PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

SECURITY AND SUSTAINABILITY IN DEFINED BENEFIT SCHEMES: CONSULTATION RESPONSE BY THE PENSIONS AND LIFETIME SAVINGS ASSOCIATION

12 May 2017

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LIFETIME SAVINGS
ASSOCIATION

INTRODUCTION

We're the Pensions and Lifetime Savings Association; 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. We work to get more money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

This consultation asks the questions necessary to move forward the increasingly pressing debate about the future of defined benefit pensions in the UK and we are pleased that the Government has had the political will to address these questions head on.

The analysis carried out by the DB Taskforce and feedback from our members indicates that the affordability challenges facing DB schemes and employers are much more significant than the position set out in the Green Paper. The interim report published by our DB Taskforce last year identified how the challenges facing DB are posing a material risk to members' benefits, to employers and the wider economy.

This work showed that schemes in the weakest solvency group allocated by the Regulator had only a 32% chance of reaching full solvency funding after thirty years, whereas schemes in the strongest covenant group had a 90% chance. Schemes in the bottom two covenant groups have approximately only a 50:50 chance of reaching funding solvency. There are an estimated 3 million people in these groups.

We recommend that further work is undertaken by DWP, the PPF and the Pensions Regulator to understand and tackle the extent of risks in the system.

We don't believe that the balance of flexibilities in the funding regime is driving the current challenges in the DB sector - the DB funding regime works best when employers and schemes work together to agree scheme funding targets and contingency plans**.** Where problems do arise, our research suggests that they are being driven by a combination of ineffective regulation and poor governance; and that both these challenges are exacerbated by the fragmentation of the DB sector and particularly prevalent in schemes which struggle to achieve economies of scale.

The PLSA welcomes the focus on member protections that has been stimulated by the BHS case. This case has clearly revealed there is significant room and appetite for for the Regulator to better utilise and more clearly articulate the scope of its existing

powers, as both a preventative lever and to address malpractice. However, it is important to take a measured approach to improving protections. Any increase in or strengthening of the Regulator's powers needs to be proportionate to the risks they seek to address and enforceable in practice.

The PLSA would like to see continued action in this area and for this progress to be under review by the DWP with a particular focus on improving the connection between the Regulator's policy and case work. However, we believe that the Regulator will be most effective if a shift in its regulatory focus is undertaken.

If the Regulator were to take on more of a supervisory role so that their focus is on monitoring the quality of trustees governing schemes it could focus its resource on supervising who does the governing and on its enforcement activity where it needs to intervene, rather than the rules schemes follow and decisions they make. The people that comprise scheme governance bodies and the structures in which they work are the key 'inputs' that determine the quality of scheme management and oversight and it is here that regulatory attention should be focused. The PLSA will publish a discussion paper expanding on these themes this Summer. There are some specific circumstances where enhanced powers for members and trustees would be helpful to enhance member protection.

We firmly support the Government's desire to explore consolidation as a way to secure the defined benefit pensions of millions of savers. The PLSA has set out its thinking on the benefits that consolidation can deliver in 'the Case for Consolidation'. We welcome many of the changes recommended in the green paper, which will help break through the practical and legislative barriers that impact schemes in their day to day operation but also acts as barriers to achieving the benefits of consolidation.

Over the coming months, the PLSA DB Taskforce is working with industry to develop the legal and economic framework for consolidation and superfunds. This will be unveiled in the next report which is due in the Summer.

ABOUT THIS RESPONSE

The questions under consideration in this consultation are very close to those that the PLSA's Defined Benefit Taskforce set out to answer in its interim report[1] and second report 'the Case for Consolidation'[2]. This response will therefore draw heavily from the evidence gathered in this work. This includes:

- 31 responses from a range of stakeholders to our call for evidence.
- In depth stakeholder interviews with 16 organisations.
- 13 interviews conducted with DB schemes (scheme mangers and trustees) and their sponsors.
- Research commissioned from Gazelle Corporate Finance Limited's 'Mousetrap' Integrated Risk Model to help estimate and better understand the probability and quantum of longer-term DB member benefit losses.
- Quantitative (comprising 15 minute online interviews with occupational pension holders) and qualitative (10 two hour focus groups and 10 one hour depth interviews with DB scheme members across GB plus 25 fifteen minute post-fieldwork depth interviews) consumer research conducted by ignition House between August and September 2016.

The PLSA has also conducted a series of 'roadshows' with our membership in order to inform our response to this consultation. We had representatives from 30 pension schemes attending these road shows.

[1] DB Taskforce, Interim Report, PLSA, October 2016, http://www.plsa.co.uk/PolicyandResearch/DocumentLibrary/0597-DB-Taskforce-Interim-Report.aspx
[2] DB Taskforce, The Case for Consolidation, PLSA, March 2017, http://www.plsa.co.uk/PolicyandResearch/DocumentLibrary/0622-The-Case-for-Consolidation.aspx

1. FUNDING AND INVESTMENT

The PLSA supports maintaining the current balance of flexibilities within the existing funding and investment regime for DB schemes. The DB funding regime works best when employers and schemes work together to agree scheme funding targets and contingency plans; we don't believe that the balance of flexibilities in the funding regime is driving the current challenges in the DB sector.

Where problems arise in scheme funding and investment, our research suggests that they are being driven by a combination of ineffective regulation and poor governance; any amendments in the policy framework for scheme funding and investment therefore ought to focus on these two areas. These are exacerbated by the fragmentation of the DB sector and particularly prevalent in schemes which struggle to achieve economies of scale.

