Scottish Affairs Committee

Oral evidence: The Referendum on Separation for Scotland: Pensions, HC 271-VI

Thursday 14 August 2014

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Watch the evidence session

Members present: Mr Ian Davidson (Chair); Graeme Morrice; Pamela Nash; Lindsay Roy.

Questions 6121 – 6242

Witnesses: **Joanne Segars**, Chief Executive, National Association of Pension Funds, and **Steven Dignall**, Membership Communications Manager, National Association of Pension Funds, gave evidence.

Q6121 Chair: Can I welcome you to this meeting of the Scottish Affairs Select Committee? As you are aware, we have been undertaking a number of investigations into the impact of possible separation for Scotland. Today, we wanted to look at the question of pension funds. What I would like is if you could maybe introduce yourselves, tell us your positions just for the record, and then we will go on to questions.

Joanne Segars: Thank you very much for the opportunity to give evidence to the Committee. It is a very important inquiry that you are undertaking. My name is Joanne Segars and I am the Chief Executive of the National Association of Pension Funds.

Steven Dignall: Thank you very much. My name is Steven Dignall. I am the NAPF representative in Scotland.

Q6122 Chair: Fine, thanks very much. I wonder if you could start off by telling us—ideally in monosyllables—what the main impact of separation might be upon pensions.

Joanne Segars: Well, at the moment one of the things that our members are looking for, and we have a large number of members across the UK and a large number of members based in Scotland, is more certainty. At the moment, there is a very great deal of uncertainty about what independence, what a separation of Scotland from the rest of the UK, would, in fact, mean for pensions and for occupational pensions in particular. In fact, we ran a survey of our members on this very question earlier this year and 95% of those who responded—and over 300 organisations responded to that survey—said that they really did not see very much certainty or they saw that it was quite uncertain what the impact of separation might be. For our members, some of the key issues are around the impact of the European Union on Scotland and the impact of EU legislation, the impact of regulation and separate tax regimes, and the impact of potentially a separate currency. Under those four issues, there are a number of issues where our members are seeking greater clarity.

Q6123 Chair: Can I just clarify who you think should be providing that degree of certainty? Is it the Scottish Government not being clear about what they intend or is this the responsibility of the UK Government?

Joanne Segars: I think it is a responsibility of both, to be honest, because some of these questions can only be answered by both sides coming to the table and both sides providing clarity. Ultimately, if there is a yes vote on September 18th, and clearly it is not the job of the NAPF to say one way or the other how people in Scotland should vote, then both sides will have to come to the table very, very quickly in order to resolve some of these questions. Making any change in pension legislation, making any change within pension schemes, is not something that can be done overnight.

Q6124 Chair: Is it in these circumstances reasonable, then, for us to assume that these things cannot be resolved before the result of the referendum or are there some areas where greater information could be provided now?

Joanne Segars: We have been saying for some time now that greater clarity does need to be provided, greater clarity on questions like: what will the legislative framework be; will there be a separate pension protection fund north of the border in an independent Scotland and south of the border; what could be the outcomes if an independent Scotland joins the European Union and what might that mean for cross-border schemes; what might a separate tax regime look like. We have been asking for some of this clarity for some time now, but given where we are now, just a month almost exactly away from the referendum, I think if there is a yes vote, then straight afterwards both sides will have to get together very, very quickly.

Q6125 Chair: Right. The difficulty for us is that we as a Committee have been trying through a whole host of investigations to clarify as much as possible before the vote what the consequences might be and we have been pressing, where appropriate, both sides—or either side depending on how you look at it—to provide the information that they can now. Before you came in, we had a session with defence trade unions and it is pretty clear there that there is a whole number of details that can be clarified now by the Scottish Government but they have not done so. What I seek from yourself is information as to whether or not you believe some of these things could be clarified now by the Scottish Government or do they all have to wait on the result of the referendum and negotiations with the UK Government?

Joanne Segars: Well, I think a number of the questions could have been clarified earlier but, as I say, given where we are and the proximity of the election to where we sit today, I suspect there probably is not time to resolve some of those questions now.

Q6126 Chair: What issues do you think could have been clarified beforehand that have not been?

Joanne Segars: I think some questions around some of the detail, if you like. The Scottish Government or the Yes Campaign have said that there will be a separate NEST for Scotland, SEST; some of the details are required about how that might be funded, how some of the commitments to the state pension might be funded and how a separate pension protection fund could be set up. It might sound like we are asking for the impossible asking for details, but in the world of pensions those details really matter.

Q6127 Chair: No, I appreciate that. I just wanted to be absolutely clear that there are a number of areas where detail could have been provided and need not wait upon the negotiations post referendum. That is what I wanted to resolve. Lindsay, you wanted to come in.

Q6128 Lindsay Roy: Yes. Why do you think that clarification has not been forthcoming?

Joanne Segars: These are genuinely complex issues, and I think that is probably what I can say. These are genuinely complex issues when you are asking for—

Q6129 Lindsay Roy: You have already said that some of the detail could have been provided. I understand the complexity.

Joanne Segars: I do not know whether there is a lack of expertise. I am not quite sure why that has not been provided, but certainly questions that we have been putting—and there has been a little bit more clarity provided, for example, in the paper that came out in November, but perhaps not as much as we might have liked.

Q6130 Lindsay Roy: Right. It is difficult to understand why there are so many unanswered questions.

Joanne Segars: I cannot answer why there are so many unanswered questions because we have been pressing for some of those answers. All we can say now is if there is a yes vote, then we have to get the answers very, very rapidly, indeed.

Q6131 Lindsay Roy: Yes, but let us just be clear. It is not just complexity?

Joanne Segars: I cannot answer that. I think there are genuinely complex issues.

Q6132 Lindsay Roy: But you did say there are some details that could have been provided.

Joanne Segars: I think there probably are some more details that could have been provided, yes.

Q6133 Chair: Sorry, you wanted to come in?

Steven Dignall: Thank you, if I may. As you know, pensions are not a devolved matter for the Scottish Government. I have met, with the Chief Executive of the NAPF, all representatives from the Finance Secretary through to his shadow counterparts. In terms of setting up a Scottish Employment Savings Trust or the equivalent, I personally, and members of the NAPF not just in Scotland, would like to have seen certainty.

The Turner Commission, which was more than 10 years ago now, and, indeed, the set-up of the National Employment Savings Trust almost two years ago now, took millions and millions of pounds, much costing exercises. Indeed, should there be a set-up of SEST, it will also take a similar amount of investment and a similar amount of time to do that. What I would like to have seen and our members would like to have seen was more certainty around those costs, the set-up costs and who will fund it. It is not in the White Paper and it was not in the Pensions Paper either.

However, all these costs have to come around currency and what the pensions themselves have to be paid in. There has been no negotiation on currency from Westminster, the UK Parliament or, indeed, the Scottish Government, because there will be no negotiation until after the referendum, which is why I believe that the questions on the set-up costs have not been answered.

Q6134 Chair: Can I just clarify, though? If we park the question of currency for a moment, am I right in thinking then that you agree that there is a whole number of areas where additional information and clarification could have been provided that was not?

Steven Dignall: There are four key areas for the NAPF and for our members. We represent some £70 billion worth of assets just in Scotland alone, large employers who you will find in our paper, who we represent and, indeed, seven of the 11 local authority public sectors in Scotland as well or administering authorities. The Scottish Government has committed to automatic enrolment, which we support at the NAPF. They also have committed to the state pension, the triple lock, which again we support, and also committed to reviewing the state pension age. We have not had the detail on two of the four key areas about SEST, which again relate to the set-up costs. For employers, for people to make informed decisions, for those medium to small employers who have yet to automatically enrol, they have to be compliant. The Scottish Government has committed to this. They will go ahead with automatic enrolment. However, who are they going to use as their pension provider? The large insurers will not touch them because they will not make enough in terms of reward and gain from that, so they have to have an alternative and that is why NEST was set up by the UK Government.

Indeed, there is the cross-border issue: if a pension scheme operates in one country and provides benefits in kind in another country, that scheme will become cross-border if they are part of the European Union. Again, when I have met with the Scottish Government and with my chief executive, there has been no clarity there as to the grace period that pension schemes will be allowed. It is a matter for after the referendum is what we are told. I believe there could have been negotiations beforehand.

Q6135 Chair: I understand the point about there could have been negotiations beforehand. As you will be aware, the UK Government has said it is not willing to negotiate. What I was trying to clarify on SEST is whether or not you feel that the Scottish Government could have clarified these points because they are, as it were, within its own remit and were not dependent upon negotiations with the UK Government.

Steven Dignall: I do believe just one chart on the set-up costs alone would be beneficial to employers, but other than that we cannot really say. There would have to be a full review, working with industry, out to consultation with industry, which again has not taken place. Again, that should be perhaps an issue after 18 September.

Q6136 Chair: Could I ask just as a second point—oh, sorry, Joanne.

