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Sixty second summary

Security & Sustainability of DB Schemes

The Department for Work and Pensions (DWP) has published a Green Paper on options for reforming the defined benefit (DB) pension system.[1] It collects numerous recommendations put forward recently by, for example, the House of Commons Work and Pensions Committee. In doing so, it touches upon controversial topics such as valuation methodology, funding rules, corporate transactions with a deleterious effect on schemes, and liability-altering measures (notably affecting indexation), but it is a call for evidence and opinions rather than a plan of action.

Introduction

The DWP groups the changes that have been mooted under four headings: funding and investment; employer contributions and affordability; member protection; and consolidation. Our brief summary of the Green Paper adopts the same arrangement.

Responses to the Green Paper should be submitted by 14 May 2017.

Funding & Investment

The Government thinks that it and others involved with DB pensions could do a better job of explaining scheme valuations and deficits to scheme members, the public, and the media. It has yet to be convinced that there are pervasive problems with use of unduly cautious discount rates, or that the flexibility available within the funding system is not being used.

It wants to know whether anything could be done to help trustees optimize their investment decisions and avail themselves of alternative asset classes. It plans to commission research into the considerations that influence their choices.

Employer Contributions & Affordability

The DWP has seen no evidence that affordability is a widespread problem for DB sponsors. Consequently, mechanisms allowing transfer of risk to members or benefit reductions are unlikely to be made generally available. However, the Government encourages comments about possible ways of relieving the pressure upon the most-stressed schemes and businesses: for example, by making it easier for struggling sponsors to divorce their schemes, permitting renegotiation of benefits, and making changes to the powers and practices of the Pensions Regulator.

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[1] *Security and Sustainability in Defined Benefit Pension Schemes* (Cm 9412) <www.gov.uk/government/consultations/defined-benefit-pension-schemes-security-and-sustainability>.Publication was announced by Richard Harrington in a Written Statement: <www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2017-02-20/HCWS479/>.

While measures to significantly water down pension promises across the board have been taken off the table - for example a wholesale move from RPI to statutory minimum increases, rationalisation of increases that may involve a move from RPI-CPI for all schemes is not. The paper quotes Hymans Robertson research which shows this would reduce member benefits by £20,000 on average.

It appears open to the possibility of allowing suspension of benefit indexation, known as conditional indexation, when a scheme sponsor is struggling to overcome a funding deficit. This comes with a hefty risk warning and would need watertight safeguards.

Member Protection

The Green Paper asks whether the Regulator should be more interventionist in its approach to scheme funding, and more candid about the appropriate level of risk to be borne by particular schemes. It rejects the idea of a blanket duty to seek clearance for corporate transactions, but says that the Government is considering the arguments for a more targeted obligation that could apply in narrowly defined circumstances.

The Regulator's intelligence-gathering powers could be bolstered by making cooperation with its investigations obligatory, and allowing it to penalize those who fail to submit to interview. It also acknowledges the existence of an argument that '*the specification in scheme rules of a particular rate of increase, or a specific index… may now be anachronistic*', and that '*there may be a case for rationalizing indexation so that there is a level playing field*'.

Consolidation of Schemes

The Government thinks that arguments in favour of supporting voluntary consolidation of smaller schemes are persuasive, but finds the prospect of compulsion unappealing. It does not consider it appropriate for it to create and operate a consolidation vehicle, but is open to suggestions as to how it might support pensions industry initiatives.

This is a Green Paper, so readers should expect to see a tentative, preliminary presentation of options, intended to stimulate debate. This one is notable for the intensity of its verdancy, though. The language used throughout is telling. We counted four instances of '*not convinced*'; three of '*not clear*'; and no fewer than fifteen phrasal variations on the theme of paucity of evidence. The overall message is very much that the onus is on respondents to produce the evidence and persuade the Government of the need for reform.

Scheme sponsors on the front lines, pouring tens of billions into schemes with little effect on their recovery periods, will no doubt be a lot less sanguine about the state of DB funding than the DWP. We have already begun to see accusations of complacency.[2]

The 'Ministerial foreword' to the Green Paper says that the DWP wants '*to continue the debate and to start building a consensus on what, if anything, we should do…*', before noting that '*2017 is set to be a busy year in the world of pensions*' (a reference in part, we presume, to the statutory review of auto-enrolment that will also take place this year). Any material changes as a consequence of this exercise are likely to be some while off: perhaps years away if primary legislation is necessary.

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[2] <http://pensionsandsavings.com/pensions/defined-benefit-pension-schemes-green-paper/>.

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