FUNDING AND INVESTMENT – ANSWERS TO CONSULTATION QUESTIONS

QUESTION 1: ARE THE CURRENT VALUATION MEASURES THE RIGHT ONES FOR THE PURPOSES FOR WHICH THEY ARE USED?

A) ARE THE FLEXIBILITIES IN SETTING THE STATUTORY FUNDING OBJECTIVE DISCOUNT RATE BEING USED APPROPRIATELY?

- **IF NOT, WHY, AND IN WHICH WAY ARE THEY NOT BEING USED APPROPRIATELY?**
- **WHAT EVIDENCE IS THERE TO SUPPORT THIS VIEW?**
- **HOW COULD SPONSORS AND TRUSTEES BE BETTER ENCOURAGED TO USE THEM?**

As described above, while the flexibilities available are appropriate, they are not functioning as effectively as possible. Many Trustee boards are not sufficiently equipped to provide robust challenge to their advisors, engage effectively with their employers and make best use of these flexibilities. More generally, PLSA members have cited concerns about inconsistent standards of regulatory intervention resulting in confusion and uncertainty about how the existing flexibilities are utilised.

Concern has been expressed by many of our members that the Regulator has not used its existing powers in relation to funding and investment effectively in the past. There is also evidence to suggest that there is a disconnect between the Regulator's policies for monitoring and responding to risks in scheme valuations and its casework. For example, feedback from our members indicates TPR engagement on scheme valuations can be very mixed, and on occasion has been described as 'less than helpful'. Our members have also observed that TPR's focus on outliers, often without effective explanation, often slows down the valuation process and could be

contributing to herding behaviour (in relation to setting funding assumptions and investment strategy).

B) SHOULD WE CONSIDER SHORTER VALUATION CYCLES FOR HIGH RISK SCHEMES, AND LONGER CYCLES FOR THOSE THAT PRESENT A LOWER RISK?

- **WHAT SHOULD CONSTITUTE A HIGH OR LOW RISK?**
- **OR SHOULD A RISK BASED REPORTING AND MONITORING REGIME BE CONSIDERED?**

No. The PLSA believes that the current triennial valuation cycle, whilst not perfect, broadly works. If it were shortened from 3 years, to say 1 or 2 years this could encourage an overly short-term focus by schemes (which should be taking a long-term outlook due to the long term nature of their liabilities) or become the dominant focus of Trustee meetings. In contrast, if the time period were lengthened, to say 5 years, employer engagement and focus on managing scheme risks could wane.

While the Regulator may wish to explore mandating more frequent monitoring of 'higher risk schemes' this would need to be proportionate to the cost involved in undertaking a valuation, and flexible approaches which utilise 'light touch' valuations should be considered.

We support greater focus on risk management and monitoring. To ensure this is effective our members have indicated that they would like to better understand how the Regulator will use its 'integrated approach to risk management' and comfort that it will be applied proportionately. Without clear and consistent guidance and application we are concerned that schemes will be discouraged from take-up or may be advised to 'gold-plate' their approach unnecessarily.

C) SHOULD THE TIME AVAILABLE TO COMPLETE VALUATIONS BE REDUCED FROM 15 MONTHS?

- **WHAT WOULD BE AN APPROPRIATE LENGTH OF TIME TO ALLOW?**

For some schemes it could be possible to reduce the timescales to complete valuations from 15 months. Where this is possible there could be a number of benefits:

- reducing the incentive to 'drag out' negotiations with employers;
- reducing advisory costs required for the length of the period; and
- reducing the time period over which the investment strategy of the scheme is unclear pending the agreement of the valuation.

However, often employer negotiations over the valuation can be complex and contracted; many schemes feel that it is important to take the necessary time to reach

the right decision.

Reducing the timescale for valuations from 15 months would be impossible for many multi-employer schemes, particularly those with complex governance arrangements, who will have extensive negotiations with employers to complete.

D) SHOULD OTHER MEASURES OR VALUATION APPROACHES, FOR EXAMPLE STOCHASTIC MODELLING, BE MANDATED OR ENCOURAGED?

- **IF SO, WHICH ONES AND FOR WHAT PURPOSE?**
- **HOW WOULD THE INFORMATION PROVIDED TO THE REGULATOR TO EXPLAIN THE AGREED RECOVERY PLAN DIFFER FROM THAT AT PRESENT?**
- **WHAT WOULD THE COSTS BE, AND WOULD THEY OUTWEIGH THE BENEFITS?**

Many schemes do undertake a range of approaches throughout their valuation cycle. However, mandating for example stochastic modelling across all schemes would not be a proportionate response and would be challenging for TPR to review in a meaningful way for each individual scheme.

QUESTION 2: DO MEMBERS NEED TO UNDERSTAND THE FUNDING POSITION OF THEIR SCHEME, AND IF SO WHAT INFORMATION WOULD BE HELPFUL?

A) SHOULD SCHEMES DO MORE TO KEEP THEIR MEMBERS INFORMED ABOUT THE FUNDING POSITION OF THEIR SCHEMES?

B) DO WE NEED GOVERNMENT COMMUNICATIONS TO PROVIDE INFORMATION TO THE WIDER PUBLIC AND MEDIA ABOUT THE DEGREE OF CERTAINTY AND RISK IN THE REGIME?

