Freedom of Information requests 2443 and 2463/2011

Received **19 and 22 Aug 2011**
Published **16 September 2011**
Updated **27 September 2011**

Information request

….. to see, please, a copy of the Towers Watson Consultation Response to "The impact of CPI as the measure of price increase on private sector occupational pension schemes" consultation.

Further to my request to see the consultation response from Towers Watson, may I also see the consultation response from the BT Pension Scheme, Eversheds LLP, the Association of Pensions Lawyers, Burges Salmon, the British Airline Pilots Association and Pricewaterhouse Coopers LLP.

DWP response

The British Airline Pilots Association response has already been released under a FOI request and can be found on the DWP Freedom of Information website at http://www.dwp.gov.uk/docs/foi-760-2011.pdf

The other requested responses are attached. Personal details have been redacted from these responses under section 40(2) of the Freedom of Information Act.

On 22 September we updated this response to include details inadvertently omitted when we originally published it. The omission was the transcript of the TOWERS WATSON consultation response included at the end of this document.

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Department for Work and Pensions consultation on switch from RPI to CPI

BTPS Management welcomes the opportunity to provide comments in response to the government's consultation on the impact of using CPI as the measure of price increases on private sector occupational pension schemes. By way of background, the BT Pension Scheme is the UK's largest corporate pension scheme, managing assets worth around £35 billion and responsible for some 340,000 beneficiaries under a defined benefit (DB) structure.

Our answers to the consultation questions are as follows:

Q1: The Government welcomes views on whether the impact of using CPI has been correctly summarised

We believe that the discussion accurately captures the impact of a switch to CPI.

Q2: The Government welcomes views on whether it is right to apply the employer consultation requirements in respect of changes to scheme rules on indexation and revaluation

We agree that it is appropriate to include such proposed amendments as listed changes and so subject to consultation requirements.

Q3: The Government welcomes views on the draft Occupational Pension Schemes (Consultation by Employers) Amendment Regulations 2011

We believe that the draft regulations carry out the intended amendment effectively and appropriately.

Q4: The Government welcomes views on whether there are any issues that should be considered in respect of career average arrangements
Q5: The Government welcomes views on whether there are any issues that should be considered in respect of GMPs

We are not aware of any particular issues in relation either to career average schemes or to guaranteed minimum pensions.

Q6: The Government welcomes views on whether there is any justification for overriding the rules of private sector occupational pension schemes to impose CPI as the measure of increase in prices

We agree that it would be wholly inappropriate for the government to intervene in private sector contracts by imposing a change without the consent of trustees and employers.

Q7: The Government welcomes views on whether there are other reasons why a scheme whose rules do contain a modification power would nonetheless be unable to, or find it difficult to, use CPI for indexation and revaluation.

We believe that this discussion captures the key limitations on modifications, which in practice are s67 and the challenge of balancing the interests of the beneficiaries.

Q8: The Government welcomes views on whether it is right to rule out granting modification powers

While we acknowledge the government's hesitancy over granting modification powers is appropriate, and we are generally supportive of avoiding modification of existing rights, we note that in the absence of intervention the s67 and beneficiary interests hurdles will be insurmountable for most trustees. This would defeat the government's policy aims of enabling funds to have greater flexibility and allowing occupational pension schemes to reflect the new statutory regime. We would therefore suggest that the government should in this narrow case intervene to clarify that the exercise of an existing discretion is not a modification under s67, and indeed such an exercise with respect to prospective matters would not be to the overall long-term detriment of schemes and therefore of their beneficiaries. It is our firm belief that without the government taking these two steps both the policy objective and the clear intentions of the scheme rules would not be carried through as the apparent flexibility in the scheme rules could not in practice be put into effect.

Q9: The Government welcomes views on whether there would be a way to restrict any modification power to those schemes which had previously adopted RPI solely in order to match the statutory minima.

We do not know of any way specifically to identify those schemes which named RPI solely because that was the statutory level or because it was the sole measure of inflation considered relevant at the time. However, we would note that the above proposal in relation

to those schemes where a level of discretion was built into the scheme rules on inflation would go some way to reflecting flexibility which was built into those rules from the start.

Q10: The Government welcomes views on whether you agree the issue of CPI underpins should be addressed

We firmly believe that the government should address the issue of CPI underpins. The alternative would be unhelpful administrative costs for pension schemes retaining RPI increases, in monitoring two indices at once. It would also leave such schemes with the worst of both worlds: with the expected higher RPI figures overall but without the benefit from those years when the usual spread between the two measures reverses.

Q11: The Government welcomes views on whether there are any other options to address the CPI underpin issue

We believe that the proposed route of an exception to s51(2) is the right one.

Q12: The Government welcomes views on whether the proposed amendments to remove references to RPI from primary legislation are satisfactory.

We believe that the proposals are satisfactory.

Eversheds LLP

The impact of using CPI as the measure of price increases on private sector occupational pension schemes

Response to consultation on government proposals

1. Background

1.1 We set out below Eversheds LLP's comments on aspects of the consultation on government proposals regarding the impact of using CPI as the measure of price increases on private sector occupational pension schemes.

