PENSIONS AND LIFETIME SAVINGS ASSOCIATION

DB TASKFORCE
CALL FOR EVIDENCE

THE ISSUES: THE SOLUTIONS

JUNE 2016

FOREWORD

I am delighted to be chairing the Pensions and Lifetime Savings Association's DB Taskforce.

It has become clear over recent weeks, with the high profile issues facing BHS and the British Steel Pension Scheme, just how important and relevant the work of the Taskforce will be.

We can all agree that ensuring we have a strong pensions sector that provides long-term sustainable outcomes for members, and supports economic growth, is in all our interests. Yet successfully achieving those aims is very challenging in today's environment.

DB schemes face pressures on many fronts, with low interest rates, market volatility, regulatory burdens, funding gaps and adjusting to the consequences of continued improvements in longevity. This can lead to sub-optimal choices for employers and pension schemes when allocating capital between business growth and funding, with broader impacts on the macro-economy. With millions of scheme members, and billions of assets and liabilities to manage for decades to come, finding solutions to these challenges is important.

Whilst much has been written about the health and future of DB provision in recent weeks, a key part of the Taskforce's work will be assessing the challenges schemes are currently facing with an open mind.

We recognise that we cannot do this on our own and want to both draw upon the expertise of others in the sector and hear from each of the many different stakeholders within the DB pension system - including not only Government, regulators, employers and members but advisers, shareholders, unions, creditors, and other employees as well.

I would encourage anyone with an interest in the future of DB provision to respond to this Call for Evidence and thank you in advance for your contributions.

Ashok Gupta, DB Taskforce Chair

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EXECUTIVE SUMMARY

Today there are more than 6,000 funded DB pension schemes across the private and public sector. They are responsible for paying pensions, now or in the future, to over 16 million members, and collectively they own over £1 trillion of assets.

It is clear however that schemes and their sponsors face a number of pressures in the current economic and regulatory conditions, as well the broader challenges to affordability associated with significant improvements in longevity.

These challenges, and size of many scheme deficits - despite record levels of employer (and employee) contributions - has brought the future of DB provision into sharp focus.

The DB Taskforce, established by the PLSA in March, intends to get to the heart of these issues and find solutions to help ensure DB pension provision is sustainable for the long-term.

The future of DB provision has been the subject of debate for some time in the industry, in the press and amongst individual scheme members. The recent high profile cases of BHS and the British Steel Pension Scheme have brought the debate into the spotlight and prompted Government interventions.

Taken individually or collectively these issues have often seemed too complex or enormous to address, however the need for a clear understanding of these issues and long-term solutions for all DB schemes and their employers has never been greater.

The DB Taskforce has been established to undertake a review of these challenges facing schemes and their employers to (a) help ensure the sustainability of open DB schemes; and (b) help closed DB schemes run off more efficiently and ultimately secure member benefits.

This Call for Evidence sets out a series of questions on which the DB Taskforce is seeking views and empirical evidence.

A Changing Landscape

The DB landscape today is far more complex than it was 20 years ago. In part due to regulatory changes, following the Maxwell scandal, the Pensions Commission, and a series of different government and global policy initiatives.

Navigating within this complexity are a wide range of schemes, employers, trustees and trustee boards, advisers, asset managers, regulators and other interested parties who all play a part in providing services to schemes and pensions to members.

The 21st Century has seen a significant overhaul of pensions, triggered by a combination of: greater focus on the economic impact of an ageing population and a culture of low savings; further pension protection scandals; recognition of funding gaps; the economic crisis and market failures.

The Main Challenges

The macro-economy: the economic environment continues to be very challenging for DB pension schemes, with record low gilt yields and low interest rates placing ongoing pressure on scheme funding and investment returns. The impact of these challenges, which seem unlikely to go away in the near future, is to stretch the affordability of recovery plans, and the volatility in the size of deficits – which are now estimated at c. £300bn.

Accounting standards: it was the introduction of more stringent mark-to-market accounting standards that first quantified the potential volatility in the liabilities of schemes. These obligations when reported in company accounts and highlighted the size of some pension scheme deficits in relation to the financial strength of their company sponsor.

Health and Longevity: improvements in public health, medication and nutrition have driven significant improvements in longevity over the last Century. Between 1900 and 2000 life expectancy increased by over 30 years for both men and women (from 44 to 76 years for men, and 48 to 81 years for women).

Regulation: the regulation of pension schemes has, for many reasons increased significantly over the last thirty years. Taken individually the impact of each change is difficult to ascertain, however the cumulative consequence has clearly been to greatly increase complexity, costs and the regulatory burden in the UK.

Examining the Challenges

The nature of DB schemes means they should have the capacity to deliver efficient management of longevity risk, achieve economies of scale, deliver long-term investment returns and provide adequacy of income in retirement.

In the challenging economic, regulatory and social environment schemes and employers face significant challenges to deliver these goals. The DB Taskforce is seeking to examine these issues within three broad categories:

Efficiency, Capital Allocation and Benefits.

Efficiency: a number of factors affect the efficient running of pension schemes; from day to day administration of benefits and systems, through to the appointment of fund managers and the implementation of investment strategies.

How efficiently in terms of cost, time and value that these tasks can be carried out or managed impacts how well a scheme performs and in the long-term how well placed it is to pay benefits to members.

Another key consideration is the impact of the considerable variation in size and scale amongst funded pension schemes which is unique to the UK system. This diversity is a product of the regulatory landscape and employer practices, and has over time, led to a wide range of plan designs and approaches - all of which require different levels of governance, trustee capability and investment strategies.

Capital Allocation: DB pension schemes hold over a trillion pounds of assets. This is an enormous sum of capital, which allocated effectively can serve both the long-term funding needs of pension schemes, provide a significant boost to economic growth and support intergenerational equity.

However, at present there appear to be a number of factors, some mutually reinforcing, which inhibit a closer correlation between pension scheme investing and economic growth, including asymmetry of information between investors and fund managers, short-termism, herding and regulatory requirements.

Employers with DB deficits to fund can find themselves with a Hobson’s choice. They may wish to choose alternative ways to allocate their finite capital, possibly with better long-term results, but they are disinclined to invest in business growth fearing the impact of pension deficit rises on their balance sheet.

Benefits: the impact on the scheme members of the recent and differing cases of BHS and the British Steel Pension Scheme has demonstrated the funding challenges facing many DB schemes. It has also highlighted the risk that pension benefits may not in all cases be paid in full and that many members will continue to need protection through the Pension Protection Fund (PPF).

Funding challenges and binary outcomes naturally seem to lead to a trade-off between the interests of cohorts of employees within the same company. The employer is effectively forced to choose between the interests of its members within the DB pension scheme and its DC members, which in turn leads to issues around intergenerational equity due to the typical demographic make-up of these groups.

This Call for Evidence

We would encourage anyone with an interest in the future of DB provision to engage with this Call for Evidence, and in particular invite responses from Government, regulators, employers, scheme members, trustees and trustee boards, representative bodies, think tanks and industry stakeholders.

A summary of questions on which we would welcome your feedback is set out on page 35.

Please submit your response by 15 July 2016 to DBTaskforce@plsa.co.uk

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ABOUT THE PENSIONS AND LIFETIME SAVINGS ASSOCIATION

The Pensions and Lifetime Savings Association is the national association with a ninety year history of helping pension professionals run better pension schemes. With the support of over 1,300 pension schemes and over 400 supporting businesses, we are the voice for pensions and lifetime savings in Westminster, Whitehall and Brussels. Our purpose is simple: to help everyone to achieve a better income in retirement. Our pension fund members own nearly £1 trillion of assets and our responsible for the pensions of 16 million people.

ABOUT THE DB TASKFORCE

The DB Taskforce was established by the Pensions and Lifetime Savings Association, in March 2016, to undertake a review of the challenges currently facing defined benefit (DB) pension schemes, and to make recommendations to Government and regulating authorities to (a) help ensure the sustainability of open DB schemes; and (b) help closed DB schemes run off more efficiently and ultimately secure member benefits.

In reaching its recommendations the DB Taskforce will:

- examine the challenges facing DB schemes and their potential impact on members' benefits, the health of sponsoring employers workplace pensions provision, and the wider economy;
- assess a broad set of solutions to the many and varied challenges facing DB schemes and, in particular DB schemes' own assessment of the feasibility, impact and risks associated with these various solutions; and
- consider the balance between scheme members, employers and other employees.

This paper sets out a series of questions on which we are seeking views and empirical evidence. In particular we would welcome feedback relating to:

- the challenges facing DB schemes;
- the impact on the macro-economic environment; and
- the available solutions.

ABOUT THIS CALL FOR EVIDENCE

We encourage anyone with an interest in the future of DB pension provision to engage with this Call for Evidence, and in particular invite responses from government, regulators, employers, scheme members, trustees and trustee boards, representative bodies, think tanks and industry stakeholders.

HOW TO RESPOND

Please submit your response by **15 July 2016 to** **DBTaskforce@plsa.co.uk**

We will not include contributions to this Call for Evidence in our report without prior permission.

Alongside this Call for Evidence, we will be undertaking further engagement with stakeholders, including scheme sponsors and members, industry groups and academic experts.

2. THE DB LANDSCAPE

The future of DB schemes has been subject to debate for some time in the industry, in the press and amongst individual scheme members. The recent high profile and differing cases of BHS and the British Steel Pension Scheme have brought the debate into even sharper focus and prompted Government interventions.

The scale and range of the challenges facing schemes is significant: sizable and protracted deficits; increased longevity; a succession of domestic and European regulatory changes; and the impact of the most significant global recession in seventy years.

