reduce red tape and agrees that there is scope to review aspects of the pensions regulatory landscape to free up employers, trustees, and those involved in the running of pension schemes to focus on delivering better pensions. Many of the burdens of regulations in this area are overly prescriptive, and are in places stifling innovation or dissuading or distracting employers and trustees from delivering better outcomes to their employees and pension scheme members. The aim of the Red Tape Challenge must be to identify where streamlining regulation can foster the efficient operation of workplace pensions, for the benefit of members, sponsors, and trustees, without putting at risk scheme member protection.

The sheer volume of regulations – with around 1,000 pieces of legislation relating to pensions being introduced since 1995 – imposes significant costs (both in terms of time and resource) on scheme sponsors. A survey of nearly 200 NAPF members last autumn confirmed this concern and showed that regulatory burdens continue to grow: 8 out of 10 respondents to our short poll thought that the costs to their scheme of dealing with regulatory and compliance issues had significantly increased over the last three years and, of those, 1 in 5 respondents thought costs had increased by more than 25%. To have a positive impact, the Pensions Spotlight will need to identify the potential for quick wins where the benefits of change readily outweigh the costs. This sentiment, and the frustration of employers currently trying to offer good pensions, is exemplified in this response from one of our members:

> *"As well as keeping our heads above water in terms of day to day management of these schemes (which is not the reason this company exists, we are here to manage business risks for the UK economy) we constantly have to get up to speed with new initiatives from Government and increasingly onerous governance requirements set by tPR."*
>
> *Pension Scheme Manager, closed DB, closed hybrid and open DC schemes*

Creating the right regulatory environment is not only about stripping back unnecessary costs and burdens from the way pensions are run under the current regulatory regime, it is also about encouraging better governance and greater innovation and risk sharing in the structure of pensions that are offered. While the Pensions Minister Steve Webb is promoting the concept of 'Defined Ambition' as a desirable middle ground between final salary Defined Benefit (DB) and traditional Defined Contribution (DC) schemes, the current regulatory landscape does anything but encourage employers to offer hybrid solutions. Once an element of 'Defined Benefit' is introduced into a scheme, employers have to comply with the full weight of DB regulations, making it potentially more, rather than less, burdensome for those who would like to offer something in between. If the Government is serious about promoting Defined Ambition models, they need to create a regulatory landscape which fosters product innovation and delivers some certainty for sponsors going forward that 'ambitions' or 'aspirations' will not be crystallised into hardwired promises over time. A better regulatory environment must therefore be part and parcel of the Government's coalition commitment to reinvigorate private pensions.

To ensure our members could fully engage with the Red Tape Challenge, the NAPF issued a Call for Evidence[2] at the beginning of February to inform our own response and encourage contributions and case studies from our members. Our response to the Pensions Spotlight is based on written responses to the Call for Evidence, and has been informed by our regular visits with NAPF members, as well as discussions at NAPF working groups and forums. We have also drawn on the pension scheme representatives and business member expertise on the NAPF Retirement Policy Council, our NAPF Legal Panel, evidence from our previous policy consultations and other published documents.

Risk-sharing, Indexation, Employer Debt, Section 67 – many of the topics raised in the responses to our Call for Evidence were raised and discussed in the 2007 Deregulatory Review of Private Pensions[3]. In some areas Government stopped short of making changes, whilst in others it has taken steps to simplify regulations or partly address issues, but the view remains amongst NAPF members that there is scope to go further. Given this Government's commitment to cutting back on both red tape and reinvigorating private pensions, and the progress that has been made across other sectors, the time is ripe for a fresh look.

We also welcome the Government's appetite to review where EU Directives and Regulations may be gold-plated. The DWP's current proposals for new legislation on equalisation of Guaranteed Minimum Pensions are a prime example of where it appears the UK may be going beyond the requirements of EU law, and a key test of the Red Tape Challenge will be whether it prompts the Government to review its plans in this area. Further changes at the EU level through the proposed revisions to the IORP directive, including requirements around disclosure, could also work against the Red Tape Challenge.

The NAPF response to the Pensions Spotlight is organised as follows. **Chapter 1** sets out the growing costs and regulatory burdens employers and pension schemes have faced in the UK and discusses the hidden costs of change. It concludes with an overview of the current regulatory landscape, its complexities and the case for reform.

Chapter 2 covers the areas raised by our fund and business members which are within the scope of the Red Tape Challenge. It discusses statutory indexation and other DB benefits, as well as the potential removal of Section 67. A section on scheme administration and the interactions with TPR and PPF looks at employer debt (Section 75), the data exchange and appeals processes, and record keeping requirements. We review the current landscape of disclosure requirements and close the Chapter with a summary of smaller individual issues that were raised in the consultation but where there was less clear consensus.

Chapter 3 covers the key areas which have been deemed out of scope for this stage of the Red Tape Challenge, but which were also raised in the responses we received from our fund and business members. They include state pension reform, GMP Equalisation, automatic enrolment and tax simplification.

Chapter 4 concludes by emphasising the need to focus on the big ticket items raised in this response, and calls for the Government to re-establish its regulatory principles around workplace pensions in developing both the response to this Red Tape Challenge and the broader coalition commitment to reinvigorate workplace pensions.

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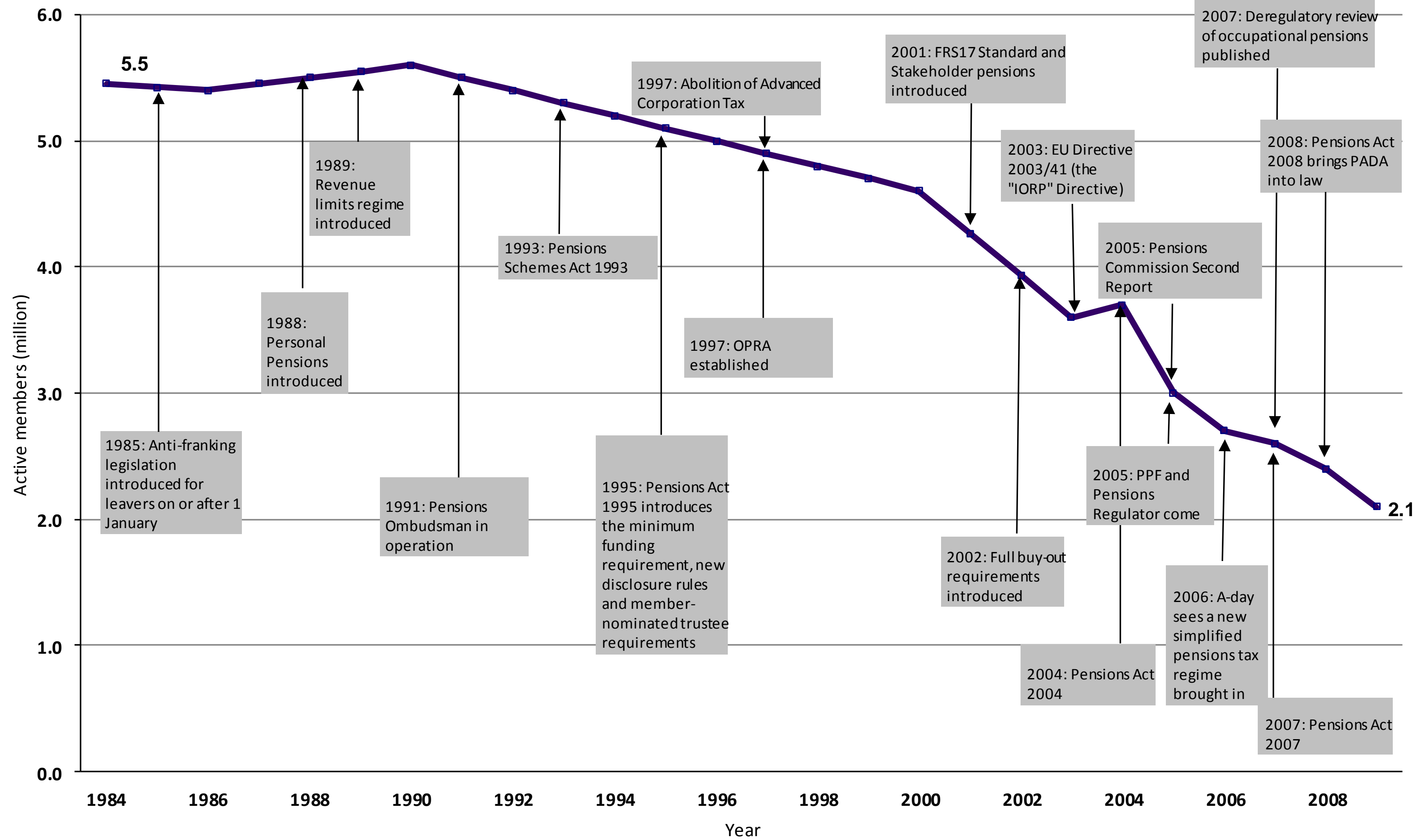
[2] Better Regulation: Responding to the Red Tape Challenge

[3] Chris Lewin and Ed Sweeney, Deregulatory Review of Private Pensions. An independent report to the Department for Work and Pensions (July 2007)

The impact of the regulatory landscape on UK pensions

Since the eighties and early nineties, swathes of new regulations have been introduced. Much of this regulation has been introduced in response to previous scandals and crises, in order to protect the benefits of the 5m individuals saving into private sector DB pensions at the time. However this has significantly increased the burdens and requirements placed on those running pension schemes by specifying and hard-wiring the benefits that must be provided, and leaving sponsors and trustees little wriggle room to adjust their pension offer over time. Increasing longevity has undoubtedly had a major impact on the affordability of traditional final salary DB structures over the last few decades, with schemes' normal pension ages only slowly playing catch up, and have been compounded by the need to inflation protect pensions in retirement and provide spouses benefits. As recent history has shown, if a pension promise becomes too expensive and there is little or no flexibility to restructure how the benefits are provided, scheme sponsors are likely to choose to close their DB schemes and move towards more DC schemes with more predictable costs. Whilst DC schemes can be of equally good quality as DB schemes, the shift to DC has often been accompanied by a significant reduction in employer contributions and members bear all of the risk. As Figure 1 below shows, the closure of DB schemes has accelerated since the introduction of the Pensions Act 2004 and since the Turner Commission published its projections of DB decline in late 2004.

