

THE ASSOCIATION OF ELECTRICITY SUPPLY PENSIONERS
**Comments on Working and Saving for Retirement
White Paper on Pensions**

The Association

1 This Association represents some 207,000 members of the Electricity Supply Pension Scheme (ESPS) together with a significant number of other employees who are members of various defined contribution schemes throughout the industry having joined since 1995 when most of the industry's defined benefit schemes were closed to new staff.

2 The Association was formed in 1995 in the wake of the privatisation of the electricity supply industry basically to address the inequities amongst the numerous individual company based schemes which were created as a consequence of the Electricity Act 1989. Our scope has widened since that time to encompass the defined contribution schemes which most of the electricity employers have offered newly recruited staff. The apparent underfunding of all ESPS schemes, including the DC schemes, is the current main concern of all our Members.

Green Paper

3 In March 2003, we responded to the Government's Green Paper with a mixture of comments and suggestions, based on our considerable experience of DB schemes over many years dating, in the case of some of our former pre-nationalisation company and ex-local authority members, from the 1930's.

4 We were rather critical of the Government's initial proposals, which seemed to amount to "work longer, retire later and pay more"; and we were very concerned about recent cases where unscrupulous employers have closed and/or wound up DB schemes, partly causing the present crisis. We were also critical of the Chancellor's decision to disallow tax credits to pension schemes, which is itself was the second important main contributor to the current situation.

White Paper – Overlay

5 In general, we welcome the Government's proposal to set up a rescue fund and also the immediate implementation of financial obligations on solvent employers who wind-up their schemes without good cause. Similarly, we support the new ideas for TUPE transfers, believing strongly that, as far as possible, all workers should make additional provision for their retirement. We are much less happy about reduced indexation, increased age for early retirements, capping of benefits, working until 70, the proposed employer consultation process and the Government's attitude to compulsion.

Existing Regulations

6 The White Paper infers that the intention is to provide Pensions legislation to "overlay" any rules existing in functioning schemes in such a way as to allow employer and trustees to decide for themselves whether or not to implement the Government's amendments. We assume that, if an employer wishes to continue operation an existing scheme under existing rules, it can do so but that all new schemes will be expected to reflect the Government's current thinking.

Protection Regulations

7 In the arrangements for the privatisation of the electricity supply industry, the then Government provided in the Electricity Act 1989 for the issue of Regulations covering the protection of pensions for staff in post on 1 April 1990. These are the Electricity (Protected Persons) (England and Wales) Regulations 1990.(1990 No. 346) They also issued the Electricity Supply Scheme (Transfer Date Amendments) Regulations 1990 (1990 No. 318).

8 These two sets of Regulations followed extensive consultations with the trades unions and with the Directors of the various 1989 segments of the industry. Effectively, they dissolved the existing pensions and management structure, made provision for the distribution of the funds ownership amongst multiple sets of trustees/Principal Employers and set up the unsatisfactory cumbersome and unique two tier pensions structure which we have today.

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9 The Regulations also prescribed ESPS rule changes for procedures resulting from takeovers, business transfers, the Schemes valuation, Schemes amendment, discontinuance and the liquidation of a Principal Employer. Regulation 6 of 1990 No.346 states:

“ ...the employer of a protected person shall at all times ensure that, in respect of each protected person in his employment the assets of the relevant scheme provided by the employer in respect of that person are such that, in the event of the winding up of that scheme, there would be available to provide accrued pension rights for such protected person a sum equal to, or exceeding the liability of that scheme in respect of those accrued pension rights”

10 This Association would strongly oppose any repeal of this, and accompanying relevant Regulations because of the very large number of our pensioners who would be affected.

11 The rules of the ESPS already contain provisions for early retirement at 50+ and have recently been amended to set normal retirement age at 63 for both men and women. Members with pre-existing rights have always previously been protected. We assume that, in any change now proposed, this protection will continue.

Valuation of Liabilities

12 We note that, in dealing with “full buy-out costs” on page 41 of the White Paper, mention is made of an expected actuarial update on the assumptions currently underpinning the MFR. You will no doubt be aware of the universal change which has occurred in actuarial valuations of liabilities since the late 1990s. Prior to that time, actuaries calculated scheme liabilities using individual scheme salary/pensions data and longevity tables. Since then, actuaries have compared interest and bond market yields and fluctuations to assess the value of liabilities, the explanation being that bond yields are thought to be a better match for such longer term costs.