Taken individually or collectively these issues have often seemed too complex or enormous to address.

The DB Taskforce firmly believes that with around 16 million[1] members in DB schemes owning over £1 trillion of assets, ensuring we have an effective long-term and sustainable pension system is critical for employers, members, and the government as well as for the wider economy.

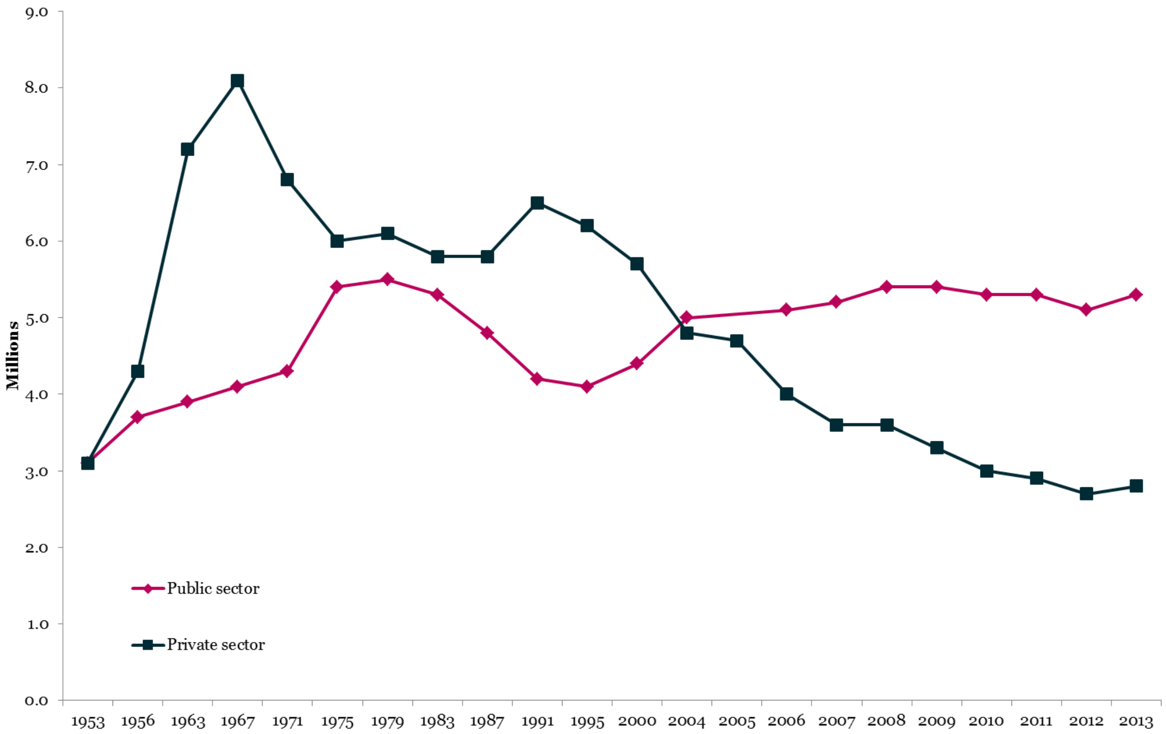
[1] 16 million comprised: 11 million in the Pension Protection Fund universe, source – Purple Book 2015, chapter 2; and, 5m in the Local Government Pension Scheme, source – Local Government Pension Scheme Advisory Board Annual Report

A (SHORT) HISTORY OF DB PROVISION

The post-war years saw a boom in employment and the rise of DB occupational pension schemes as the means for employers to provide retirement benefits to their workforce.

By the mid-1950s over six million people were active scheme members, and the number continued to grow until peak membership reached in excess of twelve million members in the late 1960s.

FIGURE 1: ACTIVE MEMBERS OF OCCUPATIONAL PENSION SCHEMES: BY SECTOR, 1953 TO 2013



Source: Occupational Pension Schemes Survey, Office for National Statistics

Providing DB schemes offered many benefits to employees, and employers – who considered provision as a means to attract, encourage and manage the workforce. The growth of DB was also fostered, directly and indirectly, by the regulatory landscape which provided, amongst other incentives, corporation tax efficiencies at a company level and major income tax advantages for senior managers - in an era of significantly higher marginal tax rates than today.

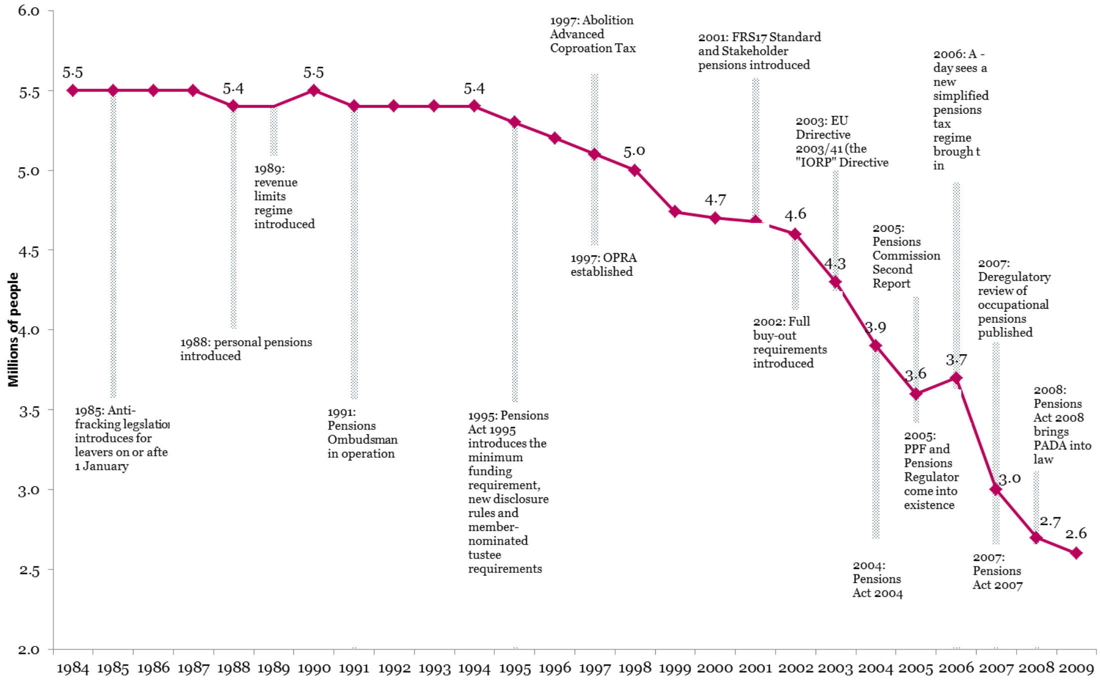
The broader regulatory context, which tolerated the unequal treatment of women, provided discretionary spouses benefits, and did not require the preservation of benefits for early leavers also acted a dampening factor on the cost of provision, and provided comfort to employers about the affordability of the promises being made. The 1970s ushered in a number of changes to the regulatory landscape, and removed many of the inequalities and in-built cross-subsidies that had been prevalent in previous decades. These changes included:

- equal access to pensions for women;
- the introduction of refunds of contributions;
- the preservation of some benefits;
- the introduction of the Occupational Pensions Board;
- changes to contracting out and the introduction of GMPs.

The result of these (and other changes), alongside increasing pressure on schemes to pay discretionary pension increases to offset the inflationary shocks common to the decade began the process of providing better protection for members, but also began to increase the costs of DB provision.

Nonetheless, the 1970s remained a period of wide-scale DB provision, without significant trends in scheme closure or shift from employers into alternative means of pension provision. Schemes continued, by and large, to be protected from rising costs due to the discretionary nature of indexation promises (with pensioners bearing the risk) and the relative immaturity of schemes, which still contained a significant proportion of active workers to pensioners.

FIGURE 2: REGULATION AND DB DECLINE - CAUSE AND EFFECT?



Despite increases in the underlying costs of provision, and growing recognition of steady increases in longevity, the 1980s and early 1990s continued to see little change in employers' attitudes to DB; although the era also saw the rise of personal pensions. Increases in costs during this period were considered easily affordable in the midst of a sustained equity 'bull run' that was returning in excess of ten per cent in real returns every year. During the peak of this period many schemes took lengthy contribution holidays, reduced surpluses to avoid tax penalties or made generous early retirement promises in lieu of redundancy.

The rise in the costs of provision became apparent in the mid-late 1990s when, following the Maxwell scandal, the Pensions Act 1995 ushered in a new regulatory framework. It included a number of measures designed to strengthen scheme governance and member protection, including:

- the Minimum Funding Requirement (MFR);
- the creation of the Occupational Pensions Regulatory Authority (OPRA);
- section 75 Debt requirements;
- minimum mandatory levels of indexation;
- section 67 prohibition on amendments of accrued rights;
- requiring minimum levels of Member Nominated Trustee representation

These changes improved transparency regarding levels of scheme funding, and did hasten the closure of some schemes, however the overall levels of funding of schemes on a MFR basis was still considered to be healthy enough to absorb the abolition of pension tax credits announced in the 1997 Budget.

This orthodoxy began to change with the collapse of the dot com bubble at the turn of the century, which ended the extended bull run in the equity market, and ushered in a return to equity returns which more closely matched trends throughout the twentieth century (of c. 5%).

That trend remained relatively stable, up to the global financial crisis of 2008, the consequences of which are discussed below.

A changing landscape

The 21st century has seen a significant overhaul of pensions, triggered by a combination of: greater focus on the economic impact of an ageing population and a culture of low savings; further pension protection scandals; recognition of funding gaps; the economic crisis and market failures.