Joanne Segars: All I was simply going to say is it would have been possible to provide some modelling, some outline of what SEST will, in fact, look like and how it might be paid for. Clearly, much of the set-up of NEST has been financed through a loan from HMT, Her Majesty's Treasury. Setting out some of the potential set-up costs of a Scottish NEST/SEST could have been possible beforehand and, going back to some of the conversations you were perhaps having this morning with the defence unions, provide some certainty not just to employers, people currently providing the schemes north and south of the border, but also, and perhaps most importantly, to scheme members and potential savers in those schemes.

Q6137 Chair: Right. Yes, I think that is what we wanted to clarify because there are clearly some issues, as I said before, that have to be the subject of negotiations after the event, but there are some, more than perhaps people realise, that could have been resolved beforehand. I wonder if I could just follow these points up by asking whether or not you think that pension trustees should perhaps have been more involved than they have been up to now in exploring some of these answers. Or do pension trustees just simply have to wait until everything is clear?

Joanne Segars: Trustees are certainly engaged with the issue and I think that is perhaps reflected in the response we had to our survey. One always hopes when one sends a survey out to members that you get an instant and overwhelming response rate and this was one of the rare occasions when we did get a big response very, very quickly. I think there is no lack of engagement from those running schemes, trustees and their advisers, but in a sense trustees cannot really take action on whether they operate the scheme cross border—some of those decisions, frankly, will be made by the employer, not the trustees; how they pay benefits, how they shape the scheme in the event of independence—until they know what the legislation is, until they really know what the terms of the deal are. I think trustees are ready to act once they know what it is they are being required to do. Of course, there is talk of grace periods and trustees will need to spend a lot of time and schemes will need to spend quite a lot of money thinking about what they then do, but making those changes is not something that can be done instantaneously.

Q6138 Chair: Yes. We will come on to the detail of some of these things. It is just the question of what the trustees should be doing now that I want to pursue. Again, both of the meetings that we had this morning and informal gatherings that we have had elsewhere, we have had very much the impression that people who are in pension schemes feel that they have not had drawn to their attention the potential magnitude of the changes that might be coming down the track. It is a question of Donald Rumsfeld's one about the known knowns and the known unknowns and the unknown knowns and all the rest of it. The feeling is that people who are trustees and those who are running the pensions funds have not been, perhaps, as vigorous as they should in outlining to people even what the unknowns are, in a sense, of telling people what the possibilities are, what the options are, what they ought or not to be anxious about. Is it too late, do you think, for trustees to be saying to people, "Look, we have a referendum in only a few days. Just take account of this. These are the things that we know and these are the things that we do not"?

Joanne Segars: One of the things that we have been doing through our group in Scotland, which Steven is running, is to be very clear and is to be debating those issues—and I would like to think that we have been at the forefront of opening some of those debates up here in Scotland—and then educating trustees, educating those who are running schemes, so that can work down through the schemes. I think there is no lack of engagement within those running schemes and within trustees. What trustees then do in terms of talking to members—and, again, one can debate whether it is the role of trustees to talk to members—is for individual schemes to decide on. Certainly, we have been very active in raising some of the issues that need to be clarified and in promoting debate on these issues.

Q6139 Chair: I presume it is not your role to instruct trustees, but you can provide nudges and nods and winks and indications and so on. We just have the impression that the trustees in some firms have taken more of a proactive role than in others in terms of going out to their workforce and saying, "Look, here are areas of anxiety. This is what we know. This is what we definitely do not know and will not know until afterwards. These are some things that we are trying to get clarification on". Is it possible for you to encourage some of your trustees to do that even now, because people are starting to focus much more on what the referendum might actually mean to them? The pension issue is growing in importance and they want to have some advice from people who are engaged and involved with their own scheme but also whom they regard they can trust. Is that possible for you to give that sort of nudge or indication?

Joanne Segars: You are perfectly right, it is not our job to tell trustees what to do. We are their trade association; we are not their regulator, something they bless us for every day. What we can do is promote debate, raise the issues and say to trustees, "These are the things that you need to be considering and these as trustees are the things that you will need to be considering". Then it is up to the individual trustees to decide what they want to do with that.

Q6140 Chair: Steven, you are the propaganda man in Scotland. Could we encourage you to encourage them to try to communicate with members to make sure that as many people as possible get as much information as possible?

Steven Dignall: Indeed. I believe we have at the NAPF in Scotland run over six different debates between March 2012 to date. We have had panels from all political parties represented. We have also run debates at our unique Scottish conference we did last year with John Swinney and the Shadow Pensions Minister, Gregg McClymont. We have also had focus groups here in Scotland, here in Glasgow as well, for our trustees to question decision makers. Ultimately, I have found—and, yes, we have a unique Scotland committee as well, similar to yourself, made up of representatives from the NAPF membership—they have asked questions, not just of their members but of the politicians, the decision makers. There is only so far that they can go because talking about pensions alone can seem like advice and if they are not advisers there are real ramifications for that. I do not feel is the trustees' role to be talking about something that is even more serious and can have more implications. I think people have to explore that information for themselves. The information is there; they have to go and look for it. At the NAPF, we have given our members and the public several opportunities to do that and engage with the decision makers.

Q6141 Chair: I do not want to labour this unduly but the point—sorry, Joanne.

Joanne Segars: I was just going to add I think it is important also to remember the legal duty of trustees, and that is to administer the trust in the best interests of the members and beneficiaries. Trustees may find, as Steven was hinting at, that they might be hemmed in or restricted in what they can say by the nature of their legal duties.

Q6142 Chair: Again, I do not want to appear unduly unsympathetic, but while I appreciate the merits of these discussions at a high level with decision makers, people who are working in some of the defence plants, for example, have absolutely no idea of any of that going on. They are not hearing anything about this very much from anybody, apart from their unions, and some of the union people are not entirely clear about it either. That is why I think we would take the view that you maybe have a bit of responsibility to try to make sure that as many people as possible are aware as much as possible, even to be told what you cannot tell them in a sense. Could you maybe pick that point up?

Joanne Segars: You can take that on board.

Steven Dignall: Indeed. We have and we will do. With the UK-wide poll that we did on our members, in Scotland alone there are 330,000 pensioners drawing benefits from schemes that are members of NAPF. Indeed, there are more saving into these new pension schemes. In our role, like I say, we have run six focus groups. We have had our conference as well and the media coverage not just in the nationals but across the trade press. The regional press here in Scotland was unprecedented last year when we published our paper. We are trying every channel that we can to get that message out.

Q6143 Chair: Okay. I look forward to hearing in maybe a few days' time that you have contacted personally the 300,000 members who are existing pensioners and all these who are paying in and your name is on their lips.

Steven Dignall: Indeed.

Q6144 Lindsay Roy: Moving on from trustees, trust and confidence is really at the heart of some of the issues on pensions. Can we turn briefly to public sector pensions? What specific concerns do you have in relation to public sector pensions in the event of separation and how can these be addressed?

Joanne Segars: Certainly, from an NAPF perspective, our public sector members are, as Steven suggested, those in the local government pension sector rather than any of the unfunded pension arrangements, so perhaps it is best if we focus on those, or we can only focus on those. Again, the Local Government Pension Scheme is administered already slightly separately in Scotland than it is for the rest of the UK. There are clearly issues again around certainty, again of member confidence, the need to know that there is stability and that people will continue to get their pensions paid. Rather going back to the Chairman's point, I think there is a big communication exercise to be done. There are clearly reforms going on at the moment already for the Local Government Pension Scheme. Those are on track to come in next year and the year after in Scotland, so a year after the rest of the UK. There is probably, I would say, more certainty around some of the public sector pension issues or the LGPS issues than there are, perhaps, on some of the other issues for funded pension schemes in the private sector.

Q6145 Lindsay Roy: Whose responsibility is it to enhance that communication?

Joanne Segars: Again, I think it is a responsibility of the UK Government and the Scottish Government as well as the individual administering authorities for the Local Government Pension Scheme, the trustees, the employers running those schemes. It is no one individual, it is no one entity's responsibility. It has to be a joint responsibility, which is a slightly trite answer but I think it has to be the answer.

Q6146 Lindsay Roy: You are saying that, basically, before the referendum nothing more can be done?

Joanne Segars: Well, there is always more that can be done in terms of communication and given the concerns that there are among the electorate about the pensions issue—it has been an issue that has been high on the agenda for a number of months now—I think there probably is something that can be done in terms of communication to reassure people about what may happen in the event of a yes vote.

Q6147 Lindsay Roy: What would be the thrust of that communication, then, in terms of content?

Joanne Segars: What would be the thrust of the communication? I think it would have to be around ensuring people were not panicked into not continuing to save in their pension arrangement. It would have to be some reassurance that they will continue to receive pension contributions and that the pension contributions they receive will be paid out to them when they retire. It is a "do not panic" message, if you like.

Q6148 Lindsay Roy: Yes. Can you understand why that has not been done?

Joanne Segars: No. Again, I think that is not necessarily something for us to comment or speculate on. It is very difficult for us to suggest why that has not been done.

Q6149 Lindsay Roy: But it should have been done?

Joanne Segars: It could have been done, yes.

