

Secretariat to the Review of Pensions Institutions
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Dear Sirs,

We are grateful for the opportunity to contribute to the Review of Pensions Institutions. Watson Wyatt Ltd is a global consulting firm focused on human capital and financial management. We specialise in four areas: employee benefits, human capital strategies, technology solutions and insurance and financial services. We provide services to the majority of companies within the FTSE100 and to their pension schemes. We also have extensive experience of dealing with some of the institutions under review. Whilst we understand the point made by some of the responses, that it is relatively early to assess the operation of the institutions that were established under the 2004 Pensions Act, we think that experience to date is a useful indicator of likely future experience and so make the following observations.

We are conscious that there are many issues which will need careful review before robust decisions can be taken for the matters under consideration. We make our opinions and observations below from a comparatively high level and have not had detailed discussions with the various interested parties nor made a substantive independent analysis. We would be glad to become more involved in the debate, subject to time constraints, if that were thought to be helpful.

Merging TPR and PPF

Our view is that any decision should be driven by the effect on the end users of both bodies and the need to ensure seamless, cost-effective delivery to them. The key concerns will be in service levels and cost. In reality, we have heard some comments from our clients concerning the lack of joined up administration and the need for separate interfaces and so would seem to favour a merger.

Merging the two institutions does seem to present opportunities to produce greater efficiencies in relation to both information and knowledge sharing (and therefore lower administration levies for our clients). Whilst we have sympathy for the PPF's concerns about possible conflicts of interest, we suspect that the majority, if not all, that may arise would be manageable within the merged institution.

Looking at the latest publicly-available Annual Reports and Accounts (admittedly in relation to the 2005/6 year), it seems that there is significant overlap in some of the 'back office' functions, which could give rise to cost savings if the organisations were to be merged. To take the most obvious examples, both organisations have strategy, HR, IT, policy and guidance, legal and communications functions, which could be streamlined under a merged organisation. In particular, given the Regulator's statutory objective to protect the PPF, it seems that both organisations require deep knowledge of the PPF regulatory framework and operating procedures. In a world where competent pensions technical people are few and far between, combining these functions would seem both to improve resilience and offer the opportunity of reducing the pool of highly-paid staff. Both organisations also seem to have short leasehold agreements that would seem to permit disposal of premises at minimal cost.

It is unfortunate that the deadline for responses is before the latest Reports and Accounts for both organisations are published, as it would have been useful to have had the latest data to permit us

to assess whether both organisations have become less reliant upon 'bought-in' services to enable them to meet their objectives. In particular, we note from the Reports and Accounts that the Regulator employed 230 permanent and 58 temporary staff at 31 March 2006 (it's not clear whether either figure includes secondees from industry) and that the PPF employed 52 permanent and 12 temporary staff and secondments. This high ratio of secondee/temporary staff to permanent employees is only to be expected in the first year of operation of both bodies, as they have both been very open about the challenges that they faced in growing the necessary expertise in-house. What would be very interesting would be to see the comparable figures at the end of this fiscal year, as we would imagine that both organisations would have become much less reliant upon 'outside help'. In particular, TPR's bill for temporary staff was £4.5m plus £6.7m for consultancy, contracted-out and professional services (compared to a salary bill for permanent staff of £7.8m), with the comparable figure for the PPF being £1.1m (temporary/secondees) and £2m permanent. For those operational functions that will recur, utilising in-house staff would seem to offer the prospect of reduced staffing costs.

Taking a longer term view, one might rationally postulate that the average funding levels on UK schemes should increase with time and the number that fall into the PPF should fall. Whilst this is probably an over 10 year view, the observation may support a merged operation on grounds of the enhanced facility to move staff between the two aspects of the organisation as the work ebbs and flows between them.

Merging TPR and FSA

We would not favour a merger between TPR and the FSA, owing to the different commercial imperatives of the bodies that they regulate. The FSA regulates the selling and administration of pension arrangements that are sold to individuals, with a strong profit motive being the primary driver underlying the operation of the provider. TPR regulates pension arrangements that are provided by an employer to his workforce and where any commercial motive is secondary. For this reason, the regulatory stances rightly differ and this dichotomy must be maintained if work-based pension schemes are to survive.

On a different aspect, we note the difficulties that HM Government is having in persuading the European Commission that UK-based occupational pension schemes are completely different from the majority of pensions institutions in the rest of the European Union and therefore that the revised funding basis proposed under Solvency II should not apply to them. To our minds, the increased solvency requirements introduced under the 2004 Pensions Act have made this argument difficult to sustain, but merging TPR with the FSA (being the primary regulator for commercial pension providers) would make it impossible.

Merging TPAS and TPR

We can see the merit in keeping TPAS separate from TPR, as the former fulfils a different consumer-facing, conflict-resolution role to that of TPR. For this reason it should continue to be funded by TPR through a grant-in-aid, but should remain as an operationally-separate charity.

Other institutions

As to the rest of the Institutions, we have had few dealings with these and believe it is too early to say whether they should be merged. We therefore suggest that the position be kept under review.

We would be happy to discuss our observations further with the review team, if that would be useful.