

Security and Sustainability in Defined Benefit Pension Schemes

Green Paper Questions and NFOP Responses

OVERVIEW

- NFOP represents 65,000 individual pensioners predominantly in three Defined Benefit Pension Schemes – BT, British Steel and Royal Mail. The average pension of NFOP members is just £4,500 - less than a £100 a week
- NFOP gave both written and oral evidence to the Select Committee Inquiry into Defined Benefit Pension Schemes and has consulted its membership (via national conference) on the Green Paper.
- The comments below therefore reflect a “members’ perspective” on the questions asked and will on occasion make general points rather than address each and every individual point
- In summary **NFOP accepts and applauds the statement in the Green Paper that the Government has “not been persuaded that there is a general ‘affordability’ problem”**. This statement is taken into account throughout its response.
- NFOP has two overarching recommendations that it wishes the Government to act upon. First, **strengthen the powers and resources of the Pension Regulator** so that it can better protect pensioners; and, second, **review the corporate governance of pension schemes**.

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?
- 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?
- c) Should the time available to complete valuations be reduced from 15 months? What would be an appropriate length of time to allow?
- 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?

NFOP response (general):

- NFOP recognise the importance of this issue as well as the technicalities, and complexities, of valuation measures. Pension scheme members should have confidence in the valuations used and the actuarial method used and how this information reflects the performance of the scheme. The existence of different statutory measures creating differing levels of deficit or surplus and other statements indicating that no deficits exists adds to the potential confusion.
- It is accepted that there has to be a method of establishing scheme funding requirements in order that the TPR can undertake its responsibilities and exercise its powers. There may be merit in relating the valuation methodology to the status of the scheme and its objectives, as agreed with the TPR, which may then create greater confidence in the position of the 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?

Yes. The pensioner him or herself should be far better informed. NFOP would recommend a review of corporate governance which should include the case for mandatory annual reporting to members - via a signed chairman's report - and more information about risk (presented in an easily understood manner and without needlessly creating fear). It is essential that the information comes with a 'health warning' to avoid the member using the information and making decisions which could have a detrimental effect.

- 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?

It is essential that there is confidence in workplace pensions and that saving in this way is seen as fair, worthwhile and will provide a reasonable return. It is generally accepted that pensions represent deferred pay. It is therefore important that the pension promises made are honoured. The Governments introduction of the compulsory workplace pensions has been seen so far as successful but adverse news on removing or reducing benefits has the potential to undo this excellent intervention. Government should be more voluble in its defence of Defined Benefit Pensions as a "good thing." Creating a better understanding of the basis of funding statements and what they mean for individuals may reduce the scaremongering headlines that cause members distress.

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?

- 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?
- b) Do members need to understand the investment decisions that are being made? If yes, are there any specific decisions that need articulating?
- 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?
- d) Would asset pooling or scheme consolidation help schemes to access better investment opportunities?
- 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?
- f) Are you aware of evidence of herding or poor advice from the intermediaries and advisors?
- g) Are measures needed to improve trustee decision making: skills such as enhanced training, more Regulator guidance, or the professionalisation of trustees?

NFOP response (general):

NFOP have longstanding concerns relating to the make-up of Trustee boards. It therefore urges that the Government commission a review of 'corporate governance' and the following issues are examined:

- Employees/officers of the company should not form a majority of trustees
- Pensioner members should be represented either by an independent chair and/or an independent pensioner trustee
- An independent chair is appointed to ensure that the correct skill sets exists amongst the trustees and appropriate steps are taken to ensure those skills are enhanced or introduced.

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?

NFOP response

As stated in the response to question two above, pension represents deferred pay which the sponsor of the scheme gave legal undertakings to protect and these should be honoured. Therefore, flexibilities such as moving from RPI to CPI must be an absolute last resort and as identified in the Green Paper can create 'moral hazards'. Safe guards must be in place and action taken where 'gaming' of the system is identified and robust action taken against the perpetrators. In particular, flexibility should not be seen as a given.

a) Do you have any evidence that Deficit Repair Contributions are currently unaffordable?

No

b) Should we consider measures to encourage employers who have significant resources as well as significant DB deficits to repair those deficits more quickly?

Yes, possibly the introduction of a an additional levy based upon the ratios between the resources and deficit

- If so, in what circumstances and what might those measures be,

Any Deficit Repair Contributions should be considered in light of the employers resources and the Regulator should not agree to extended recovery periods, particularly where dividend represents a significantly higher return than average or 'share buyback' is proposed.

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?

Case by case would be preferable to reduce the risk of manipulation to meet a general metric.

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?

