PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT
GENERAL COMMITTEES

Public Bill Committee

PENSION SCHEMES BILL

Sixth Sitting

Tuesday 28 October 2014

(Afternoon)

CONTENTS

PUBLISHED BY AUTHORITY OF THE HOUSE OF COMMONS
LONDON – THE STATIONERY OFFICE LIMITED

£6·00

PBC (Bill 012) 2014 - 2015

Members who wish to have copies of the Official Report of Proceedings in General Committees sent to them are requested to give notice to that effect at the Vote Office.

No proofs can be supplied. Corrigenda slips may be published with Bound Volume editions. Corrigenda that Members suggest should be clearly marked in a copy of the report—not telephoned—and must be received in the Editor's Room, House of Commons,

not later than

Saturday 1 November 2014

STRICT ADHERENCE TO THIS ARRANGEMENT WILL GREATLY FACILITATE THE PROMPT PUBLICATION OF THE BOUND VOLUMES OF PROCEEDINGS IN GENERAL COMMITTEES

The Committee consisted of the following Members:

Chairs: †Mr Peter Bone, Mrs Linda Riordan

† Abrahams, Debbie *(Oldham East and Saddleworth)* (Lab)
† Blenkinsop, Tom *(Middlesbrough South and East Cleveland)* (Lab)
† Coffey, Dr Thérèse *(Suffolk Coastal)* (Con)
† Graham, Richard *(Gloucester)* (Con)
† Hammond, Stephen *(Wimbledon)* (Con)
† Hemming, John *(Birmingham, Yardley)* (LD)
† Kwarteng, Kwasi *(Spelthorne)* (Con)
† Latham, Pauline *(Mid Derbyshire)* (Con)
† Love, Mr Andrew *(Edmonton)* (Lab/Co-op)
† McCann, Mr Michael *(East Kilbride, Strathaven and Lesmahagow)* (Lab)
† McClymont, Gregg *(Cumbernauld, Kilsyth and Kirkintilloch East)* (Lab)
McFadden, Mr Pat *(Wolverhampton South East)* (Lab)
Maynard, Paul *(Blackpool North and Cleveleys)* (Con)
† Mills, Nigel *(Amber Valley)* (Con)
† Morris, James *(Halesowen and Rowley Regis)* (Con)
Paisley, Ian *(North Antrim)* (DUP)
† Watkinson, Dame Angela *(Hornchurch and Upminster)* (Con)
† Watts, Mr Dave *(St Helens North)* (Lab)
† Webb, Steve *(Minister for Pensions)*

Matthew Hamlyn, *Committee Clerk*

† attended the Committee

Public Bill Committee

Tuesday 28 October 2014

(Afternoon)

[MR PETER BONE *in the Chair*]

Pension Schemes Bill

2 pm

Clause 11

EXTENSION OF PRESERVATION OF BENEFIT UNDER OCCUPATIONAL PENSION SCHEMES

The Minister for Pensions (Steve Webb): I beg to move amendment 9, in clause 11, page 5, line 42, leave out "non-salary related benefit,"." and insert

"benefit falling within subsection (1A),";

(b) after subsection (1) insert—

"(1A) The following fall within this subsection—

(a) collective benefits;

(b) benefits calculated otherwise than by reference to the member's salary.""

This amendment makes it clear that collective benefits are subject to the 30 day preservation rule for the purposes of obtaining short service benefit.

The Chair: With this it will be convenient to discuss Government amendments 10 and 11.

Steve Webb: Good afternoon, Mr Bone. It is pleasure to have you rejoin our proceedings. As I did on several occasions this morning, I will explain the purpose of the clause and then how the amendments improve it. I hope that will avoid the need for a separate clause stand part debate.

Clause 11 amends part 4 of the Pension Schemes Act 1993, which concerns what is known in pensions jargon as the preservation of benefit for early leavers of occupational pension schemes. What happens to the rights that people who leave a scheme leave behind? At the moment, members of occupational pension schemes who leave the scheme early are entitled to payment of the benefit accrued up to that point when they reach normal pension age, provided they have two years' qualifying service or have previously transferred their rights into the scheme from a personal pension.

Members who leave with more than three months but less than two years' service are entitled to transfer the value of the benefits they have accrued or receive a refund of their own contributions. The preserved benefit to which deferred members are entitled—termed "short service benefit"—has to be calculated in the same way as it would have been had they remained in pensionable service in the scheme until pension age. The Pensions Act 2014 introduces a requirement that where all the benefits are money purchase benefits, a preserved pension must be provided after 30 days' qualifying service.

The clause provides that schemes must provide a short service benefit where leavers have at least 30 days' qualifying service and all the pension benefit is not salary related—that is, not calculated by reference to the member's salary. If any of the pension benefit is salary related, the two-year rule still applies. Collective benefits will also be subject to a 30-day preservation period. Where a benefit may be calculated on a salary-related basis in some circumstances and a non-salary-related basis in others—for example an underpin benefit, which pays the higher of the two calculations—it will be treated as salary related for these purposes and the two-year period will apply. If a member's pensionable service began before the amendments came into force, the previous requirements for preservation of benefits will continue to apply.

Just to explain what is going on here, we have these new types of pension schemes and categories of benefit and we have had to ask, throughout the Bill, what they mean for the features of pension schemes. What do they mean for people who get divorced? What do they mean for people who leave schemes early? What do they mean for companies that wind up? We have had to deal with each one of those different categories. We are dealing here with preservation of benefits.

The clause ensures that the preservation requirements apply appropriately when the new scheme definitions are introduced. Amendments to the Pensions Bill 2014 reduce the period after which the member is entitled to a preserved pension from two years to 30 days in the case of money purchase benefits. The purpose of the clause is to preserve the position that money purchase benefits in an occupational pension scheme should be subject to 30-day preservation and to extend that 30-day period to cover all benefits that are not salary related. That will include all benefits under DC schemes, collective benefits and some benefits in shared-risk schemes.

Shared-risk schemes potentially cover a wide variety of benefit types. Without further amending existing legislation, benefits in shared-risk schemes would be subject to the two-year preservation rule, apart from any benefits arising out of transfers from personal pensions. A two-year preservation period is appropriate for benefits calculated by reference to salary under the current rules. A 30-day preservation period is appropriate for other benefits. It does not impose any additional administrative burdens, and is consistent with Government policy on automatic transfers, automatic enrolment and the contractual rights that apply to members of personal pension schemes.

The amendments put beyond doubt the treatment of collective benefits under the preservation requirements. In part 3 of the Bill we set out a framework for collective benefits. The framework creates the opportunity for a number of different models, and there is the possibility that some collective benefits could arguably fall within the strict legal definition of "salary related" that we drafted for the purpose of the preservation benefits. This would mean the two-year preservation rule might apply with all that goes with it, and that is not appropriate for collective benefits. Collective benefits are not salary related as there is not a promise or benefit related directly to the member's salary.

Amendments 9 and 10 add a separate reference to collective benefits that puts it beyond doubt that a 30-day rule will apply to collective benefits. The uniform accrual rules are intended to ensure that early leavers are not unfairly treated where the benefit accrues at different rates at different times. For example, if the accrual rate in a salary-related scheme increases after a specified period of time, someone leaving early may not get the benefit. Those rules were crafted for a defined-benefits world and have no relevance to the world of collective benefits. The usual rule should apply to collective benefits, that is, that short service benefit should be computed on the same basis as long service benefit. Amendment 11 ensures that the uniform accrual rules will not apply to collective benefits.

I hope that is helpful in setting out the purpose of the amendments and of clause 11, and I commend amendment 9 to the Committee.

Amendment 9 agreed to.

Amendments made: 10, in clause 11, page 6, line 15, leave out paragraph (c)

This is consequential on amendment 9.

Amendment 11, in clause 11, page 6, line 47, at end insert—

'( ) In section 74 (computation of short service benefit), in subsections (3) and (4), after "so much of any benefit" insert ", other than collective benefit,"."

As a general rule schemes are required to provide for short service benefits to be computed on the same basis as long service benefit. In cases where this doesn't apply benefits are subject to a uniform accrual rule. This amendment ensures collective benefits will not be subject to the uniform accrual requirements—(Steve Webb.)

Clause 11, as amended, ordered to stand part of the Bill.

Clause 12

Revaluation of accrued benefits

Question proposed, That the clause stand part of the Bill.

Steve Webb: Clause 12 itself is relatively uncontentious. It says only:

"Schedule 2 contains amendments about the revaluation of benefits.".

It sets up the long, detailed schedule 2, which deals with the issue of bringing pension rights built up in the past up to present day values. There are a range of ways in which that can be done. The Bill has to work out the right mechanism for revaluation in this new world of pension schemes.

When a member stops being an active member of a scheme prior to retirement, the accrued benefits are required to be revalued, so that when the member reaches the scheme's normal pension age, the value of those benefits has a measure of inflation protection over the period of the deferral. Sections 83 to 86 of and schedule 3 to the Pension Schemes Act 1993 set out the procedure for revaluation based on benefit type. Clause 12 and schedule 2 of the Bill contain amendments about the revaluation of benefits, to ensure the appropriate revaluation method applies to collective benefits and to benefits accruing after the new scheme categories in part 1 of the Bill come into force. The key point to bear in mind is that existing methods of revaluation will still apply. With the introduction of the new scheme categories in part 1 of the Bill, it is important that everyone is clear how the revaluation requirements apply to the benefits they provide. Revaluation requirements apply to benefits in both occupational and personal pension schemes. I am tempted to indulge in a short quiz at this point, because currently there are four methods for revaluation set out in schedule 3 to the 1993 Act. I will take any interventions from anybody who wishes to name any of them. I will come back to that later.

Following commencement of the new definition of money purchase benefits in the Pensions Act 2011, we introduced another one, a cash balance method, which may be used for cash balance benefits where the available sum is not calculated by reference to final salary. To reveal the answer to my quiz, the four different methods of revaluation are the final salary method, the average salary method, the flat rate method, and the money purchase method, which is a favourite of mine.

The average salary, flat rate and cash balance methods essentially aim to ensure that those who leave the scheme prior to retirement—deferred members—are treated in the same way as those who remain in the scheme until retirement. The revaluation method to be applied in the case of any benefit depends on the benefit type and not the scheme category. As I noted this morning, the Bill sets up categories of schemes—DB, DA and DC—but some of these measures relate to benefit types, not scheme types.

