



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

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Your ref:

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c/o Gabrielle Park
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Dear Mr Sweeney and Mr Lewin

Deregulatory Review of Pensions – consultation paper

The Institute of Chartered Accountants in England & Wales is pleased to submit its comments in response to the consultation paper on how to ease the burden of red tape for employers who offer workplace pension schemes, while also protecting the interests of pension scheme members, which was published on 9th March by the Department for Work and Pensions.

Please contact me if you would like to discuss any of the points raised in the attached response. We would also be pleased to meet the DWP for further discussions once the outcome of the review has been determined.

Yours sincerely

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ICAEW Representation

ICAEW REP 30/07

DEREGULATORY REVIEW OF PENSIONS

Memorandum of comment submitted in April by The Institute of Chartered Accountants in England and Wales, in response to the Deregulatory Review of Pensions consultation paper published by the Department for Work and Pensions in March 2007.

Contents	Paragraph
Introduction	- 1
Who we are	2 - 4
General comments	5 - 30
Responses to specific questions	31 - 41

INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the 'Institute') welcomes the opportunity to comment on the consultation paper *Deregulatory Review of Pensions Institutions* published by the Department for Work and Pensions in March 2006.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 128,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures these skills are constantly developed, recognised and valued.
4. Many ICAEW members act as trustees of occupational schemes and are finance directors of companies who bear the costs of the pension provision. The short time-scale in responding to this paper has meant that we have been unable to obtain the views of our wider membership as we would have wished. Rather than answering all the specific questions, we set out our high-level general comments below, together with some more detailed comments relating to accounting and auditing, and then our answers to the specific risk sharing questions.

GENERAL COMMENTS

Risk sharing

5. See paragraphs 31 to 41 below

Limited price indexation of pensions in payment

6. We agree that reduction or removal of LPI could be used as one of the forms of risk-sharing in defined benefit schemes, or perhaps members should be able to choose what level of risk they are willing to accept. The short timescale for response to this consultation means that we have been unable to take soundings from our members about the questions raised in the paper

Revaluation of deferred pensions

7. Again, we have been unable to consult our members for their views on whether relaxation of revaluation would be welcomed or advisable. However, the current nature of employment means that most people now have several employers over the course of their working life and it would seem to be

unreasonable to remove increases in deferment. It would also seriously disadvantage those who take career breaks to care for their families.

Normal pension age

8. Many schemes have already raised pension age for future service, but we believe it would be unfair to reduce accrued rights. Setting retirement age to a longevity index might render planning for old age difficult. We would prefer to link it to changes in state pension age, which is proposed to rise to 68 in stages. This would also be understandable for scheme members and would fit with their general financial planning based on state pension and related benefits.

Principles-based regulation

9. We believe that some aspects of the legislation could be replaced by principles-based legislation. This basis has been adopted by the FSA for its own regulatory regime. Indeed, in the wake of the Goode committee's report and at the instigation of the then chairman of the ICAEW's pensions sub-committee, Edward Weiss, the pensions industry prepared a series of codes of practice across the range of scheme activities which we believed would make detailed regulations unnecessary. More recently, the accounting profession was consulted in the preparation of the Internal Controls Regulations and these are straightforward and principles-based. It is perfectly possible to adopt this approach.
10. However, we submit that the legislation has been made over-complex by the DWP's current practice of amending existing legislation and regulations rather than rewriting and updating. We set out below our views on the regulations surrounding scheme audit and accounts and our members point out that the regulations on winding up are also very difficult to follow. The proof that this approach to amendment is unsatisfactory lies in the number of amending regulations which have had to be issued. In contrast, the new Scheme Funding Regulations and the Scheme Investment Regulations have been completely rewritten and as a result much easier to deal with.
11. We are of the view that it is time for comprehensive consolidation and restructuring of the legislation. From this would emerge a consensus of what was appropriately dealt with by prescription and what would be suited to a principles-based approach.

Trustees

12. Many of our members act as trustees of occupational pension schemes, but we understand that it is becoming increasingly difficult to recruit pension scheme trustees. The proposal that at least 50% of trustees should be member-nominated would create recruitment difficulties as well as, in some cases, cause employers serious concerns.
13. It is inevitable that trustees will encounter conflicts of interest. The ICAEW has issued guidance for its members to assist those who are trustees to understand and deal with such conflicts and this is available on its website at <http://www.icaew.com/index.cfm?route=145216>.
14. Our members have noted that there does not appear to be any obvious source of putting employers in touch with suitably experienced individuals. When member-nominated trustees retire from their own schemes, they might well be

pleased to assist at other schemes on a voluntary basis or for a relatively low cost, which could help smaller employers and schemes meet regulatory requirements.