Q6150 Lindsay Roy: Could or should?

Joanne Segars: Well, I think there is some general communication messages that need to go on on pensions at national level that go a long way beyond this, but it is a general thing that needs to go on across pensions full stop.

Q6151 Lindsay Roy: Okay, thanks. That has been a very full answer. What options are open to defined pension benefit schemes to secure ongoing funding?

Joanne Segars: Are you talking here specifically about cross-border issues or more generally?

Q6152 Lindsay Roy: More generally first.

Joanne Segars: More generally, this is something again that, with or without a referendum on independence, pension schemes and trustees of pension schemes are looking at on a daily basis. They are looking at their investment strategies. They are looking at their longevity profiles. They are looking at a range of issues and, of course, they are looking more fundamentally at the future of their defined benefit pension funds.

Q6153 Lindsay Roy: What are the likely consequences of separation for defined pension provision in Scotland?

Joanne Segars: Well, I think there are a number of consequences. Perhaps one of the biggest issues to consider is what would happen in the event of an independent Scotland becoming a member of the European Union, where pension schemes north and south of the border could suddenly find themselves becoming cross-border schemes because they were in the Scottish scheme and they had employees in the rest of the UK or vice versa.

Q6154 Lindsay Roy: The implications?

Joanne Segars: The implications would be very significant indeed. Pension funds and trustees would find themselves faced with some very significant and sharp decisions to take about whether or not they continued with their scheme or whether they closed the scheme. In the event of those schemes becoming cross-border schemes, European Union rules require those schemes to be fully funded at all times, so they cannot carry on operating with deficits, albeit with recovery plans. Schemes might be faced with some very tough decisions, as I say, whether or not to close the scheme, whether or not perhaps to split the scheme so a UK scheme had the rest of the UK and a Scottish section, or whether to continue as a cross-border scheme but to fund that scheme fully at all times in compliance with European Union legislation. They are not insignificant decisions because, however they are looked at, they have significant costs. The costs, for example, of splitting the scheme into Scottish and rest of UK sections would be very expensive indeed. We have been talking to one very small scheme that did just that for its operation here in the UK and in the Republic of Ireland. That was a very small scheme and it cost tens of thousands of pounds in advisory, legal, et cetera, fees. For a much larger scheme—and, of course, there are some very large schemes across the UK—the costs could be hundreds of thousands of pounds.

For schemes that had to fund themselves fully if they wanted to operate on a cross-border basis, again the costs would be very significant indeed because most schemes in the UK are operating with a deficit for reasons that are well rehearsed. Most of those schemes on average have a recovery period of about seven and a half years according to the Pensions Regulator, but those recovery periods would have to be brought forward very, very quickly indeed, requiring very significant injections of cash from the employer. These are not trivial decisions at all and so, faced with that, some employers may just say, "We are going to close the scheme".

Q6155 Lindsay Roy: That is a real worry. What percentage of the schemes that you are aware of cross-border are under-funded at present, roughly?

Joanne Segars: That are operating on a cross-border basis?

Q6156 Lindsay Roy: Yes.

Joanne Segars: Those schemes that are operating cross-border have to be fully funded.

Q6157 Chair: No, sorry, those schemes that are operating at the moment throughout the UK, which would then become, as it were, cross-border schemes in the event of separation.

Q6158 Lindsay Roy: Yes.

Joanne Segars: I think that is difficult to say. Average funding levels are at about 90% across the UK, but there are a large number of schemes, possibly as many as 3,000 schemes, that would be caught and become cross-border schemes. As many as 3,000 schemes might face those tough decisions that I was just talking about.

Q6159 Lindsay Roy: 3,000 out of—

Joanne Segars: These are defined benefit schemes, out of about 6,500 or 6,200.

Q6160 Lindsay Roy: So just under 50%.

Joanne Segars: The entire UK population of DB schemes is just over 6,000. About 65% of those are open in one shape or form to current contributions. They currently have active members in them. About 70% of those would be under-funded. Of those, there are about 3,000 that could be caught by these rules and, if they wanted to operate on a cross-border basis, they would have to fully fund.

Q6161 Lindsay Roy: So major issues and major concerns?

Joanne Segars: So very major issues. Again, if schemes choose to split, some very significant decisions and potential costs.

Q6162 Lindsay Roy: Major issues and concerns that people should be aware of?

Joanne Segars: Yes, and they are issues that we have been raising for some while now.

Q6163 Lindsay Roy: We will do our best to highlight them.

Q6164 Chair: I just want to be clear for the record that we have these figures right. You are saying approximately 3,000 pension schemes out of about 6,000-plus, which is about 40% or so, could be faced with having to take a decision that could result in either closing the scheme, splitting the scheme or having to make huge investments into the scheme. That really must cover a tremendous number of employees in Scotland.

Joanne Segars: It would and it is quite difficult to extrapolate just how many employees in Scotland, but it would also obviously affect employees in those schemes south of the border as well. Perhaps what we will do is drop you a note setting out how we got to some of those numbers.

Q6165 Chair: Right. It relates back to the previous point that I do not think that the roughly half of the people in Scotland who are in private pension schemes realise that these are the three options that their schemes would face within a relatively short period of time. Between now and the referendum, making sure that these people know that position is going to be some difficult task.

Steven Dignall: Indeed, but just to be clear these rules would not apply until independence itself, and if Scotland is to become a member of the EU—many people are saying it could take up to nine or 10 years for that to happen.

If I can give you some current information, though, the number of cross-border schemes is very low, as my Chief Executive has pointed out. EIOPA, the EU equivalent of the regulator, shows in their annual report that the number was down to 82 cross-border schemes in 2003. Half of these are between the UK and Ireland. Twenty-five Irish schemes are operating in the UK and vice versa, and there are three UK-based schemes operating in Germany, five in France, and five in the Netherlands. All those schemes that I mentioned are currently fully funded, but our interpretation of that data is there is a lack of appetite for cross-border schemes. The actual insolvency rules should not necessarily, in our opinion, be applied to pension schemes. They are long-term vehicles. These rules are looking at being reviewed, as we saw in the last IORP Directive, in the new version. There was a version of that back in March. When it was published, the Solvency II issue was kind of kicked into the long grass, as it were, at the last minute. When we met with the Scottish Government, they were speaking about recovery plans of maybe seven and a half to 10 years, but again that is all down to negotiation with the Scottish Government and the EU. Our members would like to see a recovery plan of that. To expect these employers to fully fund schemes at a stroke on 26 March 2016, or whenever the date is, is unthinkable and I do not think the legislation was intended for that to happen. Indeed, the Scottish Government's view is that the legislation was not set up for that purpose.

Joanne Segars: It will be very important that we look at some mitigation issues and there are, indeed, ways in which some of those potential impacts on schemes, whether it is splitting or funding cross-border, can be tackled. There is a particular opportunity to look at this currently. The IORP Directive, from which the requirement to fully fund stems, is currently being revised by the European Parliament at this moment. Just before the European election, the Parliament published a new IORP Directive, the IORP II Directive. That had, as Steven has suggested, right up until the last minute a clause removing the requirement to fully fund at all times, partly because there are so few schemes and it is seen as a barrier to creating cross-border schemes. The purpose of the IORP Directive is in large part to create more cross-border schemes and the amendment to remove the requirement to fully fund was removed at the last minute. But because that directive is in draft—it is going through the European Parliament at the moment—there is an opportunity to amend that.

A Scottish White Paper produced in November last year also proposed some helpful transitional measures, suggesting that schemes should be able to keep their current recovery periods, as I said, on average seven and a half years, and we would very much support that as a transitional measure so that they did not face that immediate injection of capital.

I think it is going to be very important also to provide schemes with, if it does not sound too contradictory, both certainty and some flexibility; flexibility, for example, around what is the definition of fully funding, what is the definition of "at all times", which sounds slightly contradictory because they should be fairly self-evident concepts. I think some intelligent thinking through some of those issues will help mitigate some of the impacts and some of the costs on schemes and their members.

Q6166 Chair: Pamela wanted to follow up some of these about cross-border schemes, but just before we come on to that, Steven, you mentioned the question of Scotland joining the EU in nine to 10 years. That is a slightly longer figure than we have heard from other witnesses. On what do you base that?

Steven Dignall: From face-to-face private meetings with other individuals. I cannot disclose that information. Likewise, media commentators who I am in contact with are talking of that time as well. I believe the likes of Spain and France would even try to block such an entry into the EU. However, the Scottish Government does believe that the entry would be seamless into the EU and, to quote one senior official, "The EU is not in the habit of turning away members".

Q6167 Chair: Your estimate is nine to 10 years. Now, presumably, that would obviously have consequences for this question of how the cross-border pensions are dealt with since in many ways the longer the better in terms of cross-border pensions?

Steven Dignall: Indeed.

Joanne Segars: In a sense, whether it is nine to 10 years or two to three, the issue is providing certainty as quickly as possible and, again, getting around the table with the Scottish, UK and EU Parliaments together to work through some of these issues and to think through how some of these can be mitigated. As I said, there is an immediate opportunity with the revision of the IORP Directive, and our overriding message would be no matter how long this is going to take—and, frankly, at the moment nobody knows the actual answer to that—this is not something that can be put on the back burner.