1.2 Our pensions team is the largest in the country, with over 65 specialist pensions advisers. Our clients include trustees, employers and insurance companies. This response represents our views on some of the consultation questions (we have not expressed views all aspects of proposals). In forming our views we have taken account of clients' interests and concerns, in particular where some of our larger clients have encountered potential issues around these changes.

2. Consultation questions

2.1 **Q1: The Government welcomes views on whether the impact of using CPI has been correctly summarised**

Broadly, yes. However, we would make the observations set out below.

2.1.1 At paragraph 12, we would add to this list schemes that specify a fixed rate of increase. Also, it may be that the actuary (and not just the trustees) has some discretion over increases.

2.1.2 At paragraph 13, we would suggest that member communications, contracts, previous practice etc might in some circumstances have an impact on how these changes affect members. Some trustees are

very concerned that there is a strong expectation among members that revaluation/indexation would continue to be based on RPI, albeit the drafting of the scheme rules means that the switch to CPI will be automatic (and an achieving a rule amendment to change this may be problematic for various reasons).

2.1.1 In relation to the fourth bullet point at paragraph 14, many scheme rules, in our experience, contain wording providing for the use of "RPI or such other index as the trustees determine" or similar. It is noted that this creates "a potential opportunity to move to CPI". This may be the case but it is not entirely beyond doubt that such a move would not fall foul of the "section 67" regime. Given that this situation is likely to arise commonly, we would suggest an amendment clarifying that section 67 does not apply to the exercise of such a discretion under the scheme rules.

2.2 **Q2: The Government welcomes views on whether it is right to apply the employer consultation requirements in respect of changes to scheme rules on indexation and revaluation**

This is primarily a matter of policy but such consultation requirements will increase the regulatory/administrative burden on employers undertaking these changes.

2.3 **Q3: The Government welcomes views on the draft Occupational Pension Schemes (Consultation by Employers) Amendment Regulations 2011**

We do not consider that use of the word "rate" in these draft regulations accurately captures the intention here, as it is the index rather than the rate which will (directly) change.

We also have some concerns in relation to the phrase "would be less generous". This language is imprecise and it is not necessarily a foregone conclusion that a switch to CPI will be less generous. An alternative would be to spell out specifically that the consultation requirement is triggered by a switch from RPI to CPI.

2.4 **Q10: The Government welcomes views on whether you agree the issue of CPI underpins should be addressed**

Yes, we consider that this issue needs to be addressed.

2.5 **Q11: The Government welcomes views on whether there are any other options to address the CPI underpin issue**

The current proposals should, in our view, be broadened. In particular:

2.5.1 schemes that opt to amend their rules to provide for continued RPI rather than CPI increases (and we understand that some schemes are considering such an amendment) would not appear to be protected by the underpin exemption (see draft amendment to section 51(4ZA/C)); and

2.5.2 schemes set up after "the relevant time" also appear to be unprotected.

We assume these are unintentional omissions.

If you have any queries or comments in relation to this response, please contact (**information redacted**).

Eversheds LLP
2 March 2011

The Association of Pension Lawyers' response was provided in a format DWP could not publish on our website. The following is a transcript of the APL response.

ASSOCIATION OF PENSION LAWYERS

Please reply to
information redacted
c/o Herbert Smith LLP
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APL website: www.apl.org.uk
information redacted
Date: 28 February 2011

Dear **information redacted**

The impact of using CPI as the measure of price increase on private sector occupational pension schemes – consultation December 2010

We are writing to you on behalf of the Association of Pension Lawyers which has around one thousand members. It is a non-political, non-lobbying organisation. This letter had been reviewed by the APL Legislative & Parliamentary Committee and is the APL's response to the December 2010 consultation.

Consultation questions

Q1: the Government welcomes views on whether the impact of using CPI has been correctly summarised

We would offer the following observation to the summary in paras 12-14

Para 12

The category *"schemes with rules that specify RPI"* could be helpfully broken down into:

- schemes with rules that specify RPI;
- schemes with rules that specify RPI capped at 5%/2.5%; and
- schemes with rules that specify RPI capped at another percentage (as these schemes will not benefit from the changes to section 51(4) in the Bill to avoid a statutory CPI underpin).

There are also some schemes which provide a flat rate increase which may from time to time be more than the statutory minimum.

For completeness, we are also aware of some schemes that provide the lower of 5% compound and RPI compound from date pension came into payment.

Para 13

The impact on members will in practice also depend on communications (booklets, announcements etc) that have been sent to scheme members.

It is possible that a communication will have given a member legal rights beyond what the rules provide. This is an important point to which we return in answering your question 8.

Para 14

With regard to the second bullet we would query the words *"except in years where the statutory minimum calculated using CPI is higher than RPI under schemes rules".* Surely the exemption in section 51(3) PA 1995 would currently apply, as the scheme is providing the *"relevant percentage"* (as defined in section 51(4) PA 1995) hence there is no underpin.