In terms of revaluation, the final salary method will no longer be the default. The clause and schedule change the revaluation provisions so that they work with the new scheme categories and take account of collective benefits. They update provisions written in a world of final salary schemes, and enable revaluation to apply to new scheme types in a more appropriate way. The requirements will continue to apply at benefit level, and will require little or no change for current schemes.

A default revaluation will apply, to ensure that deferred members' benefits are revalued in any way in which they would have been revalued had they not left the scheme. The default revaluation method will apply except in the following cases: for money purchase benefits, which will continue to be revalued—surprisingly enough—by the money purchase method; salary-related benefits, which will be revalued by the final salary method, unless they are average salary benefits, in which case trustees and managers will continue to have the option of revaluing by the average salary method; and flat-rate benefits, unless the trustees or managers of the scheme decide that the final salary method is more appropriate. Personal pension schemes, which include non-money purchase benefits, will be required to apply the relevant revaluation method to those benefits.

This approach is a change from the current provision, whereby the default for non-money purchase benefits is the final salary method, with the ability for trustees and managers to use a different method in certain cases, if the trustees consider it appropriate to do so.

Just to clarify, existing schemes can carry on as they are now, so this change better reflects the greater variety of benefits and pension scheme structures that exist now and will continue to develop in the future, but it will not have an adverse impact on existing schemes, which will continue to be able to carry out revaluation as they currently do.

Finally, there will no longer be any need for a separate revaluation method for cash balance benefits. Amendments that a revaluation requirement made by the 2011 Act and the Pensions Act 2011 (Consequential and Supplementary Provisions) Regulations 2014 introduce a new method of revaluation for certain cash balance benefits. The changes introduced by the clause mean that we will no longer need a separate method for cash balance benefits. The default method will apply unless the trustees or managers think that the final salary method is more appropriate for a salary-related cash balance benefit. A transitional provision ensures that any trustees or managers using the cash balance method can continue to do so.

[Steve Webb]

I hope that that has been helpful in setting out the thinking behind clause 12, and I commend the clause to the Committee.

Gregg McClymont (Cumbernauld, Kilsyth and Kirkintilloch East) (Lab): I thank the Minister for setting out the Government's position. Let us get down to brass tacks. For a member of the public thinking about, or perhaps in the future becoming a member of one of the schemes as defined in this Bill, what does clause 12 mean in reality?

Steve Webb: I thank the hon. Gentleman for his question. Essentially, what it means is that in many cases the status quo will continue to prevail. For example, if someone is already in a defined-benefits final salary pension scheme, the way that their existing rights are revalued will be the same way that they are currently revalued. However, where a brand new scheme is invented—a scheme with collective benefits—the default will not be the indexation or revaluation method used for final salary pensions. It will be the default method set out in schedule 2.

I must admit that when I saw there were four different methods of revaluation, my first question was, "What are they?" If it would be helpful, I will just explain what the four different methods are.

The final salary method says that where the amount you have built up is salary-related—that is to say, raised to your final salary—and where an amount in this case is added to the deferred pension to take account of inflation between leaving pensionable service and retirement in line with the annual revaluation order, which is something we will debate each year, potentially as an annual regulation that affects inflation.

The average salary method is where salaries have to be revalued in the same way for active and deferred members. Then, there is the flat-rate method, whereby benefits, as opposed to salaries, for active and deferred members have to be revalued in the same way. Finally, there is the money purchase method, where investment, yield and any bonuses have to be applied in the same way for active and deferred members.

There are all those different ways, and as I said earlier we introduced a fifth one for cash balance and we no longer think we will need a separate one. But the basic idea is that there is a rational method whereby if someone is a member of these new types of pensions and they leave, their money is not only left purely to be devalued by inflation but there is a method appropriate to that kind of pension scheme to bring it up to date, to the point at which someone draws it.

I did not get terribly close to lay terms there, did I? However, I hope that that response gives the hon. Gentleman a sense of what we are trying to achieve with this clause.

Question put and agreed to.

Clause 12 accordingly ordered to stand part of the Bill.

Schedule 2

EARLY LEAVERS: REVALUATION OF ACCRUED BENEFITS

2.15 pm

Steve Webb: I beg to move amendment 4, in schedule 2, page 26, line 12, at end insert—

"( ) Where this Chapter applies in relation to a benefit payable by virtue of a pension credit right, then—

(a) if entitlement to the relevant pension credit arose before the 2014 Act commencement date, the benefit is to be treated for the purposes of sections 84(1) and 84B(1) as attributable to pensionable service before that date;

(b) if entitlement to the relevant pension credit arose on or after the 2014 Act commencement date, the benefit is to be treated for the purposes of sections 84(1) and 84B(1) as attributable to pensionable service on or after that date."

For occupational schemes the new revaluation rules in Schedule 2 depend on when the member's pensionable service took place. For benefits derived from pension sharing on divorce, this amendment will mean that the revaluation rules depend on when the pension was shared rather than when the pensionable service took place.

The Chair: With this it will be convenient to discuss Government amendments 37 to 39.

Steve Webb: I will explain what schedule does before indicating why we want to change it. I will use the jargon term of pension credit. In this context that does not mean state pension credit, the benefits that people claim when they are on a low income. A pension credit relates to what happens when someone is divorced and acquires a pension right—or credit—in respect of their former partner. For the avoidance of doubt, where I use the term pension credit, I am talking about the situation after a divorce.

When a member stops being an active member of a scheme prior to retirement, benefits have to be revalued. I have described in detail how all of that is done. We then have to ensure that we have amended it correctly to take account of some of the things brought to our attention since we published the Bill.

One thing we tried to do was ensure that, although we had published the Bill, we had an ongoing process of dialogue with people such as the Association of Pension Lawyers who are expert in these matters and make a living out of pensions law. Sometimes we will publish a Bill and, although we have consulted extensively, we continue with those conversations and bring forward amendments.

Amendment 4 is to ensure that the new revaluation provisions that I just described work in the limited situations where they apply to pension credit benefits after a divorce. Amendments 37 to 39 are to make it clear that the default method of revaluation will apply to collective benefits and remove any chance of the final salary method applying.

To some extent I dealt with the content of amendment 4 in my remarks on clause 12, so unless there are further questions, I commend the amendment to the Committee.

Gregg McClymont: I seek further clarity on the explanatory statement attached to amendment 4. Will the Minister elaborate on what it means to say

"when the pension was shared rather than when the pensionable service took place."?

Steve Webb: If a man and a woman are married, let us assume we are talking about the man's pension, although that will not always be the case. He has a period of pensionable service that comes to an end when he leaves the company. Revaluation of that pension happens beyond the point where the pensionable service ends, but the provisions we are talking about for revaluation start after divorce when the pension-sharing happens. We are simply making clear that we are revaluing the value of the pension at the point of divorce, or more precisely, the pension-sharing process. We are not talking about revaluation from the point when the pensionable service ended.

Amendment 4 agreed to.

Amendments made: 37, in schedule 2, page 26, line 40, at end insert—

'( ) A benefit of the kind mentioned in section 83(1)(a) that is a collective benefit must be revalued using the default method."

This amendment means that the default method is to be used when revaluing a collective benefit.

Amendment 38, in schedule 2, page 26, line 41, after "section 83(1)(a)" insert "that is not a collective benefit".

This amendment means that a collective benefit can only be revalued by the default method. It is consequential on amendment 37.

Amendment 39, in schedule 2, page 26, line 42, after "with" insert "the following provisions of".—*(Steve Webb.)*

This is consequential on amendment 37. It does not alter the meaning.

Schedule 2, as amended, agreed to.

Clause 13

TRANSFER VALUES

Question proposed, That the clause stand part of the Bill.

Steve Webb: To keep things in a logical order, clause 13 is on the subject of transfer values. It links us to schedule 3, to which an amendment has been tabled. I commend the clause to the Committee.

Question put and agreed to.

Clause 13 accordingly ordered to stand part of the Bill.

Schedule 3

EARLY LEAVERS: TRANSFER VALUES

Amendment made: 57, in schedule 3, page 31, line 15, at end insert—

'( ) In subsection (2A)—

(a) in paragraph (a), after sub-paragraph (ix) insert—

"(x) regulations made under Part 3 of the Pension Schemes Act 2014;";

(b) in paragraph (b), after sub-paragraph (vii) insert—

"(viii) regulations made under section (Regulations under Part 3: overriding requirements) of the Pension Schemes Act 2014."' —*(Steve Webb.)*

This inserts additional references into the definition of "relevant legislative provision" in section 94 of the Pension Schemes Act 1993 and is consequential on NC11.

Steve Webb: I beg to move amendment 5, in schedule 3, page 32, line 29, at end insert—

"Pension credits: transfer values

10 Chapter 2 of Part 4A of the Pension Schemes Act 1993 (pension credit benefit: transfer values) is amended as follows.

11 In section 101F (power to give transfer notice), in subsection (4)(a), for "salary related occupational pension scheme" substitute "scheme to which section 101H applies".

12 In section 101G (restrictions on power to give transfer notice), in subsection (1), for "salary related occupational pension scheme" substitute "scheme to which section 101H applies".

13 (1) Section 101H (salary related schemes: statements of entitlement) is amended as follows.

(2) For subsection (1) substitute—

"(1) This section applies to a qualifying scheme that is—

(a) a defined benefits scheme,

(b) a shared risk scheme, or

(c) a defined contributions scheme that is not a scheme under which all the benefits that may be provided are money purchase benefits,

other than a scheme that falls within a prescribed class.

(1A) The trustees or managers of a scheme to which this section applies must, on the application of any eligible member, provide the member with a written statement of the amount of the cash equivalent of the member's pension credit benefit under the scheme."

(3) In subsections (2) and (3), for "(1)" substitute "(1A)".

(4) In subsection (4)—

(a) for "to whom subsection (1)" substitute "of a scheme to which this section";

(b) for "that subsection" substitute "subsection (1A)".

(5) In the heading, for "Salary related schemes" substitute "Schemes with a promise or target".

14 (1) Section 101J (time for compliance with transfer notice) is amended as follows.

(2) In subsection (1), for paragraphs (a) and (b) substitute—

"(a) in the case of a scheme to which section 101H applies, within 6 months of the valuation date, and

(b) in the case of any other scheme, within 6 months of the date on which the notice is given."

(3) For subsection (7) substitute—

"(7) In subsection (1)(a), "valuation date" means the date by reference to which the amount shown in the relevant statement under section 101H is determined."

