



Pensions Client Directorate

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Dear Sir / Madam,

Response to the Consultation on “Amendments to the anti-avoidance measures in the Pensions Act 2004” of April 2008

Pension Corporation is the umbrella brand for Pension Insurance Corporation Limited, Pension Corporation Investments and Pension Security Insurance Corporation Limited (“Pension Corporation”) and is pleased to have the opportunity to respond to this consultation.

Pension Corporation provides the following solutions to UK defined benefit pension funds:

- Insurance Buy-out
- Longevity Insurance
- Pension Fund Sponsorship
- Asset Liability Management

These solutions enable pension funds to protect their members’ benefits by strengthening and stabilising their financial position, and assists corporate sponsors by reducing the volatility of the true funding gap between assets and liabilities.

Pension Corporation also has investments in, or owns outright, a number of corporate sponsors of defined benefit pension schemes. It views itself as a “professional sponsor” whose aim is to ensure the schemes’ investments and liabilities are de-risked and the scheme reaches full funding.

Currently Pension Corporation has over total of £4.7 billion of pensions under its ownership or stewardship.

Executive Summary

- Pension Corporation fully supports the Government’s aim and the Pensions Regulator’s objective of protecting the full benefits of members of defined benefit schemes.
- The main risk to defined benefit pension schemes is employer failure.
- There must be a clear recognition by the Pensions Regulator and DWP that a legal duty of care is owed to the corporate sponsor by the Trustees for their actions.



- Innovation is key to bringing in new and improved solutions to the very real issues that face the c. £1 trillion of UK defined benefit scheme liabilities that remain outstanding.
- The proposed changes are neither proportionate nor necessary to deal with the potential risk.
- Any changes to regulation should be by way of primary legislation.

Introduction

Currently, every risk a pension scheme takes, such as investment risk, is ultimately borne by the sponsor of the scheme. The only risk the scheme bears is the risk of sponsor insolvency. Neither Government nor Regulators are able to prevent such risks crystallising as highlighted in the cases of Northern Rock and MG Rover.

Inappropriate decisions by trustees, increasingly influenced by the views of the Pensions Regulator, can have a major impact on the continued solvency of the sponsor company. There must therefore be a clear recognition by the Pensions Regulator and Government that a legal duty of care is owed by the Trustees to the corporate sponsor, for their actions.

New Business Models and innovation

We applaud the Government's stated intent not to stifle innovation and development in this market.

Innovation is key to bringing in new and improved solutions to the very real issues that face the c. £1 trillion of UK defined benefit scheme liabilities that remain outstanding. For example, some of the major factors that may have a significantly detrimental effect on pensions, such as inflation risk, can now be hedged away using liquid financial markets that did not exist ten years ago. This has allowed the risk of inflation to be controlled by pension schemes, providing greater security of payment for scheme members and greater certainty as to the scheme costs for the employer.

Pension Corporation is at the forefront of developing products to reduce risk in today's UK pensions market. Our longevity insurance is an example of a product which allows the longevity risk inherent in pension schemes to be limited. Again, this assists in de-risking the pension scheme for the benefit of both scheme members and corporate sponsors. We believe that the Government and the Pensions Regulator should encourage this type of innovation.

Pension scheme investment has been the subject of much criticism, not least, because it tends to react slowly to changing markets and thus less able to take advantage of market opportunities. A recent survey by Aon found that when asked to rank the most important or challenging issues facing their scheme in the future, over half (51 per cent.) of trustees stated investment as the most important challenge.

Pension Corporation has specialist Asset and Liability Management skills available to pension schemes, bringing together the latest and best financial thinking and products to manage asset allocation and returns as well as risks and liabilities. Such a service incorporates real-time scheme performance information capability, designed to aid efficient decision-making. The application of these specialist skills to the pensions market and the concomitant improvement in the risk adjusted return expectations should be welcomed by those genuinely interested in securing scheme members' benefits.



Abuse by New Business Models

As we have already told the Minister, we are happy to identify ways in which irresponsible market entrants may abuse the “corporate solution” model, which we and others such as Citibank have developed, and to identify ways in which they may be checked.