13 Most recently, the effect of this change has been to increase liability values significantly – in this industry by approximately 40%. Asset values have generally deteriorated but are now rising again, however, they are unlikely to outstrip the swingeing liability increases. The funding gaps which are now being quoted by unscrupulous employers to support closure of their DB schemes arise directly from this change.

14 Whilst this is not what the Government may wish to hear, bearing in mind the undoubted need for an increase in funding for retirement generally, we question whether liabilities are not now being overvalued as a direct result of the collapse in bond market prices. If we are right, the funding gap is not as wide as is currently projected. We suggest that the projected Pensions Commission, as a possibly independent party, might consider this matter.

Pensions Protection Fund

15 We welcome the proposal to set up a protection fund but are concerned that, at the present time, most DB schemes are in deficit, due to the reduction in equity values and to the possible over valuation of liabilities. Any additional super levy would therefore target funds, which might already be working hard to effect a recovery. Since fund deficits are often employer liabilities, such costs will fall on these employers who, as a result, may accelerate the closure of their schemes during the interval between publication of the White Paper and the passing of legislation. The “super levy” may be very unfair on these employers and we feel that a more lenient approach would be appropriate.

16 Whilst we see the reasoning behind the capping of benefits for directors and senior executives we are concerned that £40-60,000 will be too low and should be significantly higher. The salary range specified is now a mid-salary range for many professional staff such as police officers, teachers and engineers in the energy industries. If a cap is introduced it must be indexed in line with salary and wage inflation.

17 We strongly agree that employers should not be permitted to offset contributions against surpluses until a pension fund has reached the discontinuance level of funding.

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Solvent Employers – Wind-ups

18 We welcome the proposal to make solvent employers who choose to windup their schemes financially accountable for the full costs of their schemes. There is, however, the important question of how the liabilities are to be valued in any winding up situation; the present MFR is far too low and the ongoing funding method is inappropriate to an immediate cessation. There is, therefore, a need to use the discontinuance method, by which sufficient assets are set a side for all due and future pensions to be paid in full. We assume that this is what is meant by “full buyout”.

19 We strongly recommend the Government not to legitimise the practice of allowing employers to take actual cash from schemes; this would be undesirable and would be a return to the temptations and risks of the pre-Maxwell days and would set pensions law back many years.

20 Whilst the Government has made provision against solvent employers who attempt to wind up their schemes in the interim between now and the date that new legislation is passed, they have left the way open for employers to continue to close their DB schemes to new members. We respectfully suggest that a moratorium be enforced on such closures at least until the newly suggested employer consultation procedure is implemented.

Employer Task Force

21 We remain unhappy about the proposed composition of the employer task force. Surely, this should contain some member representation in addition to the two trade union officials? Not all pension schemes are associated with trade unions and even the ESPS unions have only recently become interested in pension matters. ESPS pensions have been non-negotiable since 1948.

Fair Sharing

22 We support the need for the fairer sharing of assets in liquidation but are concerned about cases which may occur prior to the new legislation coming into force.

Pensions Commission

23 Saving for retirement is not a first priority for many workers; the current all time high borrowing rate amply demonstrates that people would rather spend money that they do not have than save for a doubtful DC scheme future. Figures issued by the Bank of England in July show that an extra £10m was borrowed in June, that the average household now owes about £37,500 and that personal debt, including mortgages, personal loans and credit cards etc. is at an all time high of £868bn. How does the Government propose to address this simultaneously with persuading people to save for the future?

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New System of Regulation (Chapter 2 Para 20)

25 The White Paper is critical of OPRA for pursuing “relatively low value reports and breaches”. We hope this does not mean that the new system will ignore such reports. Currently, OPRA is the “last appeal” stage for members’ complaints before going to the Ombudsman and this is a vital link in maintaining confidence in private pension schemes. Reports and complaints from members and “whistle blowing” by advisers often uncovers unauthorised and criminal activity and these cannot be ignored in any new system.

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26 Two years ago, two of our members took a case to the House of Lords, having passed through OPRA and the Pensions Ombudsman on the way. Initially, *Laws and Mayes v National Power and National Grid* concerned the right of a single employer to pay for redundancies out of surplus but the case subsequently escalated to affect all other DB schemes. This is an example of how small matters can have considerable impact and cannot be ignored.