- **WHAT DIFFERENCE COULD THIS MAKE?**

PLSA's 2016 consumer research highlighted that consumer understanding of the risks that their DB scheme faces are generally poor. Less than half (48%) had previously considered whether a deficit could affect their scheme. Only half thought they would see a reduction in their pension if their employer became insolvent. Counter-intuitively younger DB members were more aware of the risk of a shortfall in funding, but few thought it was something that could happen in their own scheme.

Government has a role to play by incorporating these considerations into broader initiatives to improve consumers' financial capabilities and help protect consumers against pension scams. However, government should be wary about specifically

raising awareness about the degree of certainty and risks within the scheme as this exercise risks scaremongering and undermining saving in pensions more generally.

While many pension schemes are already taking steps to improving members engagement and understanding, the statutory requirements that underpin the summary funding statement is felt to undermine this and should be reviewed. They are considered to be burdensome and can result in communications which are laden with technical information and ensures they are not accessible to the typical member.

QUESTION 3: IS THERE ANY EVIDENCE TO SUPPORT THE VIEW THAT CURRENT INVESTMENT CHOICES MAY BE SUB-OPTIMAL? IF YES, WHAT ARE THE MAIN DRIVERS OF THESE BEHAVIOURS AND HOW COULD THEY BE CHANGED?

The rationale supporting investment choices by pension schemes is quite diverse and often reflects very different characteristics in terms of funding level, maturity and sponsor strength for instance.

At an aggregate level, however, the PLSA's DB Taskforce interim report identified that the current approach to DB scheme risk bearing is sub-optimal[3] as it leads to both inefficient capital allocation by sponsors and inefficient investment strategies into the economy.

Part of this reflects the trend towards de-risking investment strategies over the past decade and beyond as is evidenced by ONS data on pension scheme investments[4]. This has placed a greater emphasis on making good deficits through contributions resulting in a greater reliance on sponsor covenant. Our analysis for the DB Taskforce highlighted that for many schemes this increases the risk to members.

There are a number of factors that could be driving this trend:

- schemes' investment horizons have shortened as many have closed to new accruals, become more mature or cash flow negative;
- Trustees may not provide sufficient challenge to their advisers and are therefore susceptible to herding to 'common norms';
- regulatory guidance has been reported to nudge individual schemes towards taking lower risk approaches;
- PPF levy rewards schemes with lower risk investment strategies;
- the turbulent economic environment; and
- employers' wishing to manage balance sheet volatility

[3] DB Taskforce Interim Report, PLSA, October 2016, pages 23-24.
[4] Office for National Statistics, MQ5: investment by insurance companies, pensions funds and trusts QMI, March 2017.

Respondents to our 2016 call for evidence, analysis undertaken by the Regulator[5] and by the PLSA, indicates that trustee boards often lack strong investment skills or knowledge, which can result in sub-optimal investment strategies and possibly herding behaviour. Small schemes with fewer resources, less expertise and weaker bargaining power are especially vulnerable. In addition, many stakeholders are concerned about the level of robust challenge that trustees are able to give to their advisors and service providers. The FCA's asset management market study interim report also explores this as a problem, raising concerns about the ability of smaller, less well-resourced schemes to provide effective challenge to asset managers.

We would support further research by DWP in this area. We would also encourage the Regulator to communicate the range of options available for setting discount rates in valuations.

A) DO TRUSTEES/FUNDS HAVE ADEQUATE AND SUFFICIENT INVESTMENT OPTIONS ON OFFER IN THE MARKET?

- **IS THERE ANYTHING GOVERNMENT COULD DO TO ADDRESS ANY ISSUES?**

As schemes mature, the demand for cash flow matching assets has increased, and despite the suppression of gilt yields since the financial crisis, these assets have continued to be in high demand. Given the long-term mismatch between supply and demand of these assets, steps to increase their supply would be welcome. The Debt Management Office should review the case for issuing CPI or CPIH linked gilts following its consultations investigating the need for this in 2010/11 to which the PLSA (then NAPF) responded[6].

B) DO MEMBERS NEED TO UNDERSTAND THE INVESTMENT DECISIONS THAT ARE BEING MADE?

- **IF YES, ARE THERE ANY SPECIFIC DECISIONS THAT NEED ARTICULATING?**

Please see answer to question 2.b above.

C) WOULD IT BE APPROPRIATE FOR THE REGULATOR TO TAKE A LEAD IN INFLUENCING OR DETERMINING AN ACCEPTABLE OVERALL LEVEL OF RISK FOR A SCHEME IN A MORE OPEN AND TRANSPARENT WAY?

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[5] Trustee Landscape Qualitative Research, A report of the 2015 Trustee Landscape, The Pensions Regulator, 2015

[6] UK Debt Management Office, CPI-linked Gilts: A Consultation Document, NAPF response, September 2011, http://ow.ly/BFxT30byQoc

No. The flexibilities currently present within the funding regime are appropriate.

D) WOULD ASSET POOLING OR SCHEME CONSOLIDATION HELP SCHEMES TO ACCESS BETTER INVESTMENT OPPORTUNITIES?

Yes. Our thinking in this area is set out in our DB Taskforce report 'The Case for Consolidation'[7].

E) IS REGULATION (INCLUDING LIABILITY MEASUREMENT REQUIREMENTS) INCENTIVISING OVERLY RISK-AVERSE BEHAVIOURS/DECISIONS THAT RESULT IN SUB-OPTIMAL INVESTMENT STRATEGIES?