15 (1) Section 101P (interpretation) is amended as follows.

(2) Omit subsection (2).

(3) In subsection (3), for "salary related occupational pension scheme" substitute "scheme to which that section applies"."

Schedule 3 to the Bill makes changes to the general rules about transfers from one pension scheme to another (for reasons related to the new definitions in Part 1). This amendment makes similar changes for cases where benefits are derived from pension sharing on divorce.

Schedule 3 amends chapter 4 of part 4 of the Pensions Schemes Act 1993, which sets out provisions governing how members of an occupational or personal pension may apply for, take and use the cash equivalent value of their rights in the scheme and how that transfer value is to be calculated. In this section of the Bill we are saying, "Where you have a pension scheme, you need rules for what happens when people leave and rules for the terms on which you can transfer out. What do those rules look like for DA, DB, DC and so on?" We are trying systematically to go through all of the things that pension schemes need legislation about and setting that out. We are on to transfer values at this point.

The existing provisions provide for two ways to calculate and give effect to transfer rights. If the rights are to money-purchase benefits, the transfer value is the realisable value of the members' rights in the scheme on any given date. This will be the product of contributions and investment return less any charges. For salary-related benefits, the situation is more complex, as trustees have to convert a promised benefit into a cash equivalent. Trustees are required to give the member a guaranteed cash equivalent that is valued for a prescribed period of time.

The schedule amends existing legislation to reflect the new scheme categories defined in part 1 of the Bill and to take account of collective benefits. Under the

[Steve Webb]

changes there will still be the same two methods to offer a transfer value. Members of defined-benefits schemes, members of shared-risk schemes and members of defined contribution schemes that provide benefits other than money-purchase benefits will get a guaranteed cash equivalent. Members of a defined contribution scheme providing only money-purchase benefits will get the realisable value of their assets. As now, the details about how trustees and managers calculate a cash equivalent will be described in regulation.

The key point here is that the policy for transfers remains unchanged as a result of the new scheme categories. We are making sure that the current transfer provisions apply appropriately when the new scheme definitions introduced in part 1 of the Bill take effect. We will retain the two basic methods and apply first, a cash equivalent method for benefits under DB schemes, DA schemes and collective benefits under DC schemes—effectively the same as the current salary-related requirements —and a realisable value method for benefits under DC schemes other than collective benefits, effectively the same as the current money-purchase requirements.

This will bring all DA or risk-sharing schemes within the scope of section 93A of the 1993 Act—the right to a statement of entitlement—but we can use the regulation-making power in section 93 to exclude schemes of a prescribed description, in prescribed circumstances, if we need to, in respect of any particular models where it might not be appropriate. As now, we can modify how the law applies in relation to schemes, where not all the benefits are money purchased, so that we can apply a realisable value method for money-purchased benefits in any type of scheme.

The amendment makes similar changes to the legislation about transferring the pension credit benefit. As with transfers for ordinary scheme rights, the policy for transfers of pension credit rights remains unchanged. The existing rights to a transfer continue to apply to all benefits, including rights accrued in shared risk schemes and schemes providing collective benefits. The amendment inserts the new definitions to make it clear that a pension credit member in any of the new categories of schemes will have the same rights as current credit members to transfer their pension credit benefits and that these rights will also apply in schemes which are for collective benefits. In simple language, we are taking the current rules about rights to transfer, working out what they should look like in each of our new categories of pension schemes and broadly replicating the current approach in a fairly intuitive way. I commend amendment 5 to schedule 3.

Gregg McClymont: I thank the Minister for that explanation. I want to pick up one point. He referred to some models that might not be appropriate and excluded under the terms of schedule 3. Can the Minister elaborate on what sort of models he was thinking of and why they might be excluded?

Steve Webb: As the hon. Gentleman observed earlier, this is permissive legislation. I hesitate to use the cliché of letting a thousand flowers bloom; but, if in doubt, one reaches for cliché. The point is that we do not know what models people will come up with. It is fairly obvious, if we have a kind of vanilla DB scheme, what the right transfer arrangements should be to mirror the current regime of a vanilla DC scheme. We have seen cash balance and know what that looks like. However, it is hard to sit down in advance and specify in the Bill exactly how we should do transfers in some type of scheme we have never thought of.

I will give the hon. Gentleman a sense of the complexity of some of this. He will be familiar with the Bridge case and the definition of money-purchase schemes. We talk about little else over our tea table at home. In that case we found out that there are many different permutations—for example, things that look like money purchase but have an underpinning, so that it is money that is invested and if things go well that is what you get, but if things go badly you get something else, such as a floor amount. What is the right transfer value in those cases? The point about giving ourselves regulation-making power is simply to say that we have not thought of every possible scheme that might arise; we have set out a general approach that we think is right for the categories we have come up with. However, in the event that someone invents something else and what is in the Bill does not seem appropriate, we are reserving the right to say, "Although technically this belongs to this category, it looks more like that, so we will have a different set of transfer rules". I cannot give you an example, because to do so would be trying to anticipate things that have not been invented yet.

Amendment 5 agreed to.

Schedule 3, as amended, agreed to.

Clause 15

Regulatory own fund schemes exempt from indexation

Question proposed, That the clause stand part of the Bill.

The Chair: With this it will be convenient to discuss clauses 16 and 17 stand part.

Steve Webb: Clauses 15 and 16 relate to indexation. Clause 17 is a somewhat different issue, which is a deregulatory measure relating to the register of independent trustees.

Clause 15 amends the provisions in the 1995 Pensions Act so that schemes set up as regulatory own funds, or ROFs, will be exempt from the requirement to index benefits. Specifically, clause 15(3) inserts a definition of a regulatory own fund that refers directly to article 17 of the relevant European Council directive, 2003/41, so as to link with the relevant legislative requirements. Clause 15(3) also inserts a regulation-making power to amend the reference to any provision of an EU instrument that may replace it. It is a simple power to allow the Government to amend this piece of UK legislation if any further EU legislation overrides the current definition.

The reason we have the concept here of a ROF is that many Dutch pension schemes are established as regulatory own funds that stand separately from an employer. It is quite an important concept in terms of delivering shared risk schemes. Regulatory own funds are an attractive option for an employer wanting to set up a scheme that offers the pension income builder-style benefit design without putting a liability on their balance sheet. That concept means that slices of the pension get locked in over time. Employers might want to deliver that for their employees, but they do not want a volatile number on their balance sheets.

2.30 pm

The regulatory own funds structure is arm's length from the employer and underwrites its own promise by holding a higher level of technical provisions. We want to exempt schemes in the UK offering a promised benefit within a ROF from the requirement to index benefits. That does not mean that they could not do it but we would not require it.

In practice, a ROF will apply part of the member's contributions towards the buffer fund to meet its funding requirement. As such, the members are effectively directly bearing the cost of funding the promise. Given the direct impact on member benefits, we do not think it is appropriate to constrain the benefit design in terms of what must be contained in the promise. If members only want to underwrite a nominal promise benefit, they should be allowed to do so.

In that sense, the benefits have some similarity with money-purchase benefits, where indexation is also not required by law. While ROFs are recognised in UK legislation, the Pensions Regulator has advised that currently it does not regulate any schemes as ROFs, so the amendments would not affect any existing rights to indexation. To be clear, we are not changing anyone's existing rights.

Clause 16 provides a regulation-making power to create exemptions from the indexation provisions subject to limitations. Under clause 16 regulations can exclude pensions of prescribed description from the requirement to increase pensions in payment set out in the Pensions Act 1995. Regulations cannot be made in respect of a pension, or any part of a pension, that came into payment before the regulations came into force that is attributable to pensionable service before the day on which the regulations came into force or that is payable under a defined-benefit scheme.

That is a power to remove indexation requirements but not the DB benefits or for past service. Any regulations may not be made unless a draft has been laid before and approved by resolution of both Houses of Parliament, therefore subject to affirmative procedure.

We need to ensure that the statutory requirement to increase pensions in payment applies appropriately within the new scheme categories, especially for benefits in shared-risk schemes. Because this is a framework Bill that creates space for innovation, we hope to see a broad range of benefit designs emerge. Legislation already exists on indexation and currently works on the basis of a clear line between the traditional salary-related and money-purchase benefit split. That might not work so clearly for shared-risk schemes.

Clause 16 introduces a new power enabling regulations to be made to exclude a specified type of pension from the indexation requirements. That will allow the Government to consider whether further exclusions from the indexation provisions might be required as a result of the different type of pension arrangements made possible by the Bill. That comes back to my point on intervention to the hon. Gentleman. We are setting out the framework we think is right for what we can envisage but, if new models come up, we will have to work out whether there should be any indexation requirements on them.

In particular, we will need to see what sort of benefit designs populate the shared-risk space before deciding whether they would be covered by the indexation requirements and whether it would be appropriate to change that. It is always a relief when I say what I think I have just said and then read a paragraph that reiterates what I have just said. That is always a bonus.

The power is restricted and makes it clear that the Government do not intend to interfere either with rights already accrued or with benefits under a defined-benefit scheme. To be clear we do not intend to use the regulation-making power to remove indexation requirements where they currently apply.

Those are clauses 15 and 16 on indexation. Clause 17 covers a different set of issues. The Government have a red tape challenge. We are constantly told there is too much red tape and bureaucracy in the world of pensions. I have mixed feelings when people say that; I ask them to name three and it goes a bit quiet. However, we recognise that unnecessary bureaucracy and red tape is a cost to scheme members. If we require schemes to do something pointless or that does not add value, a cost comes out somewhere, ultimately in reduced pensions for members.

Stephen Hammond (Wimbledon) (Con): I sympathise absolutely with the Minister. He and I have sat on at least one Cabinet Committee when we have struggled with this in the past. Might it not have been better to put the clause the other way round by doing away with section 7? The cost is going to come from having those flexible procurement panels. The Minister could have kept the independent register of trustees. That would have gone to some of the issues being raised at the evidence session last week. Did we think about doing this the other way around? I suspect that there would be an even greater saving to be had from getting rid of flexible procurement panels.

Steve Webb: I am grateful and heartened that the hon. Gentleman is still with me at this point in the day. Section 7 of the 1995 Act allows the regulator to appoint trustees to replace a person who is found not to be fit and proper. We will discuss later the importance of good governance, and we want to retain the section 7 power for the regulator to appoint a fit and proper person if there is a problem. Clause 17 will simply remove the burdensome requirement to have a register of independent trustees. The Committee will recall that we took oral evidence from the interim chief executive and the chair of the Pensions Regulator, who said that they felt that there was no added value to that process. I will briefly explain why that is.