Return of surplus to the employer

15. A number of our members have represented to us that the issue of return of surplus needs to be thought through now, even though many schemes are in deficit. Many employers have paid very large sums into their final salary schemes to improve funding levels, but there are concerns that at some time in the future, funds will return to surplus. The rules are such that taking surplus out is almost impossible. As a result, employers are becoming increasingly wary of putting too much into their schemes and looking at alternative approaches, such as putting monies into escrow.
16. This is an unsatisfactory position, which was highlighted by the Myners' Review in 2001, as it still means that the employer does not have access to the capital it may need for the business and it is inefficient for tax purposes. We believe that the DWP should address (by legislation) the matter of who owns the surplus, taking into account the position of the scheme.

Section 67 of the Pensions Act 1995

17. We have had no opportunity to seek views of our members, and so have no comments on how matters are working in practice.

Employer debt and s75

18. We agree that the operation of the present s75 creates unnecessary problems in some cases. Where a group of companies runs a group pension scheme, closing down participating companies can trigger a s75 debt, even in circumstances where there is a strong sponsoring employer and there are no reasons to suppose that there are any issues surrounding its ability to fund the scheme. This is preventing rationalisation and restructuring within groups. We are aware of cases where employees are kept on a particular subsidiary's payroll just to prevent triggering the debt! We believe that where a group wishes to restructure, a simple clearance procedure should be available, just as there is a clearance procedure for takeovers and mergers.
19. We are also concerned about the impact that the s75 debt requirement has on industry-wide schemes. The imposition of such an expensive withdrawal requirement, particularly when the scheme is unlikely to wind up for many years, could cause business failure. We welcome the formation of a working group to address the issues and recommend that the industry-wide arrangements be brought into the discussions so that they can provide details of their experience and suggestions for ameliorating their position.

FRS 17

20. We do not believe that FRS 17 is the reason for company withdrawal from final salary pension schemes *per se*, as is often claimed, but it has had an impact, in two ways.
21. Firstly, it drew economic risks to boards' attention. They had been able to ignore them under SSAP 24 since so much of the obligation was 'off balance

sheet'. Even though FRS 17 contained transitional reliefs such that the information was initially only by way of disclosure, it still showed clearly what the balance sheet position was. It moved pensions from a back-office/pensions department issue to a board-level issue.

22. Thus boards of directors were made properly aware of a risk facing their companies of which they had not previously recognised, and the company was able to take any necessary steps to mitigate that risk. However, it was also realised that the cost of existing UK defined benefit schemes was too high, particularly in a global context. The adverse impact, from the point of view of scheme members, was that many boards decided to mitigate the risk by implementing changes detrimental to members' pension entitlements.
23. The second impact is that another reaction by some employers was to agree with the trustees a rebalancing of the scheme's assets to move towards a more bond-based portfolio. If the higher returns promised by equities crystallise, this will make the pension promise more expensive to fund than if the scheme had stayed in equities and not moved to bonds. It seems from reports in the press that this has been another reason for employers to curtail pension promises.
24. We believe that the accounting standard has been used as an excuse for the decisions companies have taken because of the newly-highlighted risk: the standard did not bring about their company's exposure to pension risk, merely brought it to their attention.
25. Finally, from the point of view of UK society as a whole, the loss of access to defined benefit schemes and much lower contributions mean an increase of dependence on state benefits, though it is arguable that containment of costs by employers improves competitiveness.
26. We also note that the review of FRS17 is a matter for the accounting standard setting bodies and their work is conducted in an international as well as UK context.