Figure 1: Regulation and defined benefit decline



Source: Office for National Statistics, Occupational Pension Scheme Survey, 2011 (for number of active members)

The previous Government made some explicit changes to reduce the costs for DB pension schemes. However, these reforms have had only a small impact on reducing liabilities and the costs of running pension schemes, when compared to the earlier increases that had been applied, as Box 1 shows.

Box 1: The increasing cost of running a pension

The case study below from one of our larger members shows that since the mid-eighties, the cost of running a pension scheme has increased significantly. The introduction of statutory revaluation in deferment in 1986, statutory increases of pensions in payment and statutory spouse benefits on death in 1997, and the removal of tax relief on UK dividends in 1997 have increased both the liabilities of pension schemes and the annual pension costs.

Changes which have increased costs	Date of implementation	Increase in current liabilities (%)	Increase in annual pension costs (%)
Statutory revaluation in deferment	January 1986	12	15
Statutory increases on all pensions in payment	April 1997	16	30
Statutory spouse's benefit on death	April 1997	5	7
Removal of tax relief on UK dividends	July 1997	5	7
Total		**38**	**59**

Meanwhile, the changes the previous Government introduced in the mid-late 2000s had a much smaller impact on the cost. The CPI/RPI switch announced in the summer of 2010 is often presented as an additional measure of reducing the costs DB pension schemes are facing – however, as Box 2 shows, it also increased the legal and consultancy costs schemes face in the short term.

Flexibility introduced by Government	Date of implementation	Decrease in current liabilities (if adopted at implementation date) (%)	Decrease in annual pension costs (%)
Reduction of inflation linked pension in payment increase limit from 5% to 2.5%	April 2005	1	7
Reduction of inflation linked statutory revaluation increase limit from 5% to 2.5%	April 2009	0	3
Total		**1**	**10**

It is unlikely that we will see a dramatic revival of DB pensions as employers increasingly look to shift investment, inflation and longevity risks off their balance sheets. However, ambitious deregulation of DB pensions might encourage those currently considering closing their DB schemes to new members or to future accrual to keep their schemes open for longer, to restructure and modernise their schemes, or to switch to more innovative risk-sharing models. Whilst many sponsors are closing their DB schemes, as the NAPF's latest Annual Survey has shown, there remain around 2.1m active members of private sector DB schemes. There is merit to making changes to the regulatory landscape that would encourage sponsors to keep these schemes remain open whilst they continue to deliver generous but affordable benefits to members.

The hidden costs of change

Introducing any kind of change – even if the intention is to simplify regulations or reduce burdens – will tend to create additional costs for pension schemes. These costs include ongoing administration costs - particularly if it means that future rights will follow different rules than accrued rights - but most commonly relate to the costs in terms of the legal, actuarial and consultancy advice that trustees and employers require when making any changes (Box 2). The difficulty in identifying these costs, and the variation in existing scheme rules and practice, means they can often be overlooked by Government when developing policy and carrying out Impact Assessments.

Box 2: Underestimating the costs of deregulation

In July 2010, the Pensions Minister Steve Webb announced the Government's intention to move from using the Retail Price Index (RPI) to using the Consumer Price Index (CPI) for the purposes of uprating occupational pensions. Alongside a wider package of austerity measures to reduce the costs of uprating benefit payments and public sector pensions by switching to CPI, this consequential impact, estimated to reduce liabilities by some £83 billion, was promoted as a liberalisation of DB pensions, and it was anticipated that the associated savings would persuade the sponsoring employers to keep their schemes open. The DWP Impact Assessment does not make any estimate of the associated administrative costs of making the change because of a lack of data to quantify the impact.

A survey conducted by the NAPF of 185 schemes in October 2011 found that the average cost of *considering* whether they could and should make the change given was £21,000, and some schemes, particularly larger schemes, had much higher costs. 22 schemes had costs of over £50,000. Out of these schemes 9 reported costs of over £100,000 from considering whether they could and should make the change.

The CPI change, whilst certainly imposing some administrative costs, should have a significant enough impact on liabilities to make it more than worthwhile for those schemes and employers that are automatically able to, or choose to, make the change. However, costs also need to be seen relative to their benefits, and transitional costs tend to occur upfront whilst cost reductions in the form of reduced liabilities and cash flow requirements are delivered over a much longer time scale. The Government therefore needs to be sensitive of the impact too much upheaval may have in the short-term, particularly where the decision of whether to keep the Defined Benefit scheme open is an issue of ongoing concern, and where small changes can distract pension scheme managers and trustees from focussing on areas that will deliver the most benefits to members.

Striking a balance between protecting accrued rights and future proofing good pensions

The NAPF is not suggesting making sweeping changes that would strip away the accrued rights that members have already built up, or significantly undermine their future value, as this would further dent already low confidence in pensions. One key objective of Government policy is to ensure that employers making pension promises stand by them, and the NAPF fully supports this objective. Touching accrued rights would violate this principle and is very likely to have a negative impact on the confidence consumers have in pensions. Declining trust and confidence in pensions, in turn, is likely to impact on the success of automatic enrolment and could threaten its aim of enabling 5-8m people to save for the first time into a pension, or to save more.

However our Call for Evidence has suggested that there is further scope to free up trustees and employers to make changes that could benefit their existing and prospective pension scheme membership. This is particularly true where greater flexibility for scheme sponsors in determining the benefits they offer going forward could make the difference between closing a generous scheme or keeping it open, or where the time and costs spent on administration and overly prescriptive implementation could be reduced and reinvested by the employers and trustees elsewhere.

The current regulatory landscape in the UK

A healthy workplace pension system needs to offer a mixed economy of provision so that employers are free to provide the form of pension provision that is right for them and their employees, whether DB, DC or options in between.

Increasingly, however, the form of provision is being dictated by the regulatory and economic environment (the growing burden of cost and regulation and the desire by scheme sponsors to manage down their pension liabilities and exposure to the associated risks). When altering their pension arrangements, scheme sponsors have tended to switch from DB to DC provision. A recent survey by Towers Watson[4], for example, found that only 2% of FTSE 100 companies offered a cash balance arrangement to new employees, and only another 2% offered another form of hybrid arrangement. The Pensions Regulator's latest figures suggest that there are 1,740 hybrid schemes in the UK (across both 'mixed benefit' and 'dual section' where the DB and DC benefits are accrued separately), with 710 schemes currently open, covering around 1.2 million active members.

We welcome the Pension Minister's vision of 'Defined Ambition' and risk-sharing models but share the views already expressed that, without explicit encouragement and incentives, the appetite from employers may be low. If the Government is to achieve a seismic shift towards pension provision that better shares risks between employers, employees and the state then the regulatory landscape needs to be flexible enough to view types of provision along a risk spectrum which gives scheme sponsors greater choice and flexibility. Whilst it is unlikely that we will see employers who have already moved from a DB to a DC arrangement move back to final salary DB in its current structure, risk sharing could help slow the exodus from DB, and could see enhanced DC offerings developing over time.