With regard to the second bullet on page 10 we note that the DWP is of the opinion that the words *"RPI or such other index as the trustees determine"* creates an opportunity to move to CPI. However, some lawyers are concerned that no such opportunity may exist (other than for future service), because the Court of Appeal decision in ***Aon Trust Corp v KPMG*** [2005] EWCA Civ 1004 creates doubt as to whether this (or any other move away from a stated fallback position) would amount to a modification caught by the section 67 regime. In the light of this we would request DWP to consider removing this doubt by disapplying section 67 to such a trustee power. This can be achieved through regulations made under section 67(3)(b).

The application of that reading of the judgment in the context of the switch to CPI would seem particularly anomalous, as rules which express the same substantive benefit promise would appear to require the use of different indices (on a random basis). The substantive benefit promise is essentially the same whether the scheme rules say pension increases should be in accordance with:

- "The RPI or, if the trustees so decide, the CPI";
- "The CPI or, if the trustees so decide, the RPI; or
- "Whichever the trustees decide out of the RPI and the CPI".

We do not believe that section 67 could have been intended to produce different results when the benefit promised was the same in all cases, i.e. increases (subject to overriding legislation) calculated by reference to the CPI or the RPI as the trustees choose.

Even if the DWP does not wish to confer a section 68(e) power to allow trustees to replace all references to RPI with references to CPI (see our answer to Q8), we do think it is important that DWP should clarify that section 67 does not apply when trustees exercise an express discretion conferred by the scheme rules to choose the index they use.

In this context, it is also worth mentioning that the (possibly unintentionally sweeping) suggestion in ***Aon v KPMG*** that any move away from a fallback position is caught by section 67 could have implications for many other

scheme rules – for example, a trustee discretion to cut an ill-health pension if the member recovers, or a commutation rule or early retirement rule which sets out that factors that are to apply unless the trustees decide otherwise. It seems to us that the mere existence of a stated fallback position in a specific benefit rule is not part of the mischief that section 67 can sensibly have been intended to address.

With regard to last bullet in para 14 we would note that this statement is true so long as the private scheme legislation does not diverge from the public sector legislation to generate a different rate either because of a different period over which CPI is calculated or a different index being used in future by HMG. We do not consider the current changes should cause divergence but the point is that a scheme that refers to the Pensions (Increase) Act 1971 should be providing *both* what the rules and what the private sector revaluation/increase legislation provide (which should at present coincide).

<u>Further comments</u>

The proposed changes through the Bill to section 51(4) appear to us to be deficient in two respects:

(i) Where a scheme makes a transfer payment to a scheme established after 1 January 2011 the words *"since the relevant time"* preclude the exemption in section 51 (4ZA) applying to pensions in payment. This would mean the new scheme would have to provide an underpin. This seems illogical and we suspect it is a drafting error.

(ii) Where a scheme (which currently provides increases governed by section 51(2) or the Pensions (Increase) Act) decides after the start of 2011 to amend its rules to promise RPI increases for its current pensioners instead of statutory CPI increases, it will not be able to rely on the disapplication of the statutory underpin as section 51 (4ZA) / 51(4ZC) will not apply. The schemes could offer only RPI increases subject to a CPI underpin. This is an unwelcome disincentive for schemes generous enough to wish to move to RPI in order to maintain the increases that have been provided historically, and again we think it may be a drafting error as we find it hard to believe that it reflects an intended policy. (If its aim is to stop schemes selecting against members by switching every year to whichever index is lower, might it be better to say for example that the exemption applies unless the scheme has switched previously in, say, the last three years).

Although the drafting might be difficult, we wonder if there is any policy reason why a parallel exemption from the revaluation legislation should not apply to schemes whose rules include a hard-coded requirement for RPI – linked increased to deferred pensions.

Q2: The Government welcomes views on whether it is right to apply the employer consultation requirements in respect of changes to scheme rules on indexation and revaluation.

We think it is consistent with the other listed changes. However, we do note that it seems inconsistent with the aim of reducing the regulatory burden.

Q3: The Government welcomes views on the draft Occupational Pension Scheme (Consultation by Employers) Amendment Regulations 2011.

We have three points.

First, we would suggest that the word *"rate"* may not be the right word. Is the focus of the change in fact the *"index"?*

Second, we would invite the DWP to reconsider whether the words *"would be less generous"* in the draft regulations appended to the consultation document will be successful in triggering the intended obligation to consult. This is because *"would"* conveys certainty of outcome*.* Because there is no certainty as to whether a switch from CPI to RPI or vice versa will create less generous outcomes we suggest the consultation requirement will not be tripped. We therefore suggest *"**might** be less generous"*. Alternatively, if the aim is simply to catch a switch form RPI to CPI, you could specify this.

Third, it would be helpful if the DWP would confirm that changes made before the Regulations come into force but before the pensions are increased with the new index, will not require consultation ex post facto. The DWP might also wish to consider having a transitional exemption for changes which have been announced but not implemented by rule amendment before the new consultation requirement comes in. A similar clarification was given when the Consultation Regulations were first introduced.

Q4: The Government welcomes views on whether there are any issues that should be considered in respect of career average arrangements.

The same issues seem to us to arise.

Q5: The Government welcomes views on whether there are any issues that should be considered in respect of GMPs

We would request consideration be given to an express exemption for GMPs if the schemes applies one RPI 5%/2.5% rate to all pensions.