• IF YES, WHICH REGULATIONS AND HOW DO THEY IMPACT ON THESE DECISIONS?

Our members have observed that TPR's focus on outliers, often without effective explanation, often slows down the valuation process and could be contributing to herding behaviour (in relation to setting funding assumptions and investment strategy).

F) ARE YOU AWARE OF EVIDENCE OF HERDING OR POOR ADVICE FROM THE INTERMEDIARIES AND ADVISORS?

Our members often feedback that there is herding behaviour amongst their advisors, nudging them towards central assumptions and strategies on the basis that this will encourage less scrutiny from the Regulator.

G) ARE MEASURES NEEDED TO IMPROVE TRUSTEE DECISION-MAKING: SKILLS SUCH AS ENHANCED TRAINING, MORE REGULATOR GUIDANCE, OR THE PROFESSIONALISATION OF TRUSTEES?

As DB schemes have matured, and represented, for many schemes, more of a risk to the sustainability of their sponsors, governance of these schemes has become more demanding. In addition, trustee boards are finding it increasingly challenging to recruit trustees. Where these issues arise the scheme trustees will struggle to effectively govern the run-off of their DB schemes.

Consequently, there is more work to be done in equipping trustee boards with the skills and knowledge to navigate the challenges facing DB schemes.

Ideally, trustee boards should collectively have the right set of capabilities and competences to deliver member benefits in the face of these challenges and these should be made up of both technical expertise, such as investment knowledge and 'soft skills' such as the ability to challenge advisors effectively. Individuals making up

[7] DB Taskforce, The Case for Consolidation, PLSA, March 2017

the trustee board should meet certain minimum standards.

Greater use of professional trustees would help schemes in this area. However, clear and accountable standards for professional trusteeships need to be developed before they are mandated as the current situation in which anybody may style themselves as a 'professional trustee' is clearly undesirable. We note that the Pensions Regulator has recently undertaken a consultation on the definition of a professional trustee; however this does not address minimum standards or professional accreditation.

2. EMPLOYER CONTRIBUTIONS AND AFFORDABILITY

The analysis carried out by the DB Taskforce and feedback from our members indicates that the affordability challenges facing DB schemes and employers are much more significant than the position set out in the Green Paper.

Some of the analysis presented appears overly optimistic. In particular, the assumption that employers can continue to pay DRCs at current levels for the foreseeable future, given the wider economic challenges.

Research conducted for the DB Taskforce highlighted the risk to member benefits when considering employer solvency alongside funding targets and this work has been referenced in the consultation. This work showed that schemes in the weakest solvency group allocated by the Regulator had only a 32% chance of reaching full solvency funding after thirty years, whereas schemes in the strongest covenant group had a 90% chance. Schemes in the bottom two covenant groups have approximately only a 50:50 chance of reaching funding solvency, with an estimated 3 million people represented in these groups.

EMPLOYER CONTRIBUTIONS AND AFFORDABILITY – ANSWERS TO CONSULTATION QUESTIONS

QUESTION 4: IS THERE A CASE FOR MAKING SPECIAL ARRANGEMENTS FOR SCHEMES AND SPONSORS IN CERTAIN CIRCUMSTANCES SUCH AS A DIFFERENT REGIME FOR EMPLOYERS WHO CAN AFFORD TO PAY MORE, AND/OR NEW OR ENHANCED FLEXIBILITIES FOR STRESSED SPONSORS AND SCHEMES?

A) DO YOU HAVE ANY EVIDENCE THAT DEFICIT REPAIR CONTRIBUTIONS ARE CURRENTLY UNAFFORDABLE?

Please see evidence presented in our DB Taskforce interim report[8].

B) SHOULD WE CONSIDER MEASURES TO ENCOURAGE EMPLOYERS WHO HAVE SIGNIFICANT RESOURCES AS WELL AS SIGNIFICANT DB DEFICITS TO REPAIR THOSE DEFICITS MORE QUICKLY?

• IF SO, IN WHAT CIRCUMSTANCES, AND WHAT MIGHT THOSE MEASURES BE?

The regulatory regime should act as a disincentive to employers who might seek to pay less than they can reasonably afford and who might by doing so weaken the long-term viability of the scheme, or unduly increase the risk of calls on the PPF. It is also clear that recovery plans shouldn't be being consistently extended by employers that could otherwise afford to pay down their deficits more quickly. However, it is important to recognise that closing deficits shouldn't be wholly reliant on increasing calls on employer resources, which could act to discourage use of the flexibilities within the funding regime and encourage schemes to de-risk unnecessarily.

[8] Ibid, Pages 13-19

C) IF MEASURES ARE NEEDED FOR STRESSED SPONSORS AND SCHEMES, HOW COULD "STRESSED" BE DEFINED?

• SHOULD A GENERAL METRIC BE USED, OR SHOULD THIS BE DECIDED ON A CASE BY CASE BASIS?

We think it would be very difficult to develop a definition of 'stressed schemes' that captures the range of challenges facing individual schemes and their sponsors. A number of measures could be considered 'warning signs' which might merit further investigation by the Regulator, for example, the relative size of scheme liabilities to the market capitalisation of the company, the relative size of a company's profit margins to deficit recovery contributions, or deterioration of the sponsor's covenant.