Q6168 Pamela Nash: Joanne, you did say earlier that you would provide us with a written note maybe to go into some more of the detail about the issue of cross-border schemes. Today, are there any examples that you would be able to give us of schemes that currently operate across Scotland and the rest of the UK and the issues that they might face should Scotland become independent?

Joanne Segars: Well, you can think of almost any large employer. You can think of any small employers, actually. The NAPF with its one employee in Scotland is a case in point, in fact. You can think of almost any large employer. I think something like 17 out of the top 20 employers in Scotland have employees south of the border, too. You can think of an awful lot of companies that will be in that position, many of whom will have open in one form or another defined benefit pension schemes.

Q6169 Pamela Nash: Okay. I appreciate obviously there is an element of confidentiality here, but have any of your members expressed concern to you about the implications for them for independence; and Steven as well? It would be good if you could give us those examples but, if not, if you could maybe just talk us through the issues that they have raised.

Joanne Segars: I think we cannot give you the names of those employers for obvious reasons.

Q6170 Chair: Oh, go on.

Joanne Segars: You are going to tell me no one is listening soon, aren't you, and this will never be on the public record? Clearly, because this is on the public record, we cannot give you the names of those employers, but again, through the debates that Steven has been running, through the discourse that we have been promoting about these issues, there is a lot of thought going on, going back to your earlier point, about these issues. There is certainly no complacency. There is certainly no one sitting on their hands, and there are a lot of people thinking through what some of the consequences might be for them, whether they sit north of the border or south.

Steven Dignall: Again, and to echo what Joanne was saying, these meetings that we have had, these roundtable events, make it clear where we would sit, and then we would have our member providing the pension. We have had not just employees but pensioners. They have had some pensioners phoning them to ask them, "How will our pensions be paid?" They are even phoning the advisory community and saying, "We need to know from you. It is your responsibility for you to tell us how our pensions will be paid, in what currency and will be paid on time". I would disagree with that pensioner. I can understand the concerns. The Scottish Government has already committed to paying pensions on time. They have had it in the White Paper and also in the Pensions Paper they produced. What more certainty they are looking for I am not sure. I do not think they would ask that on a regular basis from the UK Government or the DWP for that matter.

My understanding, then, is that people are aware of this issue. I understand the union representatives you spoke of earlier are not so aware of this, but the examples that we have had at these roundtable sessions is that they are having calls, queries, letters from their pensioner members as well, phoning them up and asking them these questions. Unfortunately, the advisory committee does not have the answers either, especially the one around currencies. We said at the start no one can answer those questions until after and the UK and the Scottish Governments get round the table and work out which currency Scotland is going to use.

Q6171 Pamela Nash: I think that is the case for many of the issues that we have been discussing over the last two and a half years and, indeed, the issues that we are discussing with our constituents. I have to say in pensions so much of it is so tightly controlled by legislation much of it is predictable and that is why we have asked you to come along and we have had other witnesses here on the subject. I would just like to explore a bit further about the EU requirements of cross-border pension schemes and what that might mean. My understanding is that the Scottish Government have repeatedly mentioned the example of Ireland and the Irish Pensions Board as a way to control this should Scotland become independent. My understanding is that the Pensions Board looks at it on a case by case basis in how long that they allow a scheme to become fully funded. In terms of the UK, the UK legislation is that a scheme would only have three years. Can I just ask you a bit more? Are you able to tell us a bit more how it works when there is a UK/Ireland pension scheme at the moment? Do they have three years or do they have a longer period of time? You also mentioned, Steven, that period of time, which is debatable but there will be a considerable period of time that Scotland, if independent, will not be in the EU. If that is the case, would Scottish pension schemes still have requirements to follow those EU rules because they will be dealing with pensions in EU countries?

Joanne Segars: Perhaps taking that point first, if Scotland is not in the European Union the fully funding issue does not arise because it only arises for EU to EU cross-border schemes. In that sense, the issue would not arise, is our understanding.

Turning to Ireland, an awful lot of the schemes that Steven referred to were schemes that were already cross-border before the IORP Directive came into force, so they are in a rather different position and they have existed cross-border for obvious historic reasons. The Pensions Board has a number of functions. It acts as the regulator, effectively, in Ireland. I think they do take a pragmatic approach and we would want to see and need to see a pragmatic approach being taken here, not least of all because there will be a large number of schemes potentially coming forward at the same time to request a cross-border status. It will be important that we learn from the Irish Pensions Board, which does a very good job, and learn from that pragmatism. Certainly, when the IORP Directive came in, there was a three-year transition period given for UK/Republic of Ireland schemes. That, of course, is at the point at which the directive was being implemented so it is a rather different context, but we would want to see a similar level of pragmatism delivered.

As I say, there are some wider opportunities to tackle the issue, not least of all, as I said, through the revision to the IORP Directive. I think the commitment that is there in the Scotland paper that I mentioned earlier, that schemes will be able to run off their existing recovery periods, is going to be very, very important given that that is seven and a half years on average for schemes, not three years.

Q6172 Pamela Nash: Okay, thank you. Steven, do you have anything you would like to add?

Steven Dignall: Yes, just to add on that when we met with various representatives and part of our lobbying work that we have done with the Scottish Government, our call would be that when they have negotiations with the EU it would be to call for not the grace period of three years. Fair enough to allow the transitional arrangements to take place—three years should seem adequate because the talk of 18 months in other key matters seems inadequate. However, when it comes to the funding arrangements, I think the EU would see it in its best interests to allow these schemes to continue to prosper, to continue to provide a good quality defined benefit scheme to their employees. It would be contradictory, I would say, to have this scheme to be fully funded, which could ultimately end up having the scheme to close down or, indeed, could send the employer into bankruptcy, insolvency. We would be looking for a recovery plan, as we have echoed a few times now, on a seven and a half to 10-year period to get those deficits up to those standards. But as I said, in those meetings we have had with the Scottish Government it would be that these rules, as Joanne said earlier, were not set up intentionally for independence or referendum purposes; they were set up on other matters.

Q6173 Pamela Nash: You as an organisation, have you had these conversations with the relevant people—I do not know who they are—in the EU or is there any precedent for this? I appreciate what you are saying and that there are good intentions there; that is more opinion on what should be the case. Is there any evidence that that is what would happen if Scotland did become independent?

Joanne Segars: There really is not any precedent for this. Where cross-border schemes are set up, there tend to be not very many of them, as Steven has said. There is not a flood of schemes that are set up each year. The rules are quite difficult for becoming a cross-border scheme, not just because of the fully funding rules but there are a whole host of other quite technical reasons that can be, frankly, quite off-putting, where we have had some conversations through our European trade association, Pensions Europe. But this is not something where we have had conversations with the European Union. We have been having other bigger debates with the European Commission in relation to European legislation, as you may be aware from your time on the Pensions Bill Committee.

Q6174 Pamela Nash: We touched earlier on pension schemes closing and splitting. While obviously every scheme has unique circumstances, is it your feeling that many will opt to split and will that have any impact? What impact might that have on the users of that scheme?

Joanne Segars: I think at this stage it is too early to say which particular route schemes will take. They will want to see whether some of the commitments that have been given will be honoured, particularly with regard to recovery periods. They will want to see how issues like membership of the European Union will be resolved, and they will also want to see how the currency issue will be resolved because that might push them in one direction or another. I think at this stage certainly my sense is I do not think our members have made their mind up on those issues.

Q6175 Pamela Nash: Steven, have you had any other indication on that?

Steven Dignall: No, nothing further to add on that, although if indeed Scotland becomes a tax haven, as you read in the press, or whatever it is going to become, you may see some schemes that are operating in England operate north of the border because of the potential benefits as well of this. It is not all just doom and gloom either. There could be some incentives. Again, the framework for that is unclear. They do have an opportunity to start from scratch by setting up these new bodies in the legislation themselves, so there are opportunities for this, not just the costs. All these opportunities come with cost, but some would say it would merit that.

Q6176 Pamela Nash: Just to be clear, what benefits would there be to Scotland if more companies decided to operate their schemes from here?

Steven Dignall: As I said, the framework for that is unclear. That is what we have said, but if there are tax incentives, obviously the Scotland Act 2016—which will come into place even before Scotland becomes fully independent, if it does so—we have yet to see those powers being exercised. However, if it is proven that an increase or decrease in the rate of income tax is beneficial to the people of Scotland living in Scotland, it will be interesting to see how that would affect pension schemes. Indeed, if that is just one power that we decide to use, setting up this new pensions arrangement, which again is unclear, but if you had a magic wand and you wanted to start again, I am quite sure the UK DWP would start from scratch on many of those issues.

Q6177 Chair: Well, there is a whole number of occasions in life where you would not necessarily start from here, but pensions is possibly one of them. Can I just clarify a couple of things that were said before we move on? Steven, you said that the Scottish Government had committed to pay pensions in full and on time. Am I clear that that was applying to the state pension and to public pensions only?