We would also invite the DWP to clarify the extent of the carry-forward arrangements in section 53 Pensions Act 1995. These allow schemes to apply a lower increase in one tax year to a GMP or post-1997 pension than legislation would otherwise require, if they have awarded increases higher than legislation requires in the previous tax year. In particular, the wording of section 53(3) creates some doubt over whether the carry-forward rule allows an offset only for one year and then requires the GMPs/post-1997 pension paid in future tax years to be calculated as if the full statutory increase hadbeen awarded.

Q6: The Government welcomes views on whether there is any justification for overriding the rules of private sector occupational pension schemes to impose CPI as the measure of increase in prices

This is a policy question on which the APL cannot comment.

Q7: The Government welcomes views on whether there are other reasons why a scheme whose rules do contain a modification power would nonetheless be unable to, or find it difficult to, use CPI for indexation and revaluation.

Trustees may also be constrained by other legislation for example privatisation legislation.

Q8: The Government welcomes views on whether it is right to rule out granting modification powers.

We do not think that granting a power to Trustees (who ought to embody trust and who are legally bound only to act in beneficiaries' interest) should undermine trust. We would ask DWP to consider whether, with appropriate safeguards, there is a case for creating a Section 68 power which allows modification of an earlier hard-coded RPI promise.

The DWP would of course need to be confident that use of section 68(2)(e) is Human Rights Act compliant. Alternatively, if it felt that a section 68 power was inappropriate as that would override restrictions on a scheme's own amendment power, DWP could consider instead disapplying section 67. This would then allow a scheme amendment to facilitate a move to CPI (where amendment powers so allow). This would involve regulations being issued under section 67(3)(b). A drawback of the section 67 approach as compared to conferring a section 68 power is that it would leave the estoppel claim risk at least for those who would feel uncomfortable without it being addressed through section 68 clarification as suggested above.

If the DWP feels that allowing schemes to revisit indexation rights previously promised goes too far despite the protection of trustees' fiduciary duties, we would nonetheless make two suggestions:

- first, as mentioned earlier, we think section 67 should be clarified so as to confirm that it does not apply when the benefit promise gave trustees choice over which index to apply even if the rules did set out a fallback position; any difficulty here is entirely an artefact of s67 rather than the benefit actually (or intended to be) promised by the scheme; and
- second, DWP should consider clarifying the wording of current Regulation 5 of the Occupational Pension Schemes (Indexation) Regulations to make it clear that it lets trustees pass a s68 resolution changing the index used to determine the increases on future service pensions. As noted above, a switch from RPI to CPI does not necessarily involve a reduction

We do consider that DWP should consider further issuing regulations under section 68(e). Without further clarification to aid the interpretation of section 68, there is a risk of member estoppel claims

In inviting the DWP to consider making regulations under section 68(2)(e) of the Pensions Act 1995 to enable trustees and employers to amend their scheme rules in order to adopt CPI for all service we need to be aware that trustees and employers could be dissuaded from using future regulations made under section 68(2)(e) to amend their scheme. This is because of concerns that trustees may owe members separate obligations outside the scheme to uprate and revalue pensions on the basis of RPI based on claims the member can make because he/she has received communications from trustees/employers. The concern is that even if the scheme rules could be modified by new legislation it would not help if the member has a separate (estoppel) claim he can bring even though the rules have been changed (see member claim in ***Christopher Catchpole v The Trustees of the Alitalia Airlines Pension Scheme and Alitalia – Linee Aeree Italiane SPA*** [2010] EWHC 1809 (Ch)).

How to prevent such claims arising outside the rules: clarifying section 68

We note the wording in section 68(1) of the Pensions Act 1995:

The Trustees of a trust scheme may by resolution modify ***the scheme*** *with a view to achieving any of the purposes specified….*(emphasis added)

"Scheme" is not defined in the 1995 Act. However, "trust scheme" is defined by reference to the definition of "occupational pension scheme" in the Pension Schemes Act 1993. Ultimately, this defines a pension scheme as *"a scheme or other arrangement, comprised in one or more instruments or agreements, having or capable of having affect so as to provide benefits to or in respect of people: on retirement, on having reached a particular age, or on termination of service in an employment."*

Member communications can give rise to an obligation which has the effect of modifying (i.e. increasing) benefit entitlement set out in the instrument. The trustees are bound to meet that obligation (and the employer potentially fund in future for it) from scheme assets. As scheme assets are being used to meet those benefits though the trustees' indemnity, the emerging benefits can properly be described as part of "the scheme" as contemplated in section 68(1).

To put any resolve any concerns or doubts on this issue it would be helpful for employers and trustees who might be considering using an extended regulations (if DWP decide to legislate) under section 68(2)(e) to make amendments to allow a switch to CPI, if this point could be confirmed in any new regulations made under section 68(2)(e).

For reasons outlined above, it would not be extending the meaning of "scheme", but confirming that scheme obligations arising out of member communications form part of the "scheme" and can, therefore, be modified by resolution under section 68.