27 If the new Regulator is to have powers of sanction, provision must be made for his/her decisions to be defended in the Courts against employers and others. The present Ombudsman does not have this power and his decisions are nullified as soon as the appeal process is initiated.

Codes of Practice (Chapter 2 Para 24)

28 It is disappointing that the proposed Codes of Practice will not have the rule of law. This will leave many important activities in limbo – as at present – and will not strengthen members' confidence in schemes or in their rights. We hope that, in consulting the Law Commission, a final decision can be taken on who actually owns pension funds – the employer or the members.

Trustee Training (Chapter 2 Para 27)

29 We hope that the Government will consider carefully the need to avoid providing for "professional trustees" as opposed to member trustees. Our experience is that unpaid adequately trained member trustees advised by experts appointed for the purpose are preferable to trustees who are motivated by remuneration. Members have great confidence in unpaid elected trustees and we see dangers in departing from this principle.

Improved Protection for Early Leavers (Chapter 2 Para 35)

30 We welcome the imposition of a three month vesting period but can see no reason to offer the choice of a refund of contributions or a CETV transfer to another pension scheme. Apart from the fact that few people would choose to forgo the employers' contribution, surely if we are to encourage more people to save for their future no refunds should be made and only continued membership of an alternative scheme offered?

Compulsory Scheme Membership (Chapter 2 Para 38)

31 We are disappointed in the Government's approach here. Our view is that, where an employer makes a reasonable contribution to a pension scheme (at least equal to and possibly exceeding the employee's contribution) staff should be obliged to join unless they opt to invest in another scheme, e.g. join a stakeholder scheme. In this we support the Pickering proposal. As a bare minimum, employers should bear the relevant administration fees for any scheme, be it occupational or stakeholder, in which their staff participate.

Consultation (Chapter 2 Para 41)

32 As we have already indicated in our response to the Green Paper, employer consultations must be meaningful and not superficial. We fear that some employers may wish to use "flexibility to make long term commercial decisions" as an opt out from proper consultation. Consultation is a two-way process, implying that some notice is taken of any opposing views. We feel the Government should take a stronger line here. Any consultation about a substantial change to the scheme rules should include the appropriate pensioner/member Associations, trade unions and scheme members individually where their benefits are likely to be affected.

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Net savings (Chapter 3 Para 3)

33 We are unconvinced that £155m employer savings can be achieved without savage cuts in benefits and actual reductions in pensions values. Such measures may have serious sociological and electoral consequences. We feel that the Government has not fully grasped or embraced the seriousness of the present pensions crisis and is leaning too far towards employers' savings rather than to adequate funding for pension schemes.

34 Employers must be expected to provide a proper degree of funding, bearing in mind that many employers have enjoyed contribution holidays for considerable periods. In the long-term nature of pension provision it is certain that the present crisis will not endure and that equity values will again rise. Short-term panic measures have permanent effects and it may be inappropriate to penalise pension scheme members in the long run.

Scheme Specific Funding (Chapter 3 Para 4-7)

35 Of the six key elements set out in Para 6, four are already practised in the ESPS, namely: statements of funding principles, revaluation every three years, schedules of contributions and information for Scheme members

36 However, the inability of employers/trustees to reach agreement on crucial funding issues, resulting in the trustees being given power to freeze or wind up the scheme is a new concept which gives rise to several questions:

- will the employer then be obliged to follow the same principles as the White Paper sets out for a solvent employer winding up a scheme? We hope so.
- how will the employer's liability to the scheme be measured and enforced?
- what if the trustees find themselves unable or unwilling to freeze or wind up the scheme?
- who will have the majority vote amongst the trustees, the employer or the members; will an independent trustee/chairman be appointed?

37 If the employer retains a controlling/casting vote in this situation the procedure will be meaningless and many more DB schemes are likely to close.