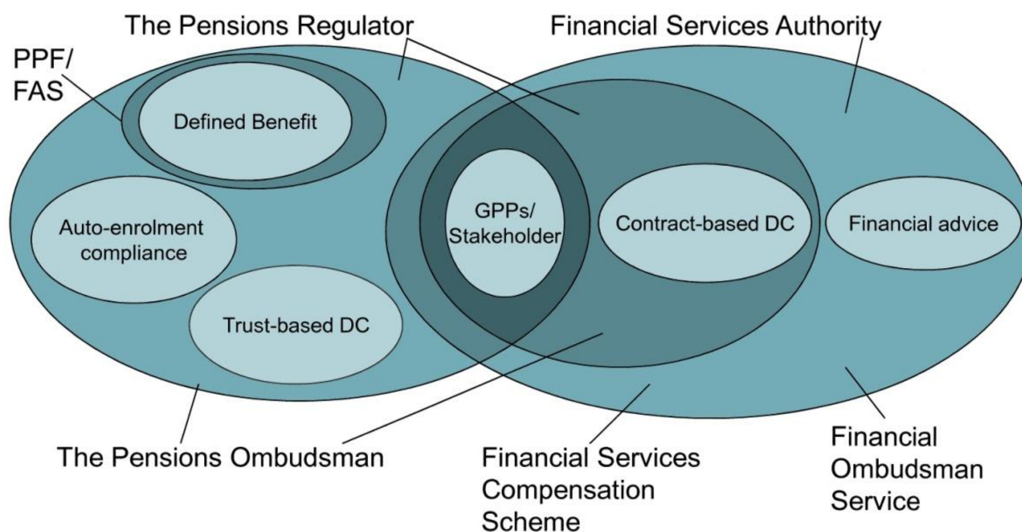
The regulatory landscape should not only encourage innovation in the Defined Ambition space, it should also encourage the consolidation of the DC market and support the development of Supertrusts that can drive better governance and economies of scale. Even where members continue to bear the majority of the risks,

[4] Towers Watson FTSE 100 DC pension scheme survey 2011 – where do you stand?

Supertrusts would provide greater assurance that members are getting good outcomes from their pension saving, through tailored communications, professional trusteeship, stronger governance around investment strategies and other areas, and better value for money around administration costs and other charges.

There is currently a multiplicity of regulatory and quasi regulatory bodies who have a role in the pensions landscape whose existence is confusing both to practitioners and pension scheme members. This is especially the case with the Financial Services Authority (FSA) and the Pensions Regulator (TPR), both of which have some responsibility for the growing number of workplace pensions covered by contract-based arrangements.

Figure 2: The UK pensions regulatory architecture



This can make little sense to scheme members, and opens up the possibility for regulatory arbitrage or duplication. One obvious example is the promotion of the Open-Market-Option to those approaching retirement, where the FSA and TPR both set requirements for members to be sent the same leaflet by providers or trustees[5] and where the policy and regulatory objectives (to encourage shopping around and help members secure the best possible annuity outcome) are the same.

Whilst TPR are expanding their work around DC arrangements, in particular to cover good governance of workplace pensions and driving better member outcomes, the regulatory overlaps are likely to continue to cause confusion. As one respondent to our Call for Evidence put it:

> *"It is going to cause particular difficulties going forward with auto-enrolment as employers and trustees/governance committees must follow TPR guidelines with the advisers/employee consultants having to be guided by the FSA in terms of the product. The FSA does not get involved normally with governance (of contract schemes) and yet this surely must be one of the most important issues going forward."*
>
> *Pension scheme manager, multi-employer contract-based arrangement.*

[5] The FSA's leaflet is 'Your pension: it's time to choose' whilst the TPR's leaflet is 'Making your retirement choices: think before you choose'.

This can also act as a barrier to policy development and improvement, as any industry-led solutions and Codes of Practice need to comply with different regulatory standards and hurdles whilst delivering a level playing field for employers and pension scheme members. The commitment to align disclosure requirements across FSA and TPR by 2013 is another positive step, but serves to illustrate the ongoing challenges of delivering consistency across a fragmented regulatory landscape for pensions where those running pension schemes, including employers, trustees, and pension scheme managers, have to find ways to work around the barriers, duplication, and inconsistencies that this creates.

> *"I believe the two regulators have a memorandum of understanding but this is quite inadequate given that be may soon have one million new pension schemes and 10 million more scheme members. I understand that currently more people are in DC contract schemes than trust schemes and yet TPR talks as though virtually everyone is, and will be, in trust plans. I think there is enough complexity just to deliver the auto-enrolment compliance and we badly need either just one regulator or a much closer liaison between the two."*
>
> *Pension scheme manager, multi-employer contract-based arrangement.*

With the onset of automatic-enrolment there will be an even larger number of employers and employees being caught by both regulators. The Department for Work and Pensions commissioned Paul Thornton to review the institutions involved in regulating and protecting workplace pensions. In his 2007 report he concluded that changes were needed to further develop the joint working between the FSA and the TPR in the area of work-based DC pensions, that "there is a need for greater clarity on the respective roles of the two bodies, with a more holistic approach to regulation of DC schemes" and that "the current boundary arrangements will need to be kept under review, in light of changes to the regulatory environment and market developments".[6] With a growing emphasis on good governance and improving member outcomes across both trust-based and contract-based DC workplace pension arrangements it may be time for a fresh review of the regulatory boundaries and how effectively they are working.

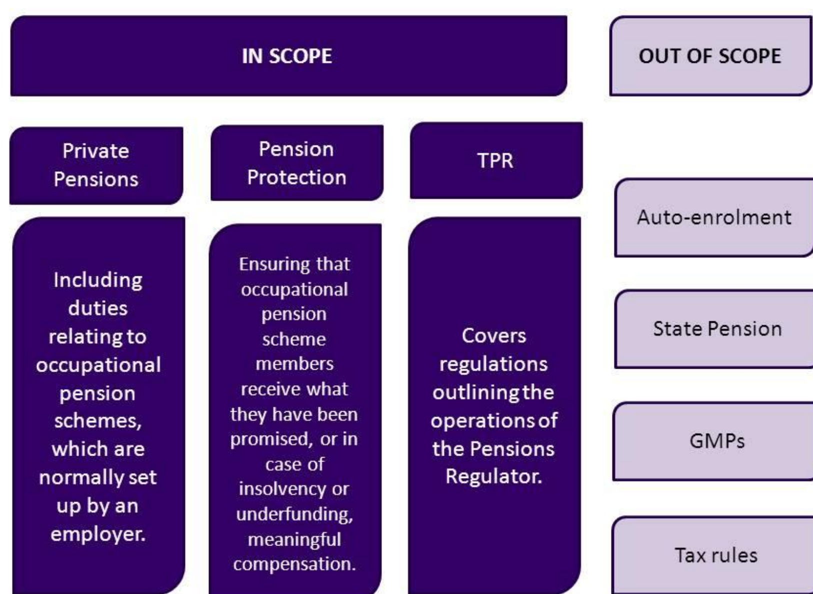
The NAPF recommends that the regulation for workplace pensions should be brought under the remit of one regulator, the Pensions Regulator, which should have a new statutory objective to ensure the longevity and health of workplace pensions.

[6] Paul Thornton, Review of Pensions Institutions (2007)

CHAPTER 2: THE SCOPE OF THE RED TAPE CHALLENGE AND ISSUES RAISED WITHIN SCOPE

The fragmented approach of the regulatory landscape is also reflected within the scope of the Red Tape Challenge itself. The Government's Pensions Spotlight covers private pensions, pension protection and the operations of the Pensions Regulator (see Figure 3), plus any general comments on pensions issues. Meanwhile, a number of key policy areas affecting those running pension schemes have been explicitly ruled out of scope. One of these areas is automatic enrolment: *"With automatic enrolment due to start in October 2012 it is extremely difficult to make changes to the legislation so close to the start-date… We have developed a full evaluation process that includes an assessment of the burden on business so that the programme can be monitored and inform post-implementation reviews of our regulatory approach to ensure it remains fit for purpose."*[7] State pensions (including the thorny and complex issues of contracting out and Guaranteed Minimum Pensions) and pensions tax relief (the domain of HMT and HMRC) are also out of scope. These issues were all raised by our members in our Call for Evidence and are addressed in Chapter 3.

Figure 3: Issues in and out of scope



The Red Tape Challenge is also focusing specifically on the removal or simplification of regulations contained in secondary legislation. However, the current regulatory regime has arisen out of a combination of both primary and secondary legislation, with secondary legislation expanding on, or adding detail to, rules contained with primary legislation. As such, it is not always possible to evaluate the impact of secondary legislation on pension schemes in a vacuum. Many of the responses from NAPF members, working groups and forums made more general comments on the combined impacts of primary and secondary legislation, as well as the supporting guidance and codes of practice, and we would urge Government to take a similarly holistic approach to the Red Tape Challenge.

[7] Red Tape Challenge website

Turning to the issues which are in scope of the Red Tape Challenge, this chapter focuses on:

- **DB member benefits:** including indexation and other statutory benefits, as well as Section 67;
- **Scheme administration and interactions with TPR and the PPF**: including Section 75 and employer debt, data exchange, the appeals process and record keeping;
- **Disclosure and communications:** across both DB and DC schemes and across trust and contract based arrangements; and
- **Other issues** raised in the NAPF Call for Evidence.

DB Member benefits

It is important to protect the benefits scheme members have already accrued, because it gives savers the certainty they need to plan for their retirement, and fosters wider trust in occupational and workplace pensions. However, a balance needs to be struck between member protection, the requirements those who offer a DB pension have to meet, and the costs and sustainability of the pension scheme. The responses we received – often from pension managers – focused on increasing the flexibility for the scheme sponsor and trustees to take pragmatic decisions for the benefit of all members, often with the aim of making it easier for the sponsoring employer to run the scheme as an ongoing concern.