Steven Dignall: Yes, that is the state pensions.

Q6178 Chair: That is right. That was not applying to—

Steven Dignall: Occupational pensions, no.

Q6179 Chair: Fine. I just wanted to be clear about that. Joanne, you mentioned the impact of possible change of currency or not as the case might be and that being a great unknown, as it were. Can you just clarify for us what the impact of not operating as part of a shared currency union might be? What are the factors that people would have to take into account?

Joanne Segars: I think there would be a number. One would be if schemes were having to pay benefits out in possibly different currencies, or take contributions in in different currencies more to the point. I think for scheme members there could be potential currency or exchange rate risk if your benefits are paid out in sterling but you are spending the money in a different currency. There may potentially be questions around the investment of those assets. Again, as Steven said, added to that there are potential tax differences. If there is a different rate of income tax in Scotland than there is in the rest of the UK and your pension contributions receive relief at your marginal rate of taxation, then again that is an extra complication.

What pension schemes crave is simplicity because that is easier and more cost efficient to administer and ultimately that benefits scheme members. The added layers of complexity, and clearly the currency one is a potential added layer of complexity, could push schemes to move in one direction or another. Again, at the moment, I think schemes are thinking through some of those consequences.

Q6180 Graeme Morrice: I remembered this time to put my microphone on. I really just wanted to follow up on some of the points Pamela raised. It obviously relates to the issue of the requirement to reduce deficits. Now, obviously, you have made absolutely crystal clear that under EU rules, cross-border pension schemes are not allowed to operate within a deficit. If you look at the current situation with those schemes that are currently based in Scotland, are you aware of how many are currently running at a deficit?

Joanne Segars: It is difficult to say exactly how many are running at deficit, but if we look at the—

Q6181 Graeme Morrice: Or even roughly.

Joanne Segars: —current funding level of DB schemes across the UK at the moment, that is 91.5% funded on a pension protection fund basis. One would imagine that schemes would be fairly evenly split or that would be reflected fairly evenly north and south of the border.

Q6182 Graeme Morrice: If we became independent and eventually joined the EU, what would be the implications of cross-border schemes based in Scotland where there was an issue of deficit?

Joanne Segars: The implications would be that those schemes would have to, if they wanted to operate cross-border, fully fund. There are the questions that we have been debating about how quickly they would need to do that. Would there be the sort of transitional arrangements like existed in the UK and Republic of Ireland? Might there be the longer deficit recovery period such as posed in the Scottish White Paper? Or would schemes have to put money in immediately? The current absolute reading of the directive would be they would have to put money in immediately if they wanted to operate cross-border. Alternatively, they could split and have Scottish and rest of UK sections. They would face some administrative costs and some advisory costs, which could be quite significant, as I said earlier, in doing that. They might also, if both schemes north and south faced deficits, have new recovery periods and new employer and potentially employee contributions, too.

Q6183 Graeme Morrice: Okay. Assuming that most if not all of these schemes remained in Scotland—and you said that they would have to plug that gap immediately—what actions are open to schemes to do that and what are the implications of that?

Joanne Segars: Schemes, or the employers who sit behind those schemes, would have to find that money from somewhere. That might mean that there is less investment elsewhere in the company. It could mean that faced with those significant costs some employers decide that they want to close the scheme. As I say, at the moment I think it is too early to tell. Because we do not have clarity on some of the issues that you are raising around the transitional periods and grace periods, the clarity around the finality of the EU legislation, particularly with the new directive, I think it is a little bit too early to say exactly what schemes might do.

Q6184 Graeme Morrice: I assume that whatever happens there is going to be a potential consequence to the employee who is paying pension contributions into the schemes?

Joanne Segars: Some employees may find that they are having to pay more into those schemes or perhaps the benefits get reduced or the benefits may get remodelled, yes.

Q6185 Graeme Morrice: So you are saying increased contributions and/or decreased benefits?

Joanne Segars: It may be one consequence, yes.

Q6186 Graeme Morrice: What is the likelihood of that happening, then, do you think?

Joanne Segars: Again, I think it is too early to tell. Somebody said no two schemes are exactly the same and that is absolutely right. While we have the average deficit numbers or funding numbers, that will vary from scheme to scheme. The strength of the individual sponsoring employer that sits behind them will vary. Schemes will make their decision on a case by case basis, so I think it is possibly slightly risky to make any sweeping generalisations at this point.

Q6187 Graeme Morrice: Considering the work undertaken by the pension's regulator around funding levels, deficit repayment plans and monitoring the strength of an employers' covenant. Will there be any marked difference in pension security, do you think, due to the necessity to have fully-funded cross-border schemes?

Joanne Segars: I think the European Commission would argue that the level of security will increase because there is full funding at all times. The counter to that might be a question around what that does to the strength of the sponsor covenant, but certainly the European Commission would argue that that would be greater security for scheme members, not reduced.

Q6188 Graeme Morrice: Yes. How does the Pensions Regulator objective to minimise any adverse impacts on the sustainable growth of an employer marry with the necessity for fully-funded cross-border schemes?

Joanne Segars: The regulator's new power to take account of the scheme sponsor's strength is one that we have very much supported. We very much instigated and encouraged that acquisition of that new power for the Pensions Regulator, so it is one that we very much welcome. We would need to think through carefully how those two things would sit together, and of course it comes back to the earlier issues I raised about the regulatory framework within which Scottish schemes, or schemes within an independent Scotland, would operate and whether there will be a separate pensions regulator and the rules that separate pension regulator might have.

Q6189 Chair: We have, as you might have expected, some questions on regulation, but before we—

Joanne Segars: I thought you might.

Chair: —come on to that, can I just go back a step, just to seek clarification on the three options that you have identified? The three options for schemes were the possibility of closure, splitting and making fully-funded. The closure section, I think we were just assuming for a moment there that would be the closure of the Scottish arm, but am I correct in thinking that this would be the closure of the entire pension scheme and therefore this could very well impact employees in England, Wales and Northern Ireland?

Joanne Segars: I think it might result in employers reviewing their schemes across the piece, but I am very reluctant to jump to too many conclusions too early on, because again it will vary from employer to employer. I do not want sweeping statements to say, "Thousands of employers will close their schemes" because I do not think we are in a position to have the evidence to support that. Employers are reviewing their schemes—as trustees are reviewing their schemes—if not on a daily basis, then certainly on an annual basis in any case, and when there are very big changes then that accentuates that.

Q6190 Chair: Of course I understand that schemes will be different. You can have 90% in one area and 10% in the other or vice versa, or any ratio therein, but I think we had always assumed—lazily, I suspect—that we were looking at the impact upon employees in Scotland, and of course it had not really been brought to our attention by employees in England that this might also imperil their scheme. Clearly, I think what you are saying to us is that it might. Can you just clarify for me: you used the term "close". It is possible to close the whole thing, but as a subset of splitting it is possible, is it, to keep one bit of it going, either the English bit or the Scottish bit, and then close the other bit so that you are not having a one size fits all sort of policy in these circumstances?

Joanne Segars: Exactly. You could do any or all of those things. You could close the scheme completely, you could set up a defined contribution scheme in its place and you could probably set up two defined contribution schemes, one in Scotland, one for the rest of the UK. You could in effect split the scheme and then close off one or other part of it, and again, different employers will do different things depending on, among other things, how many employees they have whichever side of the border.

Q6191 Chair: I just want to clarify then the impact on employees of having a split scheme or having their scheme split. Am I right in thinking that being in a smaller scheme is almost automatically more risky?

Joanne Segars: No, not necessarily. It will depend fundamentally on the strength of the sponsor, so you might operate in a small scheme, but with a very strong sponsor covenant, to go back to Mr Morrice's point. Again, we operate a defined benefit pension scheme at the NAPF, we are a small employer, but with a strong sponsor covenant. Again, it is very risky to make those sort of sweeping generalisations. It will depend fundamentally on the strength of the sponsor covenant and the commitment of the employer—and the employees to some extent—to fund the scheme and the funding position of the scheme at any one time.

Q6192 Chair: This means effectively that almost anybody who is in a pension scheme that is cross-border should be beating a path to their trustee's door or the operators of their scheme and asking for clarification of what might happen?

Joanne Segars: As I say, they are the debates that we have been having and they are issues that not just trustees in Scotland are thinking about, but trustees and scheme managers who have employees in Scotland or scheme members in Scotland are thinking about it.

Q6193 Chair: Yes. I do not think that has been fully appreciated, the extent to which this could very well impact upon lots of employees in England, Wales and Northern Ireland, but the second point that I wanted to pick up, if I could, arising from what has been said so far, great play has been made about the possibility of renegotiating the rules, the European rules and so on. Am I right in thinking that in a sense there is two different directions of travel there: one is the proposal that came forward from the Commission to try to ease the rules to make it easier to have cross-border pension schemes, but the European Parliament seemed to move in an entirely different direction by ruling that out and slamming the door or whatever other metaphor you want to use?