38 Again, we are sceptical about the £100m employer savings mentioned in this section. The last two years experience has shown that those schemes which invested in equities lost heavily, increasing further the gap between assets and liabilities. Flexibility has not assisted them but they now have a need for more funding, not less. We can only assume that the £100m will be saved by further permanent closures of schemes rather than the removal of MFR requirements. The Government's proposals seem to fly in the face of their declared aim to "ensure that pension scheme members are reassured that their money is held securely" (Chapter 3 Para 1) and to "reaffirm the role and responsibilities of employers, improving savings through the workplace and providing greater protection for members of occupational pension schemes" (Chapter 1 Para 4).

Indexation (Chapter 3 Para 8-13)

39 It is hardly surprising that the pensions industry (presumably employers and insurance companies) find limited price indexation to be excessive. We strongly support the reverse case that the true value of pensions must be maintained if there is to be continued confidence in saving for retirement and in pension schemes generally. Who wants to invest in a scheme with a depreciating value when prices and the cost of living are increasing – albeit by less than 5%? Already, the value of pensions decreases with the passing years – as was demonstrated so clearly by the public furore in 2000, when the Government had to offer various top ups to mollify public opposition to the 1.1% national increases.

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40 The argument that inflation is being kept at a low level will bear little fruit with those who remember 1975 (26.1%), 1979 (17.5%), 1980 (16.6%), 1982 (11.0%) and 1991 (10.9%). Currently, many occupational pension schemes are indexed in the following April by the RPI figure for the previous September. If the Government is successful in maintaining inflation below 2.5% nothing changes. However, when inflation goes above this capped level, as at present, pensions decline in real value. The Government's argument that it intends to maintain an inflation figure below 2.5% is already flawed; the current rate is 2.9% with higher figures having been recorded earlier this year.

41 So is the Government actually aiming to reduce pensions? If so, this becomes an important electoral matter and should be spelled out more clearly for all to see and appreciate.

42 We have noted the comment in Chapter 3 paragraph 10 that DC scheme members are not obliged to purchase inflation cover but almost all DB scheme members receive it. The fact is that the vast majority of private DB scheme members did purchase this cover as part of their contracts of service by sacrificing salary to save for their retirement. We feel this comment is part of an unbalanced package. What is the future of the National pension? Is this also to be capped at 2.5%?

43 We note that this chapter makes no reference to the Chancellor's reported wish to transfer to the European Prices Index (HICP) in November. This is currently 1.1% against our RPI of 2.9%. The Government must explain more clearly its long-term intentions as far as the future indexation of pensions is concerned. The public disadvantages of any such transfer are obvious.

44 Of all the proposals contained in the White paper, the capping of pensions increases to 2.5% is the most important and far-reaching from an electoral and pensioner point of view. To cap or reduce indexation below the actual level of price increases will do great harm to future attitudes to saving for retirement and we earnestly hope that the Government will think again about this proposal.

Survivors Benefits (Chapter 3 Para 16)

45 We welcome the decision to make no changes to these benefits.

Modifications to Members' Accrued Rights (Chapter 3 Para 17-20)

46 This section would appear merely to legislate rights for an employer to close a DB scheme. It is essential to bear in mind that, in most schemes, the employer has a controlling voting power in trustee matters which facilitates changes to the rules at his/their discretion and with minimum consultation. Trustee approval has little substance in these circumstances.

47 We welcome the decision that no rule change will be able to convert DB rights into DC rights. We hope this means what it says. We cannot see how this can be applied other than to new members. We also note that pensions in payment are not to be reduced but the capping of indexation will result in just this (*see Para 37-41 above*).

48 We would hope that the discontinuance valuation method will be used to value members' accrued financial rights under Para 19. We have already commented on employer consultation (*see Para 31 above*).

49 Section 67 of the Pensions Act was introduced after the Maxwell scandal and was designed to protect members from adverse employer rule changes designed to facilitate fraud and theft. Any changes to Section 67 can only reduce its member-defensive value and permit unscrupulous employers to benefit from a return to pre-Maxwell days. We hope the Government will reconsider the relevant parts of this proposal.

Member Nominated trustees (Chapter 3 Para 21)

50 Many of the provisions now proposed for the appointment of member nominated trustees (MNT) already operate in the ESPS. Universally two thirds of ESPS trustees are member elected but they enjoy less than half the voting strength of each Group.

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51 Whilst we support the Government's decision to impose a minimum one third rule in future, we are unhappy about the suggestion on page 37 of the Technical Paper to the Green Paper that trustees may be unempowered to prescribe/agree any increase above one third.