No

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?

Directors and advisers should face penalties where manipulation is identified including disqualification.

- Would some sort of 'quid pro quo' be appropriate to ensure the scheme is not disadvantaged relative to other creditors of the employer/stakeholders?

No comment

- What could this look like?

No comment

f) Are there any circumstances where employers should be able to renegotiate DB pensions and reduce accrued benefits? If so, in what circumstances?

No

- 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?

The Green Paper suggests not. The use of the statutory minimum has a significant effect on the poorest and oldest scheme members as pre 1997 accruals no longer benefit from indexing and over time risks individuals having to resort to pension credit.

- 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?

No.

- i) Should the Government consider allowing schemes to suspend indexation in some circumstances? If so, in what circumstances?

Although as a short term measure this appears attractive this would create a 'moral hazard' with the risk of 'engineering' a position that would meet a set of criteria and maintaining them to avoid reinstating indexing.

- 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?

Directors and advisers should face penalties where manipulation is identified including disqualification.

- 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?

No comment

- l) Should it be easier to take small pots as a lump sum through trivial commutation?

Yes

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?

NFOP strongly supports the need for the Pensions Regulator to have the appropriate powers and resources to adequately protect pensioners who rely on Defined Benefit pension schemes. In particular, the Pensions Regulator must intervene to enforce legally-binding requirements. The key to successful regulation is that it is respected consistently and not seen as a last resort – hence NFOP argue for early intervention and enforcement where necessary.

a) Would greater clarity over the requirements for scheme funding be helpful to members and to sponsors?

Yes

- If so, would this be better set out in detail in legislation or through increased guidance and standards from the Regulator?

Increased guidance and standards from the Regulator

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?

Yes

- If so how?

Clearly defined, published criteria would allow scheme sponsors to know when clearance would be required. Although circumstances can exist where a transaction is completed quickly scheme sponsors should divulge to the Regulator plans or circumstances where a prescribed transaction may result. Those approaching a scheme sponsor would equally be aware of those transactions that would require preclearance and should take account of the requirements

The Government should clarify and insist that parent companies are legally responsible for subsidiary pension funding obligations (eg Tata Steel and/or Halcrow).

It is essential that major transactions (mergers/acquisitions/demergers) should not favour shareholder/ management interests over those of the pension scheme and its members.

- What are the risks of giving the Regulator the power to do this?

The inability of the Regulator to process the clearance within the required timescale

c) Should the Regulator be able to impose punitive fines for corporate transactions that are detrimental to schemes?

Yes

- If so, in what circumstances?

Where a transaction favouring groups such as shareholders or management ahead of meeting its pension liabilities

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?

No comment

e) Should the Regulator have new information gathering powers?

The Regulator should have the powers it requires to insist that relevant information is provided and the ability to penalise non-compliance.

f) Should civil penalties be available for non-compliance?

Yes, directors and advisers should face penalties where manipulation is identified including disqualification.

g) Should levy payers be asked to fund additional resources for the Regulator?

Fees should be introduced where the Regulator provides proactive clearance which should be regarded as part of the transaction cost by the current or future scheme sponsor.

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 Regulator should prescribe the information that Trustees should be provided with and the time scales required to respond to a request for the information. The Trustees should then have the ability to report 'non-compliance with a request' to the Regulator who in turn would instruct the sponsors to comply. Failure to do so should then result in a fine.

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?

Scheme Trustees should be advised of any proposed dividend payment or share buyback. If the Trustees consider that this is disproportionate to the level of scheme funding, they should then bring the matter to the attention of the Regulator, who could then take action if in agreement with the Trustees.

j) Is action needed to ensure that members are aware of the value of and risks to their DB pensions?

Although there is merit in this suggestion it is possible that the member may not have the ability to understand the information provided as a result of which unnecessary concerns and distress may be caused. There is also a risk that it would prompt ill-advised actions in an attempt to avoid the identified risks.

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 for 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, what should be the requirements for a scheme to enter such a consolidator, especially the level of funding; and should the residual risk be borne by the member, or by the PPF?
- k) Should Government encourage creation of consolidation vehicles for stressed schemes?
- 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?
- m) How else could historic orphan liabilities be met if they were not shared between employers?
- n) Are new measures needed to help those trustees of an association or employers who could be held individually liable for an employer debt?

NFOP response (general):

It is clear that there could be some benefits from consolidation – and that consolidation might take many forms – but the guiding principles should be that:

- member benefits are not changed
- the uprating index and those who qualify are not changed
- protections currently enjoyed are not diluted.

Response finalised and submitted to DWP on Thursday 11th May