We envisage language in the regulation stating that the scheme may be modified as to its benefit obligation however arising.

Q9: The government welcomes views on whether there would be a way to restrict any modification power to those schemes which had previously adopted RPI solely in order to match the statutory minima.

Yes this could be done, at least to a reasonable approximation, providing that a modification power can only be used if the reference to RPI was only introduced at or around the time when statutory revaluation / increases were introduced. Clearly it would hard to prove beyond all doubt that the rule amendments would not have been made anyway, even if there had been no statutory obligation in the offing, but there must be a very strong presumption that that was the reason for the rule change.

Q10: The Government welcomes views on whether you agree the issue of CPI underpins should be addressed.

Yes.

Q11: The Government welcomes views on whether there are any other options to address the CPI underpin issue

See above

Q12: The Government welcomes views on whether the proposed amendments to remove references to RPI from primary legislation are satisfactory

See 1 above.

Two further points on the Pensions Bill 2011

While writing, we would like to comment briefly on clause 16 of the Pensions Bill which seeks to disapply statutory increase requirements from cash balance benefits.

First, we do not think the definition of "relevant occupational pension scheme" probably reflects the policy intention here – which we assume is that there should be no difference, at the point of retirement, between a cash balance pot built up in contracted-in employment and a money purchase built up in contracted-in employment. The wording of the definition does not seem to achieve that result, because it focuses, not on whether the cash balance built up while the individual member's employment was contracted-out, but on whether <u>anyone</u> in the scheme was in contracted-out employment after April

1997. If we have understood the policy right, surely it is irrelevant whether other members of the same scheme were in DB contracted-out employment. We also suspect that it should be irrelevant, in terms of the policy intention, if the same member was in DB contracted-out employment during an earlier part of his or her pensionable service in the scheme, before he or she started to accrue cash balance funds. We would be happy to suggest alternative wording for the Bill if you agree that it does not quite capture the intention here.

Second, we find the wording of draft section 51ZB(5) difficult to follow, but we believe it might allow someone to construct what was essentially a CARE arrangement in such a way as to fall within the cash balance exemption – which again we do not think was the intention. We wonder if it is too late to allow the section to be redrafted in a way which makes it easier to be sure what it does and does not catch.

Yours sincerely

information redacted

The BURGES SALMON response was provided in a format DWP could not publish on our website. The following is a transcript of the BURGES SALMON response.

RPI/CPI – response to DWP consultation **BURGES SALMON**

1. To give an idea of our sample of schemes, we are a Bristol-based, full service commercial law firm with a national reputation. We have two dozen lawyers (the 5th largest team nationally according to the latest survey) who work full time on pensions and we have some 500 pension clients.

2. **WITHOUT AN OVERIDE**

3. We agree with the widely held view that it is unsatisfactory for members and employers (and the trustees who are often left holding the balance) for inflation protection to depend on the accidents (and they are mere accidents in the great majority of cases) of different drafting styles - hard wired to RPI or soft wired to statutory requirements from time to time.

4. The cost to schemes of advice on their position is going to be material and, in complicated cases, very significant. Industry wide, the cost will be big.

5. We have seen many sets of rules where it is difficult to say whether a rule is hard or soft wired (e.g. “RPI as set out in the current order”). Unless they take the expensive route of playing safe, there is risk here for clients. There could be significant amounts of litigation on interpretation.

6. It is common to see rules that are hard wired to RPI for revaluation. And we have seen GMP increase rules hard wired too. At the very least, the Pensions Bill needs to rule out the better of RPI and CPI in these areas as well as on indexation.

7. It is far the case that there is a single answer whether a scheme is hard wired or soft wired for revaluation and / or indexation:

   (a) it is routine for successive editions of a scheme’s rules to apply to different groups of members, an approach driven in part by the preservation legislation. Thus new consolidated rules often say that benefits for anyone who left pensionable service before the new rules come into effect will continue to be quantified under the previous rules. As different hard and soft wired drafting styles are used over time, there is complicated (and expensive) research to be done to decide which groups of pensioners or deferred pensions are entitled to RPI or CPI;

   (b) other subsets of members with different entitlements over inflation protection can arise as a result of;

(i) scheme mergers when it is common for pensioners, deferreds and actives in transferring scheme A to be told by receiving scheme B that their benefits will replicate scheme A. These may be different on revaluation and indexation form scheme B's standard benefits. And scheme A may also import its own layers of history as in (a) above. A lot of schemes have had multiple schemes (even 100+) merge into them;

(ii) a group's purchase of another company has often led to its scheme offering non standard benefits to members bulk transferred across;

(iii) scheme can make individual promises, e.g. to senior staff.

If there is no statutory override all this history will need to be researched if the employer and the trustees want certainty (though even then subject to difficulties of interpretation). The alternative route to certainty would be for schemes to take the expensive route of offering the better of RPI and CPI wherever there is doubt.

8. **STATUTORY OVERRIDE**

9. We believe the correct approach is for the Government to legislate to override scheme rules to impose CPI for revaluation, indexation and GMPs. There should be a statutory opt-out from the override so schemes that have taken, or want to take, a positive choice in favour of RPI can follow their preference.