Key recommendations from the Pensions Commission in 2002-2005 led to the Pensions Act 2004, and prompted increased Government focus on pension policy – where it has remained, and has led, across different Governments to the Pensions Acts 2007 and 2011 and most recently the Pension Schemes Act 2014.

These acts have provided the legislative basis for the complete reform of pensions in the UK. For DB schemes key changes have included:

- The creation of the Pension Protection Fund, the Pensions Regulator and the National Employment Savings Trust.
- Automatically enrolling eligible workers into workplace pension schemes
- The introduction of legislation permitting 'Defined Ambition' schemes
- The introduction of 'Freedom and Choice'

These changes in regulation as well as other factors, including the impact of accounting standards, have highlighted the challenges associated with DB provision and coincided with the steady decline in the number of open schemes.

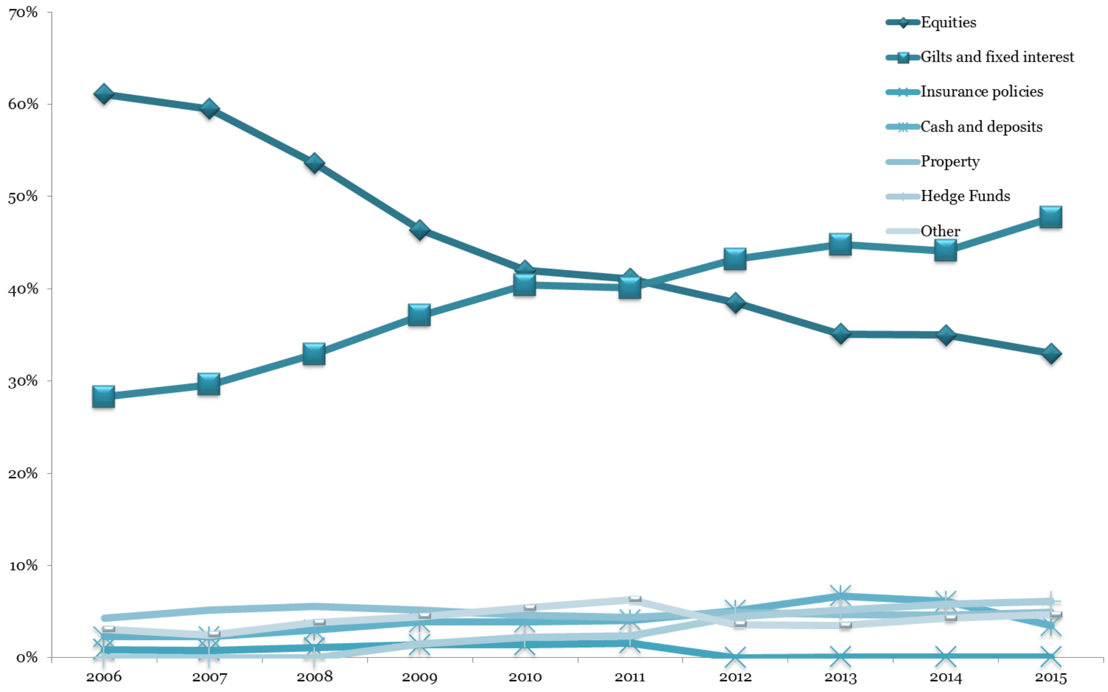
SUMMARY OF THE MAIN CHALLENGES FACING DB SCHEMES

The macro-economy

The economic environment continues to be very challenging for DB pension schemes, with the effects of quantitative easing – which increased liabilities by about 20% following the first asset purchases and further again in subsequent rounds[2] – and ongoing record low gilt yields and low interest rates which have placed ongoing pressure on scheme funding and investment returns.

The impact of these challenges, which are unlikely to go away in the near future, is to stretch recovery plans, place further pressure on employer contributions and exacerbate the volatility in the size of deficits – which are now c. £300bn.[3]

FIGURE 3: DB AVERAGE ASSET ALLOCATION IN TOTAL ASSETS



Source: The Purple Book, TPR

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[2] PLSA, Exceptional Times, Exceptional Measures? March 2012

[3] PPF7800 Index

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The effect of this operating environment has led many schemes and sponsors to examine whether their funding strategy and investment approach is appropriate given the outlook for macro-economy.

For many schemes, even those which have taken steps to de-risk or entered into arrangements to better match their assets and liabilities, the task of finding the right strategy to close scheme deficits has become extremely difficult.

When it is not possible for schemes to close their deficits by relying on steady investment returns, alternative means are needed. In recent years, more often than not, that has meant through increased employer (and in some cases employee) contributions, one-off or multiple deficit repair contributions or pledging assets as collateral.

In a period of economic pressure this behaviour has a number of consequences including placing constraints on the activities of the sponsoring employer and their ability to borrow and invest. All of which may ultimately hinder the broader economy.

To some extent, the general trend toward de-risking by schemes may also fuel pro-cyclical outcomes, with a shift from risk bearing assets, such as equities, into 'safer' assets like gilts having a detrimental effect on long-term market performance and long-term investments.

Accounting Standards

The introduction of mark-to-market accounting standards through the Financial Reporting Standard 17 (FRS17), and International Accounting Standard 19 (IAS19) and their successor updates is often cited as a significant contributory factor, as highlighted in Figure 2, behind the closure of DB pension schemes.

The requirements quantified the liabilities of schemes for the first time but the mark-to-market basis adopted introduced volatility into their measurement. When reported in company accounts highlighted the size of some pension scheme deficits in relation to financial strength of their company sponsor. For many finance directors and boards this led to the realisation that their scheme dwarfed the market value of the company. This realisation, combined with the ensuing deficit volatility led to a greater focus from employers on minimising their ongoing risk and liabilities and the accelerated closure of many schemes.

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Whether this approach to accounting appropriately reflects the challenges schemes face and the very long-term nature of pensions promises and their long-term financial viability is an open question.

Health and longevity

Improvements in public health, medication and nutrition have driven significant improvements in longevity over the last Century. Between 1900 and 2000 life expectancy increased by over 30 years for both men and women (from 44 to 76 years for men, and 48 to 81 years for women)[4]. In 1901 the proportion of the population over 50 was around 15 per cent; in 1951 it had risen to 25 per cent and 31 per cent by 1991[5]. Not only are more people likely to receive their pension but they were likely to live longer in retirement. Today a man retiring at the age of 65 can expect to live for 18 years in retirement and a woman for 21 years[6]. In comparison a man retiring at 65 in 1950 would have expected to live for 12 years and a woman 14 years.

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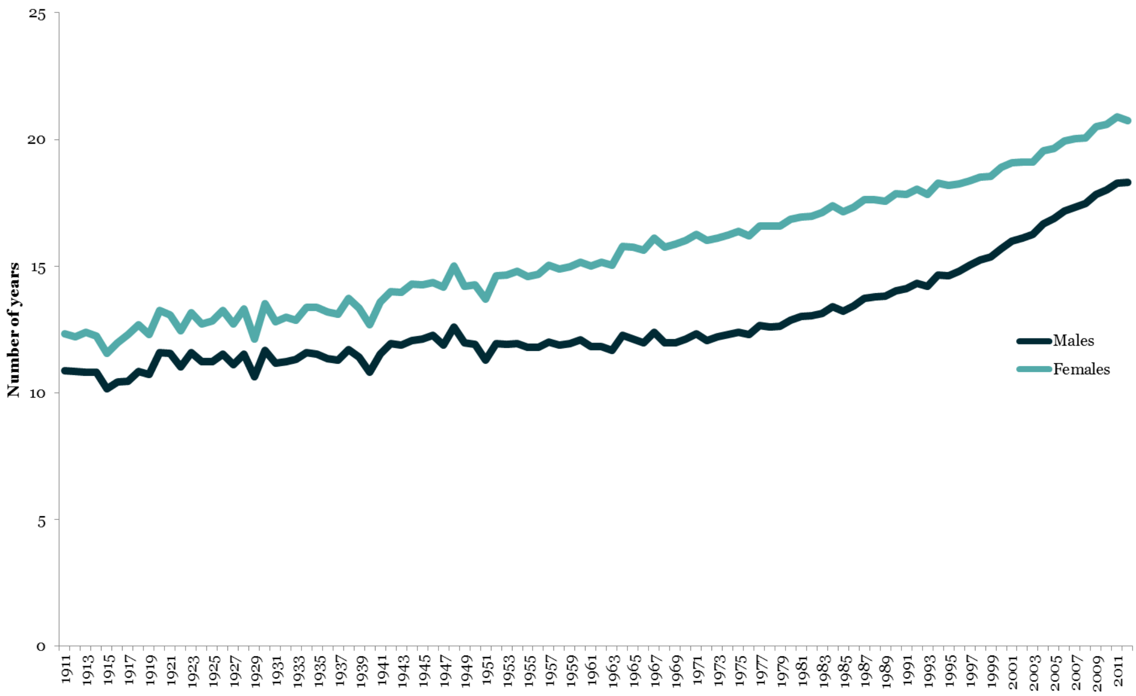
[4] ONS, Mortality in England and Wales: Average Life Span 2010, 2012
[5] House of Commons Library, A Century of Change: Trends in UK Statistics since 1900, 1999
[6] ONS, Life expectancy at birth and at age 65 by local areas in the United Kingdom, 2006-08 to 2010-12, 2014

FIGURE 4: UK LIFE EXPECTANCY AT 65 FOR MEN AND WOMEN 1911 - 2012



Source: ONS

For employers and society these increases in longevity have come with many benefits including greater productivity and longer working lives, but they have also increased costs and uncertainty. The cost for individual schemes may vary considerably, but overall it is estimated that each additional year of longevity increases an individual's pension liabilities by 3 to 4 per cent[7] .