Schemes that are sponsored by CG3 and CG4 employers would be considered to be the most vulnerable and considered stressed or at risk of becoming stressed in the near future. We recognise that this categorisation is unrefined and has been developed for a different purpose. In order to employ such a definition more widely, the Regulator's covenant allocation criteria should be developed further and made more transparent. This would enable greater scrutiny and a wider understanding of the risks across the DB sector.

D) ARE THERE ANY CIRCUMSTANCES WHERE STRESSED EMPLOYERS SHOULD BE ABLE TO SEPARATE FROM THEIR SCHEMES WITHOUT HAVING TO DEMONSTRATE THAT THEY ARE LIKELY TO BECOME INSOLVENT IN THE NEAR FUTURE?

The current legislative framework leads to binary outcomes for schemes, sponsors and scheme members whereby schemes can either be:

- supported by a solvent employer and funded (or funding) to provide full benefits; or
- unsupported by an employer, and transferred to the PPF.

These binary outcomes can foster a regulatory misalignment and a lack of flexibility for solvent schemes. Schemes have typically only sought to examine alternative means to structure their benefits when insolvency is inevitable. The result is a situation in which TPR and scheme trustees are either incentivised to keep poorly funded schemes limping on for as long as possible in the hope of a recovery; or that there is failure to act for fear of crystalising a problem that may go away, but may also get considerably worse. This approach unnecessarily narrows the options available to schemes, their members and their sponsors, many of which could provide better long-term outcomes.

Scheme resolution should be more flexible - it should be easier to separate schemes from struggling employers and it should be easier to separate very well-funded schemes from their employers to run on as stand-alone entities, where this is in the best interest of members. The PLSA has set out the benefits of these options in significant detail in our DB Taskforce interim report, and 'the case for consolidation'.

E) HOW WOULD IT BE POSSIBLE TO AVOID THE MORAL HAZARD OF EMPLOYERS MANIPULATING SUCH A SYSTEM IN ORDER TO OFF LOAD THEIR DB LIABILITIES?

- **WOULD SOME SORT OF 'QUID PRO QUO' BE APPROPRIATE TO ENSURE THE SCHEME IS NOT DISADVANTAGED RELATIVE TO OTHER CREDITORS OF THE EMPLOYER/STAKEHOLDERS?**
- **WHAT COULD THIS LOOK LIKE?**

We believe it would be possible to create the right regulatory safeguards to enable the separation of scheme's and employers. This could include tests to demonstrate the risk to member benefits, requirements to provide capital or to seek approval from the Regulator.

F) ARE THERE ANY CIRCUMSTANCES WHERE EMPLOYERS SHOULD BE ABLE TO RENEGOTIATE DB PENSIONS AND REDUCE ACCRUED BENEFITS?
- **IF SO, IN WHAT CIRCUMSTANCES?**

The unyielding pressures on DB schemes and their sponsoring employers cast into doubt whether all DB members will receive 100% of their benefits. Our analysis, presented in the DB Taskforce interim report, highlights how an estimated 3 million members have only a 50:50 chance of their scheme reaching solvency funding by 2030.

The impact of more limited indexation, than would have been applied in their scheme had it continued, means that – in aggregate – PPF benefits for deferred members are in the order of 80% rather than 90%. Therefore, the scheme member may be bearing as much as 20% of the risk to their benefits.

We have also highlighted in answers above how scheme resolution is inflexible and the options for schemes with stressed employers are too binary.

Where there is a high probability that schemes are going to be unable to provide 100% of accrued benefits, and cannot rely on employer support to address deficits, there may be a case for trustees to access lower, but above PPF levels of benefits, if in their judgement, it results in a better member outcome than would otherwise be the case. The merits of that case depend, however, on there being very carefully thought

through safeguards. For example, benefits that have been amended could be increased again in the future should a change in circumstances allow it.

G) IS THERE ANY EVIDENCE TO SUGGEST THAT THERE IS AN AFFORDABILITY CRISIS THAT WOULD WARRANT PERMITTING SCHEMES TO REDUCE INDEXATION TO THE STATUTORY MINIMUM?

Please see the introduction to this section.

H) SHOULD THE GOVERNMENT CONSIDER A STATUTORY OVER-RIDE TO ALLOW SCHEMES TO MOVE TO A DIFFERENT INDEX, PROVIDED THAT PROTECTION AGAINST INFLATION IS MAINTAINED?

• SHOULD THIS ALSO BE FOR REVALUATION AS WELL AS INDEXATION?

We would support a statutory override to allow scheme trustees to move to a different index, for both revaluation and indexation, where they think it is in the best interest of their members.

The 'drafting lottery' in which some schemes can alter the measure they use for statutory increases, others can do so only under limited circumstances and some cannot under any, should be addressed. It is necessary to ensure that appropriate safeguards are put in place to ensure members' interests are protected and trustees are equipped to challenge undue employer pressure to arbitrarily change benefits.

Trustee should be supported with clear guidance in relation to:

- when an amendment might be in the best interests of their members;
- how to manage pressure from their sponsoring employers to make changes, even where the current pension commitments are affordable; and
- what consultation and communication requirements with scheme members would be required.

In addition, we recommend that any statutory override does not replicate the mistakes of the past by hard-wiring a specific indexation measure (which might subsequently be replaced) into legislation.

I) SHOULD THE GOVERNMENT CONSIDER ALLOWING SCHEMES TO SUSPEND INDEXATION IN SOME CIRCUMSTANCES?
• IF SO, IN WHAT CIRCUMSTANCES?

See answer to f) above.