10. We believe this is fairer to members, employers and trustees than the government's current proposal.

11. At the very least, a CPI underpin should be ruled out by statute in relation to revaluation and GMPs as well as indexation.

Burges Salmon LLP (MHO8)

The PRICEWATERHOUSE COOPERS response was provided in a format DWP could not publish on our website. The following is a transcript of the PRICEWATERHOUSE COOPERS response.

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28 February 2011

Dear **information redacted**

Using CPI as the measure of price increases in private sector pension schemes

PricewaterhouseCoopers LLP is pleased to have the opportunity to respond to the discussion points raised in the consultation document entitled “The impact of using CPI as the measure of price increases on private sector occupational pension schemes”.

The Appendix provides answers to the specific questions raised in the document and our key suggestion are summarised below.

Modification power
Our main suggestion is that the Government should legislate to introduce a modification power under Section 68 of the Pensions Act 1995, providing the flexibility to switch to CPI-based indexation where the circumstances are appropriate. The Government is right to view modification powers as a “finely balanced “ issue but we believe that, provided the new power rests only with trustees, checks and balances will be applied to guard against it being exercised inappropriately.

Many private sector employers are reviewing their pension strategies and the terms of their pension schemes at the moment. Decisions about the future course of pension benefits are intrinsically linked to the terms of, and resources expected to be devoted to, existing arrangements. Employers and trustees alike would welcome discussions about how benefits should be inflation-proofed in future, in the knowledge that there are no legislative barriers to adopting a new approach.

In practice, it may be that the adoption of CPI is not widespread in the private sector, even if a modification power becomes available. Having given due to consideration to the pros and cons in the circumstances of their pension scheme, some trustees will no doubt decide that it is not appropriate to change. However, some will; and it is important that where there is consensus for change, it can take place freely.

Promoting confidence in private pensions – Public perceptions
A degree of consistency between public service pension schemes, contracted-in private sector schemes, contracted-out private schemes and state pensions is desirable, to avoid the public perception that different measures of inflation are being used arbitrarily for the same purpose.

The Government is clear that CPI is a more appropriate measure of inflation than RPI for inflation proofing pensions and other benefits. It has acted decisively to switch to CPI-based indexation for public service pensions, state pensions and contracted-out pensions rights in the private sector. Those involved with private sector pension who share the Government's views about inflation measures should not be prevented by legislation from taking similar action.

The paper stresses the need to preserve and promote confidence in saving into private pensions. On balance, our view is that removing the barriers that prevent switching to CPI even where there is consensus from all involved is consistent with this aim. Inertia poses a greater risk.

We would be very happy to discuss any of the points in our response. Please feel free to contact me or my colleagues listed below.

Yours sincerely

information redacted

appendix

PwC's response to discussion points raised

Q1: The Government welcomes views on whether the impact of using CPI has been correctly summarised.

We think the impact has been correctly summarised.

Q2: The Government welcomes views on whether it is right to apply the employer consultation requirements in respect of changes to scheme rules on indexation and revaluation.

We assume that consultation will be required only where rule changes are proposed (ie not in situations where scheme rules provide discretion as to the index upon which to base indexation/revaluation and a decision is taken to switch to CPI). Subject to this, it seems reasonable to apply the employer consultation requirements.

Q3: The Government welcomes views on the draft Occupational Pension Schemes (Consultation by Employers -Amendment) Regulations 2011.

The draft regulations achieve their aim.

Q4: The Government welcomes views on whether there are any issues that should be considered in respect of career average arrangements.

There are no particular issues in respect of CARE arrangements

Q5: The Government welcomes views on whether there are any issues that should be considered in respect of GMPs

There are no particular issues in respect of GMPs.

Q6: The Government welcomes views on whether there is any justification for overriding the rules of private sector occupational pension schemes to impose CPI as the measure of increase in prices

We see no justification for over-riding rules that impose CPI.

However, as we say in the comments that follow, we urge the Government to remove the hurdles that stand in the way of changing scheme rules on a scheme-by-scheme basis to switch to CPI.

Q7: The Government welcomes views on whether there are other reasons why a scheme whose rules do contain a modification power would nonetheless be unable to, or find it difficult to, use CPI for indexation and revaluation.

We can think of no other reasons (ie reasons in addition to those mentioned in paragraph 39) why it may still be difficult to switch to CPI in circumstances where there are suitable scheme modification powers to facilitate.

Of the four barriers to switching mentioned in paragraph 39, the possibility of having to comply with Section 67 of the Pensions Act 1995 is the most intractable. This is likely to make it impossible to switch to CPI even in circumstances where the trustees' are in favour of switching to CPI and view it as compatible with their fiduciary duties.

We strongly suggest that such amendments should be taken outside of the scope of Section 67.

Q8: The Government welcomes views on whether it is right to rule out granting modification powers.

We do not agree that the Government should rule out introducing a modification power.

We understand that any such power, assuming it were to be introduced through Section 68 of the Pensions Act 1995, would rest with scheme trustees. As such, its exercise would be subject to the checks and balances that trustees would have to apply in accordance with their fiduciary obligations.