The provision of DB pensions is voluntary, and while members need to be protected, employers who decide to offer this benefit should have a reasonable amount of discretion as to what exactly they offer. Auto-enrolment will introduce a floor in pension provision, and it is right that a minimum employer contribution should not be optional. But once an employer is offering something clearly over and above this minimum they should be able to have discretion over the form and terms of their pension offer.

Only if employers are allowed or even encouraged to set up a pension arrangement that suits them and their employees, will risk sharing become more likely. The responses we received called for more flexibility in particular in two areas: Indexation and Section 67.

Indexation and revaluation

"All revaluation (in deferment) and indexation (in payment) should be entirely voluntary."
Consultant

Indexation (and revaluation) are costly yet compulsory elements of what have always been voluntary benefits. Whilst the uprating of deferred pensions and pensions in payment can be an important and valuable member benefit, particularly when considered against a volatile and uncertain economic environment (an element of which most savers are likely to experience over a typical 40 year savings period), the burden placed on DB schemes and their sponsors by such compulsory increases has had a huge impact on the viability of DB pension provision. One respondent felt that statutory revaluation and indexation "*have played the biggest part in destroying DB pensions in the UK by making solvency a tougher test than funding".*

It is estimated that the introduction of statutory revaluation (1986) and indexation (1997) increased scheme liabilities for the typical DB scheme by around 25-30%. The previous Government made some inroads to reducing these costs by first lowering the cap in the indexation Limited Price Indexation (LPI) regime to 2.5%

for service on or after 6 April 2005, and then lowering of the cap in the revaluation LPI regime to 2.5% for service on or after 6 April 2009 following the deregulatory review in 2007.[8]

In our conversations with pension scheme managers we heard that the introduction of these caps had a helpful but relatively small impact on the level of liabilities and annual pension costs (particularly in comparison to the overall costs attached to statutory indexation and revaluation (see Box 1 in the Introduction)). Any liability savings can also be overshadowed by the greater administration tasks the caps have created. For example, for those schemes which have closed to new members, the impact on future liabilities was minimal, yet, because the different caps now apply to different periods of service, the scheme now has additional benefit layers to monitor and administer.

In 2005 the Government made changes in the context of DC occupational pension schemes. There is now no obligation to provide a scheme pension or annuity that increases when in payment in respect of DC benefits that came into payment on or after 6 April 2005. DC scheme members instead have to choose, when they retire, whether to buy a level annuity that erodes in real value over time, or one that rises with inflation and has a lower starting value.

Although members of DB schemes, by the nature of the DB arrangement, carry far less risk than members of DC schemes, there are far more legislative protections for members of DB schemes than members of DC schemes. This incongruity could be addressed by the removal of statutory indexation for future rights in DB schemes, the benefits of which, for still open schemes, should outweigh the administrative costs. Scheme sponsors face a trade-off between providing indexation and revaluation, their contribution rates and ultimately whether they can afford to keep the scheme open. We heard pension scheme managers argue that employers should be put in a position where they can make a choice and decide whether they want to make amendments to their scheme rules for future accruals and keep their scheme open rather than having to close a scheme because it is not financially sustainable.

In addition to indexation, additional benefits such as a spouse's pension or life assurance are required in a DB pension, but not in a DC pension. The savings of shifting to a 'Core DB' form of provision could be substantial, as Box 3 shows.

Box 3: Providing 'Core DB'

Adopting a core DB pension rather than a traditional final salary will make DB pension provision far more affordable to provide and so more likely that a salary related benefits will continue in existence. The NAPF estimates that providing a single life pension without indexation compared to a DB pension under today's rules (where indexation and a spouse's pension must also be provided) would reduce the cost of offering the pension significantly. Individuals would still continue to enjoy the security and guarantee of a DB pension while the scheme would benefit from reducing funding and accounting costs. For one of today's typical DB schemes with 500 members, an accrual rate of 1/60th and an average pensionable salary of £20,000 per year, switching to a core DB pension would reduce annual funding and accounting costs from around £2 million to just under £1 million.

Source: Fit for the Future: NAPF's Vision for Pensions, 2010

[8] Chris Lewin and Ed Sweeney, Deregulatory Review of Private Pensions. An independent report to the Department for Work and Pensions (July 2007)

Giving employers the option to pass on some of the risk of running a DB scheme (as for example cash-balance schemes do) might lead to more schemes sitting in between the DB-DC divide, and might lead to solutions around risk-sharing and 'Defined Ambition'.

In the responses we received we heard different views on whether indexation should be made voluntary for future benefits only, or whether it should also be made voluntary for accrued rights. The removal of statutory indexation in respect of future rights only (i.e. for benefits payable in respect of service on or after the date of the removal) facilitates greater risk-sharing whilst affording protection to members' accrued rights. However, given amount of schemes now closed to new members and/or accrual – 23% of schemes are closed, and 58% of schemes are closed to new members but open to future accrual[9] - it may have limited impact. It would also create another layer of administration by providing another layer of service accrual for schemes to monitor and administer in addition to the various caps (although for some schemes this would be a small price to pay for a much needed reduction in liabilities).

However, changing the nature of accrued benefits is very likely to damage trust and confidence in pensions. The NAPF therefore argues for a middle road where indexation is made voluntary for pension rights accrued in the future. We also stop short of recommending that statutory revaluation is removed, as revaluation is a mechanism to hedge against a past risk (inflation whilst the member was deferred), and removing both revaluation *and* indexation could see a significant erosion in the real value of a pension over both working life and retirement. Removing statutory revaluation would also see the real value of deferred pensions actually decline in the accumulation stage, whilst that investment should be seeing some real return (as it typically would in a DC scheme and whilst invested in growth assets).

Any changes to the compulsory provision of indexation will need to be carefully drafted. The legislation governing this area is already complex, particularly given the recent amendments made to accommodate the legislative switch from RPI to CPI. The impact on accrued benefits, and the extent to which any changes are retrospective, should be made clear. There was no definitive statement made by the Government as to whether the switch from RPI to CPI was intended to be retrospective (even after the relevant legislation came into force). The switch was in some instances retrospective (e.g. any statute-linked increases to pensions in payment on or after 2011 will reflect the use of CPI and this requirement will apply to the whole pension - unless a pension is already in payment, in which case a member will remain entitled to RPI based increases already granted in past years). As such, the Government appears willing to make changes that affect accrued rights if they consider the benefits to be of sufficient merit.

If the Government decided to remove the requirement for statutory indexation for future accrual it will be important that schemes communicate the potential changes and their implications to members in terms of the sharing of risk. State Pension reform will help to make it clearer what savers can expect from the State, and should provide a foundation for any additional savings. In addition, the triple lock (the state pension will increase with the best of prices, earnings or 2.5%) will ensure that the State Pension itself is inflation-proofed, potentially reducing the demand for private savings to be index-linked also.

The NAPF recommends that the Government removes the statutory requirement for future accrued rights in DB schemes to be indexed for pensions in payment, and considers the case for removing other statutory requirements on the structure of benefits.

[9] NAPF, Annual Survey, 2011

Section 67

"Why do we need Section 67? It adds nothing to the legal position and can create huge technical burdens for schemes and employers."

Pensions lawyer

A clear balance must be struck between the safeguarding of members' accrued rights and the ability of the sponsor to rationalise benefits so as to maintain its on-going support for the scheme. Whilst member expectations of promised benefits must be protected, the pensions regulatory regime should also enable scheme sponsors to have a continuing stake in the operation of the scheme and permit rule changes that promote efficient and cost-effective scheme administration.

Section 67 of the Pensions Act 1995 restricts the ability to make changes to the rules of an occupational pension scheme if those changes would or might adversely affect a scheme member's accrued rights (or the rights of a member's survivor). The restricted changes include changing accrued DB benefits into DC benefits, and reducing the prevailing rate of a pension in payment, retrospectively reducing the accrual rate or any other change that would *"alter the nature or extent of the entitlement or right so that benefits, or future benefits, to which the entitlement or right relates would or might be less generous"*[10]. The wide-ranging nature of such changes can include, for example, those which result in a small reduction in accrued benefits for some members but an overall increase in accrued benefits for the total membership.

If the sponsor and/or the trustees of an occupational pension scheme wish to make any restricted changes they need to satisfy several requirements set out in legislation. Depending on the exact nature of the change these will include obtaining the informed consent of every scheme member adversely affected by the change or obtaining an actuarial statement that the value of the accrued rights will not fall for any single member as a result of the change. The legislative requirements in Section 67 are very prescriptive (and are further expanded upon in Regulations[11]) and compliance with them is often costly or impractical. Consequently, Section 67 can act as a disproportionate barrier to pragmatic benefit rationalisation that could reduce the administrative costs and complexity of operating the scheme.

The NAPF's response to the 2006 White Paper gave two examples of how Section 67 may prevent schemes from rationalising their benefits:[12]

- A scheme provides for a spouse's pension on death after retirement of one half of the member's pension but for historical reasons for a small number of members the entitlement is based on two-thirds for part of their service. In order to introduce a rationalisation of 60% for all members for all service (which would result in a reduction in accrued benefits for some members of less than 2% but an overall increase in value of accrued benefits of around 2.5%) the requirements of Section 67 would need to be met.

