

Please reply to:

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The Hundred Group
of Finance Directors

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State Pensions Reform Consultation Team
Department for Work and Pensions
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Dear Sir,

A State Pension for the 21st Century

I am writing on behalf of the Hundred Group of Finance Directors with regard to the DWP's above-named consultation paper.

Who we are

The Hundred Group represents the views of the finance directors of the UK's largest companies drawn largely, but not entirely, from the constituents of the FTSE100 Index. Our members are the finance directors of companies whose market capitalisation collectively represents over 80% of that of companies listed on the London Stock Exchange. While this letter expresses the views of The Hundred Group of Finance Directors as a whole, they are not necessarily those of our individual members or their respective employers, who may be making their own submissions.

Introduction

We believe that the level and design of the state pension and the mechanism for setting state pension age are essentially political decisions on which it is not appropriate for the Hundred Group to comment. However, the Hundred Group does have a legitimate interest in expressing concerns about the impact such proposals would have on contracted-out defined benefit schemes which are still open to further accrual and as a consequence on the employers who provide such schemes.

Under these proposals, it appears that simplification at the state pension level is likely to lead to additional complexity for occupational pension schemes. Such complexity will in turn lead to additional costs, which can only serve to reduce the competitiveness of UK companies. In particular, we do not believe that the consultation fully engages with the significant difficulties that pension schemes are likely to encounter in responding to the removal of the contracted out rebate.

Our response therefore only covers those questions which are relevant from our perspective.

Question 7: What would be the impact of ending contracting out, as implied by any single tier model?

It is important for the DWP to recognise that the removal of the contracted out rebate will affect schemes in different ways.

Scheme rules: The consultation paper assumes that all pension schemes would be able to reduce their pension scheme accrual in order to compensate for the lost rebate. In fact, some schemes (including those of some Hundred Group companies) have rules which prevent any reduction to future benefits. Such schemes would therefore be required to continue to provide the full level of benefits from the scheme as well as the member now becoming entitled to additional state pension in future. Schemes that were designed to be integrated with the state pension could now be at risk of overprovision for members in retirement.

Communication with members: Even where schemes have the ability to reduce benefits under their scheme rules, it should be noted that this is unlikely to be a simple decision to take. The challenges of communicating such changes to members will be significant. Whilst employers and the DWP may understand that the member is not losing out in the round when state and scheme benefits are combined, individuals may well be suspicious about the motives behind such a reduction in benefits.

Consultation requirement: Under current legislation, employers are required to consult members where a reduction to future accrual is proposed. Running a genuine consultation programme for a large employer is a substantial, time-consuming and expensive exercise. Arguably, when change is being proposed by the employer, it is reasonable to expect the employer to meet the costs of consulting on it; however, it does not seem appropriate that such a requirement should apply where the change is effectively being forced on the employer by the DWP.

Calculations: Calculating the appropriate reduction to benefit accrual rates is also unlikely to be straightforward and could be open to challenge by aggrieved members in future when their combined state and scheme benefit at retirement gives them less than they had previously anticipated.

Statutory definitions: It is also important to remember that many scheme rules contain references to statutory definitions. For example, many schemes (contracted in as well as contracted out) contain an offset of basic state pension in their pensionable salary definitions. Changes to the definition of basic state pension will leave such schemes providing a different benefit from that which they had intended to provide. Alternatively, replacing the term basic state pension altogether would leave schemes needing to redefine terms for the purposes of their own scheme rules. This could lead to costly legal fees being incurred simply so that scheme rules had the same effect as they did before the change.

Question 8: If the decision is taken to end contracting out, how could the process be best managed so as to minimise any adverse impacts on employers and individuals?

As the question appears to accept, any measures would only act so as to minimise adverse impacts on employers, not to remove them entirely. The following measures from the DWP would be welcome, but it should be noted that pension schemes would still be faced with significant difficulties in adapting to the removal of the contracted-out rebate.

Statutory overrides and/or modification powers: pension scheme trustees should be given the right to amend their scheme rules where they would otherwise be prevented from reducing the rate at which future benefits accrue in order to take account of the removal of the rebate.

Consultation: employers should be exempted from the requirement to consult members where benefits are being reduced in order to offset the loss of the rebate. We recognise that some sort of communication with members explaining the change would still be required.

Communication: the DWP should spread the message to the media and to scheme members that it expects employers to reduce benefits to take account of the loss of the rebate, and that overall members should be no worse off as a result of the change. For example, it could produce a standard information sheet that could be sent to members of affected schemes. This would give employers some defence against challenges from members.

However, even if these measures are implemented, the DWP must still recognise that the removal of the rebate and the corresponding reduction in benefits will lead to significant costs to employers – in legal fees, in benefit redesign costs and in communication with members.

Question 10: What mechanism should be used to determine future increases in State Pension age?

As noted above, we believe that this is essentially a political decision. However, it is important that the DWP appreciates that the decisions taken on state pension age will also impact on occupational pension schemes, for example where a bridging pension is payable until state pension age or where scheme benefits are defined by reference to state pension age. Any change to state pension age could therefore act to increase the benefits to which schemes have committed themselves (for example, a bridging pension might now need to be provided for two or three years longer than previously anticipated).

Again, we would recommend that the DWP considers introducing statutory overrides or modification powers to address such cases.

Please let me know if I can be of further assistance to you in formulating your proposals in this area.

Yours faithfully,

Philip Broadley
Chairman
The Hundred Group – Pensions Committee