This would go some way to facilitating a switch to CPI in circumstances where this is reasonable and appropriate, such as schemes where:

- the trustees' interpret the intention of the trust as protecting pensions from erosion by inflation and they agree with the Government that CPI is the most appropriate measure of inflation for this purpose.
- the trustees are convinced that, on balance, the long-term prospects for scheme members would be better if the switch to CPI were made.

Conversely, in other situations (eg those highlighted in paragraph 33(a)), where the trustees' believe that the intention of the trust is specifically to increase pensions at RPI, the balance of power to retain RPI would rest squarely with them.

Q9: The government welcomes views on whether there would be a way to restrict any modification power to those schemes which had previously adopted RPI solely in order to match the statutory minima.

We can see no feasible way to do this. However, we see no need for any modification power to be restricted in this way.

Would it not suffice simply to relax Section 67 for the purpose of switching to CPI, as we suggest under Q8? The balance of power for any amendment would rest with the trustees and they would be able to take their own view of whether it is appropriate to switch to CPI. One (not the only) consideration for them, would be whether the reason for adopting RPI previously was to match the statutory minima.

Q10: The government welcomes views on whether you agree the issue of CPI underpins should be addressed.

Yes, we agree.

Q11: The Government welcomes views on whether there are any other options to address the CPI underpin issue

The proposal in paragraph 50 of the consultation document seems sensible and should achieve the desired outcome. We can think of no other convenient options.

Q12: The Government welcomes views on whether the proposed amendments to remove references to RPI from primary legislation are satisfactory

We believe the proposed amendments are satisfactory.

The TOWERS WATSON response was provided in a format DWP could not publish on our website. The following is a transcript of TOWERS WATSON response.

TOWERS WATSON (Information redacted) (Information redacted)
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2 March 2011

(Information redacted)
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Dear Sirs

Response to consultation paper "The impact of using CPI as the measure of price increases on private sector occupational pension schemes."

Towers Watson is a leading global professional services company with over 14,000 associates around the world. In the UK we have particular strength in the area of pensions and we advise over half of the 100 largest corporate pension schemes.

We welcome this opportunity to comment on the consultation paper "The impact of using CPI as the measure of price increases on private sector occupational pension schemes.".

We have responded to the specific questions in the consultation paper below, but we would like to highlight the following important issue, which is not covered by the questions asked. We are pleased that the Government has acknowledged that it is inappropriate for schemes to have to pay the higher of CPI and RPI inflation-linked increases *for pensions in payment*, but this should also apply for the statutory minimum increases in *deferment*. The financial impact in terms of benefits paid out is likely to be small as over most periods CPI inflation is likely to be lower than RPI inflation. However, this cannot be assumed and therefore for any calculations involving a deferred pension the CPI underpin would have to be determined. There is therefore a very real administration cost, even more frustrating to incur when it is unlikely to have any impact in most cases. This was the main issue identified by our consultants when we sought views on responding to this consultation.

Q1: The Government welcomes views on whether the impact of using CPI has been correctly summarised.

It is important to note that most schemes will not fall within just one of these categories. For example, the most common scenario will be for a scheme to refer to the legislation for revaluation in deferment, but to refer to RPI in the rules for pension increases in payment. This can lead to hard to explain inconsistencies where members with very similar benefits will end up being treated differently, just because rules in different sections have been drafted differently.

Q2: The Government welcomes views on whether it is right to apply the employer consultation requirements in respect of changes to scheme rules on indexation and revaluation.

We can understand why employers should consult before making major changes to the pension arrangement and it is a matter of debate where the line is drawn. On balance, we feel that changing scheme rules on indexation or revaluation, particularly revaluation, are not sufficiently major changes to require a bureaucratic consultation exercise.

There also seems to be inconsistency. Consultation was not required for changing the cap from 5% to 2.5% for either pension increases in payment or revaluation in deferment. Depending on the level of inflation, the change in the cap could have a greater impact than changing the inflation index from RPI to CPI (which we assume is the change which these new regulations are designed to capture).

Q3: The Government welcomes views on the draft Occupational Pension Schemes (Consultation by Employers) Amendment Regulations 2011.

It appears to us that the draft regulations do achieve the Government's objective but, whilst making these changes, could the Government clarify the scope of regulation 10(1) (a) of the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006 (SI 2006/349). "…*no account is to be taken of any change which – (a) is made for the purposes of complying with a statutory provision*,"? It is unclear whether this includes optional changes, or only those imposed by statute. For example there was confusion in 2009 as to whether the reduction in the cap on revaluation in deferment fell under this clause. In this case, the Regulator helpfully stated that in its view any such change was being made "for the purposes of complying with a statutory provision" and, therefore, fell under the exclusion in regulation 10(1)(a). It is this that prompted the comment above that the current proposal is inconsistent.

Q4: The Government welcomes views on whether there are any issues that should be considered in respect of career average arrangements.

We are not aware of any special issues for career average arrangements.

Q5: The Government welcomes views on whether there are any issues that should be considered in respect of GMPs.