- A scheme provides guaranteed pension increases on pre-1985 accruals at a fixed rate of 3% but no increase beyond the statutory minimum for subsequent accruals, so that the portion accrued between 1985 and 1997 is not subject to any guaranteed increases. At present, a move to a

[10] S.67A(10)(b) Pensions Act 1995
[11] The Occupational Pension Schemes (Modification of Schemes) Regulations 2006
[12] NAPF, Security in retirement: towards a new pensions system – NAPF Response (September 2006)

consistent basis of increase, such as the lesser of RPI and 2.5% for all accruals, would require compliance with the requirements of Section 67 because the value of some members' benefits could be marginally reduced.

It can also be difficult to establish whether Section 67 applies to a proposed change in the first place and this imposes further legal costs on pension schemes. The construction of Section 67 (and related legislative provisions) is complex and the terminology used is unhelpful. For example, opinion can be divided even between professional advisers as to whether a certain change 'would or might' adversely affect a member's rights or whether the rights in question are in fact 'accrued rights' and therefore fall to be restricted by Section 67. There have been several guidance papers over the years to help with the interpretation of Section 67, including the Joint Opinion of Nicholas Warren QC and Paul Newman on 19 April 2000 (albeit on the previous incarnation of Section 67) and the Code of Practice on Modification of subsisting rights[13]. However, there are still many grey areas and the application of Section 67 remains prone to not insignificant amounts of adviser fees. As one respondent said, "Section 67 is a very high technical hurdle".

The difficulty of interpreting and applying Section 67 can be magnified when a scheme has different categories of members who may be affected differently by the proposed change. One respondent gave the example of scheme members falling into 500 different categories depending if joined pre or post 97, pre or post A-day, pre or post some benefit changes etc. Assessing whether for any of these groups a change might be detrimental is difficult and time consuming and as such, the respondent felt that a system has been created which is "designed to fail as it is just too complex". A consequence of Section 67 is that to reduce this complexity, a sponsor can only level up all members up to the highest benefit, which is unlikely to be attractive to the sponsor.

Other respondents felt that Section 67 was superfluous. Trustees have a fiduciary duty to act in the best interest of all members and exercise their judgement, which means they should not agree to any changes which would fall under Section 67 and leave members worse off – unless it would benefit the membership as a whole to a greater extent. Section 67 was felt to turn consideration of any scheme modifications into an overly prescriptive, process driven 'tick-box exercise' which distracts trustees from focussing on their objectives for the scheme.

Any changes to Section 67 would need to be approached carefully to ensure that sponsors do not use undue influence to make changes in their own interest to the detriment of members and to ensure the trustees position is not undermined. It will be important, in any review of Section 67, to ensure that the protection of members' accrued rights remains a priority.

However, a blanket removal of Section 67 would increase the flexibility for the scheme sponsor and trustees allow some much needed rationalisation and consolidation of member benefits which currently accommodate all the numerous legislative changes made over the last three decades.

But if the Government felt scrapping Section 67 was a step too far, it could at least introduce an easement to allow schemes to rationalise their administration. To balance sponsor flexibility with member protection, one option could be to ease the current Section 67 requirements for certain de minimis changes. For example, benefit rationalisation could be permitted for changes that would reduce the value of individual member's

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[13] http://www.thepensionsregulator.gov.uk/docs/code-10-modification-of-subsisting-rights.pdf

accrued rights by not more than, say, 5% of the value of those accrued rights whilst not reducing the total scheme liabilities (subject to some form of actuarial sign-off, simple member disclosure and reporting to the Pensions Regulator). This might lead to some reduction in the costs of the actuarial advice required but, more importantly, would make it more likely that a change could then be made.

The NAPF recommends that Section 67 should be removed or amended as it is superfluous to existing fiduciary duties and creates a high technical, and process driven, hurdle for trustees when considering changes to their scheme. If Section 67 is kept, an easement should be introduced so that schemes can make changes that have only minimal detrimental impacts on individual members and do not reduce the overall liabilities of the scheme.

Scheme administration, and interactions with TPR and PPF

In the responses to our Call for Evidence and in discussions with our members we heard that the operations of the Pensions Regulator were burdensome. Respondents felt that this burden was growing, and talked about "increasingly onerous governance requirements set by tPR". The testimony of a pensions manager outlined in Box 4 illustrates the financial and opportunity costs the Regulator imposes on pension schemes. While smaller employers are less likely to offer a DB pension, if they do, they will face the same regulatory burden larger schemes face, which can lead to disproportionate scheme administration costs.

Box 4: The burden TPR imposes on schemes

"Regardless of the size of the Company employers and trustees have to company with tPR requirements to the same extent. In a small to medium sized company with no Pensions Department as such, this means that much of the work connected with implementation of tPR requirements falls to advisers – hence cost of running the scheme increases significantly.

In the last 10 years the bills we used to receive quarterly are now exceeded on a monthly basis. The annual pension administration budget is over £1m.

Trustee meetings take twice as long as 10 years ago. Governance and new policies take up significant time. Investment management and strategy are so critical to the trustees and the company that that a new Investment Subcommittee has had to be created to relieve the full board. Solvency II proposals brought a co-ordinated approach to EIOPA representing cross-Europe objections to the plan which will increase liabilities and mean even higher Employer contributions. IAS19 accounting framework means there is significant analysis and reporting to do.

Record keeping and scheme administration – the 15-hours a week pension's manager has to manage everything – board proceedings *and* communication with members. Time that should be spent chatting to members approaching retirement is largely taken up by governance and record-keeping. Member queries are an inconvenience which has to be squeezed in. Plans for auto-enrolment are an additional burden we must shoulder with minimal resource."

There was also general support for greater flexibility in dealing with employers and trustees, most notably around deficit recovery plans where the existing TPR guidance means that a maximum 10 year recovery period is often regarded as being hard coded. This means schemes and employers will go to great lengths to stay within the 10 years threshold to avoid the costs of advisers associated with needing to defend anything longer than 10 years with TPR. TPR's recently issued statement on DB scheme funding in the current economic climate[14] suggested greater flexibility around recovery plan length for schemes facing affordability difficulties with their current triennial valuations. There is an opportunity here for TPR to demonstrate that this flexibility can be made use of without imposing significant additional costs on the scheme. Linked to this were concerns about the varying quality of responses lawyers and pension scheme managers got when contacting TPR.

While TPR's principles still do not include an overarching objective to promote good pension provision this imbalance may continue. In practice TPR's work seems particularly driven by the third of its five statutory objectives – to protect the Pension Protection Fund. This leaves the Regulator overly focused on managing the legacy issues Defined Benefit pensions and insufficiently focused on the continuation of good-quality workplace pensions. The NAPF has therefore argued to make the longevity and health of workplace pensions a key objective for the Pensions Regulator[15]. In summer 2011, Oliver Heald presented an amendment to Parliament to include at end of Section 5 of the 2004 Pensions Act, the new sub-clause "(4) In implementing the objectives set out in Section 5(1), the Regulator shall have regard to the promotion of good pensions and to ensuring their health and longevity." However, this amendment was not passed, leaving the Pensions Regulator without a clear steer to promote the sustainability of workplace pensions.

Employer Debt

Despite several goes by the Government to introduce easements, the Section 75 regulations remain hugely complex and can have the effect of artificially and unnecessarily crystallising scheme deficits, missing the bigger picture of what the regulations are intended to achieve. One respondent commented that the recently expanded and increasingly exercised moral hazard powers mean than TPR can impose contribution notices and financial support directions on any group company and make them assume responsibility for a Defined Benefit deficit existing elsewhere within the group. Therefore, provided no value leaves the group as a result of a transaction, and the strength of the overall employer covenant remains unchanged, there is no need for a Section 75 to trigger a crystallised deficit. On this basis it is argued that any intra-group restructuring should not trigger a Section 75 debt.

It was also noted that further guidance may be required on the appropriate events for payment of '"amount B" (i.e. the amount payable by the guarantor) under a withdrawal arrangement as the legislation only specifies a number of events, none of which are likely to be appropriate in the context of last man standing schemes.

A related matter raised was around the different definitions of 'employer' for the purposes of employer debt, PPF eligibility and scheme funding legislation. Alignment of these definitions could make it easier for trustees to understand the tests being applied and to achieve the regulatory aim of trustees identifying which employers are responsible for member protection.

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[14] The Pensions Regulator, Statement on pension scheme funding, 2011
[15] NAPF, Fit for the Future: NAPF's Vision for Pensions, 2010

A legal expert commented that the regulations have been poorly drafted, giving rise to significant legal risk to employers who have had to try and guess or interpret what the provisions mean, creating a situation where arguably the burden imposed by the regulations outweighs the potential benefits. And one respondent proposed that with the apportionment arrangements finally 'got right', the now seven alternatives to the liability-share method of implementing an employer debt could be rationalised.

A Section 75 debt can currently be triggered by a corporate restructuring even where no value has left the corporate group. This could be simplified by relying on The Pensions Regulator's (TPR) increased powers to intervene and take action against any company within a group rather than crystallising the deficit.