[7] Coughlan G., D. Epstein, A. Ong, A. Sinah, I Balevich, J. Hevia-Portocarrero, E. Gingrich, M. Khalaf Allah and P. Joseph, (2007), LifeMetrics
A Toolkit for Measuring and Managing Longevity and Mortality Risks, JP Morgan, London.

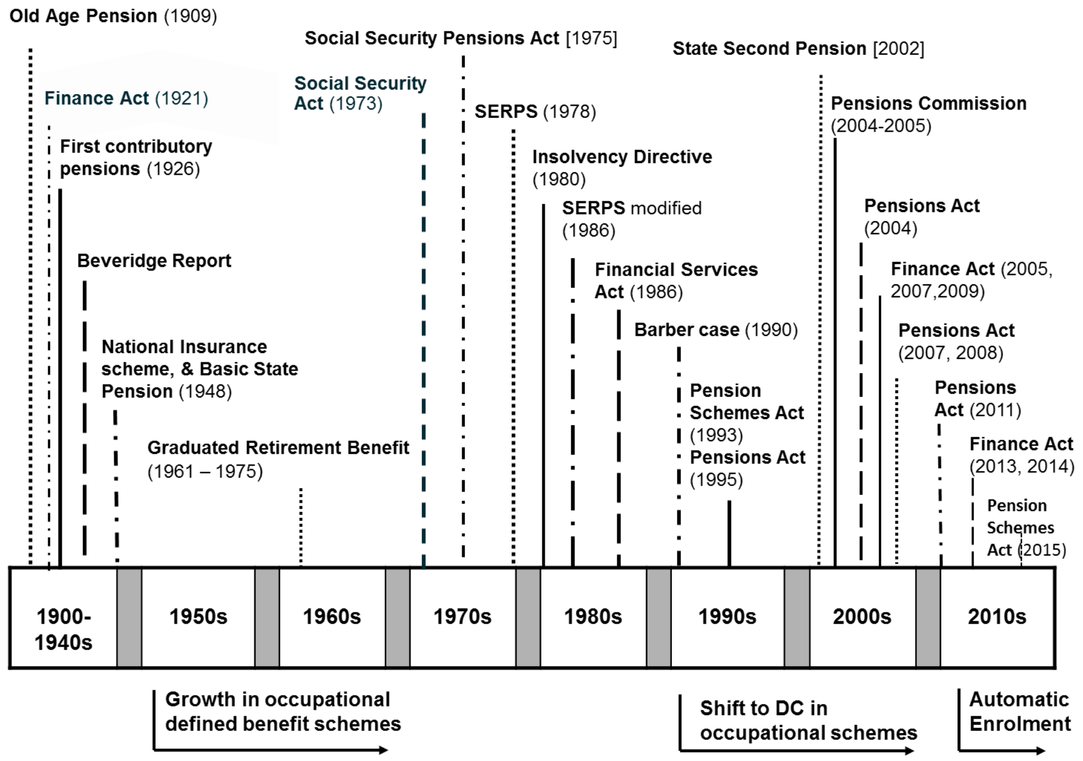
Regulation

As discussed above, the regulation of pension schemes has, increased significantly over the last thirty years - with over 850 legislative or regulatory changes since 1995 alone.

Taken individually the impact of each change is difficult to ascertain. However the cumulative consequence has clearly been to greatly increase complexity and costs and make the regulatory burden in the UK far greater than in other OECD countries.

The consequences of this complexity, layered over many years, has been applied in differing manners across all 6,000 funded DB schemes, and has also proven to be a significant factor in the reduction in flexibility available to schemes to change their rules, to simplify their administration or the structure of their benefits.

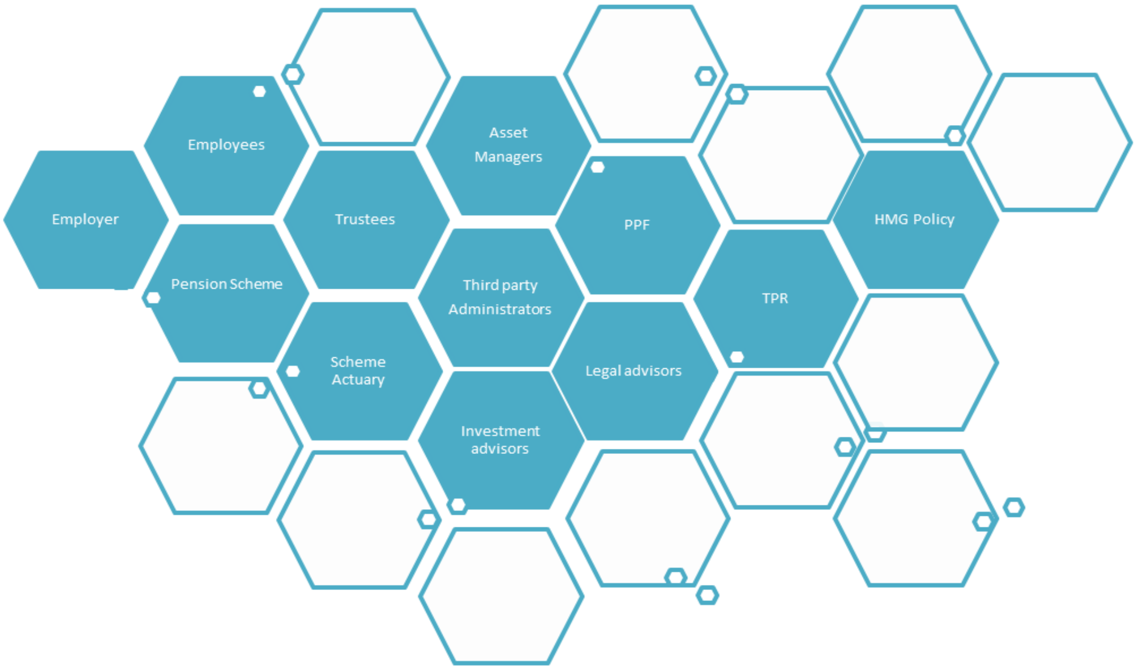
FIGURE 5: TIMELINE OF SIGNIFICANT LEGISLATIVE CHANGE



DB TODAY

The DB landscape today is incredibly complex, with a wide range of schemes, employers, trustees and trustee boards, advisers, asset managers, regulators and other interested parties all playing a part in providing services to schemes and pensions to members. Navigating this system with its range of stakeholders, with competing roles, objectives and motivations is increasingly challenging, and unlikely to get any easier in the near future. This level of complexity also extends the length of supply chains, with a range of associated costs and hurdles to overcome to effectively achieve value for money and efficient outcomes.

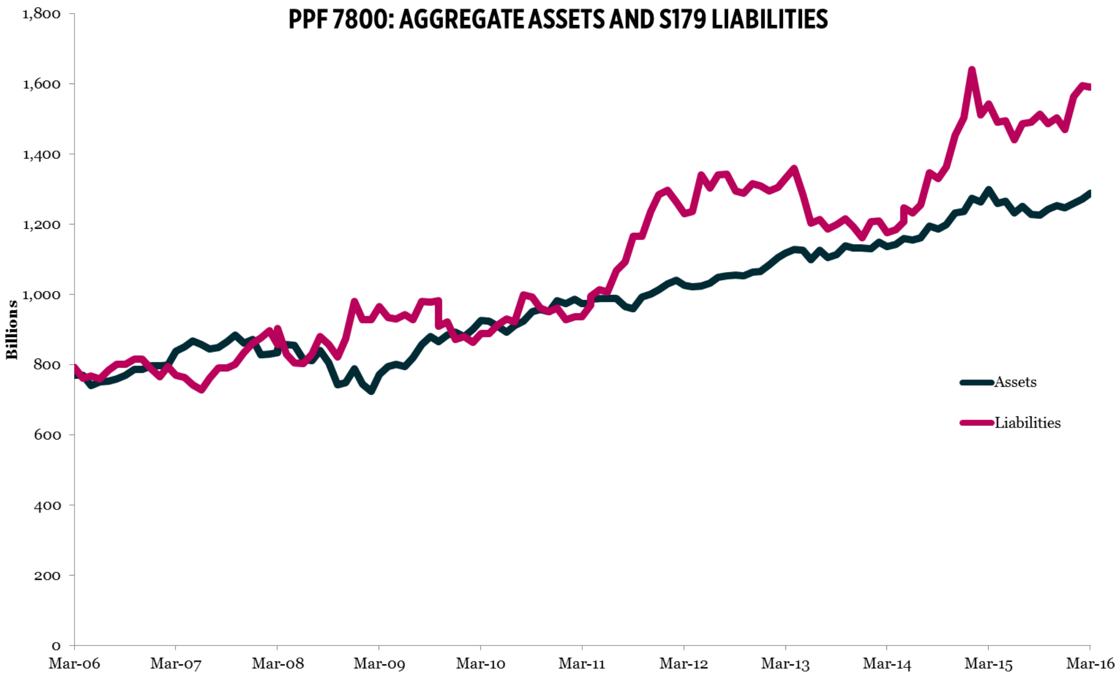
FIGURE 6: DB STAKEHOLDER MAP



There are currently more than 6,000 UK private sector DB schemes and in excess of 100 funded public sector schemes, the bulk of which are in the Local Government Pension Scheme (LGPS).