To rewind, the red tape challenge is an initiative that has taken place across Departments, in which the Government have invited those whom we regulate to identify regulations that do not deliver. As my hon. Friend mentioned, he and I have served on the Reducing Regulation Sub-Committee, a particularly gripping Cabinet Sub-Committee that tries to evaluate the cost to business of almost every regulation that we introduce. The Government initially had "one in, one out", under

[Steve Webb]

which for every £1 million of regulatory burden that I or another Minister put on business, we had to find £1 million to take off. As the Parliament progressed, it was felt that that was not ambitious enough, because it would simply leave the aggregate level of regulation where we started. We now have something called "one in, two out", whereby for every £1 million of regulatory cost we want to impose on business, we have to find £2 million of regulatory savings. That has been quite an effective discipline on Departments such as my own. Of course, everybody thinks that the regulations that they want to introduce are good, but cumulatively they have a cost. The requirement to find ways to deregulate has become more pronounced as a result of the "one in, two out" process.

Clause 17 fulfils a red tape challenge commitment to remove the statutory requirement that regulations must provide for the Pensions Regulator to compile and maintain a register of independent trustees. As my hon. Friend has observed, the provision was originally included in the Pensions Act 1995, with the aim of having a register of independent trustees whom the regulator could place in schemes to ensure their effective running. As has been observed, the regulator already has a general power to appoint trustees to replace persons who are not fit and proper. The regulator appoints such trustees, as we have just heard, using flexible procurement panels. That process can cover the appointment of independent trustees as well, and it is less burdensome and costly for the regulator and trustees. We feel that the legislative requirement for a register of independent trustees is unnecessary.

Mr Andrew Love (Edmonton) (Lab/Co-op): I understand the need for "one in, two out" cost savings, but, as I understand it, appointment from the trustee register takes place where an employer has suffered an insolvency event. In those circumstances, trustees may require additional expertise and experience, and an element of speed of appointment may be necessary. Has the Minister assured himself that although we will save money in the short term, the policy will not cost us in the long term?

Steve Webb: We certainly want to make sure that trustees who are appointed in the event of insolvency have the expertise that they need to do their job effectively. The Pensions Regulator advises us that the process of flexible procurement panels finding such people works perfectly well. That process is already in place for other purposes, such as replacing someone who is no good. The regulator uses and is familiar with that process, and it can be used equally in the circumstances we are talking about to find an independent trustee. The regulator's view is that it works already in parallel circumstances, so there will be no loss.

I stress this point about any extra costs. The Pensions Regulator's costs do not come from the taxpayer, generally; they come from pension schemes. Pension schemes' costs do not come, on the whole, from pension schemes; they come from members or employers, depending on the type of scheme, and they come out of people's pensions. Therefore, anything that we can do to avoid unnecessary cost will simply lead to better pensions, as long as we are satisfied that the job can be done. In this case, we are satisfied.

Gregg McClymont: Starting with clause 17, I would be interested in the Minister's definition of a flexible procurement panel because I have no idea what it means. It sounds like jargon, which is often unavoidable in this space, but it would be useful for the Committee to have a definition of a flexible procurement panel. The Minister's argument in favour of removing the register is that the flexible procurement panel is in place and that is the way in which the Pensions Regulator can and will exercise its obligations as they pertain to this clause. For us to judge that in Committee, knowing what a flexible procurement panel is would be useful.

On clauses 15 and 16, I thank the Minister for bringing the term "ROF" to our attention. More widely, indexation is a very thorny issue in pensions for obvious reasons. It is the way in which one's pension retains its value relative to inflation. The Minister made it clear that the Government were reserving the right to change indexation requirements in the future, if there emerged forms of schemes which at the moment the Government were not anticipating. Could the Minister say a little more about the space in which that sort of reserved power is likely to function, not necessarily the Government's view of what they would do, but what the options are around indexation requirements and the different sorts of schemes which might emerge through collective defined contribution? It is also worth having on the table something which we have not yet covered, which is that there are a number of different types of collective defined contribution.

First, then, what is a flexible procurement panel and why does it work better than an independent register? Secondly, it is worth pointing out that the Pensions Regulator is looking for new management. The search for a new chief executive has been going on for a considerable period. Is it possible that a new chief executive would have a different view from the current caretaker? Thirdly, could the Minister talk a little more widely about reserving the right to change indexation?

Steve Webb: I am grateful to the hon. Gentleman for his questions. Let me explain as far as I am able what a flexible procurement panel is. I am very happy to ask the regulator to write to him with further details.

The basic idea, as I said to the hon. Member for Edmonton a moment ago, is this. The regulator sometimes finds himself in a position where a trustee has to be found, for example where someone is disqualified or, as in the case discussed, where there is an insolvency event and a trustee needs to be put in. We have to make sure that a scheme is still being well run. What the Pensions Regulator can do is get somebody in flexibly, without going through the processes that a scheme might go through. It is a more light-touch framework for putting trustees in place. Whereas a pension scheme will have a set of rules about how trustees can be appointed, for example, with rules on member-nominated trustees and so on, the regulator can be much more flexible because the priority is to get someone in who can do the job. That is what we mean by flexible, that they are not subject to rules in the same way that the scheme would have been. If that is something the hon. Gentleman is keen to hear more about, I am very happy to get the regulator to write to him with further details.

As the hon. Gentleman says, we have an interim chief executive at the Pensions Regulator. We had a change of chair earlier this year, and the new chair, Mark Boyle, has made a very good start in his role. We took the view that we have to try and co-ordinate these things, and having the new chair oversee the recruitment process of the chief executive seemed a logical structure. I can tell the hon. Gentleman that the recruitment process is now at an advanced stage. I hope that we will be able to make a permanent appointment before too long. I have no reason to think that the new appointee, whoever that may be, and I do not know, will take a different view on these issues.

The hon. Gentleman asks about the power to amend indexation. I can give an interesting example, or as interesting as it gets. We had to decide whether cash balance schemes should have mandatory indexation. It could be argued that those schemes are really DC—they are like pots of money—and, therefore, why would there be mandatory indexation? Or it could be argued that they are salary related and, as in the supermarket example which I gave, the amount of cash which someone builds up in a cash balance scheme depends on their salary. It is a percentage of their salary. So which is it? Is it salary related and therefore indexed, or is it cash and therefore not indexed?

2.45 pm

We took the view some years ago that we would not require indexation of cash balance benefits, because what most people were actually doing was taking the cash and buying an un-indexed annuity. It therefore seemed a bit odd to say that there had to be mandatory indexation of the benefits of cash balance schemes. When other people building up pots of money were buying un-indexed annuities and that was the norm or the default, why would we say that if someone has a cash balance scheme the only annuity which that could provide had to be an indexed one? That is an example where the case could be argued both ways. Should it be mandatory indexation, or should it not? We concluded by analogy that it should not but, as you can see, whether it looks more like it is salary-related and DB, or whether it does not, depends on whether you think indexation is appropriate for consistency.

That is really all that we mean by these powers. We have set out our general approach and we are not touching existing indexation or DB more generally. However, if in future a type of scheme comes up that is in a bit of a grey area, we would reserve the power to make a judgment on whether indexation applied.

Gregg McClymont: I thank the Minister for those responses, which were illuminating. I look forward to hearing from the Pensions Regulator on the flexible procurement powers. There is a danger: the Government are clearly very keen to meet their obligations under their red tape challenge, but it seems that a lack of transparency is possible. Everyone can see who is on a register of trustees and who has been accredited, for want of a better word. It depends on what we find out about the flexible procurement panel, but there could be concerns about a lack of transparency of the procedure for appointing a trustee to do the job regarding insolvency.

Of course, time is often of the essence in these matters, and I am not insensitive to the importance of giving the regulator the power to act quickly and decisively in an insolvency event. However, some questions remain about this issue. I thought the Minister was going to give me a tautological explanation of a flexible procurement panel when he described it as "flexible" but, to his credit, I must say that he did significantly better than that. However, further clarity on this issue would be welcome.

Question put and agreed to.

Clause 15 accordingly ordered to stand part of the Bill.

Clauses 16 and 17 ordered to stand part of the Bill.

Clause 18

Rules about modification of schemes

Steve Webb: I beg to move amendment 12, in clause 18, page 8, line 35, at end insert—

'( ) In section 67 (the subsisting rights provisions)—

(a) in subsection (3), omit paragraph (b) and the "or" before it;

(b) after subsection (3) insert—

(3A) Regulations may provide for cases in which the subsisting rights provisions do not apply.""

This amendment relates to the subsisting rights provisions. The amendment replaces the existing regulation making power with a broader power to provide for cases in which the subsisting rights provisions do not apply, so for example, in relation to collective benefits.

The Chair: With this it will be convenient to discuss Government amendments 13 to 17.

Steve Webb: I shall explain the purpose of clause 18 before explaining the changes we have made since Second Reading. We have gone through transfers, early leavers, indexation and trustees. We come now to the issue of how schemes are modified, and what the provisions are for the modification of pensions schemes.

First, let me explain what the clause does. Sections 67 to 67L of the Pensions Act 1995 contain provisions to protect members against modifications to what are called their subsisting rights. They protect members by placing restrictions on modifications to schemes, where the change would or might have an impact on the members' subsisting rights. Some changes can be made only if the member agrees, and these are called protected modifications. Section 67A sets out the circumstances in which a modification to members' rights is a protected modification.

Currently, section 67A states that

"a change must be considered as a 'protected modification' where money purchase benefits would replace non-money purchase benefits, or where the change would result in a reduction to a pension in payment. This clause amends section 67A to include a proposed modification where a right to benefits that include a pensions promise is to be replaced by a right to benefits where there is no pensions promise."

This comes back to the question asked by my hon. Friend the Member for Amber Valley: where you have an existing right, can it be changed? Just to reassure him, we are extending earlier legislation to make sure that where a pension promise is replaced by a right to benefits where there is no pensions promise, that is regarded as a protected modification, in other words, one that requires member consent.

The definition is extended to take account of the changes in part 1. The pensions promise has the meaning given in clause 5 and it can be made only if the member

[Steve Webb]

consents. We have added another protected modification to ensure that there is a similar level of member protection as exists now.