We think it will be common for schemes to incorporate in their rules how revaluation and indexation apply for GMPs. However, this will be most commonly done by using

the GMP Model Rules and these use legislative references so the changes to the legislation will flow through. We agree that very few schemes will reference RPI directly in relation to GMPs.

Q6: The Government welcomes views on whether there is any justification for overriding the rules of private sector occupational pension schemes to impose CPI as the measure of increase in prices.

Pension increases in payment

This is a very difficult area, with a range of views from our consultants and clients.

As the consultation document notes, there are various reasons why schemes may have RPI written into their rules. People also have different opinions as to whether it is ethical to rewrite rules. We understand the reasons why the Government has decided against granting a blanket statutory override, but consider that it might be appropriate to do so in the circumstances identified in Q9 and/or to provide a modification power as discussed in Q8.

Revaluation in deferment

There is a case to be made for overriding scheme rules with respect to revaluation in deferment. We think that there will be very few schemes that linked revaluation to inflation other than to meet statutory requirements. It seems to us that the concerns that the Government has about interfering with scheme rules do not apply to revaluation to the same extent as for pension increases in payment.

Q7: The Government welcomes views on whether there are other reasons why a scheme whose rules do contain a modification power would nonetheless be unable to, or find it difficult to, use CPI for indexation and revaluation.

The consultation document sets out the issues here.

Q8: The Government welcomes views on whether it is right to rule out granting modification powers.

We agree that the Government is right to rule out granting modification powers with the exception of assisting schemes that are unable to amend their rules to make changes to future accrual and in the following, relatively extreme, circumstances.

Whether or not revaluation in deferment and/or pension scheme increases in payment are linked to RPI or CPI is now arbitrary depending on how the scheme rules were drafted. This is particularly difficult to explain where the differences arise in different sections of the same scheme, or even for different periods of service. We note in the Appendix to this letter some specific examples where a relatively small section of the scheme and/or tranche of benefits will not be able to switch to CPI. This will cause significant communication and administrative difficulties. We would ask that the Government legislates for a modification power jointly exercisable by the employer and trustees in situations where there are demonstrable administrative (not solely financial) advantages in allowing a change such that certain benefits are calculated on

a CPI basis. One way of ensuring that this is applied appropriately might be for the Regulator to be given a specific power to judge whether such an approach is a proportionate response to an administrative issue.

Q9: The Government welcomes views on whether there would be a way to restrict any modification power to those schemes which had previously adopted RPI solely in order to match the statutory minima.

Pension increases in payment

We think it would be possible to set out criteria which should be satisfied by schemes claiming that they only give pension increases because they are forced to by statute. For example, such schemes could be required to certify that, as far as the current trustees are aware, they meet some or all of the following:

- The scheme did not guarantee pension increases prior to 6 April 1997.
- The scheme did not pre-fund for pension increases prior to 6 April 1997.
- The scheme has not granted discretionary pension increases.
- The scheme took advantage of the reduction in the LPI cap from 5% to 2.5% wef April 2005.

Amongst our client base, we suspect that very few schemes would be able to meet all of the above criteria. This is mainly because many of our clients did provide pension increases before there was a statutory requirement to do so.

If the Government is minded to provide an override where some (but not all) of the above conditions are met, then it might wish to consider going further. There are schemes that guaranteed increases in anticipation that they would be forced to do so under section 11 of the Social Security Act 1990, which was never enacted, and so would not meet the above criteria. The Government could offer the option of schemes self-certifying that this was the reason why they incorporated pension increases into their rules before April 1997.

In applying the above, trustees would prefer the certainty of a statutory override rather than consider exercising a modification power.

Revaluation in deferment

As mentioned in Q6, we think there is a case for granting a general statutory override here. If not, then questions similar to the above could be used to identify schemes which only revalue deferred benefits in order to match statutory requirements.

Q10: The Government welcomes views on whether you agree the issue of CPI underpins should be addressed.
And

Q11: The Government welcomes views on whether there are any other options to address the CPI underpin issue.

We absolutely agree that the issue of CPI underpins should be addressed and note that such measures are in hand.

As noted in the introduction, we consider it essential that the issues for a CPI underpin for revaluation in deferment are similarly addressed.

Q12: The Government welcomes views on whether the proposed amendments to remove references to RPI from primary legislation are satisfactory.

There are other references to RPI, mainly to do with determining HMRC limits; it might be helpful if these were amended so that they are consistent with the options for statutory minimum increases.

Yours sincerely

(Information redacted)

Appendix 1: Example of actual schemes where a small amount of the liability will not switch to LPI increases

Scheme 1

The scheme basically applies statutory minimum increases only. However, there is the exception of pensions accrued between 6 April 2005 and 5 April 2006 which are hard-coded at RPI maximum 5%. This was due to the timing of member communications at the time.

It would be administratively complicated to provide RPI 5% for this one year since it would require identification of this element for all pensioners, and the amounts are clearly trivial in the context of the benefits as a whole.

Scheme 2

Pre-97 deferred revaluation is hard-coded at RPI for one section out of 12; the remaining sections can change to CPI.

Scheme 3

Similar to scheme 2 – CPI in deferment for all but one section where RPI hard-coded for service to 5 April 2010.