At present, the majority of these funded schemes are in deficit, with 4,804 (of 5,945) in the PPF 7800 Index are not fully funded on a s179 basis and the 2015 LGPS Annual Report publishing an aggregate funding level of c.80%.

FIGURE 7: PPF 7800: AGGREGATE ASSETS AND S179 LIABILITIES



Source: PPF 7800 Index

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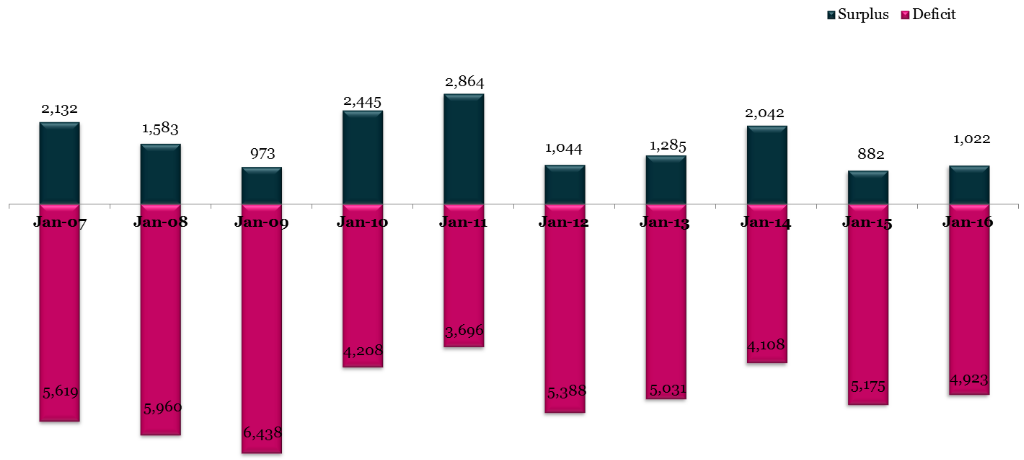
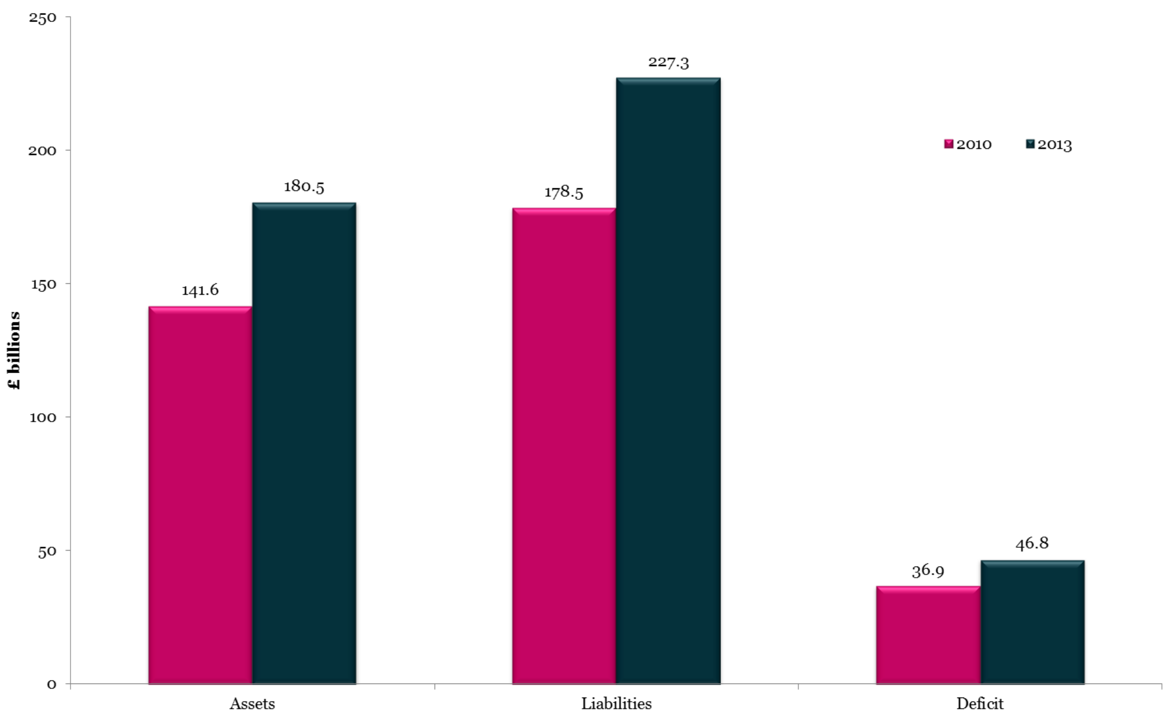
FIGURE 8: PPF 7800: NUMBER OF SCHEMES IN SURPLUS AGAINST NUMBER OF SCHEMES IN DEFICIT



Source: PPF 7800 Index

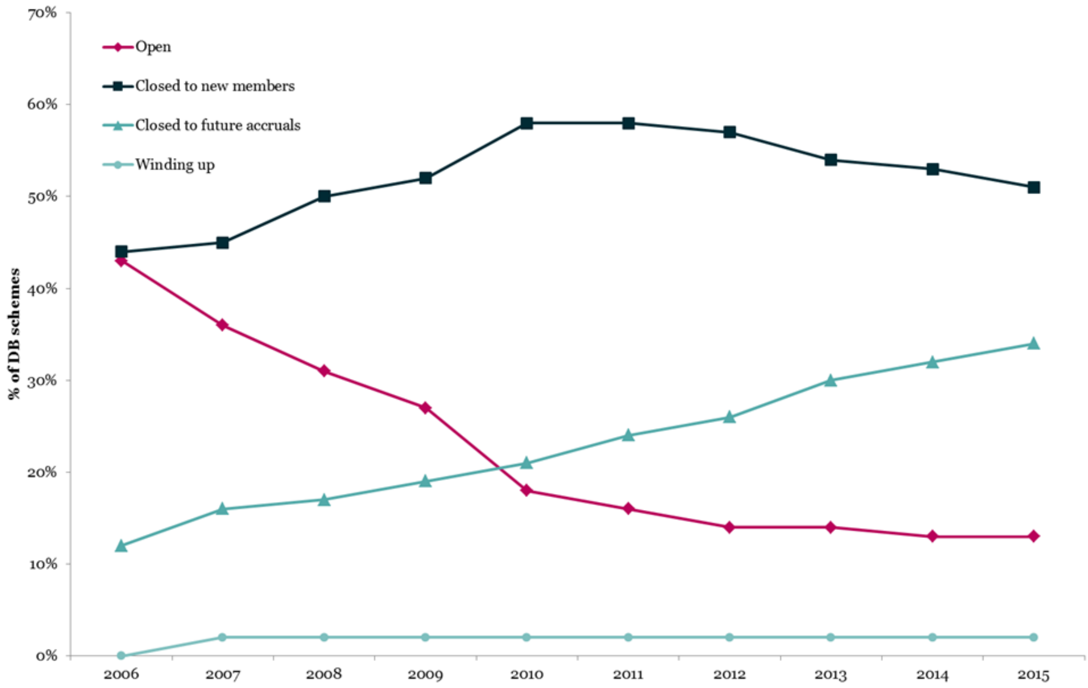
FIGURE 9: LGPS FUNDING POSITION 2013



Source: The LGPS Advisory Scheme Annual Report,2013

As set out above, there are a wide range of reasons for these deficits. Their emergence over the last ten years has contributed to the continued, steady closure of DB schemes; from a relatively healthy 43 per cent of open schemes in 2006 to only 13 per cent remaining open today. Those that are better funded are on average larger and more mature[8].

FIGURE 10: DB SCHEME STATUS 2006 – 2015

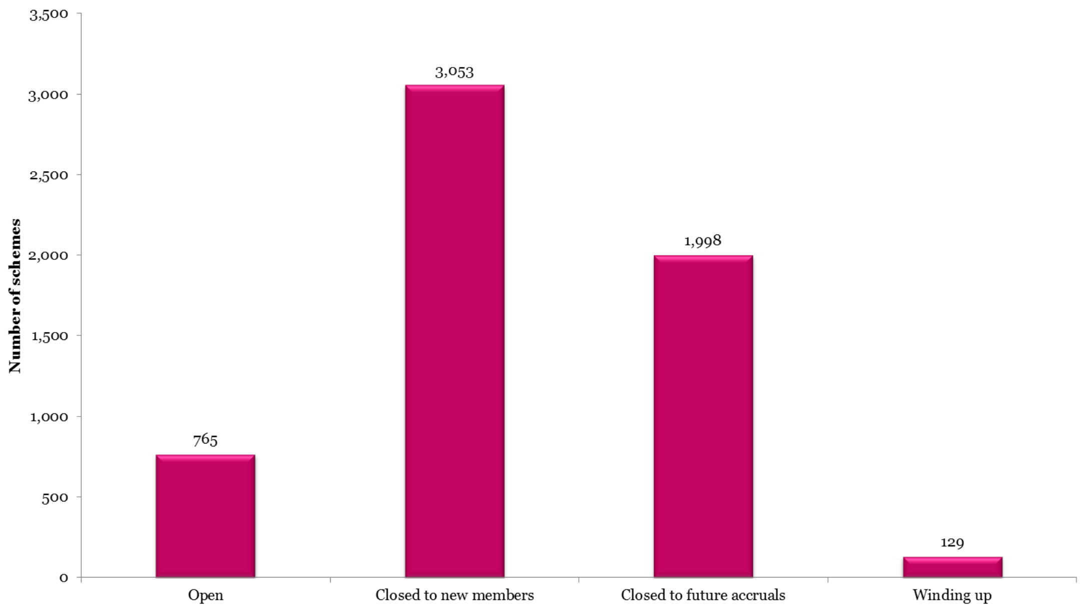


Source: The Purple Book, TPR

Over the same period the majority of schemes have closed entry to new members whilst an increasing number of schemes are also closed to future accrual.