Joanne Segars: No, we have not quite come to the door of the European Parliament yet in discussing and debating this directive. The directive was published moments before the European election, so is not in the European policy-making machine proper, so it is not in the European Parliament debates and discussions yet.

Q6194 Chair: But there was a surprise, wasn't there? There was a surprise in who gave us it.

Joanne Segars: You are absolutely right. The surprise—you make it sound far more dramatic than it was—was that the early draft of the new directive, the sort of leaked draft, had right up to almost the date of publication a new clause removing effectively or amending one directive, so removing the requirement to have to fully fund at all times. When the directive was published by the Commission, eventually that was excluded, but we have not yet come to the point of debating this in the European Parliament and going through all of that, which is why I say that we have this opportunity now to look at that.

Frankly, with or without this particular moment and this particular focus on cross-border schemes because of the referendum, we, as NAPF, and my colleagues in Pensions Europe, would like to see that clause removed, because it is an inhibitor on the creation of cross-border schemes. We have been stuck. As Steven said, the number of cross-border schemes has declined, not gone up, over the last few years and most of those that do exist exist between the UK and Ireland for those historic reasons.

Q6195 Chair: In terms of the EU's direction of travel, the ever-closer union and so on, it would seem quite surprising that that clause was removed, and therefore there has obviously been something going on behind the scenes there. I presume that you and your lobbyists will be au fait with this. Is this something that you are able—confidentially, since nobody is listening—to tell us?

Joanne Segars: You keep telling me that. I do not know there was that much of a conspiracy, and it perhaps reflects the contradiction in EU pensions policy making, that on the one hand they do want to see greater cross-border transition—and they do want to see good and adequate pension provision across the EU—but on the other hand, push for such gold-plated regulations that frankly it is going to move in exactly the opposite direction, so completely outwith this debate, those contradictions get played out. I think this was just one of those contradictions, on a very purest view, with which the Commission view pensions and occupational pensions, and do not necessarily understand the nuances between the sort of trust-based occupational pensions that we have been discussing today and other financial services products.

That is something that we wrestle with all the time when we come to making European policy, so one of the things that we would like to see reinserted into this new directive, and when this directive does start to make its way through the EU policy-making machine or legislation-making machine, it is one of the things that we will be pushing to be reinserted, with or without this focus on the referendum, but that does give us particular focus.

Q6196 Chair: It was just that it was a big shock.

Joanne Segars: Absolutely, it was, yes.

Chair: It was certainly a big shock to the Scottish Government, because they have been predicting that this change was going to take place for some time and they were left with egg all over their face when the European Commission changed its line.

The final point on this is to what extent do you think—given how much of the work of the European Commission is about politics and the like rather than legislation—this will be subsumed within an argument about Scotland renegotiating its position in the EU in the event that we vote for a yes, and to what extent will it be dealt with just simply as a pensions matter?

Joanne Segars: I hope it will be the latter. I say that partly because this is already on a sort of particular legislative path, so I think it does give the opportunity to split the whole thing out. If I think about my colleagues who sit around the board table with me at Pensions Europe, our European trade association, there would be quite a degree of unanimity on that point, so I would hope that this would be looked at on its merits as a pensions issue, and frankly, that is how it should be viewed.

Q6197 Chair: Yes, but a degree of unanimity of course is not unanimity, and if somebody—

Joanne Segars: Shall I say a degree of unanimity, certainly among my colleagues who work in my counterpart organisations across Europe, so the task for us will be to work—as we have on European pensions issues generally across party at Westminster and with the Scottish Government—on these policies.

Q6198 Chair: I understand that, but if another European government decides, for reasons of its own, it is not going to be helpful to Scotland joining the EU for again internal political reasons and decides to be as obstructive as it can on every opportunity, this would clearly be one where a single nation could effectively, if not veto, as least block it or hold it up for a long, long time.

Joanne Segars: Yes. These tend to be QMV points rather than veto points, so—

Q6199 Chair: But again, if somebody feels strongly about something, then generally there is a willingness to try to accede, particularly if it is to do with other bigger issues that the nation involved has the concern and sees as being part of an essential national interest, which the question of breakaways and so on is likely to be.

Joanne Segars: That could potentially be the case, but I think all that means is we will have to work extra hard with those governments who do support the position that we have been talking about, to lobby against and make sure there is not that qualified majority that would be required.

Q6200 Chair: No guarantees then?

Joanne Segars: No. I think it would be only a foolish person or a rash person might predict the outcome of EU legislation at this point.

Q6201 Chair: But lots of people are. The whole case—

Joanne Segars: Not on this particular technical issue, on this particular directive.

Q6202 Chair: That is right. The whole yes case on pensions and cross-border pensions is based on that sort of optimism that—

Joanne Segars: I think I am talking about achieving an amendment to this particular directive.

Q6203 Chair: No, but virtually the whole of the EU, of the yes case on pensions, cross-border pensions, is based upon that being all right on the night.

Joanne Segars: Of course it was there when they were talking about the particular issue, so I think we will have to work very hard to get this reinstated back into the directive.

Chair: Okay. Moving on to regulation, Graeme.

Q6204 Graeme Morrice: Yes. As we are aware, currently UK pension funds share the single regulatory system and if we do go down the road of independence, how would that be affected, do you think?

Joanne Segars: I think again it is one of those areas where we would need some very rapid clarification. There are some very important institutions that we have spent a good number of years creating, the future of which would need to be clarified and the position of which within an independent Scotland would need to be clarified. The position of the

Pension Protection Fund, on which we have touched already, the Pensions Regulator, which you have mentioned, and NEST and SEST, which we have also mentioned, in particular would need some very early clarification and we would want to know whether they would exist across border and how they would be set up in an independent Scotland and how what currently exists, in particular with relation to the Pension Protection Fund, could be split if that were to be the case.

Q6205 Graeme Morrice: That is right. We obviously have the Pension Protection Fund. Do you think that fund could continue to operate after separation? I understand that the Scottish Government is suggesting that if we cannot see a negotiated settlement between the two separate governments, they would set up their own fund. How realistic is that, do you think?

Joanne Segars: I think there would be a number of discussions and debates to be had about if there were to be a separate pension protection fund, how the assets might be split: would there simply be a share of the fund; would there be a calculation of the number of Scottish members, the degree of Scottish liability and how a separate pension protection fund could be sustainable and be insulated from a big hit from a big employer entering the PPF. I think there would be a number of issues to look to.

Your original question was could the PPF operate cross-border. It may be able to do that with separate sections, so again, I think all of that would need some very, very close examination.

Q6206 Graeme Morrice: In terms of a separate PPF, you will be aware that the UK Government is saying that to create a separate PPF in Scotland would be, to use their quote, “Difficult”. What do you think those difficulties are and how do you think they could be overcome?

Joanne Segars: One of the difficulties would be assessing the levy. The Pension Protection Fund is paid for through a levy on existing pension funds, so there would need to be a new levy calculation and that levy would need to be set at a level that would be sustainable for a new pension protection fund to become credible and sustainable. The Pension Protection Fund at the moment is on a journey to being self-sustaining. It has grown over the last almost 10 years of its existence to just around £18 billion worth of assets under management at the moment, which it has gathered through taking in other failed pension funds. One issue would be setting the levy; one issue would be making sure that it is sustainable and sustainable over the longer term, because if it were not, it probably would need the Government to sit behind it to make sure that it could continue. Part of that might relate to how it was then split and the share of assets it might get from the current PPF.

Graeme Morrice: Yes, Steven.

Steven Dignall: I would completely concur with what Joanne has said there. I think one of the key things that should be part of your ongoing evidence collection is to calculate and work out what a Scottish fund is and what a Scottish scheme member is: is it where they are domiciled; is it where the scheme is headquartered or administered? These questions are up in the air at the moment, so setting up a separate Scottish pension protection fund in itself would be impossible until those questions are answered.

Likewise as well with the regulator of that, if you take, for example, my own personal experience, I am domiciled in Scotland, I live in Scotland. I work for an English-headquartered company. Should the association end up insolvent and there is a yes vote and there is an independent Scotland, how will the assets be divided and how will I, when I come to retire, draw down those benefits? Those questions are unclear, but again, all this is centred around the currency and that cannot be answered until the currency question is clear.

Q6207 Chair: Can I just respond to some of those points? Those who are arguing for change have, in my view, a responsibility to clarify, as far as they possibly can, what that change would be, and therefore the question of how a scheme would be set up and how would you be affected by it can be identified. The rules about whether or not you would be in it, given your circumstances, is something that those who are proposing a constitutional change could have thought of before and could have made quite clear before. That does not require, surely, negotiation with anybody else. I understand your issue then about currency, but the question of who would be in that scheme, surely those who are, as I say, proposing a change have a responsibility to spell out exactly what change they want.

Joanne Segars: I think it is about early clarification of what they will mean, because it then goes to how many schemes can you possibly levy for a pension protection fund levy, how many schemes can you levy to create a new pensions regulator and so on, and how do you start to fund any of those institutions.

Q6208 Chair: But this should have been made clear yonks ago, surely.