J) HOW WOULD YOU PREVENT A SPONSORING EMPLOYER FROM ONLY FUNDING A SCHEME TO A LOWER LEVEL IN ORDER TO TAKE ADVANTAGE OF SUCH AN EASEMENT?

K) SHOULD GOVERNMENT CONSIDER ALLOWING OR REQUIRING LONGER, DEFERRED OR BACK LOADED RECOVERY PLANS?

- **IF SO, IN WHAT CIRCUMSTANCES?**

- **SHOULD OTHER CHANGES BE CONSIDERED, SUCH AS THE VALUATION METHOD OF TECHNICAL PROVISIONS?**

These options are already available to schemes and can be used where appropriate, for example in setting the schemes funding position and recovery plan.

L) SHOULD IT BE EASIER TO TAKE SMALL POTS AS A LUMP SUM THROUGH TRIVIAL COMMUTATION?

Not answered.

3. MEMBER PROTECTION

The PLSA welcomes the focus on member protections that has been stimulated by the BHS case.

The Regulator has an important role in the pensions system and is equipped with wide-ranging powers to help support and maintain high quality pensions provision.

We recognise that the Regulator's powers are delicately balanced between their competing objectives, which may have made it difficult to reach a clear decision to act at times. However it is clear, in light of recent high profile cases that there is significant room and appetite from pension schemes for the Regulator to better utilise and more clearly articulate the scope its existing powers, as both a preventative lever and to address malpractice. This would assist the industry in understanding why it may need additional powers to enforce its existing objectives. It is important to take a measured approach to improving protections. Any increase in or strengthening of the Regulator's powers needs to be proportionate to the risks they seek to address and enforceable in practice.

There have been some signals over the last few months that the Regulator is taking positive actions to address these shortcomings. The PLSA would like to see continued action in this area and for this progress to be under review by the DWP with a particular focus on improving the connection between the Regulator's policy and case work. However, we believe that the Regulator will be most effective if a shift in its regulatory focus is undertaken, which we set out further below.

One way to tackle these challenges would be for the Regulator to take more of a supervisory role so that their focus is on monitoring the quality of trustees governing schemes. This would enable the Regulator to focus its resource on supervising who does the governing and on its enforcement activity where it needs to intervene, rather than the rules schemes follow and decisions they make.

The collective capabilities and competences of scheme governance bodies, and the structures in which they are situated (in terms of support and accountability) are the key inputs that determine the quality of scheme management and oversight. If the right people are in place and they are appropriately accountable to the relevant stakeholders then confidence that they will take the right decisions leading to better outcomes for members should follow. Therefore, it is on these 'inputs' that regulatory interest should focus. The PLSA will publish a discussion paper on trusteeship and governance later this Summer, which will outline our thinking in this area.

There are in addition, some specific circumstances where enhanced powers for members and trustees would be helpful to enhance member protection, as set out in response to the questions below.

MEMBER PROTECTION – ANSWERS TO CONSULTATION QUESTIONS

QUESTION 5: DO MEMBERS NEED FURTHER PROTECTION, AND SHOULD THIS BE DELIVERED BY A STRONGER AND MORE PROACTIVE REGULATOR, AND/OR TRUSTEES WITH ENHANCED POWERS?

The Regulator has, for the most part, sufficiently wide ranging powers to deliver its objectives. However, there is some evidence to suggest that they have historically been too reluctant to exercise their powers or have faced technical challenges in using them. We think a shift in regulatory approach would be more helpful.

In response to the questions raised in this consultation, some of our members have made the following comments regarding the Regulator's current use of their powers:

- that the Regulator takes too passive an approach to intervention;
- feedback on quality of engagement with Regulator staff is mixed, and a review of the skill sets and resource of personnel would be helpful;
- that the Regulator's focus on producing guidance around decision-making, rather than making proactive regulatory interventions on decisions that have been made is unhelpful; and
- there has been a tendency of government and regulators to 'micro-manage' the actions of trustees, scheme manager and their advisers, often in a way that reflects sub–standards governance arrangements.

A) WOULD GREATER CLARITY OVER THE REQUIREMENTS FOR SCHEME FUNDING BE HELPFUL TO MEMBERS AND TO SPONSORS?

• IF SO, WOULD THIS BE BETTER SET OUT IN DETAIL IN LEGISLATION OR THROUGH INCREASED GUIDANCE AND STANDARDS FROM THE REGULATOR?

Please see answers to questions 2 a) and 2 b) above.

B) IS IT POSSIBLE TO DESIGN A SYSTEM OF COMPULSORY PROACTIVE CLEARANCE BY THE REGULATOR OF CERTAIN CORPORATE TRANSACTIONS, WITHOUT SIGNIFICANT DETRIMENT TO LEGITIMATE BUSINESS ACTIVITY?

• IF SO HOW?

• WHAT ARE THE RISKS OF GIVING THE REGULATOR THE POWER TO DO THIS?

Currently TPR will not engage with an application for clearance unless the scheme can show detriment to scheme members. Applications for clearance have decreased because there is (a) either greater confidence about what is and isn't going to be acted upon or (b) because clearance is being actively avoided/ignored.

If further powers are developed they need to have a clear objective and be proportionate to the risk being managed. It is also important that any process is not overly complex, costly or lengthy. The risk that 'good' corporate transactions are hindered or that a substantial proportion of the Regulators resource or focus is

absorbed in clearance should be avoided.

