Pension Reforms

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THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND

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“My Government will begin long-term reform to provide sustainable income for those in retirement”

So said the Queen, on 17 May, 2005, at the State Opening of Parliament, following elections in early May.

Legislation “might be necessary”, after the report of the Pensions Commission, headed by Adair Turner, in November – said the Department for Work and Pensions.

“We need reform”, says Robin Ellison, chairman of the NAPF.

The historical mix of state and non-state pensions

- The basic pension
- The mandatory second component (from 1961)
- Occupational pension schemes
- Personal pensions and “stakeholder” pensions

Historical attitudes influencing non-state pensions

- paternalism
- William Beveridge – 1942
- “contracting-out”, post 1961
- a twenty-year “bull-market”

Trusteeship and “good housekeeping”

The influence of supportive fiscal legislation

The Inland Revenue as a regulator:

- actuarial certification
- accounts and contribution recording

The great pension debate – 1959 to 1985

Political Interference – led by the Treasury

Pension Fund Surpluses – introduction of limits – Nigel Lawson: 1979

Pension Taxation – E.E.T.

(Exempt contributions / Exempt investment income / Taxable benefits

Changes to tax treatment of dividend income – Gordon Brown

Effects of Treasury-led interference:

- prudence discouraged
- pension fund income “raided” to the tune of GBP 5 billion per annum
- stock-market turmoil
- elimination of surpluses/emergence of deficits
- a growing uncertainty

Other changes involving the Treasury

- Demise of DSS – Department of Social Security
- Delegation of functions to “agencies” under the control of the Treasury – collections and benefits
- Emergence of Department for Work and Pensions (DWP)

Forms of Regulation for non-state pensions

- Inland Revenue – fiscal controls
- Financial Services Authority – all investment related issues

  (note: the Actuarial, Audit and Legal professions are still Self-Regulatory Organisations – SROs)
- The Pensions Regulator
- EU (European Union) Directives

The new Pension Tax Regime - I

Background:

- The Income and Corporation Taxes Act, 1988
- The Income Tax (Earnings and Pensions) Act, 2003
- Consultation Paper, December, 2003:
  "Simplifying the taxation of pensions: the Government's proposals"
- Finance Act, 2004
- Inland Revenue Budget 2004, Note 39:
  "Simplification of the Taxation of Pensions"

The new Pension Tax Regime - II

Finance Act, 2004 and the Pensions Act, 2004 introduce new challenges for employers, trustees and managers of occupational pension schemes.

Effective date (“A-Day”) : 6 April, 2006

New Legislation is “permissive” – it sets out the benefits which may be paid from tax-privileged schemes: much of the detail will come in the form of regulations.

Contributions: tax exemption continues, up to an “annual allowance” (increase in personal pension value) of GBP215,000 in the first year (ten times increase in pension value accrued, at any age, during the year)

The new Pension Tax Regime - III

Lifetime Allowance: initially, GBP 1.5 million (increasing after A-day: quinquennial reviews)

Benefits:

- Lifetime pensions
- Tax-free commutation of some one-quarter of pension value
- Minimum pension age – to be 55 (from 2010)
- Compulsory annuities – from age 75
- Income withdrawal – must end before age 75

The new Pension Tax Regime - IV

Registration: with the Inland Revenue:

Occupational pension schemes (established by an employer)

Non-occupational pension schemes, established by:

- Insurance companies;
- Unit trust scheme managers;
- Authorised open-ended investment companies;
- European financial institutions

Financial Services Authority (FSA) – I
(centralised financial supervision and regulation)

Responsible for banks, insurance companies, C.I.S. and investment managers, capital markets activities, deposit-takers and “advisers”

Financed through a scale-related levy on all financial institutions and intermediaries

Illegal to perform any financial services without authorisation of the FSA

Financial Services Authority – II

For pensions – FSA's main focus is on the selling and marketing of personal pensions and stakeholder pensions.

Standards of advice: "income withdrawals", "short-term annuities".

Advisers to meet their obligations under Section 2.6 of the "Training and Competence Sourcebook": (continuing professional development).

Financial Services Authority – III

IT Systems and controls

Revised “pensions literature”

FSA’s competence does not extend to the new tax regime and occupational pension scheme benefits

Consultation paper expected in July, 2005

The Pensions Regulator (TPR) – I

TPR reports to the Department for Work and Pensions (DWP)

Successor to OPRA (Occupational Pensions Regulatory Authority)

OPRA established in response to the “Maxwell” fraud

Fraud is not a significant issue.

Biggest problems concern “funding”

Largest schemes	:	Annual returns
Smaller schemes	:	Triennial returns
Actuarial certification	:	Annual
Actuarial valuations	:	Triennial
Audit (independent)	:	Annual

The Pensions Regulator – II

Main risks:

Defined-contribution schemes: market-related risks

Defined-benefit schemes: as “unsecured creditors of employers.

Development of “risk-models” – based on “impact” and “probability”.

BT is the biggest fund: impact of failure would be considerable – probability of failure is small.

The Pensions Regulator – III

Powers include:

- Power to “freeze” schemes;
- Power to issue “improvement notices”;
- Power to fine trustees for compliance failures;
  (fines are payable to the Treasury)
- Power to obtain information;
- Power to impose “scheme-specific funding” and enforce a “recovery plan”;
- Power to enforce a minimum contribution payment;
- Power to decide on recourse to the Pension Protection Fund

The Pensions Regulator – IV

The Pension Protection Fund (operative from 6 April, 2005)

Insolvency of pension funds

Limits on benefits from the Pension Protection Fund (PPF): 90% of benefits in the rules – maximum, GBP 25,000.

PPF funded by a per-capita levy on pension funds

PPF empowered to take a stake in a company (which will continue to be a "going concern") in taking over a pension fund deficit.

EU Intervention – I

Directive: on Institutions for Occupational Retirement Provision

Deadline for “transposition”: 23 September, 2005 (serious doubts concerning its implementation in Germany and other member States)

Effects on liberalising of investment portfolios

Comparison of options / competition between funds

EU Intervention – II

Committee of European Insurance and Occupational Pensions Supervisors says:

“occupational pensions supervision will require increased attention….. and may require further developments in applicable solvency regimes and supervisory practices”.

A so-called “Budapest Protocol” is expected in October, 2005.

Pension Reform is vital: it is an on-going process in all countries.

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