Joanne Segars: It is one of the things again we have been asking for clarification on, and to answer Mr Roy's question from earlier, we do not know why that has not happened. We have been asking those questions for some time.

Lindsay Roy: Following on from currency, what is the most desirable currency option for a separate Scotland from the point of view of pension funds?

Chair: Sorry, could we just finish this section? Sorry, I just wanted to, if we can. Graeme was on the question of regulation and stuff, so if we finish that section. Sorry, I should not have allowed you to divert us. That is the old, "Oh look, there is a unicorn" trick, for every hard question to raise something that diverts people on to something else. We will maybe just come back to the question of regulation.

Graeme Morrice: I was in full flow, Mr Roy.

Chair: Exactly, full flow.

Graeme Morrice: Anyway, I forgive you.

Chair: Keep flowing.

Q6209 Graeme Morrice: I am worried about the water flowing behind me. If we look at the number of defined benefit schemes in the UK, obviously there are many of them, so the risk could be kind of shared across the UK. Obviously in a separate Scotland, there would be a much smaller number of providers. I think the UK Government estimate that that figure could be around about 7% of the total number of defined benefit schemes currently, so presumably there would be a real risk in an independent Scotland with a much smaller number of providers. What do you think those risks would be?

Joanne Segars: I think the risks do go to the long-term sustainability of any pension protection fund or any lifeboat scheme, so it would raise some fairly significant questions about whether or not—or the extent that even—the Government are prepared to stand behind any lifeboat scheme in the event that it was either destabilised by a very large employer entering the pension protection fund or Scottish pension protection fund, or the extent to which there simply was not a big enough base on which to levy funds into that pension protection fund.

Q6210 Graeme Morrice: If there was a large Scottish employer that was in a separate Scotland scheme that became insolvent, would it not be the case that the costs of that would have to be borne by the existing members, and the fewer members there are, the greater the cost to them, and then in turn that impacts on those poor people paying their pension contributions to such schemes?

Joanne Segars: Yes, and the Pension Protection Fund, as we currently know it, has had a number of large employers entering it through the last 10 years of its existence and it has been able to weather that, partly because there is a large base on which to levy contributions, but partly also because it has built up a significant asset base. It is not purely the levy base, it is also the asset base from which it starts and that provides some of that insulation. But clearly one of the ways in which it is able to do that is because of its size and because of the potential risk pool that it has.

Q6211 Graeme Morrice: Would there be an obligation for the Scottish Government to assist by topping up?

Joanne Segars: Either topping up or agreeing to be the guarantor of last resort potentially. In the US, the Pension Benefit Guarantee Corporation does have the US Government as a guarantor of last resort, in effect.

Q6212 Graeme Morrice: If we look at a cross-border PPF, say there was a desire between the two Governments to achieve that post-independence, obviously that would be a negotiated situation, but on the basis that the SNP Scottish Government have said that if there is not a formal currency union they would renege on Scotland's share of the national debt, then presumably there would be a real issue there.

Joanne Segars: I might need to think about that, because clearly the PPF is not reliant on any state support. It is funded by the assets it brings in and the levy that it raises, so it is not reliant on—

Q6213 Chair: I suppose it is about willingness, because it is not going to be a currency union, because the rest of the UK have said that, and the SNP Scottish Government said they want there to be a formal currency union, and if there is not, then they are not going to take their fair share of the national debt. Then it is down to willingness from both parties to come to agreements on that—and no doubt other things—so there could be a negative impact when it comes to discussion on other issues such as this.

Joanne Segars: Potentially, but again, it is rather like the question on the European Union and the IORP II directive. I would hope that we would look at this on its merits and on a case by case basis. Of course, a lot of these discussions are cumulative or interrelated, but these are very important decisions and many, many hundreds of thousands of people are now relying on the Pension Protection Fund and we cannot put that at risk.

Graeme Morrice: I mentioned currency, which probably allows Mr Roy to come in on this point.

Q6214 Chair: Before we do that, can I just mention that I think if you are expecting things to be dealt with on a case by case basis on their own merits, that is exceedingly unrealistic. I would have thought that nothing will be decided until everything is decided; that there will be big issues that will either poison the water for everything else or will allow things to be resolved amicably. This whole question of non-payment of debt is obviously one of them, and I cannot genuinely see much chance of progress on a whole number of other things until some of these other big issues are sorted, so you might get trampled. You are not a mouse, but you get the parallel, being trampled by the elephants.

Joanne Segars: No, I think what I am saying is I would not like to see the futures of the hundreds of thousands of people who are relying on the Pension Protection Fund to pay their benefits each month to be horse-traded away in any of these discussions.

Q6215 Graeme Morrice: But it could be an unintended consequence.

Joanne Segars: It could be an unintended consequence. I think all I am saying is that will be—

Graeme Morrice: Unfortunate.

Joanne Segars: —highly unfortunate for the hundreds of thousands of people, because at the end of the day, we have to remember that what our members are trying to do is pay pensions, and what the Pension Protection Fund are doing are paying pensions to people who otherwise would not get those pensions but for the Pension Protection Fund.

Q6216 Graeme Morrice: Indeed, but then we are not the ones calling for separation.

Joanne Segars: Quite so, but we are just trying to do our job and pay pensions to people.

Graeme Morrice: Indeed.

Chair: Indeed. Lindsay.

Q6217 Lindsay Roy: Returning again to currency, what is the most desirable currency option for a separate Scotland from the point of view of pension funds?

Joanne Segars: I think we do not want to be drawn into the single currency/not single currency debate. We are not going to come down and say one or the other, but I think what we can do is to—as we have done throughout this discussion—flag some of the practical issues that do relate to there being a single currency or to there being dual currencies. We have talked about those in the context of splitting schemes in the event of the cross-border issues that we have touched on, we have talked about the issues around the complication of schemes taking in contributions in different currencies and for the potential currency risk that individuals might face when they draw their benefits from defined contribution schemes. I think what we can do is to flag those issues, but we are certainly not going to enter the political debate on which is the right currency.

Q6218 Lindsay Roy: But it would be true to say that within a currency union where the union remains, these issues would not appear.

Joanne Segars: I think it would be true to say that schemes would like simplicity. How that will work will be different depending on what the currency is or how simple things will be will differ depending on what the currency is and the decisions the schemes then make.

Q6219 Lindsay Roy: Supposing Scotland does vote for a separate currency, what would be the implication for pension funds?

Joanne Segars: As I have mentioned, and Steven has mentioned too—and Steven may wish to pick this up—there will be issues around schemes if they are operating cross-border, taking in contributions in different currencies. There will be issues if they are operating defined benefit or defined contribution schemes for the scheme members receiving benefits in sterling, if the scheme is based in the rest of the UK, but converting it to whatever the Scottish currency might be, so exchange rate risks and there may be issues for the appetite of the pension funds' institutional investors in Scotland.

Q6220 Lindsay Roy: Okay, I appreciate that. We know that pension funds invest heavily in government bonds. What is the likelihood that pension funds would buy Scottish Government bonds in the event of it being a separate state?

Steven Dignall: I think there is every likelihood of that, just as there is every likelihood that if there was to be a separate currency then naturally when you, as an individual, are travelling abroad or trading in any currency, there are costs to that. The questions that many of our members are receiving from their own pension scheme members would be, as I said earlier, "What currency will my pension be paid in?" and until that answer is clear and is known—I have just returned from vacation myself and I have had these two leaflets through the door, which everyone in Scotland will have received. You said, "Will Scotland renege on its share of debt?" However, in here it says that you will keep the pound and in this one here it says you will not keep the pound, so it is up to the people to decide then on that matter. It is not a matter for the NAPF to tell its members what it is going to be paid in. That is a matter for both the UK and indeed the Scottish Government to decide after the referendum.

Q6221 Lindsay Roy: Okay. Investment in government bonds, if you renege on debt, what is the chances?

> ***Steven Dignall***: As I said, it is whether you believe they would do such a thing and renege on that debt.

Lindsay Roy: But if they do?

> ***Steven Dignall***: If they did, the chances are slim, aren't they, but that is a speculative thing.

Lindsay Roy: As high as slim? Highly unlikely.

Q6222 Chair: To be fair, we are not asking you to speculate on what might happen. As we have done with a number of academic witnesses, we have asked them, "What would be the consequences if such and such happened?" and therefore we are not asking you to express a view on whether or not a particular course of action is desirable or likely, but just what were the consequences if it did happen. These are not trick questions in a sense designed to catch you out. They are designed to try to clarify for people who are going to have to vote on these issues.

Just coming back again, does defaulting on the debt make it more or less likely that pension funds and the like will invest in Scottish Government bonds? You might say it would make absolutely no difference whatsoever or you might say to us that under no circumstances would it be touched or it might be something in the middle, and what would be the factors that would affect where it was in the middle?

> ***Joanne Segars***: I think our analysis would show that at least in the early stages, Scottish Government bonds might just yield higher rates partly because there is a less liquid market and that might be attractive to investors.

Q6223 Lindsay Roy: Why might they yield higher rates?

