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UK

Volume 2018 | Issue 17 | 22 March 2018

Protecting Defined Benefit Pension Schemes (the DWP's White-ish Paper)

If a week is a long time in politics, 13 months must rank as an eternity, but following publication of its Green Paper on the security and sustainability of defined benefit pension schemes, the Department for Work & Pensions (DWP) has now published its latest instalment.

The White Paper promises very little in terms of imminent new legislation, but indicates where the government's focus lies in terms of the running of defined benefit schemes.

This FYI Alert looks at the main points to come out of the White Paper.

Background

Last year's Green Paper considered the future of defined benefit pension schemes around four different areas:

- funding and investment;
- employer contributions and affordability;
- member protection; and
- scheme consolidation.

It stated the DWP's view that there was no inherent problem with the funding of such schemes, but that certain measures might be required for certain 'stressed schemes'. The Green Paper was published in the aftermath of the BHS and Tata Steel scheme headlines.

Fast forward to 2018, and following the collapse of Carillion, member protection in defined benefit pension schemes seems to be the overriding priority for the government. This seems to be borne out by the very first sentence in the executive summary of the White Paper:

"The government believes the system is working well for the majority of Defined Benefit schemes, trustees and sponsoring employers but accepts that we need a tougher approach for those few whose irresponsible decisions impact on their pension scheme."

Strengthening the Pensions Regulator

In its response to the Green Paper, the Regulator sought greater powers to tackle pension abuses by sponsoring employers, with increased scrutiny of corporate transactions. These calls have been largely recognised by the DWP, with the Regulator to be given powers to impose punitive fines on those who deliberately put pension schemes at risk.

The Regulator is to be given additional statutory information gathering powers, including powers to:

- compel any person to submit to an interview;
- issue civil sanctions for non-compliance with the Regulator's request for information without reasonable excuse; and
- inspect records, documents and electronic devices of parties at premises (in appropriate cases without giving notice).

There are also plans to strengthen the existing notifiable events framework, and investigate whether any further events should be added to the current obligations for trustees/sponsors to notify the Regulator. This is not the first time that the notifiable events requirements - first introduced in 2005 - have been reviewed, although there have been no major changes made in the past 13 years. Calls for a mandatory system of clearance, where sponsors can obtain the Regulator's prior agreement to not using its anti-avoidance powers in relation to certain corporate transactions, have been rejected. In the case of both notifiable events, and still-voluntary clearance procedures, the government will work with the Regulator to ensure that employers have appropriate regard to pension considerations in any relevant transactions. The government will also work with relevant parties to ensure these measures do not have an adverse effect on legitimate business activity and the wider economy.

Legislation will be introduced to make it a criminal offence to commit wilful or grossly reckless behaviour in relation to a pension scheme. (In the aftermath of the Carillion collapse, this type of proposal is likely to be well received, but it is questionable how often, if ever, it would be used were it to actually become law.) In addition, further work will be undertaken to support the existing processes for disqualifying company directors.

Improving the Scheme Funding Regime

The Regulator's ability to enforce defined benefit scheme funding standards is to be strengthened through a revised code of practice (which will be the second time the code on funding defined benefits has been updated). The revised code, which is to be subject to prior consultation, will focus on:

- how prudence is demonstrated when assessing scheme liabilities;
- appropriate factors to take account of when considering recovery plans;
- ensuring that a long-term view is considered when setting the statutory funding objective (SFO).

The DWP acknowledges the lack of clear definitions for prudence and what is considered appropriate, and that this means that proving trustees have failed to comply with the legislation is costly, resource intensive and time consuming.

There is a perception that the triennial valuation process can result in trustees adopting a short-term focus on the period up to the next valuation, rather than long-term strategic outcomes. The White Paper reinforces the view that trustees and sponsors need to set appropriate long-term scheme objectives, which are then taken into account when setting the SFO.

The Regulator would like to see greater awareness from sponsoring employers and trustees in relation to the analysis of and response to downside risk events that affect delivery of the SFO.

To drive accountability and clearer decision making, trustees of defined benefit pension schemes will be required to appoint a Chair of trustees and prepare a Chair's statement. This is something that most schemes providing money purchase benefits already do, and so will be familiar to many defined benefit trustees. The statement will have to be included with the submission of a scheme's triennial valuation to the Regulator.

Exactly what the Chair's statement for defined benefit pension schemes is to cover is currently not clear and will be subject to consultation, but it is expected to:

- Set out the scheme's long-term financial destination and a description of the scheme's strategic plan for reaching the SFO.
- Show the key risks to meeting the SFO (covenant, actuarial, investment and governance) and how trustees have chosen to mitigate and manage them.
- Include a narrative setting out how trustees will meet key governance standards and achieve value for money from their running costs and investment decisions.

Scheme Consolidation

Consolidation (where administrative functions and/or assets and liabilities are pooled in some form) already takes place in various ways across the pensions market. Advantages exist in terms of reducing scheme costs per member, enabling more effective investment strategies and improving governance.

Although a major part of the Green Paper, the DWP's latest update does not seem to press the idea of consolidation quite so strongly, with no concrete plans to promote consolidation.

Consultations are planned for later this year on proposals for a legislative framework and authorisation regime within which new forms of consolidation vehicles could operate, and also on a new accreditation regime which could help build confidence and encourage existing forms of consolidation.

In addition, the DWP plans to work with the Regulator to raise awareness of the benefits of consolidation with trustees and sponsoring employers, while some minor changes are to be considered to the guaranteed minimum pension conversion legislation to support benefit simplification, which will help reduce complexities in existing benefit structures.

Comment

While a Green Paper acts as a mechanism to float some ideas and proposals, a White Paper is normally used to outline exactly what will happen. With this White Paper, all we really know is that the DWP and the Regulator will be consulting on issues over next 12 months, but there is no word on when any legislation may appear, beyond an acknowledgment from the government that any primary legislation (i.e. a new Pensions Act) is unlikely for at least a couple of years.

This will act as scant consolation to many sponsors and trustees of defined benefit pension schemes, with the government apparently dismissing some of the ideas raised in the Green Paper, such as a statutory override for schemes to move to linking pension increases to the consumer prices index. This is not necessarily a surprise, but the various proposals contained in the Green Paper to specifically assist 'stressed schemes' appear to have been dismissed.

The proposals intended to increase member protection are to be welcomed, but the White Paper largely feels like a response to the Carillion collapse, rather than a strategic plan to protect defined benefit pension schemes going forward.

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