First Briefing, March 2018
White Paper: Protecting DB Pension Schemes

Introduction

On 19 March, Government published a policy paper[1] on how it intends to increase the protections for defined benefit (DB) scheme members and make improvements to the pensions system. It follows from the consultation published in Spring 2017 as a Green Paper[2].

Summary

There are three main themes to the proposals:

- Strengthening the Pensions Regulator's powers to deter corporate wrongdoing and avoidance in pension scheme funding;
- Improving the scheme funding system by implementing a revised, enforceable Funding Code and requiring a triennial DB Chair's Statement to the Regulator; and
- Encouraging scheme consolidation to reduce costs - either via existing options such as DB master-trusts, or by legislation allowing commercial pension scheme consolidators (so-called superfunds).

Most of the changes proposed will require changes to primary legislation. The earliest these changes will be considered is the 2019-20 parliamentary session, so they are unlikely to be effective before 2021.

Strengthening the Regulator's powers

Whilst Government believes that the existence and occasional use of the Regulator's powers already acts as a deterrent to avoidance of pension liabilities, it proposes several ways to strengthen these powers:

- punitive fines for those who deliberately put their pension scheme at risk, potentially applying to any conduct occurring after the publication of this White Paper;
- a criminal offence of wilful or grossly negligent behaviour in relation to a DB pension scheme by directors of sponsors and any connected persons;
- working with the Insolvency service to improve the effectiveness of information sharing and, where appropriate, director disqualification;

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[1] https://www.gov.uk/government/publications/protecting-defined-benefit-pension-schemes
[2] https://www.gov.uk/government/consultations/defined-benefit-pension-schemes-security-and-sustainability

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- a stronger notifiable events framework and voluntary clearance regime - in particular, a requirement for companies to produce a *declaration of impact*[3] before any business transactions that pose a high potential risk to a DB pension scheme;
- greater information gathering powers akin to those in use for auto-enrolment. These include compulsory interviews, fixed and escalating penalties for non-compliance with requests for information, and visits to premises to inspect paper and electronic records.

Improving the scheme funding system

Government believes that there are a significant minority of DB schemes where poor decision-making and risk management, a lack of focus on the long term, or a lack of accountability mean that current good practice is not being followed. The Regulator will implement a revised Code of Practice on Funding focusing on:

- how prudence is demonstrated when assessing scheme liabilities;
- what factors are appropriate when considering deficit recovery plans, and
- ensuring a long-term objective for the scheme is considered when setting a scheme's Statutory Funding Objective (SFO).

Unlike the Regulator's existing Funding Code, it is intended that compliance with key principles in the revised Code will be a statutory requirement.

The main tangible change is the introduction of a triennial trustee Chair's Statement to the Regulator (this will first require trustees of DB schemes to appoint a chair if they haven't already done so). The Chair's Statement will be submitted alongside each valuation. The content of the Chair's Statement will form part of the consultation on the revised Funding Code, but is likely to include:

- whether the scheme's long term financial objective is
  - to run on with continuing employer support,
  - to achieve financial self-sufficiency,
  - to buy-out with an insurer, or
  - to transfer to a commercial consolidation vehicle (see next section);
- a description of the scheme's strategy for reaching the SFO;
- the key risks to meeting the SFO (covenant, actuarial, investment and governance) and how they are being managed and mitigated; and
- a narrative setting out how trustees will meet key governance standards and achieve value for money from its running costs and investment decisions.

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[3] A statement explaining how the sponsor or parent companies involved intends to mitigate any detrimental impact caused by the proposed transaction to any DB scheme affected.

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Encouraging scheme consolidation

Government is keen to encourage innovation around scheme consolidation, as it believes it can reduce costs per member, enable more effective investment strategies and improve governance. In particular, Government sees an appetite within the pensions industry for commercial pension consolidators – vehicles that would take on the risk from existing sponsors in return for a premium that would be less than the cost of buying-out accrued benefits in full with an insurer. Government recognises, however, that there is a *delicate balance to be struck* between making commercial consolidation financially viable and protecting members' benefits.

It therefore proposes to:

- consult in 2018 on proposals for a legislation framework and authorisation regime for new commercial consolidation vehicles (i.e. Superfunds);
- consult in 2018 on a new accreditation regime to build confidence and encourage the use of existing forms of consolidation (i.e. DB Mastertrusts);
- work with the Regulator to raise trustee awareness of the benefits of consolidation; and
- consider minor changes to GMP conversion legislation to support benefit simplification.

What's not in the White Paper?

Other suggestions that were included in the original Green Paper where no specific change is now proposed are:

- no change to valuation intervals (three years) or deadlines (15 months);
- no further member disclosure requirements in relation to scheme funding or investment policy;
- no changes to trustee investment decision-making or specific action to improve the range of investments available to smaller schemes;
- no legislation to permit trustees to reduce members' benefits, e.g. stopping or suspending pension increases due to funding difficulties;
- no legislation allowing trustees to transfer members benefits without consent to a scheme that provides benefits lower than the transferring scheme;
- no statutory over-ride to allow schemes to switch from RPI to CPI increases
- no weakening of the criteria under which TPR may allow a solvent sponsor to settle a defined benefit pension scheme liability without securing members' accrued benefits in full[4]; and

[4] i.e. a Regulated Apportionment Arrangement such as that implemented in relation to the British Steel Pension Scheme to allow Tata Steel to continue to trade.

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- no relaxation of the Employer Debt requirements, other than the deferred debt easement for sponsors in multi-employer schemes that already comes into effect on 6 April 2018.

Comment

The threat of punitive fines and criminal convictions for corporate wrongdoers has grabbed the headlines, unsurprisingly in the wake of BHS and Carillion. The real work for trustees, sponsors and their advisers, however, will result from the other proposals – for example, the need to produce a Chair's Statement on funding and a Declaration of Impact for certain business transactions.

The intention to make key elements of the revised Code of Practice on Funding a statutory requirement causes us some concern. The settled position after more than a decade of the scheme specific funding regime is that

- the scheme-specific funding system deliberately does not require solvency-based funding;
- trustees need to consider what employers can reasonably afford to pay to meet funding deficits, balanced against the sustainable growth of sponsors;
- the PPF is there to provide a safety net in the event of employer insolvency, and recognising its existence, in conjunction with prudent ongoing funding, is exactly what pension schemes should be doing.

A statutory Funding Code risks enshrining in legislation what is currently just Regulator preference – requiring schemes and sponsors to de-risk and plan for buy-out (or perhaps consolidation), so increasing costs for sponsors. There is some irony that this is being proposed only a few years after Government handed the Regulator an additional statutory objective of employer affordability.

There will be important, and we suspect, lively, consultations on both the revised Regulator Code of Practice on Funding and the introduction of commercial scheme consolidation vehicles. It remains to be seen how much of the detail survives debate in a polarised parliament.

Finally, we note that the original Green Paper was titled 'DB Security and *Sustainability*'. In First Actuarial's response to the consultation, we expressed some frustration that the Green Paper didn't address sustainability, that is. the ongoing decline of private sector defined benefit provision. This absence appears to be acknowledged by the title of the White Paper. More positively, however, we are pleased to see the willingness of Government to explore Collective Defined Contribution pensions which appears in the section on the wider pensions context.