> ***Joanne Segars***: Because there is just a less liquid market, there would be fewer people just trading those bonds potentially, and I think also our analysis suggests that because there will be a lack of a track record for a new bond market, for a new gilt market, that could encourage higher yields. That might be something that is attractive to investors, and that in turn could, going back to some of our earlier questions, for the Scottish pension funds invested in Scottish gilts—or any pension funds invested in Scottish gilts—have a beneficial effect on those deficits, which are valued off the back of gilt yields. Much will depend on the size of the market, the yields at which those gilts trade initially and over time the experience of operating in that gilt market.

Q6224 Lindsay Roy: Again, if you renege on the debt?

> ***Joanne Segars***: If you renege on the debt, then I think we would need to see what the ultimate size of the market might be and what that would then look like on the yields and the certainty with which investors felt that was operating.

Q6225 Lindsay Roy: But would you agree it is rather slim?

Joanne Segars: I agree it makes it an awful lot tougher, yes.

Q6226 Chair: Can I just clarify, some of these jargon terms, "yield higher rates" that means a higher—

Joanne Segars: Higher interest rates.

Q6227 Chair: Higher interest rates. I am not clear: give me a feel, if you can, for how much higher. Are we talking 1%, 0.5%, 10%? I can remember when mortgages were 15% and so on. I have no clear idea about what sort of rates you are talking about, given just solely at the moment this question of a small limited illiquid market.

Joanne Segars: I think it is very difficult to say until you know exactly what the size of the market is and what the state of—among other things—the world economy is in which that gilt market or that gilt issuance is released and what the size of the issuance is. I think it is too early to say at this stage. It is impossible to predict what that might look like at the moment, but given where UK Government gilts are at the moment, a smaller market, a less liquid market would inevitably have higher yields, but I do not think it is possible to say how much higher.

Q6228 Chair: But that in a sense does not help me much. When you say "higher" is that 0.25%, 5%, because ultimately taxpayers presumably are going to have to pay the interest on these bonds, and if it is considerably higher, that is a much higher borrowing rate.

I was then wanting to lead on to whether or not that, you thought, would have a consequence for ordinary people's mortgage rates or interest rates on credit cards or anything else. It is that connection that I think we are interested in just pursuing with you.

Joanne Segars: I perfectly see the connection and I am not trying to be unhelpful, but I just think at this point in time, until you know the quantum of the potential gilt market, what is being released when, it would be simply too early to say, or impossible to say, in fact, what the yield would be on those gilts.

Q6229 Chair: Right, so if I said 10% then, you could not contradict that?

Joanne Segars: I could not contradict it, but I would say it is probably very high. I mean, unless your—

Q6230 Chair: Okay, if that is very high, would you contradict it if I said 5% then? You can see where this is going, can't you?

Joanne Segars: I can see where this is going, but I—

Q6231 Chair: You are the expert; you are the witness. You know far more about this than we do. We have people who will be taking an interest in this who will be seeking some sort of guidance and—

> ***Joanne Segars***: As I say, if I could give you an answer and if I could tell you it is going to be X% definitively, then I would, but until we have greater clarity on a number of other questions, I think we simply cannot. If we can, we will, and when we can, we will, but currently I am afraid I cannot.

Q6232 Chair: But, you see, people will want to know these sorts of things before the referendum if they possibly can, but am I right in thinking then that Scottish taxpayers will end up paying more for debt because just simply it is an illiquid market and so on and so forth and that they would end up potentially paying even more if they were to default on debt? Because again, that raises the question of the riskiness of the lending to somebody who has previously defaulted, but you cannot place a figure on either of those?

> ***Joanne Segars***: We cannot put a figure on that, no.

Q6233 Chair: Right, okay. I think you have covered those points off. In terms of currency then, you will be aware probably of much of the debate and discussion that has been taking place about the alternatives. Are there any particular issues that you think from the pension fund aspect that have not been adequately covered? We could spend hours discussing what the ramifications are, but most of the ground has been pretty well-trodden. I am not clear whether or not there is anything that pension funds would say, "You have not adequately discussed this, because this affects us more than anybody else".

> ***Steven Dignall***: No. I think currency, without the referendum being a topic, is a risk in itself just based on the nature of its market. Again, this is all down to the fact that there has been no negotiation on either side, and for that to happen, for any certainty, when you are asking me to speculate on interest rates and things is—

Q6234 Chair: No, we are not asking you to speculate. It is just a question of whether or not there are any sort of issues that have not been touched on. This is one of the known unknowns. It might be known to you, but it is an unknown unknown to us.

> ***Joanne Segars***: I think we have covered most or all of the issues relating to currency throughout the discussions that we have had. I think in terms of the discussions, the issues are about cross-border regulation, currency, public sector pension schemes and the regulatory institutions, I think they are the key drivers for our members and they are the key concerns that our members have.

Q6235 Chair: What of this could have been resolved beforehand that has not been? I think we take out of this the fact that although not all of it can be resolved because some of it will be subject to negotiation, a lot of it could have been resolved beforehand but has not been, and I think we regard that as regrettable.

Can I ask my colleagues whether or not there are any other points that we want to raise? Normally, we end these sessions by asking people whether or not they have any answers prepared to questions that we have not asked, anything that coming in you thought, “We want to make sure we get this, that or the other point across” that we have not covered? Because I am sure that there will be a number of areas where our knowledge is lacking and you might feel there is a point that we have not looked at that you want to draw to our attention, so please do so.

Joanne Segars: No, I think you have covered all the issues that we hoped you would have covered, in particular raising the issues around the cross-border point and the regulatory institutions, which are vitally important, and as we said, it is important now that if there is a yes vote next month that these issues are resolved as quickly as they possibly can be.

Chair: Fine.

Steven Dignall: I would concur with that. You have covered the four key areas that we had intended to send in our paper in response to the Scottish Government’s paper on pensions. As I said earlier to Mr Morrice, I would like to see certainty around what exactly a Scottish pension scheme would entail. The Institute and Faculty of Actuaries have done some work on that, but there is no prescribed detail on that and there is no stepping stone and no base for pension funds to look to if there is a yes vote.

Q6236 Chair: Sorry, just on that point again, the meeting that we had this morning with the defence unions, there were a number of points where they are still pursuing the Scottish Government on to try to get clarification before the vote. Some of these areas of uncertainty that you have identified the Scottish Government could still clarify before the vote. Not all of the ones that you have identified are the ones where they solely depend upon discussions post the referendum result.

Steven Dignall: I believe that matter I just mentioned would have to have negotiation.

Chair: Fine, thanks. Lindsay.

Q6237 Lindsay Roy: You said “as quick as possible”. What is your best estimate? How long will it take?

Joanne Segars: We would hope it would be as quick as possible and this would be an issue that can be dealt with in a couple of months rather than a couple of years.

Q6238 Lindsay Roy: Is that realistic?

Joanne Segars: I think it has to be realistic, because there is so much that then hangs off. The issues that we have been covering this afternoon then do hang off much of that, so this will be something that has to be dealt with quickly.

Q6239 Chair: Again, just resolving these issues, how many of the issues will not be resolved until currency issues are resolved? I think we take the view that the currency issue has been resolved in the sense that you are not getting any change before the general election, and indeed, there will be manifesto commitments going out of that general election that will mean it will not be resolved in the way that the Scottish Government will want after the general election either. It is in the Scottish Government's interests to try to keep that ball up in the air, so presumably it is not in their interests to get this resolved; that would be them conceding that there was not going to be a currency union.

Joanne Segars: I think there are a number of things that can be resolved before those discussions are finalised, if they are to be finalised, and in particular I think what can be done is at least the direction of travel, so we can set out the framework for what a Scottish NEST and SEST would look like; we can resolve the question about what the definition of a Scottish scheme is; we can resolve what would happen to the Pension Protection Fund question, and it should be possible—it must be possible—to start negotiations with the European Union if they need to be commenced.

Q6240 Lindsay Roy: Is this not an act of faith too much? It is almost like, "It will be all right on the night".

Joanne Segars: From the yes campaign?

Lindsay Roy: From resolving the pensions issue.

Joanne Segars: I do not think it is an act of faith on our part. I think it is a commitment on our part that we will, for all our members north and south of the border, engage fully in these discussions to create a good outcome, not just for those people who are running schemes, but most importantly for those who are saving in the schemes.

Q6241 Lindsay Roy: Given the slow response and the many unanswered questions so far, it is maybe rather optimistic to talk about it too much.

Joanne Segars: It will be partly our job to make sure that it is two months and not two years.

Q6242 Lindsay Roy: And the Governments.

Joanne Segars: And the Governments both sides of the border, absolutely.

Chair: Okay. Could I thank you very much for coming in? I think this has been very helpful. I do not think we fully appreciated the extent to which this might very well impact on members of pension schemes in the rest of the United Kingdom before we had this session. I think it has been very helpful to have that brought to our attention and the way in which you clarified the options of closing, splitting or paying the money into private pension schemes. Again, that has moved things forward. Thank you very much for coming along.