The first part of amendment 13 adds another protected modification to section 67A. On reflection, we had some concerns that we had not gone quite far enough to reflect the breadth of shared risk schemes. Making modifications that take a benefit from a pensions promise to no pensions promise is clear cut, but there may be other benefits where the nature of the promise changes. So we have added another protected modification, which applies where the proposed modification would take accrued rights where there is a right to an income, subject to a pensions promise and change them to a non-income benefit. Amendments 16 and 17 add a definition of retirement income for this purpose by cross-referencing to clause 7. We have also made a technical amendment to facilitate the restructuring of the Bill.

The second part of amendments 13 and 14 import existing text from schedule 4. We will be discussing amendment 40 in due course which seeks to remove schedule 4 as part of a restructuring of the Bill. The second part of amendment 13 ensures that any modification that would or might result in a subsisting right of a member, or survivor of a member, being replaced with a right or entitlement to collective benefits is a protected modification. Amendment 14 ensures that collective benefits are carved out of the ambit of one of the existing protected modifications, which applies where the modification would or might result in the prevailing rate of pension in payment being reduced.

Stephen Hammond: I am sure that everyone on the Committee will support efforts to ensure that there are proper rights and that they are protected. Can the Minister set out whether, if there is a change to collective benefits, any one member can veto those changes, or do a majority of people within the collective scheme have to support the change? If one member does not support the change, can they stop it going through?

Steve Webb: I am grateful to my hon. Friend. To clarify, the types of changes we are talking about in section 18 relate to pensions promises, which get changed. In a collective scheme, there are no pensions promises, so we are talking about shared risk schemes, in particular. In answer to his general question—in a collective scheme, who gets to decide—there will be trustees or a governance committee. For shorthand, let us say trustees. They are there to represent the generality of the interests of the members as a whole. Therefore, there is a set of scheme rules, which govern how they have to act. They are put in place to act on behalf of scheme members. For example, where there is a shortfall, relative to a target, there will be scheme rules which indicate what should happen. Obviously, those scheme rules can be amended in certain circumstances and there will be rules about that. There will be a whole structure of governance, of people looking out for the generality of members across the board. Different members will have different interests, so there will be a conflict of interest. For example, if you are short of money, do you take money off the pensions or the workers? When the scheme is set up there will be a set of principles that govern what should happen in those circumstances. They are not set in stone; they can be changed. The manner in which they can be changed will differ from scheme to scheme. I hope that gives my hon. Friend some explanation.

If I may clarify what is in the clause, this idea of protected pension rights is down to a matter of individual consent. In the sorts of schemes I am talking about these changes are subject to the consent of the individual member.

Finally, we have also inserted a new regulation-making power to enable us to disapply the subsisting rights provisions where appropriate. We need to make sure that the subsisting rights provisions do not put obstacles in the way of collective benefits operating as we intended. There could be circumstances where it might be appropriate to disapply subsisting rights provisions in relation to collective benefits. That is not to say that protecting the rights of members with collective benefits is not important, but as we will discuss later, those benefits are different and the way we protect the interests of members is different —so we will be coming back to my hon. Friend's point.

There is a regulation-making power in section 67(3)(a) of the Pensions Act 1995 to disapply the subsisting rights provisions in relation to the exercise of a power in a "prescribed manner". We do not think that the wording of the existing regulation-making power is quite wide enough to let us do this. That is why this amendment replaces the existing power with a new, slightly wider power.

I hope that that explains what we are trying to achieve. Again, there is a set of rules already out there for the modification of schemes. We are saying, "What about shared risk schemes, for example, or schemes where there is a pension promise and a proposal to replace that with something else, whether that is a different promise or no promise at all?" In general terms, we are saying that that sort of situation would be covered by similar provisions. I commend amendment 12 to the Committee.

Gregg McClymont: I have an observation to do with something that I think clause 18 eliminates and it applies to a number of other clauses as well. The Government lack a prescriptive definition of what constitutes a shared risk scheme, so they are having to try to cover a lot of ground in drafting these clauses. At the end of his explanation the Minister alluded to the breadth of shared risk schemes, and to the variety of promises therein that are possible under this legislation. Can the Minister elaborate a little on what he thinks that breadth amounts to? Where are different sorts of risk-sharing scheme likely to emerge? He mentioned no-promise, a bit of a promise and a significant promise. Can he elaborate on his sense of how the powers in the clause are likely to end up being applied to the various shared risk schemes?

Steve Webb: A variety of shared-risk schemes is possible, some of which provide quite a high level of guarantee and some of which put a lot of risk on the individual, although with a limited underpin. There is a whole spectrum.

We envisage one model of shared risk that we call the pension income builder, whereby people lock in a bit of guaranteed pension for each year that they serve. That might be provided by an annuity provider, an insurance company or someone like that. Clearly, there is a cost.

Therefore, with that scheme, if someone is the sort of person who wants some certainty on their retirement income, they might find, as they get through their working life and nearer to pension age, that they have been building up more and more certainty each year. That is a progressively harder pensions promise—those things cannot be ripped up.

I mentioned cash balance, where the promise is a pot of money but what someone gets for it depends on how life is at the time—inflation, interest rates, annuity rates and so on. Essentially, the nature of the promise could entail a pot of money but with some sort of guaranteed underpin and, therefore, a downside risk protection. Some schemes pool longevity risk, which look like an old-style DB scheme. For example, the Tesco shared-risk scheme—although I would not want any lawyer watching to say that I am decrying that scheme—is set up so that each year someone serves with Tesco, the age at which they draw their pension relates to any change in longevity since a year ago. If longevity is improved, the date at which they can draw the pension they have earned potentially goes up. That is risk sharing of a sort: it is still a final salary or salary-related pension, but there is some risk sharing on longevity.

Therefore, people will share risk in different ways: investment risk, inflation risk, longevity risk and so on. We do not know the combination, whether that risk sharing is between the employer and employee or with a third party, or whether it is a ROF. There will be all those different combinations, which is why we cannot be too prescriptive in the Bill about the rules that will apply. We have tried to set out general principles and give examples, but we cannot in primary legislation deliberately cover every eventuality, because we want to see creativity.

3 pm

Gregg McClymont: That is very interesting. The Minister mentioned Tesco and he is not an expert on Tesco's scheme. He said that the risk sharing lay in the fact that, if longevity increased every year, the date on which someone could draw their pension would go up. Is that correct?

Steve Webb: Rather than describe Tesco's scheme, let us take a hypothetical scheme that looks like that. Let us say that the normal pension age was 65 before this process sets in. Longevity implies that 66 is the answer to the question. They would say that the person had acquired their sixtieth at the age of 66. We will then devalue it back to 65. It is not that someone has to wait until they are 66 to get it; it becomes available at 66. If someone still wants to draw it at 65, they will get a slightly reduced value equivalent. That is how it works. It is not that someone gets a little bit of their pension every year until they are 90. It can all be drawn on a given date, but it is all converted into a common numerator.

Gregg McClymont: In that hypothetical scheme, it sounds to me that the risk is all taken by the scheme member not the employer. How is that a shared risk?

Steve Webb: Because an awful lot of the final pension is still promised; it is still a sixtieth, or whatever, of the final salary and it still has statutory indexation. For example, if inflation went mad, there would still be statutory indexation, so the inflation risk is being borne by the scheme up to the statutory limits. If wage growth went crazy, the member would still get a pension as a percentage of their wage whatever it happened to be. If the stock market crashed, the scheme would have to fill the hole in the pension fund; the member would not have to do so. That is what we mean by shared risk. Future changes might mean that the pension scheme member gets something different from what they expected, but many other changes mean that the employer still bears the risk and has to deal with it.

I have a couple of other examples of a shared-risk scheme to offer the hon. Gentleman: hybrid schemes under which all members are entitled to both DB and money purchase benefits; and schemes that offer indexation additional to that required by statute but on a discretionary basis. A scheme could offer statutory indexation but say that, as long as things go well with the fund, it would meet inflation up to a higher figure. I hope that I have given a flavour of those different models. There are a lot of permutations and, no doubt, many we have not yet thought of. That is why we are keeping a degree of flexibility in the legislation.

The Chair: It may be of interest to the Committee to know that I intend to allow a stand part debate on clause 18.

Amendment 12 agreed to.

Amendments made: 13, in clause 18, page 9, line 3, at end insert—

"(ab) on taking effect would or might result in any subsisting right of a member of the scheme which is a right to retirement income in respect of which there is a pensions promise becoming, or being replaced with, a right to benefits other than retirement income,

"(ac) on taking effect would or might result in any subsisting right of—

(i) a member of the scheme, or

(ii) a survivor of a member of the scheme,

being replaced with a right or entitlement to collective benefits under the scheme rules,"."

The amendment relates to the subsisting rights provisions so that any proposal to modify a scheme which would or might replace a right to income with a right to a non-income benefit would be a protected modification. The text in (ab) is taken from paragraph 3(2) of Schedule 4 to the Bill, which is left out by amendment 40.

Amendment 14, in clause 18, page 9, line 3, at end insert—

'( ) In subsection (3)(b) of that section, after "rules" insert ", other than a pension that is a collective benefit".'

This text is taken from paragraph 3(3) of Schedule 4 to the Bill, which is left out by amendment 40. The effect is unchanged.

Amendment 15, in clause 18, page 9, line 4, after "(aa)" insert ", (ab), (ac)"

This is consequential on amendment 13.

Amendment 42, in clause 18, page 9, line 4, at end insert—

'( ) In subsection (9)—

(a) in paragraph (a), after sub-paragraph (vii) insert—

"(viii) regulations made under Part 3 of the Pension Schemes Act 2014;";

(b) in paragraph (b), after sub-paragraph (v) insert—

"(vi) regulations made under section (Regulations under Part 3: overriding requirements) of the Pension Schemes Act 2014."'

This inserts additional references into the definition of "relevant legislative provision" in section 67A of the Pensions Act 1995 and is consequential on NC11.

[The Chair]

Amendment 16, in clause 18, page 9, line 5, leave out "place" and insert "places"

This paves the way for amendment 17.

Amendment 17, in clause 18, page 9, line 8, at end insert—

""""retirement income" has the meaning given by section7 of the Pension Schemes Act 2014;"."—*(Steve Webb.)*

This defines "retirement income", which is used in amendment 13.

Question proposed, That the clause, as amended, stand part of the Bill.

