Session II: Pension Protection in the US and UK – Lessons the UK Can Learn

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July 20, 2005

Creation of the Pension Protection Fund - which Lawrence has just described – has been an important innovation in UK pensions introduced by the Pensions Act 2004. The Act has also established the Financial Assistance Scheme and a new Pension Regulator, and I will just outline the fuller picture on protection which the new legislation has provided.

New Pension Regulator

The new regulator has been in place since April. The key difference with its predecessor is the new emphasis on proactive and proportionate regulation. We want to ensure that regulation is as small a burden as possible on well-run, well-funded schemes. At the same time, we need to ensure that schemes that represent the biggest risk of failure are scrutinized, and where appropriate recovery plans put in place. A small number of schemes account for a disproportionate share of total pension deficits in the UK. The new Regulator recognizes this, and will focus effort accordingly.

Intervention at the right time is key. We want the Regulator to get involved before there is a crisis. The earlier plans to restore deficits are put in place, the easier they are to implement - just like repaying any sort of debt. So the new Regulator will have a responsibility to be proactive, and to become involved at an early stage when a scheme starts to experience problems.

The Regulator can spot problems in the regular information schemes have to supply, or through a new statutory whistle-blowing obligation which means that anyone who notices problems has an obligation to inform the Regulator. Schemes also have to notify the regulator of particular events, such as mergers, should they occur. If there are problems, the Regulator will then issue an improvement notice which details the actions the scheme must take to correct the situation and the deadline by which the actions must be taken. If this is not complied with, the Regulator will begin an investigation.

The Regulator will also have a role as an educator. Parliament has specified a number of areas where the regulator should provide codes of practice to inform and educate Pension Fund Trustees and others.

Financial Assistance Scheme

Alongside the Pension Protection Fund and the new regulator, the third pillar of protection is the Financial Assistance Scheme. This is designed to help some of those who have already lost out when their pension scheme wound up underfunded and their employer became insolvent between 1997 and the start of the Pension Protection Fund. People thought their pension was guaranteed, and many have suffered deep distress at the prospect of real hardship in their retirement. Most scheme failures occurred after 1997, and in particular, after 2000, when the stockmarkets began to fall. We know of around 70,000 people in affected schemes – although many were not badly affected and so should be in a position to make appropriate financial arrangements for the future.

The Government did not have a legal duty to help, but there was a strong view in Parliament that those facing the most severe loses, who did not have time to re-build their retirement funds, should be helped, and our response was the Financial Assistance Scheme.

Establishing the Scheme raised difficult questions. Those it helps lost their pension through no fault of their own – they had contributed to an occupational pension scheme and made retirement provision, in some cases for many years. But any help we give is at the expense of tax-payers. Some comes from people who do not have pensions themselves. So we had to strike a difficult balance. We decided that the Scheme should top people up to a level of 80% of the benefits they could expect from their scheme, subject to a cap of £12,000 per year, and only in the first instance for those within three years of scheme pension age.

Protection

We take the view that a pension promised must be a pension delivered. People will only have confidence to save in a pension if they really believe that to be the case. Many people's trust in the financial sector in Britain has been shaken. We had a pension mis-selling scandal in the early 1990s, heavily publicised later, where many people were encouraged by financial advisers to leave or not to join their high quality occupational schemes in favour of shifting to less suitable personal pensions.

There have been many Press reports about schemes failing and people finding themselves with little or no pension. Bad news stories will always receive greater press coverage than good.

It is our job to put in place a regulatory framework that ensures pensions are delivered. Protection can only be provided at a price. In the case of the Pension Protection Fund, it is the annual levy. This levy has to be kept reasonable or we risk destroying the very schemes we seek to protect. We spent a lot of time considering the best way to set the levy, and Lawrence brought you up to date on the current proposals.

Regulation of pensions faces similar problems. UK employers are under no obligation to provide a pension – they do so because they believe the benefits in recruitment and retention justify the expense. Whilst we need to make sure employers running pension schemes are acting responsibly, we also need to ensure the burden of regulation is not so onerous that it inhibits the provision of pensions in the first place.

Summing up

A balance is needed and we believe that the Pension Protection Fund and the new Regulator provides that balance.

Individuals no longer face huge losses if their pension scheme winds-up underfunded and their employer is insolvent, but we have also ensured that the Pension Protection Fund will not face unsustainable liabilities.

The balance we have struck with regulation is light-touch regulation for well-run, well funded schemes, and closer scrutiny for those schemes representing the greatest risk.

And we have also helped out those that lost out because such protection was not in place in the past. Some believe we should have done more, but again, a balance had to be struck and we believe our promise of £400 million over 20 years – equivalent to $700 million – was the right balance.

I hope in our panel these questions of balance will be illuminated further.

Thank you.