A comparison of US and UK pension security systems

David O. Harris
Consultant
Watson Wyatt Worldwide

International Pensions Seminar
7 June 2001
Brighton, United Kingdom
Outline

- Theoretical considerations of pension regulations.
- Consumer policy outlook.
- Regulatory stance - UK
- Protecting pension consumers - UK
- Regulatory stance - USA
- Protecting pension consumers - USA
- Common and future roles of the US/UK actuarial profession.
- Conclusions and future directions
Underlying Industry Realisation that...

“People these days are more concerned about living too long than dying too soon”

Mr. Steve Orluck, Vice President, Individual Sales, Metlife, 1996
The Theoretical Considerations Underlying Pension Regulation

- Necessary to maintain public confidence.
- Ensure financial stability of individual plans and industry as a whole.
- Prudential and conduct regulation encompass most pension regulations.
- Common self interest - 'internal' and 'external' regulators.
- Excessive degree of regulation can create dispute with industry.
- Proactive vs Reactive
- Prescriptive approach to regulation is inclined to rules escalation.
- Highly prescriptive regulation may prove a barrier to innovation.
Consumer Policy Outlook

- Consumers are becoming:
  - More demanding;
  - More willing to complain; and
  - Less loyal to existing and well established brands.

- Litigation is growing rapidly.
  - 'Slip, Trip and Blame Culture'
  - Impact on the actuarial profession - assumptions.

- Consumer regulators and regulations are being strengthened in response to greater individual retirement choice options.

- Market and systemic failures in the US and UK has bolstered regulatory levels linked with pension arrangements.
Regulatory Stance - UK

- Financial Services Act 1986 - pronounced impact on the way pensions were regulated.
  - Self Regulatory Organisations (SROs)
  - Regulating the 'rowing club'
  - Individual pension products

- Occupational Pensions Board (OPB) - Occupational Pensions

- Maxwell Case.
    - The Occupational Pensions Regulatory Authority (OPRA) - 1997

- Pensions mis-selling crisis.
  - Rethink on regulatory approach
    - Financial Services Authority - consolidation of roles
    - Financial Services Markets 2000
Protecting Pension Consumers - UK

- Highly prescriptive approach to regulations.

- Reactive regulation - blending of internal and external regulators.
  - Trustees (OPRA).
  - Actuaries and Accounting professions.

- Pensions Act 1995
  - 'Whistleblower' requirements - Actuarial profession.
  - Increased compliance costs - mandated best practice approach.
  - OPRA - reactive regulator working closely with trustees and consumers.
  - Largely occupational pension plan supervision.

- Financial Services Authority
  - Largely regulating individual pension plans on a largely reactive level.
  - Anomalies of stakeholder pensions.
Protecting Pension Consumers - UK

- Effective disputes resolution mechanisms.
  - Pensions Ombudsman
  - Occupational Pensions Advisory Service (OPAS)

- Office of Fair Trading
  - Director General's Report into Pensions (1997)
    - Explore consumer detriment linked with pensions including the 'actuarial discretion' linked with transfer values.

- Increased levels of litigation and political intervention.
Both state and federal government involvement in the regulation of pension funds.

Pension and Welfare Benefits Administration (PWBA) - Department of Labour is the primary regulator of pensions.

Fundamental legislative 'footprint' linked with pensions is largely through the Employee Retirement Income Security Act of 1974 (ERISA).

- Goal: protect the interests of participants and their beneficiaries in employee benefit plans.
- Covers pension plans and welfare benefit plans
- Contains standards that must be met by employee pension benefit plans.

ERISA's origins date back to the JFK Administration - Studebaker Collapse prompted a strong Congressional response.

ERISA - Title IV covers the insurance of DB plans by the Pension Benefit Guaranty Corporation (PBGC)
Protecting Pension Consumers - USA

- PBGC was established to ensure that participants in DB plans receive their benefits even if plans terminate.
  - Funded through an insurance levy placed on employees in pension plans.
  - Actively manage plans if distress is encountered by trustees.
- Weakness with PBGC - only covers DB plans.
- Retirement Protection Act (1994)
  - Increases the funding of underfunded pension plans
  - Strengthens the pension insurance program.
  - Underfunded plans - increase from 60% to 85% over 15 years.
- The Retirement Protection Act (1994) also enhanced the PBGC's authority to enforce compliance with pension obligations.
- Civil legal actions are seen by some as effective legal remedies.
- No effective disputes resolution mechanisms as seen in the UK.
Common and Future Roles of the Actuarial Profession

- Valuation and Data Collection functions for plan beneficiaries.
- Highlighting the risk profile of the pension plan and alerting trustees, regulators and ultimately plan beneficiaries of these issues.
- UK actuarial profession providing an increasingly pseudo-regulatory function through 'whistleblower requirements.'
- US actuaries working more in 'partnership' and also are responding to the direction of regulators and the judiciary.
- Greater role in interpreting the policy impacts of an increasingly ageing workforce.
Conclusions and Future Directions

- Both the US/UK are having to deal increasingly with consumer policy issues linked with pensions.
- Regulatory approaches in both countries have distinct differences and similarities - reactive vs proactive.
- Legal outcomes are driving the actuarial profession to look more closely at the validity of assumptions.
- Increasing public policy debates on the retreat of public welfare in favour of more definitive pension plans.
- US/UK governments are likely to work more closely together - pension design and consumer policy issues.
- Actuarial profession will continue to be integral in ensuring that pension security is maintained for the plan participants.
Thank you for Attention.
david.harris@eu.watsonwyatt.com