Appeals process

We were told that multi-employer schemes can face particular challenges around the Appeals process surrounding the calculation of the PPF levy as the testimony of a Senior Pensions Adviser to a multi-employer scheme shows.

Box 5: the PPF levy appeals process – case study

Once the PPF levy invoices have been issued, trustees can submit an appeal if they believe that the levy was calculated incorrectly or based on incorrect data. For example in a large multi-employer scheme trustees may be unaware that an employer which was in liquidation actually completed the liquidation process shortly before the end of March PPF deadline. Instead of being removed from the list of "current" employers as would be the case if the employer was updated as liquidated, the employer would be given a failure score of 1, which greatly increases the scheme's risk based levy. This is particularly problematic for trustees who also have to monitor overseas companies.

The PPF appeals process requires the trustees to submit a formal request to re-calculate the levy based on the correct data, and setting out the precise reasons why they believe the levy is not correct. This requires a detailed knowledge of the criteria set out in the PPF Determination document and is typically drafted in conjunction with the scheme's advisers and actuaries. Legal advice is also commonly required at each stage of the appeal. In addition, trustees can appeal to Dun & Bradstreet (D&B) if they believe that the wrong Dun's number has been matched to a particular employer. It can therefore be the case that appeals are lodged with both the PPF and D&B.

Up until recently, the PPF appeal process consisted of five stages (now amended to three). As each stage is reached, the case is considered by progressively more senior staff. If the appeal is declined, a fresh appeal has to be submitted at the next stage of the process, setting out the reasons why the trustees disagree with the previous appeal judgement. This is often the same reason as the original stage 1 appeal. The current process results in a significant cost to the scheme in terms of time and resources, as well as legal and actuarial costs.

Record keeping and Data Exchange

Record keeping can be a challenging, time consuming and costly exercise for schemes where employee turnover is high and the scheme needs to keep track of a large number of deferred pension scheme members.

Discussions during visits with our members have revealed frustration where the TPR requires trustees to track down records for deferred members on an ongoing basis, but where that data is then supplied by DWP when the members approach retirement. This suggests some consolidation of data sources across TPR and DWP could save considerable cost. Other NAPF members expressed frustration at the resource that has to be dedicated to keeping track of members, so that requirements around communications and disclosure can be met.

Box 6: Scheme Communications – a pension managers perspective

"We have two separate and different schemes to administer. Annually the trustees must report to all members so we post out paper documents to pensioners and deferred members. Every time we do this a dozen are returned as Gone Away. Last year we undertook a review of address details which led to certain members being tracked down via means such as Facebook – this took time and money. And still we don't know where all the members live!

We have streamlined internal communications so that these are mostly done by email for active members, but we still have to post out paper copies of their annual benefit statements – even though this information is available online for DC scheme members. We do not have the resource to create an email address book for deferred and pensioner members – whose numbers now outweigh the number of active members, and this balance will tip further as active members age."

Multi-employer schemes also expressed concerns around the processes for the data that they have to submit to TPR via the online scheme returns to Exchange and, in particular, the challenges they face in keeping a fully accurate record of companies "in liquidation" or "liquidated". This is exacerbated where not all companies are listed on Companies House, e.g. because they are statutory bodies, charities, or are registered overseas. Whilst schemes can invest a considerable amount of time into reviewing their participating employers, errors can inadvertently occur and, when they do, can only be rectified through the PPF's formal appeals process.

The burdens around compliance and governance were felt to be onerous and disproportionate, particularly for smaller schemes. Particular issues were raised around the time and effort spent on record keeping, and around data exchange and appeals processes, especially for multi-employer schemes. DWP and TPR should review where the processes around scheme record keeping and data exchange can be further streamlined to reduce the burdens on individual schemes.

Disclosure and Communications

Pension schemes are required under current regulation to disclose a great deal of information to scheme members. Whilst it is important that scheme members have the information they need to make good decisions about their retirement saving, the current regulatory framework around disclosure is at the same time disjointed (with different types of pension schemes subject to different rules) and overly layered (piling technical memoranda over regulation over EU directive).

The DWP has already acknowledged that the existing complexity around disclosure requirements is burdensome for employers. In November 2010, the DWP published a response to its consultation on

disclosure requirements covering DB and DC pensions.[16] However, many respondents to our Call for Evidence did not feel that the DWP's consultation went far enough. One respondent described the current disclosure rules as "*complicated, misleading and too prescriptive".*

Current regulatory regime

Currently, employers and schemes face different disclosure requirements depending on whether the scheme is defined benefit or defined contribution, and within the latter, whether it is trust- or contract-based.

- All schemes are required to disclose certain information to new joiners. This information must also be available to other members upon request.
- DB schemes must provide benefit statements to members upon request. DB schemes must also provide a statement of funding to members explaining the funding position of the scheme.[17]
- DC schemes must provide an annual benefit statement along with a Statutory Money Purchase Illustration (SMPI). The assumptions underpinning SMPI assumptions are different for trust-based and contract-based schemes.

The disclosure rules specify exactly how these communications must be delivered (in most cases via post), even though DWP introduced reforms to allow schemes to communicate electronically with their members in some areas. There are also rules on what must be included in each communication to members, in the case of DB schemes going down into details such as:

- The amount of benefit payable
- The amount of death benefits that would be paid if the member were to die or leave service within one month
- Date on which pensionable service commenced
- Formula used to calculate benefits
- Amount of pensionable remuneration
- Details of how any deductions are calculated
- Value of protected rights and accrued rights
- Options available to the member under the scheme rules and the rights and options on the event of a members' death.

Complying with these disclosure requirements is costly and time-consuming for employers. To make a real difference to the burdens faced by schemes and employers when disclosing information to scheme members, the DWP must take action not only to simplify the requirements but also to align requirements for trust-based and contract-based schemes. Almost one in ten (7%) of all employers (including those who do not offer a pension scheme) currently offer different types of pension schemes[18] and in a single move, the DWP could remove unnecessary duplication and cost for employers.

[16] Department for Work and Pensions, Disclosure of information (pension schemes), 2010
[17] For the requirements around funding statements, see TPR Website
[18] Department for Work and Pensions, Employers' Pension Provision Survey 2009, 2010

At the end of April, the Department for Work and Pensions issued a consultation on The Occupational Pension Schemes (Disclosure of Information),[19] which consults on the draft legislation for aligning the requirements for trust- and contract-based pensions by 2013. The NAPF welcomes this consultation and will submit a response.

Looking to the future

The key litmus test for any requirements around communication should be whether they add value for the member. If they do not do that, they should be removed to give schemes the flexibility to design their communications in a way which helps their scheme members understand their pension savings. On this background the NAPF believes that it is possible to remove many of the prescriptive details included in the current disclosure rules whilst ensuring that scheme members receive the information they need to make good decisions about their retirement saving.

Table 1: Current requirements and suggested changes

Requirement	Suggested change
Joining packs	Retain requirement to provide relevant scheme details to new members, but remove prescription on information and allow relevant information to be given at an appropriate time.
DB Benefit statement (provided on request)	Remove prescription on information as what is set out in legislation is not always relevant to scheme, allow trustees to determine what information is relevant
DC benefit statement (provided annually for trust- and contract-based schemes	Retain annual requirement and some form of projection, but align with FSA requirements for contract based schemes. Remove requirement to include detail on contributions made over the year as detracts focus from important info, which is the pension that is building up.
Annual Summary of Scheme Funding Statement	Remove prescription on information as it is unhelpful. Members misunderstand how scheme funding does or does not impact their pensions and it detracts from useful messages. Could replace with simple requirement for Trustees to inform members about funding level of scheme and how they are protecting benefits.

Improvements to the way schemes and providers disclose information to members is already underway. The NAPF is currently leading the development of an industry-led Code of Conduct on the disclosure of pension costs and charges, an example of how a less top-down approach to regulation, especially in the area of member communication, can lead to best practice. Another example of an industry-led initiative to ensure user-friendly communications is the Pension Quality Mark (Box 5).

[19] Department for Work and Pensions, The Occupational Pension Schemes (Disclosure of Information) (Amendment) 2012, 2012

Box 5: The Pension Quality Mark - www.pensionqualitymark.org.uk

To qualify for the Pension Quality Mark (PQM), schemes need to comply with a number of requirements around contribution rates, governance and communication. To meet the standards around communications, they must be clear, engaging and easy to understand. In addition, communications must take place at three specified stages of membership:

1. At induction/joining, employers or schemes should provide engaging information that emphasizes the scheme benefits and the need to take action.
2. On an ongoing basis, employers or schemes should offer face-to-face or over phone (such as group seminars, 1-2-1s or a helpline); or tailored individual information (such as access to pension account online); or regular generic information (such as newsletter or up-to-date intranet site).
3. When an employee nears retirement employers or schemes should ensure they receive information to help them consider retirement options.

Schemes will have to provide examples of communication with members when they first apply for a PQM and will have to certify annually that they still meet the qualifying criteria. There will also be verification checks on a number of randomly selected schemes to ensure they are meeting the necessary criteria.