[8] The Purple Book

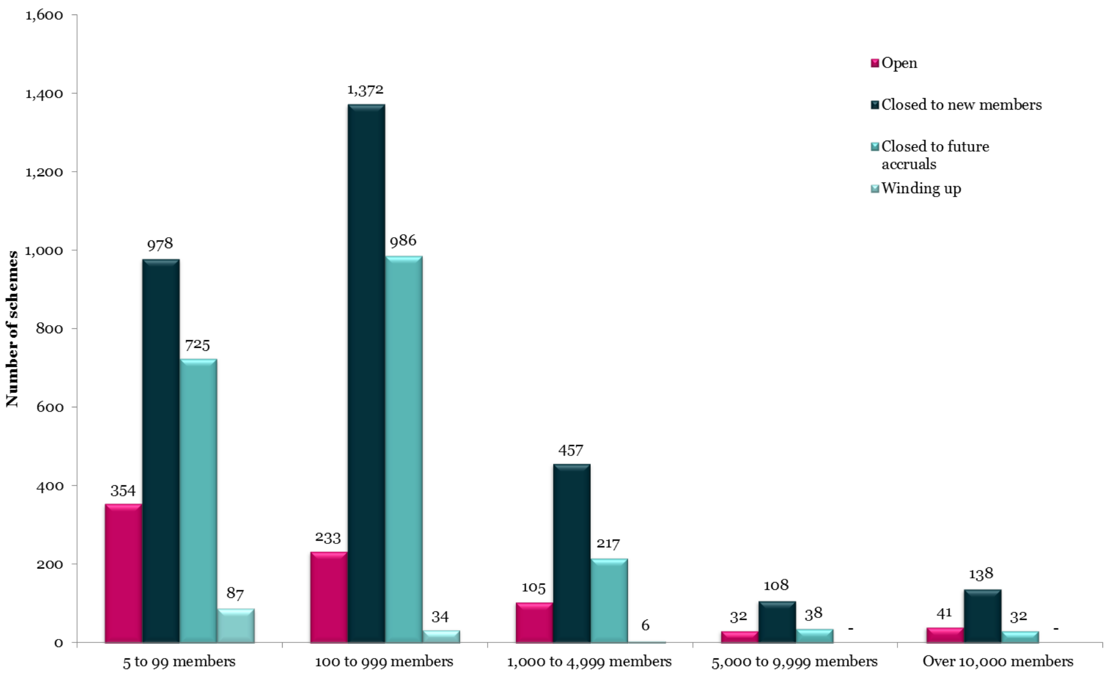
FIGURE 11: NUMBER OF DB SCHEMES BY SCHEME STATUS



Source: The Purple Book, TPR

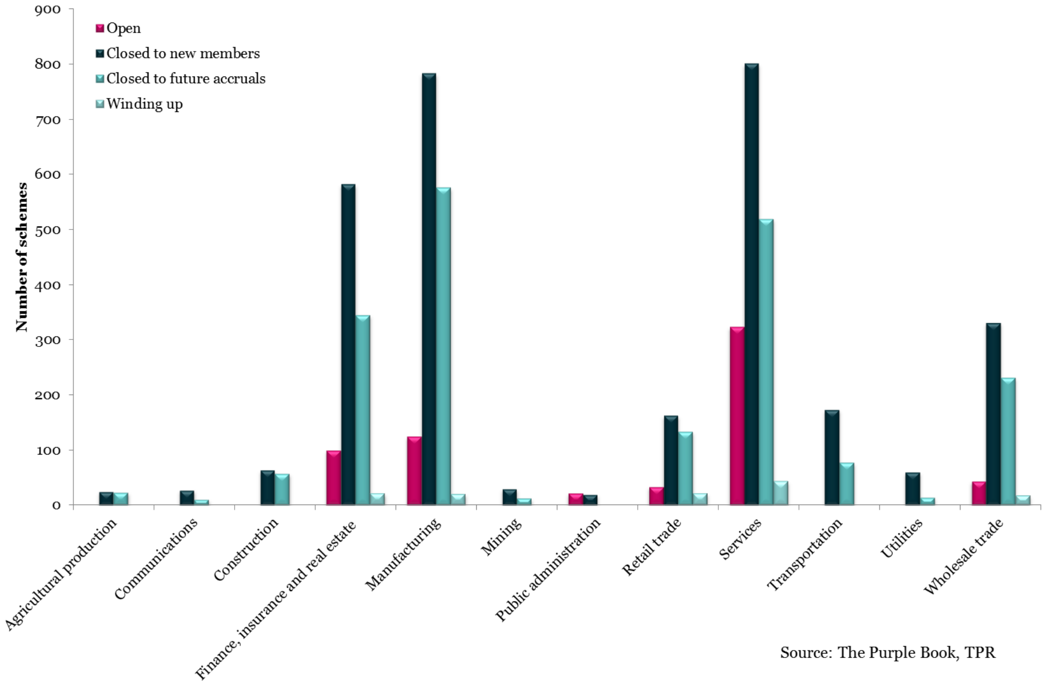
Although the bulk of DB assets and liabilities continue to be with schemes sponsored by larger companies, the breadth of employer provision remains significant in size, scale and across different industries.

FIGURE 12: NUMBER OF DB SCHEMES BY MEMBERSHIP SIZE



Source: The Purple Book, TPR

FIGURE 13: DB SCHEME STATUS BY INDUSTRY



Source: The Purple Book, TPR

Since the creation of the new regulatory framework in 2005 funding requirements have driven record levels of employer contributions, which have targeted closing funding gaps. Even with 10 years of regulatory oversight, and employer payments, at the end of April 2016, the section 179 deficit across the DB scheme universe stood at c. £300bn, whilst scheme recovery plans have remained at 8.5 years on average.

FIGURE 14: AVERAGE RECOVERY PLAN

TPR Tranche	1	2	3	4	5	6	7	8
Valuation period[9]	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2011/12	2012/13
All schemes	8.1	7.7	8.6	9.7	8.5	7.8	8.5	8.5

[9] Each tranche represents schemes with a Valuation period between 22 Sept to 21 Sept of given years

Rising contributions have in many cases been playing 'catch-up' with rising liabilities, principally driven in recent years by weak returns, low interest rates, the impact of quantitative easing and unstable markets.

In the same period over 700 schemes have entered the Pension Protection Fund - which now provides compensation to over 200, 000 members. Eligible schemes have paid over £5bn in levies to help fund this protection.

DB 'status quo' projections

It is very difficult to make accurate forecasts about the future of any industry, not least one that that has seen such rapid change over the last 20 years, and is so acutely intertwined with the macro-economy and broader societal changes in the ageing Western world.

Several expectations, based on the current landscape and trends in pension provision are however generally accepted as fact. The first is that it is very unlikely that private sector employers will begin to provide a new raft of traditional DB pensions.

Secondly, we acknowledge that given the size and scale of DB provision millions of members will be receiving pensions from funded DB schemes for many decades to come; and in public sector DB provision may well extend into the next century.

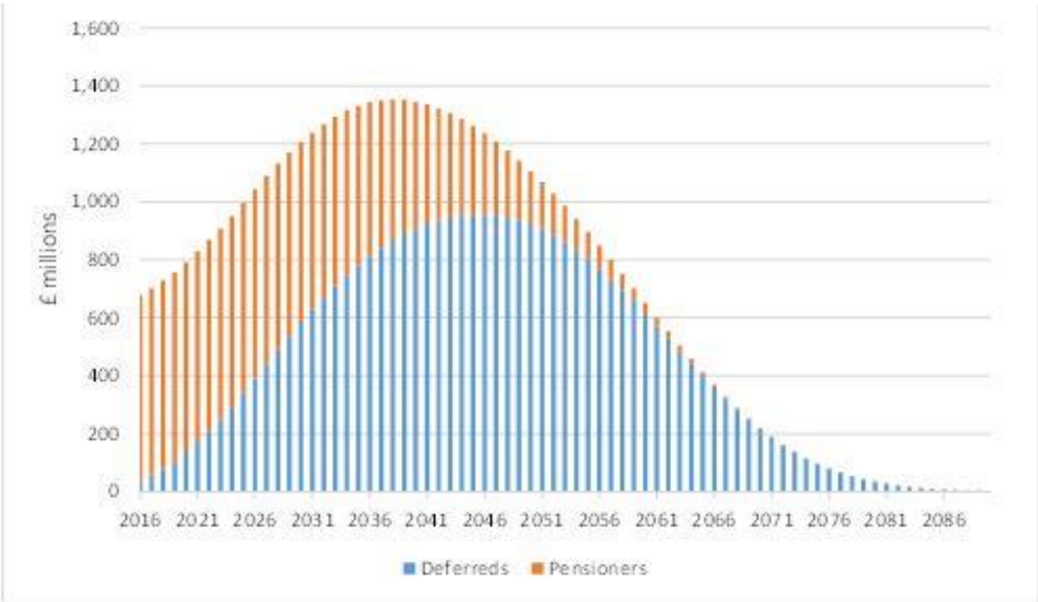
Following a sharp decline in the number of open schemes in the first half of the last decade, levels of scheme closure have stabilised over recent years. However, private sector DB provision remains vulnerable, and a reversion to accelerated scheme closure remains a risk given the current challenges and ongoing economic risks.