Having carefully considered the consultation and proposals however, in our view it is too simplistic to say that new business models increase the risk to members and the PPF. As we noted above, the principal risk outside of the pension scheme is in fact the economic risk of the corporate sponsor.

If the Government is concerned that a sponsoring employer could be removed and replaced by an entity with no resources, and indeed in our view this is the most likely method of abuse, we would suggest that this may be dealt with in a different manner than via the amendment of the tried and tested anti-avoidance and clearance system.

For example, a requirement could be introduced that if any sponsoring employer ceases, completely or substantially, to carry on an operating business, then security acceptable to the PPF must be put in place to the level of the self-sufficiency basis or the value of the business, whichever is the lowest. This would provide both members and the PPF with security without placing unnecessary burdens on business.

Making Profits from Pension Schemes

It is, of course, naive to believe it is only the new business models that seek to make a profit from pensions. Pension Buy-out providers have in the past benefited from the lack of competition and been able to make attractive profits. There are also a wide array of advisers; actuaries, lawyers, covenant specialists, pension managers, not to mention independent trustee firms, who all make not just a profit, but a living, from pension schemes and who, of course, take no downside risk.

Business exists to make profit; no profit means no employers and thus no retirement provision in the private sector and no taxes to pay for the public sector.

The suggestion in the consultation seems to be that scheme surplus should not in fact be returned to the sponsor. We note that most scheme rules deal with the distribution of surplus and in view of the fact that the sponsor bears all the investment risk it seems to be only a matter of natural justice that a surplus, if allowed by the rules, returns to the sponsoring employer.

Without the opportunity for any surplus to be returned to the sponsoring employer there is no incentive for sponsors to fund at a level which that may risk surplus being trapped in pension schemes. It is for this very reason, of course, that many pension schemes have established contingent funding vehicles (e.g. escrow accounts) which, whilst belonging to the sponsor, provide additional security to the scheme.

We also note that pension schemes were set up to pay pensions as they fell due and not to purchase annuity policies. The clear push by the Pensions Regulator for pension schemes to buy-out when possible will in fact result in the closure of more defined benefit schemes and reduce the opportunity for other employees to participate in defined benefit pension schemes. In addition, it ignores the potential increases in members' benefits from surplus sharing agreements that can be put in



place along with an appropriately risk-averse asset and liability management strategy.

Offshore Entities

We note the concerns expressed in the consultation paper about moving the employer or pension scheme to another jurisdiction. We accept that moving the only employer offshore would be detrimental to the pension scheme in that it would no longer be eligible for the Pension Protection Fund.

However, the implication appears to be that offshore operations that may own or be investors in sponsors are somehow less trustworthy than those in the UK. Offshore operations are now standard practice in business for a host of legitimate operational reasons. It is in keeping with the principle of free movement of goods and capital that business should be allowed to conduct its affairs in this way.

Effective financial regulators exist in most of these offshore locations and it is therefore incorrect to imply that all offshore operations are in some way less reputable than the U.K.

In view of the fact that the Pensions Regulator has consistently said its powers will work on overseas entities, and the successful issue of Financial Support Directions to a company based in Bermuda but under US Court jurisdiction, (not to mention the front line protection for members of pension schemes being in fact the trustees, followed by the statutory advisers with whistle-blowing duties), we do not believe further protection in respect of the potential moves overseas is necessary.

Pension Scheme Security

Pension Corporation believes that there is a real risk, in the near to medium term, of the catastrophic failure of the corporate sponsors of one or more very large pension schemes as a result of the economic downturn and credit crunch. This would undermine the security of the members of those pension funds and in turn has implications for the Pension Protection Fund.

This potential for catastrophic failure is of course recognised in the PPF's levy which now includes provision for such a risk.

Nothing in the current proposals by DWP targets the fundamental structural risks inherent in UK pension schemes.

The Trust Model

The Trust model relies on the willingness of scheme members and employees to give up their time voluntarily and take on the increasingly onerous regulatory burden of running defined benefit pension schemes.

Whilst trustees are required to have sufficient knowledge and understanding to run their schemes, this often means in practice a heavy reliance on professional advisers.

Without wishing to take anything away from the thousands of voluntary trustees, we believe it is time to consider professionalising the trusteeship of the more than £1 trillion of pension funds in order to secure member benefits in full.