The NAPF recommends that more focus should be placed on the principles of what information should be provided and how, by 'trusting the trustee' or the pension scheme manager to determine how to best communicate with their members. Aligning the requirements for trust-based and contract-based pension schemes from 2013 should help to streamline the regulations in this area, provided it does not lead to overlaying of prescription and a levelling up of information requirements.

Other issues raised in the Call for Evidence

While there was broad consensus on the areas above, a number of smaller problems were raised by our fund and business members. In discussion we found that views were not clear cut on all of these, or that in some cases they could be a significant problem for some schemes but a low priority for others. However, where other responses to the Red Tape Challenge lend support to these suggestions they may be worth further exploration by Government. Other topics raised included:

- **Transfers:** one respondent argued that transfer values provide little benefit for the member and should therefore be entirely voluntary, both in terms of availability and how they are calculated.
- **Timetable of valuations:** one respondent suggested that the 15 month window for triennial time available for valuations be reduced, as this would increase the efficiency of pension schemes and the associated costs spent on advice, because they would have to complete them in less time.
- **The minimum number of member-nominated trustees**: some respondents had difficulties in finding lay member nominated trustees with the appropriate skills and experience, others, however, did not find this a particular problem.
- **Trustee knowledge and understanding**: some respondents argued that a lot of knowledge is required of trustees, much of which often does not apply to the scheme they are actually responsible for (e.g. rules on winding up).

- **Divorce Sharing Rules**: we heard from some members that divorce sharing orders are complicated and time consuming, and that schemes easily miss deadlines in the process. However, it was felt that since most schemes only deal with a handful of cases per year, streamlining the process was not a priority.
- **Tax free lump sum**: one respondent argued that where a member has both a DB and a DC scheme, the tax free lump sum should be payable out of a DC/AVC scheme only.

CHAPTER 3: ISSUES RAISED OUT OF SCOPE

Areas deemed out of scope for the Red Tape Challenge Pensions Spotlight include the state pension, auto-enrolment, and the pensions tax relief regime. As our members raised issues in these areas as a regulatory concern we have included them here, in the hope that they receive attention by Government and the regulators in due course.

State Pension

"The state has – and will continue to have – an important role to play as a direct provider of pensions, to provide an adequate floor of benefits that keeps its citizens out of absolute poverty without resorting to means-testing for the majority."

Fit for the Future: NAPF's Vision for Pensions, 2010

The NAPF has long argued for radical reform of the UK's state pension system. The State Pension system has a key role to play in providing an adequate retirement income for pensioners and in providing a solid foundation on which to base private pension saving. From this October onwards, millions of people will begin saving in a workplace pension for the first time. The introduction of automatic enrolment is one of the biggest reforms to UK pensions in decades. To ensure the success of auto-enrolment, it is imperative that the state pension system is reformed in an equally radical way.

Since coming into office in May 2010, the Coalition Government has acted on its commitment to restore the link between earnings and the Basic State Pension from April 2011 and has introduced the "triple lock". These measures are an important first step in maintaining the value of the state pension, but in our view does not go far enough. In 2010 the NAPF published proposals to combine the Basic State Pension and Second State Pension into a single Foundation Pension set above the means tested benefits level and we welcomed the publication of the Government's Green Paper *A state pension for the 21st century* in April 2011 which proposed two options for state pension reform. To inform our response to the Green Paper, the NAPF commissioned the Pensions Policy Institute to analyse the different options for reform[20]. The introduction of a single, more generous Foundation Pension coupled with innovations in workplace pensions would significantly increase the size of individuals' pension pots and would provide a powerful incentive to people by ensuring that it pays to save for their own retirement. Without radical reform, even after the introduction of auto-enrolment, the current system would continue to deliver inadequate incomes—especially for those on low to median incomes where the value of their savings are eroded away by means tested benefits. The introduction of the Pension Credit fulfilled its purpose by lifting 900,000 pensioners out of poverty since 1998[21]. However, the political debate has moved on considerably, especially given the current pressures on Government spending. The gap between the level of the Basic State Pension and the Pension Credit has continued to widen. High levels of eligibility to means tested benefits simply do not chime with the Government's objectives of encouraging personal responsibility, especially with the introduction of auto-enrolment scheduled for 2012.

The Chancellor confirmed in March 2012 that the Government will be moving forward with the Single Tier option for reform, which would combine the Basic State Pension and State Second Pension into a single pension set at £140 a week. The focus now needs to be on putting these plans into practice because we still have one of the lowest state pensions in the developed world and, as the Pensions Commission acknowledged,

[20] Pensions Policy Institute, An assessment of the Government's options for state pension reform, 2011
[21] Work and Pensions Select Committee, Tackling Pensioner Poverty: Fifth Report from the Committee, 2008-9 Session

it is also one of the most complicated. Currently, around half (45%) of pensioners need some form of means tested benefit to support their income.[22] According to the OECD, the gross replacement rate for a median earner in the UK is just 37% compared with the OECD average of 60%.[23]

Based on the need for simplification and to provide a clear incentive for savers, the responses to our Call for Evidence to the Red Tape Challenge were supportive of state pension reform, but also raised concerns about the potential issues for pension schemes. Although the introduction of a Foundation Pension is welcomed, there will be complex transitional issues for pension schemes, particularly contracted out DB schemes, such as contracting out, anti-franking and GMP equalisation, with the latter mentioned most often in the responses we received. In our response to the Green Paper, the NAPF outlined a number of measures the Government could implement to help make the ending of DB contracting out easier to manage. In particular, it is important that employers have the power to amend their scheme rules to take account of the lost National Insurance rebate.

Given the legislative changes the Government has to make before introducing a foundation pension, it could use the opportunity to introduce an override to allow schemes to align their normal pension age for future accruals with the State Pension Age. This would give schemes some degree of protection against future increases of longevity, as long as the Government of the day increases the State Pension Age accordingly.

Giving certainty to schemes is one way the Government can help make the process of ending DB contracting out easier. Schemes will need at least five years to prepare for the ending of contracting out, so we encourage the Government to publish further details about the ending of DB contracting out as soon as possible.

The NAPF welcomes the progress the Government has made towards introducing a Foundation Pension, and recommends that the Government sets out concrete plans and workable timetables as soon as possible, with a consideration for employers who will face upheaval from the abolition of contracting out and who will need to manage the transitional costs of restructuring their schemes.

GMP Equalisation

"Although there are many areas of unnecessary regulation and bureaucracy that one could target, for me there is one paramount issue that dwarfs all others – GMP Equalisation."

Pension Scheme Trustee

Excluding GMP Equalisation from the Red Tape Challenge is at odds with the underlying objectives of the Government to reduce regulatory burdens on employers. Even if the Government were to take significant steps to improve the regulatory environment for pensions through the Red Tape Challenge, any benefits would be undone in the short term by the costs of GMP equalisation. Gold-plating of international law and the benefits provided voluntarily by employers can have a severe impact on the costs of providing workplace pensions. As the Red Tape Challenge is also aimed at identifying areas where the UK is gold-plating EU regulations, GMP equalisation has to be considered under this Red Tape Challenge, because it is the prime example of gold-plating what are otherwise voluntary employer benefits.

[22] Department for Work and Pensions, A State Pension for the 21st Century, 2011
[23] OECD, Pensions at a Glance, 2011

The NAPF strongly argued in its response to the consultation on GMP equalisation[24] that the DWP should withdraw its proposed new Regulations on equalisation of Guaranteed Minimum Pensions (GMPs) and should conduct a full assessment of the impact on pension schemes, including the impact on public sector schemes. The DWP should also disclose the legal advice it received to increase transparency and to give schemes more certainty.

It is crucial to estimate the costs of GMP equalisation. The DWP has argued that, as there is (strictly speaking) no new legal obligation to equalise GMPs, there is no requirement to produce a regulatory impact assessment. But given that pension schemes now face extra liabilities estimated (in figures given by the Joint Working Group) at around £13 billion, plus £300 million of extra administrative costs, this argument seems out of kilter with the spirit of the Government's Better Regulation agenda.

A full impact assessment should take account of (i) the increased benefits that would arise and (ii) the administrative costs involved in checking whether each beneficiary's benefits need to be adjusted in order to ensure they are equalised. The impact assessment should also take account of the opportunity cost that will arise from lost investment in the economy; if employers incur extra costs as a result of GMP equalisation and have less money available for investment in expanding their businesses and creating new jobs.

GMP equalisation could also affect public sector pension schemes. Slaughter and May estimate a cost of around £4.6 billion in extra benefits to be paid by public sector schemes.[25] The Government should set out the full position in relation to public sector schemes and should take full account of the extra costs and administrative burdens on the public sector.

The NAPF has argued that it is not clear that an obligation to equalise GMPs actually exists under EU law. As an immediate step, the DWP should publish the legal advice that underpins its view that equalisation is required and that there is a need for new Regulations to show that it is not gold-plating EU legislation. This would improve the transparency of the Government's policy-making and would help the industry to make a constructive contribution to the policy process.