Assuming a direct analogue of the levels of claims the PPF has faced over the last ten years would also indicate a further 500 – 1000 DB scheme sponsors will have suffered an insolvency event, and their schemes will have entered the PPF.

Over the same period, we may also expect to see a steep increase in the cash-flows from DB schemes to members as their demographic profile reaches maturity[10]. In the same period we can expect the increase in DC membership to mean that more assets will be held in UK defined contribution schemes than in DB schemes.

[10] The chart below shows PPF cash flow projections adjusted to approximately reflect the increases in deferment and retirement that schemes in the DB universe provide.

FIGURE 15: PPF PROJECTTED CASHFLOWS WITH THREE PER CENT REVLAUTION AND INDEXATION



If we consider the chart above, then we may forecast a situation whereby schemes currently expected to complete their recovery plans in the mid-2020s will simultaneously be facing increasing drawdown from scheme assets to pay pensions.

The third, expectation is that in the next 10-20 years we must expect another or several economic shocks, and whether they are mild recessions or a more significant global event like 2008 they will have an effect on the health of DB sponsors and pension scheme liabilities.

These changes may fundamentally alter the pension landscape, the shape of member benefits and the wider economy. The period over which this change happens, the impact cash flow demands will have on the sponsors of both DB and DC schemes (where contributions can be expected to rise) will be important considerations for all our economic well-being, members' security in retirement and intergenerational equity.

In the following section we seek to examine the challenges that schemes are facing in detail. To ensure we develop tangible, long-term solutions to the identified challenges we believe it will be important to consider the context in which they will be applied, whether that it is the economic, demographic or societal trends or considerations

Question 1a: Do you consider the projected view of the future of DB schemes and the pensions landscape set out in this Call for Evidence to be broadly right?

Question 1b: If so, are there other factors which have contributed?

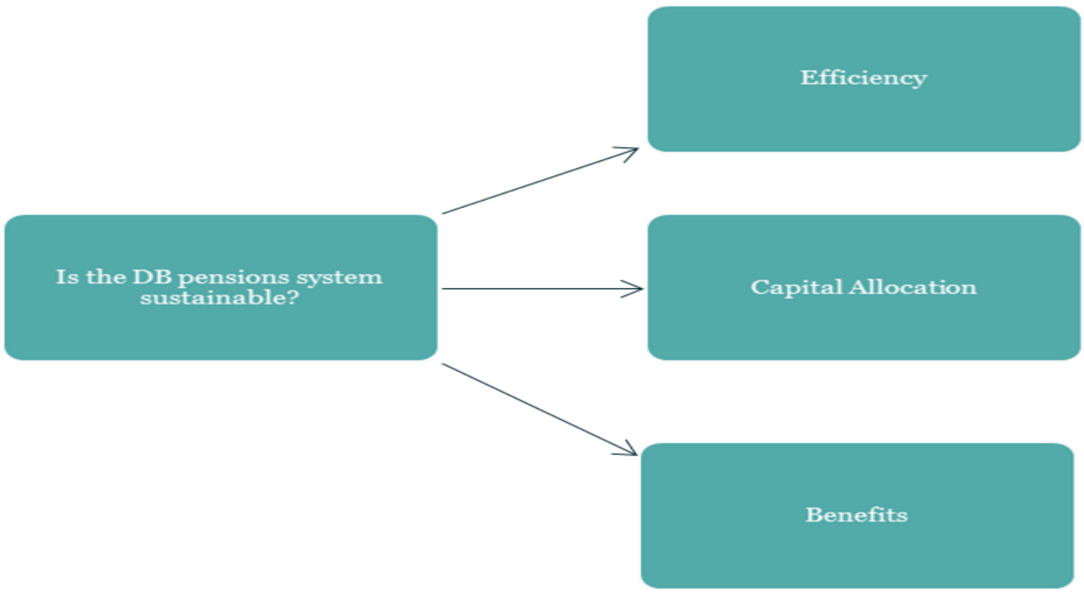
Question 1c: If not, what other factors should be taken into consideration?

3. EXAMINING THE CHALLENGES

The nature of DB schemes means they should have the capacity to deliver the very efficient management of longevity risk, achieve economies of scale, deliver long-term investment returns and provide adequacy of income in retirement.

Successfully delivering these outcomes is however not easy, even in the best of times. In the current challenging economic, regulatory and social environment schemes and employers face even greater challenges.

For the purposes of this Call for Evidence and to examine the sustainability of DB provision we have grouped the challenges (described below) within three broad categories: Efficiency, Capital Allocation and Benefits:



EFFICIENCY

Defined as: the cost effectiveness of the day-to-day running of a scheme; the scheme's design and scale; its investment strategy and ability to execute this strategy.

A number of factors affect the efficient running of pension schemes; from day to day administration of benefits and systems, through to the appointment of fund managers and the implementation of investment strategies.

How efficiently in terms of cost, time and value that these tasks can be carried out or managed will impact how well a scheme performs and in the long-term how well placed it is to pay benefits to members.

The interaction between these tasks and the regulatory and legislative environment has a significant bearing on the demands on sponsors and schemes, and as highlighted above, has become increasingly complex over many decades and in particular in the last 15 years.

This increased complexity has a number of consequences for all those involved in pension provision, requiring greater time, skill, resource and governance in each and every aspect of scheme management.

> *Question 2a: What are the specific regulatory factors that impact the efficient running of DB schemes?*
>
> *Question 2b: What financial and operational impact do they have?*

The considerable variation in size and scale amongst funded pension schemes - with the very largest providing pensions to tens of thousands of members, managing billions in assets, and the smallest to dozens and millions - is unique to the UK system.

This diversity is a product of the regulatory landscape and employer practices, and has over time, led to a wide range of plan designs and approaches - all of which require different levels of governance, trustee capability and investment strategies.

There is however a correlation between the size of pension funds and the strength of their governance structures, the levels of available in-house or external expertise and effective scheme and investment management.[11]

The inefficiencies inherent in this wide variation of schemes has been subject to much debate, and learning the lessons from international best practice (eg the Netherlands, Canada) has in recent years been a real focus for the industry in particular how to achieve scale or accessing the benefits of scale across a greater proportion of schemes. Both of these goals are at the heart of recent initiatives such as the Pensions Infrastructure Platform (PiP), and the Government's reforms to the Local Government Pension Scheme or greater direct collaboration amongst schemes.

Question 3: What are the governance issues, if any, that impact the efficient running of DB schemes?

Question 4: What issues, if any, impact DB schemes, achieving efficient and effective investment decisions and outcomes? How could they be overcome?

Question 5: Are there any other issues affecting the efficiency of pension schemes?

[11] TPR trustee toolkit

CAPITAL ALLOCATION

*Defined as: the allocation of company investment capital between employees; the balance between company growth and scheme sustainability; and ultimately how scheme capital is invested in the macro-economy***.**

Funded pension schemes manage over a trillion pounds of assets. This is an enormous sum of capital, which allocated effectively can serve both the long-term funding needs of pension schemes, support intergenerational equity and provide a significant boost to economic growth.

However, at present there appear to be a number of factors, some mutually reinforcing, which inhibit the closer correlation between pension scheme investing and economic growth. They include:

- The requirement that Pension schemes are run on a prudent basis (often interpreted as risk-aversion)
- Trustee liability
- Three year valuation cycles
- Herding behaviour
- Asymmetry of information between investors and fund managers
- Regulatory drivers eg accounting standards

The trend over the last ten years away from equity holdings by pension schemes reflects many of these tensions. Although at a macro-level equity is a better means of fostering long-term economic growth and investment current funding drivers and regulatory pressures encourage individual schemes towards greater investment de-risking – which in turn may make the macro-economic environment weaker; the consequence of which may ultimately lead to poorer outcomes for members.

Question 6: Which specific economic or macro-economic factors are impacting DB schemes?

Question 7: Do you think greater alignment between the allocation of pension scheme assets and the macro-economy is possible? How should it be achieved?

Question 8: If not, why do you think this is not possible?

Generally, employers will only have a finite amount of capital to allocate between competing demands such as business growth, staff wages and funding pension benefits to their employees and returns to shareholders. For many employers, with DB deficits to fund, the current environment leaves them with a Hobson's choice. They may wish to choose alternative options, possibly with better long-term results, but they are disinclined to invest in business growth fearing the impact of short-term deficit rises on their balance sheet.

Question 9: How do you make decisions about prioritising the allocation of your capital?

Question 10: What are the consequences of these choices for your business, employees and your pension schemes?

BENEFITS

Defined as: the types of benefits being offered; their complexity; whether funding challenges are placing them at risk; and the potential trade-offs between different employee groups.

The impact on the scheme members of the recent issues faced by two large national employers has demonstrated the funding challenges facing some DB schemes. It has also highlighted the risk that pension benefits may not in all cases be paid in full; some members have and will end up receiving PPF levels of compensation.

In part, these topical examples reflect the binary nature of the current legislative framework: schemes will for the most part succeed in paying benefits in full for life or they will fail and scheme members will receive PPF compensation levels (for life).

There is no in-between for ongoing schemes - any conditionality to flex benefits (even temporarily), such as in the Netherlands, or historically in the UK, has long been removed from the legislative framework. In very limited circumstances this flexibility exists for schemes that are funded well enough to exit the PPF assessment period and can seek to buy-out higher levels of benefits than the PPF minimum. At that point the connection to the employer and the ability to improve the funding position over time has however long passed.