Simplification of the rules on scheme audit and accounts

27. We are very concerned about the complexity of the regulations determining which schemes require an audit. The overlay of later requirements on previous regulations makes the interpretation of what does and does not require an annual audit a time-consuming process, added to which in some cases an auditor is appointed as such and in other cases as a professional adviser and the audit appointment and engagement letters have to reflect this distinction. We believe that all occupational pension schemes with more than one member should be audited and that there should be no exceptions.
28. In addition, we believe that the auditors' statements about contributions should be dropped. In a regime which requires all those involved in the administration to report to the Pensions Regulator if there are failures, there is little merit in continuing with a requirement to report to members many months after the late contributions, particularly as so few members request the full annual report and accounts.
29. We request that the audited accounts and scheme administration regulations be amended so that all matters relating to audit and appointment of auditors be contained in one short set of regulations. We further suggest that these regulations stipulate that each time an actuary undertakes a valuation, trustees

are required to obtain audited accounts. At present, this requirement is scattered across different regulations. Such complexity makes it difficult for trustees and auditors to understand the requirements of the law and adds to scheme costs.

The role of actuaries

30. The mortality assumptions used by actuaries vary widely. Some transparency on mortality would be helpful to trustees generally. We are aware that there are some initiatives on this.

RESPONSES TO SPECIFIC QUESTIONS

Risk Sharing

Q1: Do you consider that interests of employees will be served by the presence of more risk-sharing schemes? What risks do you believe are most appropriately shared?

31. We believe that any action to mitigate some of the risks borne by employees is in their interests.
32. Bearing in mind the many risks associated with pension provision, it is impossible to pinpoint which risks ought to be shared as they can vary so much. Risks may be shared, for example, by reducing limited price indexation, changing benefits for dependants and changing pension ages. What is certain is that the employee should be better off in retirement as a result of saving in an occupational pension scheme. This means that whatever the shared risk arrangement, an adequate level of contributions should be paid into schemes.
33. Research has shown that for some lower paid people, saving in an occupational pension scheme does not make them better off. We believe that this should be addressed, as in such circumstances, not only are employee savings wasted, but so are those of the employer.
34. We note that the Pensions Policy Institute addressed the issues of low incentives to save in its response to the Government's White Paper 'Personal Accounts: a new way to save' and it has also examined the matter of management charges.

Q2: Do you believe that employers are interested in supporting schemes in which the risks taken by employers and employees are balanced differently than under traditional money purchase or defined benefit schemes?

35. The introduction by a number of groups of for example, career average revalued earnings with capped earnings schemes indicates that this is the case.

Q3: Are you aware of situations in which the present framework has prevented the implementation of an arrangement under which risks were shared between the employer and the member in a novel way? Can you describe what specifically prevented implementation?

36. No.

Q4: What do you believe to be the main obstructions to creativity in scheme design? Do you believe that they should be removed?

37. It would be interesting to have had some real-life examples of such creativity. What we have seen is the establishment of very complex scheme contribution and investment structures which are confusing to members and disproportionately costly to administer. In this respect, we welcome the abolition of money purchase contracting out.
38. For the future, HMRC has removed many of the obstructions to scheme design by setting very straightforward limits. However, the legacy of the past and the inflexibility of dealing with accrued rights is a barrier to innovation.

Q5: Would you favour an approach under which specific forms of shared risk schemes are recognised, along with appropriate safeguards, or would you prefer that regulations be loosened to allow a variety of approaches?

39. We believe that there should be appropriate safeguards – it is unacceptable to have a situation where employer insolvency or decision to not support a scheme would result of complete loss of pension as has happened in recent years. In the past, defined contribution schemes were sometimes contracted out on a Guaranteed Minimum Pension basis, with the GMP providing an underpin. A defined contribution scheme with a salary-related underpin would be worth consideration and this would be relatively easy to monitor for PPF purposes and to set the levy.

Q6: What challenges do you see in the effective disclosure to members of the nature of the risks they are running and how their benefits may be affected in risk sharing schemes?

40. Effective disclosure would depend on the nature of the risk-sharing arrangement. A number of these challenges are already present in individual pension schemes with insurance companies and much could be learnt from the events at Equitable Life. We suggest that the DWP consult with the FSA on this issue.

Q7: What should the role of the PPF be in risk sharing schemes? Are there changes to the present legislation pertaining to the levy and the treatment of schemes on wind up that would be necessary in order to fairly regulate these schemes?

41. We believe that the PPF should act as a safety net for shared risk schemes but the extent will need to be assessed when more details of such schemes are available. We also believe that there should be some arrangements for compensation to be made available to members of money purchase schemes where there has been gross maladministration and the employer is insolvent. At present, there is no safety net in such circumstances.