C) SHOULD THE REGULATOR BE ABLE TO IMPOSE PUNITIVE FINES FOR CORPORATE TRANSACTIONS THAT ARE DETRIMENTAL TO SCHEMES?

• IF SO, IN WHAT CIRCUMSTANCES?

It is clear that the Regulator's avoidance powers can work very effectively. We would support removing legislative impediments to their use, if there is clear evidence that they are overly burdensome to utilise.

D) WHAT SAFEGUARDS COULD ENSURE THAT ANY ADDITIONAL POWERS GIVEN TO THE REGULATOR DO NOT IMPACT ON THE COMPETITIVENESS OF THE UK BUSINESS OR THE ATTRACTIVENESS OF THE UK MARKET?

Not answered.

E) SHOULD THE REGULATOR HAVE NEW INFORMATION GATHERING POWERS?

A more flexible information gathering power, along with a general duty on parties to cooperate with the Regulator, would improve the efficiency and effectiveness of the Regulator's information gathering activity.

F) SHOULD CIVIL PENALTIES BE AVAILABLE FOR NON-COMPLIANCE?

We would support proportionate penalties for non-compliance.

G) SHOULD LEVY PAYERS BE ASKED TO FUND ADDITIONAL RESOURCES FOR THE REGULATOR?

Levy payers would welcome a more efficient and effective Regulator, so long as their regulatory focus is clearly defined and they have a coherent connection between their case work and policy making. The proposals we have set out regarding a shift in regulatory focus would help ensure that the Regulator makes best use of their resource.

H) SHOULD TRUSTEES BE GIVEN EXTRA POWERS SUCH AS POWERS TO DEMAND TIMELY INFORMATION FROM SPONSORS, TO STRENGTHEN THEIR POSITION?

• IF SO, WHAT EXTRA POWERS MIGHT BE HELPFUL?

The notifiable events regime is relatively weak, especially with regards to corporate activity. For example, an employer only needs to tell TPR when it has made a decision

to cease UK business; the employer's position could have deteriorated significantly before then. We believe it would be useful to consider instances in which this regime could be bolstered in ordered that useful information is shared with both TPR and trustees.

Trustees do not always get the covenant and funding information they need from employers, particularly in the context of corporate transactions. For example, the obligation in the 1996 scheme administration regulations requiring employers to give Trustees information reasonably necessary for them to do their job could be strengthened.

I) SHOULD TRUSTEES BE CONSULTED WHEN THE EMPLOYER PLANS TO PAY DIVIDENDS IF THE SCHEME IS UNDERFUNDED – AND IF SO, AT WHAT LEVEL OF FUNDING?

Some employers could afford to close their deficits more quickly if they were to pay additional contributions to the pension scheme instead of making dividend payments to shareholders.

Such a move may be superficially attractive, but potentially hides a more complex decision:

- FTSE 100 companies and the dividends they pay are not representative of most pension scheme sponsors;
- pension schemes themselves are significant beneficiaries of dividend payments. In 2015, pension scheme income from dividends constituted 13% of their total income and was as high as 45% in 1997[9];
- the failure to pay dividends may result in the downgrading of the scheme sponsor by analysts and markets. This will in turn have a negative impact on the strength of the sponsor covenant and their cost of capital, which will in turn have a negative impact on the pension scheme it supports; and
- there may be wider macro-economic benefits from dividend payments.

Nonetheless, at times, dividend payments can be disproportionate to the amount of capital a sponsor is willing to commit to closing a deficit; therefore, measures to ensure adequate sponsor support should be considered. Consultation with Trustees on dividend payments could be meaningless and unenforceable in practice. Instead, it would be helpful to formalise the requirement to agree the relationship between the companies' approach to dividend payments and significant capital outflows as a formal part of setting the valuation agreement.

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[9] ONS, MQ5: Investment by Insurance Companies, Pension Funds and Trusts: Quarter 4 (Oct to Dec) 2016

J) IS ACTION NEEDED TO ENSURE THAT MEMBERS ARE AWARE OF THE VALUE OF AND RISKS TO THEIR DB PENSIONS?

See answer to Question 2 above.

4. CONSOLIDATION

The PLSA has set out its thinking on the benefits that consolidation can deliver in 'the case for consolidation'. Some legal and regulatory changes will help consolidation and the Superfund model put forward in this report to develop further:

- a new requirement for trustees to 'consolidate, improve or justify ' with an annual report explaining either they plan to consolidate or else justifying how existing arrangements produce better value for money;
- a review and overhaul of the regulations and guidance setting out the process for re-shaping scheme benefits to simplifies structures of actuarially equivalent value (either within a scheme or upon transfer to a new scheme) – consolidation depends on clear standards that schemes and their advisers can implement with certainty; and
- a regulatory framework for the creation, authorisation and supervision of superfunds, which will permit employers to discharge their obligation in respect of transferring benefits.

We are working with a number of stakeholders to develop these requirements in more detail as well as to develop a working model for a Superfund.

Below we have addressed issues pertaining to DB Multi Employer Schemes that are not covered by that publication.

QUESTION 6: SHOULD GOVERNMENT ACT TO ENCOURAGE, INCENTIVISE, OR IN SOME CIRCUMSTANCES MANDATE THE CONSOLIDATION OF SMALLER SCHEMES INTO VEHICLES WITH GREATER SCALE AND BETTER GOVERNANCE IN ORDER TO REDUCE THE RISK TO MEMBERS IN FUTURE FROM THE RUNNING DOWN OF CLOSED, ESPECIALLY SMALLER, DB SCHEMES?