52 The maturity of schemes varies considerably and many have diverse membership, being split benefitwise and geographically. All sections of membership should ideally be represented and the election of more trustees (albeit with less total votes than employer appointed trustees) eases these problems.

53 We feel that further consideration should be given to trustee nomination and election from the various segments; a very mature scheme will have all or a majority of pensioners. In a new scheme the active members will form the majority and, in either event, the majority can outvote the minority in MNT elections. The Regulator's "Fair and Open" rules should cover these matters in some detail to avoid undue pressure from employer sponsored candidates.

54 We recommend the appointment of whatever number of trustees in proportion to the membership amongst actives, pensioners and deferred members (if they have any voting rights).

55 We recommend that an independent Chairman should be appointed to each trustee panel.

Contracting Out (Chapter 3 Para 25-26)

56 We recognise these proposals as reducing scheme administration costs.

Other Simplifications (Chapter 3 Para 27-29)

57 We support proposals for more timely, and up to date information, to be provided to members. Simplification of pensions on divorce would be welcome.

58 We hope that the jurisdiction of the Ombudsman will have regard for the need for his decisions to be fully binding (without recourse to the courts) or, alternatively, for him/her to be able to defend his/her decisions in any appeal process which follows. Litigation to enforce the Ombudsman's decisions makes lawyers very rich and pensioners and their schemes very much poorer (*see also Para 26 above*).

Planning for Retirement (Overlay – Chapter 4 Para 1-9)

59 We recognise that the current pensions crisis exists and is real. We take the view that it has been caused by three events, namely:

- the Chancellor's recovery of tax credits from pension schemes
- the possible present overvaluation of liabilities due to bond yield deterioration
- the short term reduction in asset values, largely related to equities.

60 Against the additional background of employers' contribution holidays over a considerable period we strongly disagree that employees "should either save more or be prepared to work for longer or a combination of the two" (Chapter.4 Para 1). This is only part of the remedy. Employers and the Government have a duty to fund some of the deficit now appearing and we take the view that the funding of all occupational pension schemes should in future be at discontinuance level thus, as far as possible, avoiding the need for large scale rescues.

61 The Government must not see pension schemes as reservoirs from which tax can be extracted to support the general economy. Pensions are deferred income - specific savings for retirement - which will be legitimately taxed as income when received. Public confidence has been undermined for the future of saving by the Chancellor's actions.

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Pension Age Matters (Chapter 5 Summary)

62 Since women have, until recently, retired at 60 and men at 65, there will inevitably be a catch-up period whilst these are harmonised. Any change in the retirement age - including setting the state pension age at 65 - will need to take account of this. Many members of present occupational schemes entered such schemes having an existing lower set retirement age. Existing members will expect their contractual retirement age to be honoured.

Combined Pension Forecasts (Chapter 4 Para 7-15)

63 Whilst the proposal to provide a combined pension forecast /benefit statement may seem attractive, and we support the concept, it is possible that some people may see that their savings are not increasing, or doing so quickly enough, to purchase a pension of any real value. They might feel that they would be better off leaving the scheme and spending the money, thus relying on the national pension to provide for their retirement, rather than increasing their contributions to a worthwhile level. We feel that Government has not properly thought through this scenario. Some degree of compulsion towards continued membership of an alternative or the existing pension scheme must be considered here.

Working Longer (Chapter 4 Para 23-31)

64 We cannot add further to our comments in our response to the Green Paper that present economic conditions are not sufficiently favourable for most employers to offer older people extended working lives. Those who take early retirement at 50+ and continue to work thereafter, taking the national pension at a later date, may benefit from increased national pension for a shorter pension life but the State sees little or no benefit. Both the national pension and the occupational scheme pay the same capitalised sums as they would have paid previously.

65 As a response to the criticism that the Green Paper proposals would not encourage employers to avoid early retirements and offer a longer working life the latest suggestion is age discrimination legislation. Nothing in the White Paper proposals will prevent employers from making people redundant at 55 (instead of 50) and it is likely that ill health retirements and dismissals will increase significantly, resulting in greater public expense for Industrial Tribunals.

66 We support the general view that those who may wish to work for longer should be able to do so but we believe that the imposition of even more legislation to increase minimum retirement age and to enforce age discrimination will be counter productive.

JCA
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