Funding challenges and binary outcomes naturally seem to lead to a trade-off between the interests of cohorts of employees within the same company. With the employer effectively forced to choose between the interests of retirees and active members or between members within the DB pension scheme and its DC members, which in turn leads to issues around intergenerational equity due to the typical demographic make-up of these groups.

This tension may exist for many years if the scheme has a typical recovery plan, potentially creating a cohort of employees without the benefits of DB or good or potentially better DC provision. In some cases we may expect this to come into sharp focus very soon, when the planned escalation in contributions for automatic enrolment schemes begins in 2017.

Question 11: What risks, if any, are there to the benefits promised in DB schemes being paid?

Question 12: What specific measures, if any, would help ensure scheme funding is more sustainable over the long-term?

Question 13: What, if any issues are faced by companies or schemes regarding intergenerational equity in pension provision? How could these issues be addressed?

Question 14: If you could resolve any of the issues you have raised in answer to the above questions, which would it be, and how?

Question 15: Are there any other issues affecting DB schemes that you wish to comment upon?

4. CONCLUSION

The 21st Century has seen a significant overhaul of pensions, but it is clear from recent high profile cases, and wider thinking that DB schemes face a number of significant challenges.

With millions of members relying on schemes and their employers' for a good retirement, and with schemes investing billions of assets in the UK and Global economy it is vital that these challenges are addressed.

If we are to find genuine, long-term solutions we must first develop a clear and comprehensive understanding about why these challenges are occurring and what impact they are having, at an individual and macro level.

In this Call for Evidence we have set out our views on some of the challenges and how we intend to explore their impact. We would encourage anyone with an interest in the future of DB provision to respond, and help shape this important piece of work.

SUMMARY OF QUESTIONS

DB pensions landscape

Question 1a: Do you consider the projected view of the future of DB schemes and the pensions landscape set out in this Call for Evidence to be broadly right?

Question 1b: If so, are there other factors which have contributed?

Question 1c: If not, what other factors should be taken into consideration?

Efficiency

Question 2a: What are the specific regulatory factors, if any, that impact the efficient running of DB schemes?

Question 2b: What financial and operational impact do they have?

Question 3: What are the governance issues, if any, that impact the efficient running of DB schemes?

Question 4: What issues, if any, impact DB schemes achieving efficient and effective investment decisions and outcomes? How could they be overcome?

Question 5: Are there any other issues affecting the efficiency of DB schemes?

Capital allocation

Question 6: Which specific economic or macro-economic factors are impacting DB schemes?

Question 7: What are the consequences of these choices for your business, employees and your pension schemes?

Question 8: Do you think greater alignment between the allocation of pension scheme assets and the macro-economy is possible? How should it be achieved?

Question 9: If not, why do you think this is not possible?

Question 10: How do you make decisions about prioritising the allocation of your capital?

Benefits

Question 11: What risks, if any, are there to the benefits promised in DB schemes being paid?

Question 12: What specific measures, if any, would help ensure scheme funding is more sustainable over the long-term?

Question 13: What, if any issues are faced by companies or schemes regarding intergenerational equity in pension provision? How could these issues be addressed?

Conclusion

Question 14: If you could resolve any of the issues you have raised in answer to the above questions, which would it be, and how?

Question 15: Are there any other issues affecting DB schemes that you wish to comment upon?

Please submit your response by 15 July 2016 to DBTaskforce@plsa.co.uk

We will not include contributions to this Call for Evidence in our report without prior permission.

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DB TASKFORCE MEMBERSHIP

Ashok Gupta (Chair)

Ashok divides his time between directorships and entrepreneurial activities.

He is a non-executive director of New Ireland Assurance, JP Morgan European Smaller Companies Trust, the Ethical Journalism Network and is a member of the FRC Codes and Standards Committee and Actuarial Council. He also chairs eValue Investment Solutions.

He was recently joint deputy chair of a Bank of England Working Group on Procyclicality. He was formerly Chairman of AA Insurance Services and Skandia UK, a Founder Director of the Phoenix Group, an NED of the Pensions Regulator and J Rothschild Assurance plc (now St James Place Capital).

His executive career has included Group Strategy Director at CGU (now Aviva), FD & Actuary of Scottish Amicable and a Principal of Towers Perrin.

Duncan Buchanan
Duncan is a partner in the London Pensions group of Hogan Lovells International LLP. Duncan advises both employers and trustees on the operation of work based pension schemes.. Duncan was until recently the President of the Society of Pension Professionals as well as being a member of the Association of Pension Lawyers' and a lapsed APMI.

Frank Johnson
Frank joined RPMI Railpen Investments in 2004 as Finance Director and became Managing Director, Investments in 2009, supporting the Trustee of the multi-employer rail industry pension schemes. He oversaw the investment business streams of RPMI and Railpen Investments, with assets under management of some £20 billion, until his retirement from RPMI in 2015.

Frank is an independent non-executive director at First State Investments, UK and at GO Investment Partners. He is also a non-executive director of the Pensions and Lifetime Savings Association and Chairman of the Association's DB Council. He also sits on the board of the Railway Benefit Fund, a registered charity.

Frank is a chartered accountant and holds a Commerce degree. Before joining RPMI, Frank held a number of finance director posts in the transport sector.

Paul Johnson
Paul has been director of the Institute for Fiscal Studies since January 2011. He is a visiting professor at UCL.

Paul has published and broadcast extensively on the economics of public policy including tax, welfare, inequality and poverty, pensions, education, climate change and public finances. He is author of major books on pensions, tax and inequality. He is one of the authors of the "Mirrlees review" of tax system design.

Paul has previously worked at the FSA and has been chief economist at the Department for Education and director of public spending in HM Treasury as well as deputy head of the UK Government Economic Service.

Paul is currently a member of the council and executive committee of the Royal Economic Society, is a member of the Climate Change Committee, member of the banking standards board and has just completed an independent review of consumer price inflation statistics for the UK Statistics Authority. He has previously served on the council of the Economic and Social Research Council. He was a founder council member of the Pensions Policy Institute and in 2010 he led a review of the policy of auto-enrolment into pensions for the new government.

Jackie Peel
Jackie has been UK & Ireland Benefits Director at Mars, a multinational food company, since 2011. Her principal responsibilities are for the DB (final salary and cash balance) and defined contribution pensions arrangements. She is also a member of the Mars Global Benefits Leadership Team which steers the company's strategic direction for benefits. Jackie has also held in-house roles as Associate Director of pensions at Barclays Bank and Pensions Director at VT Group plc (a service company specialising in government outsourcing contracts).

Before moving in-house, Jackie spent 17 years with Aon Hewitt in various roles specialising in Executive benefits and Global benefits.

Stephen Soper
Stephen has recently joined PwC in the role of Senior Pensions Adviser. He previously held the positions of Interim Chief Executive and Executive Director for DB (DB) Regulation on the board of the Pensions Regulator.

A Chartered Banker, Stephen began his career at RBS in 1986 within the international banking division and subsequently worked in executive positions at the Allied Dunbar Group, Zurich Financial Services, Eagle Star and Aon.

Paul Trickett
Paul is a non-executive director and trustee working with a number of organisations in the asset management and pensions fields. He is Chairman of Trustees of the Legal and General Mastertrust and of the Zurich UK pension scheme. He also chairs the advisory board of Muse Advisory. He has previously worked at Goldman Sachs asset Management, Towers Watson, where he ran the EMEA investment consulting business sand the British Coal pension schemes where he was Chief Executive.

Kevin Wesbroom
Kevin is an experienced pension consultant who has been advising pension clients for nearly 35 years. He is a qualified actuary and currently the UK lead for Global Risk Services, a fusion of actuarial and investment skills designed to help clients make sense of rapidly changing investment markets and new developments such as buy out, longevity and risk driven solutions.

He is practising what he has been preaching about phased retirement by working four days a week. If his views about the shape of future pensions are right, then his final phasing into full time retirement, and the end of private sector DB pension provision, could come together in 10 years time.

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Lesley Williams
Lesley is Group Pensions Director at Whitbread, with responsibility for Corporate pensions strategy and to the Trustee Company for the operation of the Pension Fund and its investments. The Whitbread pension fund has a closed DB and open DC section. Lesley has worked in the pensions industry for almost 30 years, with previous positions in Gateway Foodmarkets, Abbey National, the Pearl Group and Henderson Global Investors. She is a Fellow of the PMI and has an MBA. She has been a Council member of the Pensions and Lifetime Savings Association since 2009, and became chair of the association in October 2015.

TERMS OF REFERENCE

To undertake a review of the challenges currently facing funded defined benefit (DB) pension schemes, and make recommendations to Government which will (a) help ensure the sustainability of open DB schemes and (b) help closed DB schemes run off more efficiently and ultimately secure member benefits.

In reaching its recommendations the DB Taskforce will:

- examine the challenges facing funded DB schemes and the potential impact of these challenges on members' benefits, the health of sponsoring employers, workplace pensions provision and the wider economy;
- assess a broad set of solutions to the many and varied challenges facing DB schemes and, in particular DB schemes' own assessment of the feasibility, impact and risks associated with these various solutions; and
- consider the balance between scheme members, employers and other employees.

The Taskforce will seek evidence from DB schemes and their sponsoring employers as well as government, regulators, scheme advisers and a wide range of industry stakeholders in order to fully assess the impact of any proposals and build a consensus around solutions to support DB pensions.

The Taskforce will ultimately issue a report setting out the Taskforce's view of the DB landscape and set out recommendations which can be used by government, regulators, employers and the industry to help ensure a sustainable DB pensions system.

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