



Pensions briefing

Green Paper: Security and sustainability in defined benefit pension schemes

Briefing

March 2017

Introduction

The green paper security and Sustainability in Defined Benefit Pension Schemes (Green Paper) was published by the Department for Work and Pensions (DWP) on February 20, 2017. It explains how the current defined benefit (DB) pension system operates and outlines the current regulation mechanism. It seeks to address concerns surrounding recent high-profile DB cases and a range of issues raised by industry commentators lobbying for change. The DWP's key aim is to investigate the strength and flexibility of the current pension system, the nature and size of potential risks to DB pension schemes and the sustainability of the burden of costs falling to sponsoring employers. Responses to the consultation are requested by *May 14, 2017*. In this briefing, we identify some of the Green Paper's key areas of focus.

Funding and investment

The DWP is exploring suggestions from commentators that the current valuation and unding arrangements influence trustees to make overly cautious investment decisions. The Green Paper explores whether this is correct and whether there is any need for change. The questions raised in the consultation include

- Is there scope to encourage or facilitate some schemes to make more optimal investment decisions, and to mitigate any barriers to the greater use of alternative asset classes? For example requiring trustees to be trained on investment matters or to be appropriate professionals.
- Should the actuarial valuation period be reduced from 15 months to nine months?
- Should there be a proactive role for the Pensions Regulator (TPR) in scheme funding and risk management? For example, via the introduction of risk-based reporting for high-risk schemes?

Employer contributions and affordability

Since the financial crisis in 2008, deficits in most UK DB schemes have increased significantly. Some 90-95 per cent of DB schemes are now in deficit on a technical provisions basis. As a result, the DWP poses the following key question

“ ... [is] the current regime sustainable for employers, or [could it] be in the best interests of members, employers and the [Pension Protection Fund] and potentially the wider economy to alter the current balance of the regime between the protection of members and the demands of sponsors?”

Some of the areas and issues for consultation include

- Interim targets/tougher funding regime for employers with severely underfunded schemes
- Making it easier for members to be transferred to schemes providing lower benefits
- Allowing some schemes in specific circumstances to move from the retail prices index to a more modern index of inflation
- Widening the trivial commutation rules
- Making it easier to separate pension schemes from struggling employers

Member protection

The member protections discussed in the Green Paper range from those relating to scheme funding to the impact on members of corporate transactions. Whilst there is some overlap with other sections of the Green Paper, some areas for consultation are

- Whether to provide TPR with additional scheme funding powers
- Proactive compulsory TPR clearance of certain corporate activities in limited circumstances
- Imposing a duty on employers to co-operate and engage with TPR, backed up with civil penalties
- Requiring employers to engage with, and provide information to, trustees in a timely manner.

Consolidation of schemes

The Government is aware that there are many small DB schemes in the UK. There are currently around 6000 schemes with approximately 11 million members. However, 1.1 million of these members are spread across 81 per cent (4860) of these schemes – meaning there are many small schemes.

Consolidation of schemes can offer significant cost-saving benefits due to economies of scale but currently, consolidation comes with a number of practical, financial and legal hurdles. The Green Paper therefore considers the types of consolidation available and how they might be achieved. These range from ring-fenced consolidations to new superfund consolidations.

The main potential challenges to successful consolidation identified in the Green Paper are

- Considerable upfront costs for the sponsor
- Trustees and advisers potentially having vested interests
- Sponsors being unwilling to share sensitive commercial information, relating for example, to the scheme covenant
- Schemes with different characteristics such as maturity and funding level may find it difficult to agree investments which meet both the employer's and members' needs
- Full consolidation could be difficult due to varying benefit structures between schemes

Summary and comment

The Green Paper has been long-awaited and in it, the DWP offers a wide range of proposals for consideration. Although the Government is careful to state that it does not consider DB schemes to be 'unaffordable' for employers, its proposals focus on how that affordability could potentially be better managed.

The scope of the DWP's suggestions is very broad. It ranges from possible increased flexibility in the scheme funding regime, which is likely to be uncontroversial, to a possible reduction of members' future DB benefits in some circumstances, which is likely to meet with strong objection.

Many aspects of the Green Paper's contents have been aired and discussed in both the pensions and national press since its intended publication was first announced. This has been advantageous in that some of the more radical proposals it sets out have taken root in the collective pensions consciousness and have, as a result, attracted less criticism than they otherwise might have.

One issue on which the press are likely to comment further is the increased role of TPR which would be required if some of the proposed changes were implemented. The possible increase in workload seems incompatible at a time when TPR has committed to reducing its scheme regulation budget by 17 per cent over the next four years.

However, the Green Paper is not advocating a complete overhaul of the existing pension framework and could be viewed as simply 'testing the water' as to whether there is an appetite for change. Nevertheless, the DWP and the pensions industry as a whole seem to be in agreement that some refinement of the existing system may be beneficial, especially for those schemes with struggling employers.

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