Stephen Hammond: I will try not to delay the Committee for too long in what I hope will be a short stand part debate. In the light of the contribution that I am about to make, the Minister will recognise why I posed my earlier question. Public sector schemes fall into two basic categories: those provided principally to civil servants, and those provided to other public sector bodies such as the BBC, the Bank of England and Transport for London. I want to address that second group of schemes in my short contribution. It seems to me that this is an appropriate time to raise, using the example of TfL, some of the problems that those schemes have and to test the Minister on a couple of things.

The TfL scheme is a public sector scheme that is not specifically provided for in legislation, although a lot of public service pension schemes are provided for in legislation, and TfL makes the rules of the scheme. That is done in a similar way to many private sector organisations. The scheme was established under a trust arrangement with a corporate trustee, and it is governed by a trust deed and rules. For accounting purposes, however, the TfL scheme is treated as a local authority scheme. In addition to the members of the TfL public service pension scheme, a small number of TfL employees are still members of a local government scheme. The scheme must still follow all the usual HMRC rules.

Although there is a great deal of commonality between public sector pension schemes, not least because they have rightly been subject to generally applicable legislation, there are still significant differences between the governance and benefit arrangements of some schemes. Those arrangements have evolved over time, and if they cannot be changed as working practices change, the sustainability of the scheme may be undermined. Unusually, the TfL scheme is governed by a restrictive trust deed, and its requirements are not all reflected in other public sector schemes by any means. The TfL scheme is not the only such scheme; a small group of schemes are structured in a similar way. The TfL scheme, almost uniquely, allows any individual member to veto any rule that might change benefits in any way. Effectively, they can block changes of any sort to the scheme, even those that might allow the scheme to provide better benefits or to benefit from the Bill. Even if the trustees might find proposed changes in benefits agreeable, the trust deeds of the TfL scheme and several other public sector schemes allow one member to veto the whole thing.

The Bill does not quite catch those unique arrangements, and that has important consequences for the sustainability of some public service schemes. At least one of the schemes has considered closing to future accruals, which would be highly undesirable. There is potential, either in the Bill or afterwards, for the Government to look at a small, technical piece of legislation that will allow such schemes to bring their trust deed and governance into line with common practice in the public and private sector, which will allow scheme changes such that the scheme becomes sustainable on both a cost and benefit basis on the future.

I recognise that I am talking about a small and technical situation. The Minister may not necessarily want to address the TfL scheme individually, so he may find it difficult during the passage of the Bill to meet me and the commissioner for TfL, but I hope that he will agree after the Bill receives Royal Assent to meet the commissioner and me to discuss the problem that affects this group of schemes, and to discuss whether we might find a small piece of pretty minor secondary legislation to address that point. It is hugely important to people who have pensions with such organisations, because it affects their sustainability into the future.

I understand the Minister's point about not making too many overall commitments in the Bill, but the situation is serious. I would be grateful for his recognition of that seriousness, and I hope that he will agree to meet me afterwards.

Richard Graham (Gloucester) (Con): May I add to my hon. Friend's points about Transport for London? Although it is not strictly part of the Bill, my memory of the TfL scheme is that it was paying out pensions to many people who were no longer alive. That is not unique, but a fairly frequent problem with large pension schemes. Given that the taxpayer in general is the person paying—

The Chair: Order. I am sorry to interrupt the hon. Gentleman. The Minister must not pass notes to his officials directly, or I will remove his officials from the room.

Richard Graham: If the Minister responds to my hon. Friend the Member for Wimbledon on the TfL scheme, will he touch briefly on whether paying pensions to people who are no longer alive, but whom the pension scheme is unable to trace, could be tackled at the same time?

Steve Webb: I am grateful to my hon. Friend the Member for Wimbledon for raising this issue. I appreciate that when pension schemes are governed by trust deeds or rules that are restrictive, it can be a challenge for them. The rules of the TfL scheme are that pensions must be uprated in line with the retail prices index, and the Government generally use the consumer prices index for indexation. When we made that change to the basis on which we stipulate the minimum indexation requirements, we did so allowing schemes whose own rules allow them to change to switch to CPI. We then had to make a decision on whether to override scheme rules to allow, in the circumstances that my hon. Friend described, schemes to say that, although their trust deeds say RPI, today's Government say CPI and that dominates what the scheme rules say in the statutory override.

We consulted and thought long and hard about that and on balance—it was a balanced judgment after thinking about it for a long time—we decided not to have a statutory override. It was some years ago when we looked at this for the first time. The challenge is that schemes are set up on a particular basis for a particular reason. For example, it may be far-fetched, but RPI or high inflation protection might have been part of the deal, not with reference to a particular scheme but in general terms. When the rules are written, they often reflect a deal, a conversation or a bargaining process. For example, a scheme might have had hard-wired generous indexation in return for scheme members accepting something else that was less generous. If one bit of that deal is allowed to be unpicked some years later, there is a danger of creating unfairness.

Sponsoring employers often say to us—I appreciate that in this case the sponsoring employers want to make the change—that they make rules and Governments then come along and change them and that it is hard to plan and to have certainly about pensions if people change the rules and when they have decided a package and a future Government comes along and says they do not like one element of the package so they change it without looking at the issues in the round.

We looked hard at a statutory override. My hon. Friend the Member for Wimbledon said that this is a minor and technical matter but, sadly, I beg to differ. Our survey research shows that 47% of schemes have RPI indexation hard-wired and cannot change their rules. If changes were made that applied just to TfL, we would have a queue at the door and 47% of schemes would say, "What about us?" It would have a far-reaching impact.

Stephen Hammond: I am following carefully what the Minister is saying. He will recognise that I did not actually talk about indexation. I made the point that this was not just about indexation, but about any change to the rules in these groups of scheme. The point is that any change to the rules can be vetoed. The essence of the Bill is to make changes so that we can create particular types of scheme that are sustainable in the future. I understand his point that indexation is not necessarily a minor technical matter, but allowing a change in the rules such that the trustees could vote for something would seem to be simply what the Bill is trying to achieve.

3.15 pm

Steve Webb: I am grateful to my hon. Friend; going forward, schemes can be set up on that basis. The challenge we face is that we are dealing with a set of promises that were agreed, in some cases decades ago, as part of a package. It may be that the participants were told, when the deal was offered, that the pension scheme would look like this and part of the reassurance when many people signed up to it was that there was no need to worry. There would have been a concern that a future employer could "renege", though that is a value-laden term, or could have made a deal and then five years later would want to change that. If members did not have a right of veto, it could have been imposed on them. Coming back some decades later and saying, "Well, we can all see that it is reasonable that this should be allowed to be changed", makes it much harder to agree these deals in the first place, because people are given reassurance that things will not change by the rules of the scheme. That is part of the basis on which they accept the rules of the scheme. I appreciate that this constrains trustees and schemes, but we did look very hard at this earlier in the Parliament in the particular case of indexation. We took the view that it was a significant change and we would not override what schemes themselves had decided.

It is worth adding that we came back for a second bite at this when we looked at the position of protected persons. Where people have worked in the nationalised industry in the past and they now work for a privatised company, part of that deal was, and I oversimplify, that their pension rights would be protected and a future Government would not come along and change those protected pension rights. There will be some long-serving TfL workers who are protected persons. When we considered the 2013 Act, we looked at whether we should have a statutory override for protected persons because their employers would not be able to recover the loss of the national insurance rebate through changes to the scheme. On balance, we decided not to override the pension promises given in the past. As my hon. Friend will know, having been a Minister in the Department for Transport, the promise was given in that case by Transport Ministers to scheme members that their scheme rights would not be overridden. I have to be honest, Governments do change pensions, and state pensions in particular, but I feel that there has to be a very high bar before Governments override scheme rules.

My hon. Friend makes an important and valid case. There has been correspondence between the Secretary of State in my Department and the Mayor of London on this issue. There has been correspondence at official level. I can assure him that we have tried to respond fully to the concerns that have been raised. We hope that the Bill will receive Royal Assent around March. In the event that I am still in post after that period, I will be very happy to meet him.

Clause 18, as amended, ordered to stand part of the Bill.

Ordered,

That clauses 9 to 18 be transferred to the end of line 6 on page 15—(*Steve Webb.*)

The Bill needs restructuring in light of the proposed Government amendments. There are a number of motions to transfer provisions around. Collectively they are designed to move Part 2 of the Bill to after Part 3 and to move clause 8 and Schedule 1 to the end of what is currently Part 2.

Clause 19

Introduction and definition

Question proposed, That the clause stand part of the Bill.

Steve Webb: We have arrived at the sunlit uplands of part 3 of the Bill, which deals with collective benefits. We have dealt with scheme definitions: DB, DA or risk sharing, and DC. We are now talking about benefit-level definitions and the distinction between individual benefits and collective benefits, which is a relatively new concept in British pensions law. Clause 19 is introductory and sets out some definitions of collective benefits.

Why are we interested in that? If we look around the world at the most highly respected pension schemes—many are in Denmark, the Netherlands and Canada—very often, the schemes that are well regarded have collective elements to them. For example, in the Netherlands,

[Steve Webb]

around 350 collective schemes are operating. The Danish pensions scheme, which has collective elements in parts of it, was ranked No. 1 in the world in a survey for the integrity, adequacy and sustainability of its provision. In a sense, the question we asked ourselves in the UK is if these kinds of models can work well in other parts of the world, are they things that we could learn from, and is there something that we can do in this country? This part of the Bill—clause 19 begins that process—establishes the concept of collective pensions. It says what it is and what it is not, and enables us to have a discussion about this exciting new form of pension provision.

To be clear, as part of reinvigorating the private pensions landscape, we want to enable people to access a wide range of pensions. We are not saying that this is the right model for everybody, but we think it should be part of the mix, and as I have said, some of the best pension schemes in the world offer collective pensions. Although we tend to get fixated on the Netherlands, in Canada there are a number of very interesting—well, relatively interesting—new forms of pension provision that are of a collective nature. We take the view that we have a lot to learn from high-quality pension systems of the sort that are viewed as the best around the world.

One reason why we are keen to allow for this sort of provision is that collective benefits can potentially provide more stability in outcomes, compared with individual DC schemes. As a Government, we are not making grand claims that collective schemes will always be a vastly bigger. They may be, depending on the circumstances, but that is not the claim we are making. However, our modelling suggests pretty clearly that in general, they will provide more stability of outcome and our consumer research shows us that that is what consumers want.