A) IS THERE ANYTHING IN THE EXISTING LEGISLATIVE OR REGULATORY SYSTEM PREVENTING SCHEMES FROM CONSOLIDATING?

• HOW MIGHT SUCH BARRIERS BE OVERCOME?

B) WHAT OTHER BARRIERS ARE THERE WHICH ARE PREVENTING SCHEMES FROM CONSOLIDATING?

• HOW MIGHT THEY BE OVERCOME?

C) SHOULD GOVERNMENT DEFINE A SIMPLIFIED BENEFIT MODEL TO ENCOURAGE CONSOLIDATION?

D) SHOULD RULES BE CHANGED TO ALLOW THE RESHAPING OF BENEFITS WITHOUT MEMBER CONSENT?

• IN WHAT CIRCUMSTANCES?

- SHOULD THERE BE PRESCRIBED RESTRICTIONS TO THE TYPES OR LIMITS OF SUCH RESHAPING?

E) ARE COSTS AND CHARGES TOO HIGH IN DB SCHEMES?

F) SHOULD SCHEMES BE REQUIRED TO BE MORE TRANSPARENT ABOUT THEIR COSTS OR JUSTIFY WHY THEY DO NOT CONSOLIDATE?

- IN WHAT CIRCUMSTANCES?

G) IS THERE A CASE FOR MANDATORY CONSOLIDATION?

- IN WHAT CIRCUMSTANCES?

H) SHOULD THE GOVERNMENT ENCOURAGE THE USE OF CONSOLIDATION VEHICLES, INCLUDING DB MASTER TRUSTS?

- IF SO HOW MIGHT IT DO SO?

I) ARE FURTHER CHANGES NEEDED TO THE EMPLOYER DEBT REGIME IN MULTI-EMPLOYER SCHEMES TO ENCOURAGE FURTHER CONSOLIDATION?

J) IS THERE A CASE FOR CONSOLIDATION AS A CHEAPER, BUT MORE EFFICIENT FORM OF BUY-OUT, WITH THE EMPLOYER AND TRUSTEES DISCHARGED?

- IF SO, (A) WHAT SHOULD BE THE REQUIREMENTS FOR A SCHEME TO ENTER SUCH A CONSOLIDATOR, ESPECIALLY THE LEVEL OF FUNDING; AND

- (B), SHOULD THE RESIDUAL RISK BE BORNE BY THE MEMBER, OR BY THE PPF?

K) SHOULD GOVERNMENT ENCOURAGE CREATION OF CONSOLIDATION VEHICLES FOR STRESSED SCHEMES?

Please see evidence set out in 'the case for consolidation'

L) SHOULD EMPLOYER DEBT LEGISLATION FOR MULTI-EMPLOYER SCHEMES REQUIRE FULL BUY-OUT AND FOR THE ACTUARY TO ASSESS LIABILITIES FOR AN EMPLOYER DEBT BY ESTIMATING THE COST OF PURCHASING ANNUITIES?

Our thoughts on this issue have been set out in our response to the Government's 2015 call for evidence[10] and we will respond to the Government's current consultation 'the draft Occupational Pension Schemes (Employer Debt) (Amendment) Regulations 2017' setting out further views on this area on 18 May.

M) HOW ELSE COULD HISTORIC ORPHAN LIABILITIES BE MET IF THEY WERE NOT SHARED BETWEEN EMPLOYERS?

Orphan liabilities represent a varying proportion of scheme liabilities in different multi-employer schemes, from under 1% in some instances up to 60% in others.

Many MESs have undergone exercises to apportion orphan liabilities.

Orphan liabilities, and particularly those attributable to employers who departed the scheme prior to the current legislative regime, are a major issue for some MESs. There are issues of fairness to remaining employers, many times small businesses or charities, who under the current legislation must shoulder debt incurred by unrelated employers, and in many cases competitors. The debts were often incurred at a time when the law regarding how multi-employer schemes are funded and the degree to which benefit promises were enforceable were very different.

Areas that could be explored further to help solve this problem include:

- Providing legal clarity (via legislation or a test case) on the extent to which schemes can pursue employers that departed prior to 2005 for additional contributions in respect of the liabilities attributable to their participation. It is worth noting that even if trustees could pursue previous employers, many will no longer be trading. The costs of legal action, combined with the likelihood of recovering the debt in full may make this an inefficient and or fruitless exercise.

- Enabling trustees to create a section within their scheme for members whose employers ceased paying contributions prior to 2005; the section would run on without a sponsoring employer and is aligned with our thinking on superfunds set out in 'the case for consolidation'.

- A mechanism for the PPF to take on the liabilities of employers that exited the schemes prior to 2005 in certain circumstances.

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[10] DWP Call for evidence: Section 75 Employer Debt in Non-Associated Multi-Employer Defined Benefit Pension Schemes, PLSA Response, May 2015: http://www.plsa.co.uk/PolicyandResearch/DocumentLibrary/~/media/Policy/Documents/0438-Section-75-Employer-Debt-in-Non-Associated-Multi-Employer-Defined-Benefit-Pension-Schemes.pdf

N) ARE NEW MEASURES NEEDED TO HELP THOSE TRUSTEES OF AN ASSOCIATION OR EMPLOYERS WHO COULD BE HELD INDIVIDUALLY LIABLE FOR AN EMPLOYER DEBT?

Not answered. ‘