The proposed legislation is unlikely to remove the uncertainty that surrounds GMP equalisation in the absence of a test case. In fact it is likely to put trustees in a difficult position. The advice to many trustees from their own legal advisors is likely to be not to equalise – even though they might then be exposing themselves to a claim under the UK legislation. The situation is likely to become further confused, with some schemes equalising and others not doing so - and with no certainty about the method to be used.

The NAPF recommends that the DWP should withdraw its proposed new Regulations on equalisation of Guaranteed Minimum Pensions (GMPs) and should conduct a full assessment of the impact on pension schemes, including the impact on public sector schemes. The DWP should also disclose the legal advice it received to increase transparency and to give schemes more certainty.

[24] NAPF, Response to the DWP consultation on GMP equalisation, 2012
[25] *Pensions and Employment: pensions bulletin*, Slaughter and May, January 2011

Automatic enrolment

"Plans for auto-enrolment are an additional burden we must shoulder with minimal resource."

Pensions Manager

As discussed above, auto-enrolment is out of scope for the Red Tape Challenge. We welcome that the Government is going ahead with the automatic enrolment reforms for all employers (rather than excluding micro employers) and think that exempting automatic enrolment from the Red Tape Challenge will help to maintain this position and create much needed certainty for employers. However, not only the outcome of automatic enrolment, but also the process of its implementation needs to be monitored carefully and regulations around it need to be tweaked if necessary. The Government should monitor in particular the overall burden the process of introducing automatic enrolment imposes on employers and ensure that they have the flexibility they need to provide good workplace pensions to their staff.

In the responses we received and in discussions with our members we heard that the automatic enrolment regulations are so inflexible, overly-prescriptive and needlessly burdensome to implement that it will be almost impossible for any employer to be fully compliant with the full details of the rules. Successful implementation will depend on the Regulator taking a targeted and common-sense approach, focused on making sure that the vast majority of employers are at least trying to do the right thing and complying with the spirit of the law.

However, this approach will not stop employers and schemes feeling compelled to spend huge amounts of time and resources in order to be fully compliant with details and aspects of the regulations which provide little if any measurable benefit.

The root of the problem is three-fold:

- An incorrect assumption that most employers will try to flout the rules, when in fact all the evidence is that they will do their best to comply, and many already voluntary choose to offer good pensions.
- A desire to give small employers certainty by giving very precise requirements, without much consideration of the need for flexibility for other employers, particularly those who already have good pension arrangements in place.
- An attempt to reduce opt-outs by making the process needlessly difficult for employees, employers and schemes, rather than simply rely on the power of inertia, which all the evidence suggests is the main reason why automatic enrolment is so successful in increasing take-up.

The NAPF has argued at all stages for the regulations to be simplified, and had some success with the 'Making Auto-Enrolment Review'.[26] A simpler system of certification for DC schemes and allowing employers to use waiting periods of up to 3 months are both very welcome flexibilities. However a range of other proposals for simplifying the automatic enrolment regulations were not taken up and there is huge scope to reduce the regulatory burden in the future.

Top of NAPF members list of simplifications would be:

- Allowing workers to complete opt out forms during the waiting period;

[26] Department for Work and Pensions, Making Automatic Enrolment Work Review, 2010

- Allowing employers to automatically enrol non-eligible jobholders, if they wish to avoid the burden of endlessly monitoring if they have become eligible;
- Allowing employers to exempt employees from automatic enrolment if they know they have enhanced tax protections that could be endangered; and
- Create legal safe harbours for those employers who offer good schemes with contributions above the minimum requirements to administer and communicate auto-enrolment in their own way, to their own timescales, and around their own business needs.

These simplifications would all benefit employees and employers, and encourage employers to offer better pensions.

However, the current situation is difficult. What employers and schemes most want at present is certainty so they can get on with implementing automatic enrolment, even though the rules are not helpful. Therefore the DWP and the Pensions Regulator must do two things:

- Monitor implementation to see what problems are occurring with the current regulations, and take swift action to change the rules which are causing severe problems or are just proving unworkable.
- Prepare for a major review and simplification of the regulations in 2017, in light of real life experience from this October.

The NAPF recommends that with only five months to go, no changes are made to automatic enrolment. However, it seems crucial to keep the process under review with a focus on the problems raised above and potentially make changes before the next major review in 2017.

Tax simplification

"Simplification it was not."

Head of Pensions, DB scheme closed to new members but open to future accrual, DC scheme for new joiners

Despite the pensions tax regime and related issues being out of scope in the Red Tape Challenge, we have heard a number of individual frustrations from those running pension schemes as well as from consultants and lawyers in the business community advising their clients on taxation. These comments in response to our Call for Evidence were supported by discussions at the NAPF Legal Panel and those working within leading consultants in the pensions industry.

The consensus was that the A Day simplification reforms in 2006 had not, in the long run, had the desired effect. Constant tinkering and adjustments of the pensions tax relief regime to new policy and market developments and to supply saving measures at successive Budgets has meant that layers of legislation have been laid over each other, making the system complex and difficult to navigate and creating huge administrative burdens. As one consultant put it, *"The Government should accept that its attempt to legislate to capture all variations of pension scheme design and practice through a codified pensions tax regime has been a failure"*.

Despite these concerns, pension professionals argued for stability in the short-term rather than further tinkering around the edges. As any change, regardless of how small it might be, is likely to have repercussions throughout the system, changes need to be consulted on and impacts need to be fully assessed. The Office for Tax Simplification has recently carried out a review of the taxes pensioners pay,[27] which also included discussions with a group of stakeholders. A similar exercise should be conducted looking at the taxation of pension savings and could tie in with the timetables for broader changes to the system expected around state pension reforms and contracting out, and the review of auto-enrolment in 2017.

As an immediate step, there should be scope for improving the way that HMRC interacts with individuals and professionals. The Hampton principles, which were laid out in 2005 and should be consistently applied across the regulatory systems, state that "regulators should provide authoritative, accessible advice easily and cheaply".[28] However, the evidence we heard from the professional community, suggests that this principle is not being met. We heard that legal professionals who asked for clarification from HMRC officials were often simply directed back to legislative text and were given little help with interpretation. The consensus was that a 'call centre mentality' had developed in HMRC and that a return to the caseworker approach that had previously existed would be a vast improvement.

How legislation is implemented, and the support that those running pension schemes and the professionals advising them get, significantly impacts on the burden the legislation creates. Our Call for Evidence suggests that there is significant scope to reduce the administrative burdens and costs of professional advice in this area.

As a first step, HMRC should review the delivery of its services and the costs the pensions tax relief regime is placing on pension schemes, with a view to improving the way it communicates and interacts with those running pension schemes and the professionals advising them. In addition, the NAPF recommends that the Office for Tax Simplification conducts a separate review to identify opportunities to streamline and simplify pensions tax legislation.

[27] Office for Tax Simplification, Taxation of Pensioners Review, 2012
[28] The Hampton Review – Assessing our Regulatory System, 2005

CHAPTER 4: CONCLUSIONS

Despite its narrow focus, the Red Tape Challenge covers a lot of ground. The Government therefore needs to remind itself of its underlying objectives of regulation on workplace pensions and what regulation is trying to achieve and prioritise on which areas to focus. As we have argued in this submission, reforms, change and even simplifications can be costly to pension schemes and their sponsoring employers in the short term. The Government should therefore focus on a handful of key areas where benefits will outweigh the costs and which allow sponsoring employers, trustees and pension scheme managers to bear down on the costs of running their schemes, as part of a broader drive to reinvigorate private pensions in the UK. The areas identified by NAPF members are:

- Indexation and other statutory DB benefits
- Section 67 and Scheme Modifications
- Section 75 and Employer Debt
- Interactions with TPR and PPF, including record keeping, data exchange, and appeals processes
- Disclosure and Communication requirements

The other areas within scope of the Red Tape Challenge and raised by members in our Call for Evidence, such as issues around transfer values, divorce sharing rules and appointment of member nominated trustees received less consensus or are seen as smaller burdens and so may merit some further exploration from Government before considering further changes.

Of all the areas raised in our Call for Evidence, the single biggest priority is around Guaranteed Minimum Pension equalisation and the £13bn anticipated cost (and £300m administration cost) this is expected to impose on employers who, according to the Government's latest legal advice, may need to further level up benefits within their schemes. This new burden alone, which is believed by many in the industry to be gold-plating EU legislation, could wipe out at a stroke any benefits delivered by the Red Tape Challenge, and would undermine the Government's deregulatory agenda on pensions. We have raised this issue, and issues around the auto-enrolment regulations and the operation of the pensions tax relief regime, in the hope that they receive attention through the Red Tape Challenge and can be addressed by the relevant Government departments and regulatory authorities in due course.

On all these issues, we would urge the Government to return to the first principles of what it is trying to achieve through the regulatory landscape for pensions and focus on the ultimate goal of reinvigorating private pension saving in the UK.

ABOUT THE NAPF

The National Association of Pension Funds is the UK's leading voice for workplace pensions. Our members operate 1,200 pension schemes. They provide retirement income for nearly 15 million people and have almost £800 billion of assets under management. Our membership also includes over 400 providers of essential advice and services to the pensions sector. This includes accounting firms, solicitors, fund managers, consultants and actuaries.

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