The Bill will mean that collective benefits in the UK cannot attract a funding deficit for an employer, which will limit the employer's liability and reduce risk. From an employer's point of view, a nice thing about CDC is that it might offer greater stability than an individual DC scheme, but without all the risks associated with having a DB pension scheme on their balance sheet. There is also the potential in future to develop sector-wide schemes that provide collective benefits that could allow people to build a pension in one scheme over their whole career, even if they move employers. On one of my visits to the Netherlands, I recall being introduced to the Dutch tulip growers' scheme; if someone spends their entire life growing tulips, even with a range of employers, they will remain a member of the tulip growers' scheme. I do not know how many tulip growers there are in the Netherlands, but the principle is that for larger industries, that could deliver on a large scale that could further boost members' pensions by enabling more efficient operation.

We have evidence of demand and interest from employers. As we heard in oral evidence, although it is difficult for employers who are interested to say so publicly, we know that there is interest—indeed, a witness said that one of his clients was looking at this model, and I think that as we get nearer to 2016, as we discussed this morning, the level of interest will grow. For example, the Ford Motor Company said in its response to our consultation that it thought that collective DC plans could provide a successful addition to current pension scheme models. As the hon. Member for Cumbernauld, Kilsyth and Kirkintilloch East said this morning, the Institute for Public Policy Research conducted research with employers and consumers, finding that

> "there would be strong public support for a collective pension…it appealed across different income levels, life-stages and ages.",

and that

> "participants in our research preferred a Dutch-style collective scheme that shares the risk among all members and removes the need for an annuity, and that incorporates some form of smoothing into the accumulation phase."

Given the attractiveness of the model, we think it is crucial that we have a fresh definition and separate provision for collective benefits, because they are different from the current pervading models. To reiterate, collective benefits and shared risk schemes have different identities. Part 1 of the Bill defines three categories of scheme. Part 3 introduces a new legal definition of "collective benefits" and contains powers to enable us to create a governance framework for schemes to the extent that they offer collective benefits.

Clause 19 defines a collective benefit as a benefit where, in all circumstances, the rate or amount payable depends entirely on the amount available to pay that member's and other members' benefits and the factors used to determine what proportion of that amount is available for the provision of a particular benefit. To state the blindingly obvious, it is not a collective benefit if it is a straight money purchase benefit, or of a description specified in regulations. We will be able, as new models emerge, to clarify what is and is not a collective benefit.

This is a building block. It provides for key legal requirements to be applied or disapplied, and that definition is used throughout part 3 for schemes to the extent that they provide collective benefits. They are distinct to the nature of collective benefits. That is why we have a distinct definition and why they are not merely defined at scheme level or synonymous with the shared risk scheme definition. The new benefit definition is also used in the context of existing legislative requirements so that certain elements of current requirements are applied or disapplied as appropriate.

We talked this morning about the concept of a pensions promise, but to be clear, collective benefits cannot contain a promise. Promised benefits are excluded by the definition of "collective benefits", as such benefits will not depend entirely on the amount available to pay that member's and other members' benefits and the factors used to determine what proportion of that amount is available for the provision of a particular benefit. Collective benefits are provided on the basis of investing members' assets on a pooled basis in a way that shares risk across the scheme's membership.

There are a number of concepts that we will come to in this clause and the succeeding clauses. Clause 20 refers to targets, so I will say a word about those. There will always be a target attached to collective benefits. That target must be achievable within a specified probability range, in order to provide all scheme members with some confidence about the indication of what they might receive from the scheme, but it is not the same as promising members that they will receive a benefit at a specified level or amount. Collective benefits are not the same as the definition of a shared risk scheme. There could be collective benefits in a shared risk scheme if there is also another form of non-collective benefits that offer a promise, for example. Alternatively, there could be collective benefits in a DC scheme, either as the sole type of benefit or in conjunction with money purchase benefits.

Another attraction from an employer's point of view is that there is no employer liability to stand behind or guarantee a target offered in relation to a collective benefit, because there can be no promise attached to a collective benefit. We have chosen the definition so that there can be no liability on an employer's balance sheet, as well as to allow the scheme to pool the available assets and distribute them among members so as to provide the benefits on a collective basis.

To be clear, collective benefits and money purchase benefits are mutually exclusive, as is specifically mentioned in clause 19. That is due to the unique nature of collective benefits. They need a different set of governance requirements and involve a different approach to the distribution of assets among members compared with a money purchase scheme. The rights to a collective benefit are different from the rights in a money purchase scheme. For example, there can be redistribution of assets among members in respect of a collective benefit in a way that is not possible for a money purchase benefit. That feature is also reflected in the definition of a collective benefit in clause 19, such that in all circumstances, the rate or amount of benefit must depend on the amount available for the provision of benefits to or in respect of a member and one or more other members collectively.

Finally, regulations allow us to make exceptions from the definition to ensure that we can attach the right requirements to the right types of benefit. The power will be used in situations where it would be more appropriate for the provision of those benefits to be subject to a different regulatory regime. For example—I know that the hon. Member for Cumbernauld, Kilsyth and Kirkintilloch East likes to ask me for examples—the Government might wish to exclude certain with-profits pensions arrangements, which currently exist and are regulated by the Financial Conduct Authority, from the definition of collective benefits to ensure that they are not regulated twice: once by the Pensions Regulator and once by the FCA. The power to exclude benefits of a certain description from the definition of collective benefits is delegated to secondary legislation to allow the Department to react flexibly—there is that word again—and responsibly.

Nigel Mills (Amber Valley) (Con): We heard in oral evidence that probably the most difficult part of the schemes is getting from zero members to a critical mass. Does the Minister have any thoughts on what approach the regulator ought to take to ensure that early movers do not join a scheme that is insufficiently resourced and not capable of providing collective benefits? That would leave them in a bit of a mess.

Steve Webb: Yes, we have given a lot of thought to that. There are various ways to do that. At the start, a solvency buffer might be needed. Because there is a target, in order to be reasonably confident of reaching it, the scheme must put some money aside that is not invested aggressively. Although that helps to achieve the target, it does not give people as big a pension as they might otherwise get. One potential way around that is for the target-setting to take account of the stream of future contributions that we know are going to come. Because we know that money is coming in future years, we can take account of that on day one when modelling a scheme's ability to reach its targets. We do not say, "Well it might not be there in a few years' time, so we have to hoard the money now and not invest it aggressively." That is one example.

A lot depends on where such collective schemes come from. For example, if a former DB scheme, which could potentially have tens of thousands of members, decides to become a collective DC scheme, it could quickly build up scale and volume of assets, so that might be another route in. I am not speaking for the National Employment Savings Trust at this point, but one could imagine scenarios in which NEST has a role to play. I have not discussed that at length with NEST, but I can see immediately that that is a scheme with scale. Some of the master trusts that exist at scale could come into this space. Although there is a blank sheet of paper problems, I regard those problems as opportunities because they mean that we can learn from the mistakes of others. Of course, auto-enrolment has a great advantage. Due to very low opt-out rates, if an employer uses a CDC scheme for auto-enrolment, people would, on the whole, stay in and volume would potentially build up relatively quickly. My hon. Friend raises an important issue, but there are ways in which we can seek to mitigate it.

There are obviously a lot of detailed issues to discuss on collective benefits in this part, and clause 19 gives us some introductory concepts and definitions.

3.30 pm

Gregg McClymont: The Minister is right that this is an important part of the Bill. We are discussing what we mean by "collective defined contribution." The Minister made an admirable stab at it, but at this stage it might be useful to try to get a sense of what we are talking about in language that is intelligible to people who are not pension experts like us.

This came up in the witness sessions, so it might be useful for the Minister to say what he thinks is the big advantage of collective defined contribution vis-à-vis individual defined contribution. I know that it is implicit, and to some ears it may be explicit, in what he says about smoothing, targets, stability and outcome, but it might be useful to bear down on that language. We are constantly searching for more straightforward language on pensions.

It would be equally useful to be honest about the potential downsides of collective defined contribution. Most things have upsides and downsides. The Minister used the term "balance" a moment ago, and it would be useful to have a sense of where he sees the potential downsides. There is an issue with one scheme potentially cutting pensions in payment, which he is concerned about. He has tried to do this, but he should explain it simply at a general level. He said that collective benefits cannot contain a promise. There will be people who do not understand what that means, so it is important that, as we begin discussing these clauses, we have a common vocabulary on these issues.

The Minister talked about the fixation on the Netherlands, and he also mentioned Canada. I suspect that the Department for Work and Pensions has been

[Gregg McClymont]

looking at New Brunswick as an example. He quoted the IPPR, which has done some research on this subject. This morning I asked whether there is a danger in defining something as shared risk if all the risk is being borne by the employee, the scheme member, rather than by the scheme. Are there forms of collective defined contribution that would fail that test?

Another issue, which we have not yet discussed, is the best form of collective defined contribution and whether it should be at an industry level. The Minister mentioned master trusts—does he have a sense of whether we are talking about master trust level or company level? It might even be on a national basis, which is certainly how some schemes operate, admittedly in smaller places.

There are a number of issues with the language. The Minister did not create that language, and it is a constant issue for all of us. This is a cliché, but it has struck me that the communication challenge with this will be significant. The governance challenge will also be significant, and I will say more about that. If we can find a common vocabulary and agree on the terms we use and what they mean, we can hopefully make some useful progress. Those are not the easiest questions—if they are questions—but they are my observations on a common vocabulary as we proceed into the collective benefits part of the debate.

Nigel Mills: It is a pleasure to serve under your chairmanship, Mr Bone. I entirely welcome the move to create collective pension schemes. That has to be the right way forward. The headline figure of the potential increase in pensions—the idea that someone could get a 30% higher pension than they would with an ordinary defined-contribution scheme—must make these schemes worth pursuing. I suspect that a lot of that is down to the fact that someone would not have to have their investments de-risked towards their retirement date and would not be locked into a particular day when they have to cash in their pension scheme. The scheme could take a longer-term view of the investment risk, and that has to be an attractive way forward.

I agree with the Minister that we want to let a thousand flowers bloom and see what grows up in this market. At some point, however, we have to plant some seeds in the right place if we want to see certain sorts of flower bloom. I wonder if, at some point, these schemes will come to fruition and provide the very real advantages that are often cited. There perhaps needs to be a duty for the regulator or the Department to help employers, trade unions or others to start creating these schemes so that we can get from where we are—zero people in these schemes—to having some top-quality, well managed schemes around and get those higher pension returns. Even as someone who prefers the free market, I think we perhaps ought to look at how we get over that first hurdle, get these schemes into existence and realise their great advantages. I suspect that it will be very hard for the first person to make that move.

I can see a defined-benefits scheme trying to move into a collective scheme, but at that point the employer promise is lost. I suppose that any of the pre-existing fund could be moved, because that is when the promise was pledged, so a whole collection of employees and their contributions would be moved over. I sense that we need to be very careful with employees who are going from having a pension that is promised by their employer as a certain amount to being told, "I'm moving you into a collective scheme where not only am I not guaranteeing it but your contributions could be used to fund other people's pensions or top them up, and you may end up getting less than you paid in for." I suspect that move would not be easy to convince people of.

There are a range of risks in how these schemes are managed and how people understand what they have. The key risk is what happens if we have to reduce pension payments. A retired person might think they have £12,000 coming in a year, but something could go wrong in the investment market or the fund, meaning that that pension then has to be cut. That has to be the right thing for these schemes because we cannot have future savers taking all the risks. Otherwise we will have no future savers left or a sort of Ponzi scheme with no one paying in and everyone trying to draw out but having no money left. That has to be the right answer, but it is a real change in risk for the UK pension market. It involves moving to a situation where what we thought was safe could be reduced overnight by quite a large amount. People need to understand that fully, because that is the risk: someone could sign up for a scheme and start to contribute when they are 25, but almost up until the point when they die their pension will be at risk. There will be no point at which they have an absolutely safe pension income, whereas now if someone buys an annuity they at least have some certainty at that point about what they will get in retirement. These schemes will not provide that.

It may be that losing that certainty is a trade-off for a better pension. I can see the advantages of mixed schemes, in which a certain level is completely safe in retirement but some of the money is not. However, we must be very careful that, before schemes are registered, we know what communications about them should look like, so that when people first start saving into the schemes they are certain that they understand the risks they are taking and the advantages. Perhaps the regulator should undertake a long consultation on those details before it gives approval to any of those schemes to start taking cash.

Gregg McClymont: I am sorry to stop the hon. Gentleman in the middle of his interesting contribution. Listening to him talk about the challenge of communicating with savers, it strikes me—it is probably clear to all of us—that this approach to pensions could well have significant advantages in terms of actual retirement income, but it is clearly a form of building up such income that depends on a lot of expertise. Individuals will have to accept that a lot of complicated decisions about smoothing, targets and management of assets will have to be placed in the hands of actuaries, investment experts, and either trustees or managers, as the Bill describes them.

It also struck me, listening to the hon. Gentleman's contribution and our debate so far today, that that is somewhat in tension with the approach the pensions tax Bill—and this Bill, to some extent—brings in, in which the idea is that individuals themselves will take control of their retirement income. Does he think that that is a potential issue, as pension flexibilities come into play that encourage an approach and a cultural change that focuses on—

The Chair: Order. I am in a generous mood, but that was rather a long intervention.

Nigel Mills: Thank you, Mr Bone. The shadow Minister has raised an interesting point. It is right that people have choice and that we do not have a regime that punishes them for making certain choices, but equally we want a pension market in which people can choose the best quality schemes that provide the best quality return. The issue is how we end up with informed customers and scheme members at that early point, and how we make sure that people understand that this sort of scheme is not a simple one. It is not like a defined-benefits scheme, in which people have a chance of understanding what the final benefit might be. Even in a defined-contribution scheme people effectively get what they pay in and pray that it works at the end. This scheme has a completely different set of risks.

Richard Graham: There is a danger of confusion about who will make what decisions and who will be responsible for them. One concern that my hon. Friend flagged up was that those currently in DB schemes would suddenly be plunged into a CDC scheme and so on. The point of the offer of defined ambitions in the Bill is that a risk-sharing offer can be available to people who are currently running DB schemes but may be thinking of closing them when contracting out comes to an end. For the individuals in DC schemes, those schemes will continue and they will have control over their own pensions.

The third category—the 100,000 new schemes that are likely to be created at the beginning of 2016—will come into auto-enrolment and the employer will make the decision. That is the opportunity for CDC, with organisations such as NEST, the People's Pension and the Danish scheme offering a collective vehicle that might suit very small employers really well. I hope my hon. Friend agrees that that is a way of summarising the three different situations.

3.45 pm

Nigel Mills: I do agree. When I mentioned moving defined-benefits schemes into CDC, I was responding to the Minister's response to me about large CDC schemes starting. I was expressing concern that if I were in a DB scheme, I would not fancy that change in my situation. It is an interesting question. When relatively small employers start creating new pension schemes in 2016, I imagine that trying to create a collective one may be a little ambitious for them. I wonder whether the ideal situation would be to have industry-wide schemes, or ways of aggregating schemes, so that people would have the chance, through their employer, to sign up to a collective scheme that was not the employer's own. The idea of the proposal is to ensure that employers are not on the hook for anything other than their annual contributions, so it would strike me as a great opportunity for them.

Before any of the schemes can register and start inviting members and signing up employees, I suspect that we need the regulator to implement a framework to make clear the requirements for communication, scheme rules, quality standards and management. Otherwise, we may end up with some pretty bad collective schemes, run by people who do not know what they are doing. If that happened, some members might end up in collective schemes that had huge downsides, when they did not really want to do that and did not understand what they were doing. They could find themselves with a large amount of their savings trapped in such schemes.

I do not want us to have a mis-selling nightmare in 10 years' time where people who are in these schemes are all underwater and will never receive what they were aiming for, and companies have to start worrying about paying out to people who have already retired with certain promises. If we get the system right at the start, it could be really powerful, but if we get it wrong, we could end up with the next mis-selling nightmare.

Mr Dave Watts (St Helens North) (Lab): Is the hon. Gentleman as concerned as I am about risk? I think that is what he is talking about. If someone takes their pension assets out and sticks them in the bank, they will have some guarantee of return on those assets, and they will have a guarantee on their cash lump sum. Alternatively, if they take their assets out and buy a house, they will probably have some security there. It seems to me that what is being proposed is a pension scheme that does not give its members a great deal of safety that the assets that they have worked for years to build up will be protected, or that their income will be protected.

Nigel Mills: I think there is a point, once someone has retired, at which they have little chance to replace income that they lose. If they are absolutely reliant on the £12,000 that they think they will receive for life from their collective DC scheme and that is cut to £10,000, they have no way of replacing that lost £2,000. They really are exposed. Until they retire, however, they have the scope to extend their working life or whatever else. I think that that is the right situation.

I suspect that none of us fancies being Pensions Minister the first time one of the schemes has to reduce in-payment pensions. There will be a huge outcry, and everyone will be saying, "What on earth is this? How can you reduce payments in retirement? I never thought that would happen. Surely the taxpayer must ride in to the rescue and protect all those whose pensions have been slashed." We need to get this right from the start so that if and when that happens—the experience in Holland was that that had to happen—people either know that it is a risk, or the material that they should have read made it clear that it would be a risk. I do not think that we can ever say that people will ever read or understand everything. We need to get the system right from the start and move slowly into it, so that we do not end up with a load of poor-quality schemes coming into existence for people who simply do not understand what is happening.

Gregg McClymont: This time I will make a speech rather than the longest intervention on record, Mr Bone.

The hon. Gentleman has raised some interesting points. I was going to ask, but he caught me napping by sitting down, what he thought was the way to achieve the right outcome. There is a view, rightly or wrongly—I hope rightly—that the advertising campaign around auto-enrolment has been very successful, but we do not know whether that is the case. We know that auto-enrolment has been successful so far, but we do not know whether the campaign has been part of that. It is quite hard to assess. *[Interruption.]* The Minister says that we do, and that is good news.

[Gregg McClymont]

Communicating to individuals that their pension in payment could be cut, which has never really happened in the UK system, is a big challenge. Most people will not know what a pension in payment is, to start with. That language will not make sense to them. However, they will soon work it out if we say that their pension when they retire could, in the worst circumstances, be cut.

I was trying to say at great length earlier something that can be said quite simply. The Government are going down the path of saying to individuals "This is your money," and they are on the side of people turning their pension pots into an income. The language is very much, "You will have savings that, from the age of 55, you can do what you want with." That potentially increases the difficulty of selling a form of pension that involves smoothing the process and gives a retirement income, rather than one that allows people to buy something for themselves. The challenge is perhaps significant to begin with, but the way in which the budget reforms interact with the Minister's desire to promote CDC might well not work to the advantage of those who favour it. That question needs to be asked. There cannot be a definitive answer, but I am concerned about getting people to believe on the one hand that CDC is the way to go and, on the other hand, putting powerful emphasis on "This is your money, you can access it whenever you want."

There is obviously a specific question: what impact will the possibility of exit at 55 have on CDC? We heard from one witness who thought that it could be overcome, but that depends on the design of the scheme. To be fair to the witness, they seemed to give a rounded explanation, but it was not one that we could communicate to a member of the public in any clear fashion, and that is a significant challenge.

Richard Graham: The only point worth adding is that we do not need to take too seriously the contribution from one witness that the presence of a CDC pension necessarily means that the people in it are going to get pensions that are 30% to 40% better than those who are not in it. I do not think the witness presented any credible evidence to substantiate that suggestion. The reasons for having a CDC pension are much more to do with administration, simplicity, governance and making life easy for small employers who are going to do the right thing under auto-enrolment and put their employees into a pension scheme. They are not going to be able to offer all the trappings and substance of a large trust-based scheme that has been around for the past 50 years. I see that as the main role of the CDC, and it will save money on the cost side. We all hope that the investment returns will be better, but I do no think there is any evidence to substantiate that at the moment.

Nigel Mills: It strikes me that some of those advantages could be achieved by some big consolidated scheme whereby people are allowed to enrol members in a big, defined-contribution scheme rather than having any collective angle to it. Is that perhaps what my hon. Friend is envisaging?

Richard Graham: Where my hon. Friend is right is that if someone has a big company with a significant number of employees, they can get economies of scale from their own scheme. The 100,000-plus businesses that are going to come into the scheme after January 2016 are small companies with fewer than 10 employees. For them, there are no such options available. If NEST and the other entities that I mentioned set up CDC options, they will be incredibly appealing to small employers.

Ordered, That the debate be now adjourned.—*(Dr Thérèse Coffey.)*

3.54 pm

Adjourned till Thursday 30 October at half-past Eleven o'clock.

Written evidence reported to the House

PS 11 Association of Professional Financial Advisers