HYMANS ROBERTSON

Sixty second summary

Protecting DB pension schemes: White Paper

The Government published a highly anticipated White Paper, '*Protecting Defined Benefit Pension Schemes*', on 19 March 2018.[1] Its proposals include an overhaul of the DB funding Code of Practice, the introduction of triennial 'chair's statements', new powers for the Pensions Regulator, and clearing the path for existing and new consolidation opportunities. Steps toward implementation have begun, but will not reach fruition until the 2020s.

Scheme funding

The Regulator will clarify its expectations in a revised *Code of Practice No. 3: Funding Defined Benefits*. The Government proposes that it will require trustees to lay out their funding plans in the context of a declared, long-term objective. The updated Code will also offer more guidance on what it means for technical provisions (funding needs) to be determined '*prudently*' and for recovery plans to be '*appropriate*'. The importance of risk-management and having a long-term view will also be considered.

The Government intends to make some aspects of the new Code *mandatory*; currently, despite its evidential value and authority, non-observance of the Code does not render a person liable to legal proceedings. The Regulator's powers to fine and direct funding activity will be enhanced accordingly.

Trustees will be required to appoint a chairperson and produce a DB 'chair's statement' somewhat akin to those currently required in respect of money purchase benefits. It will cover matters such as the trustees' assessment of their main funding risks and how they are managing them, how they set their long-term funding objective, and their reflections on past decisions. They may also have to show how they will meet governance standards and achieve value for money. Rather than being an annual obligation, as it is for DC benefits, the DB chair's statement will be integrated into the triennial valuation process. Although intended primarily as an internal, scheme-governance tool, it will also be provided to the Regulator to assist it in the performance of its functions; it will have the power to demand out-of-cycle statements in cases of most concern.

The Government plans to work with the Regulator and others to improve cost transparency and members' comprehension of summary funding statements. The Regulator will publish a factsheet intended to promote better understanding of DB funding methods.

Regulator's powers

The Government intends to back up the Regulator's contribution-notice powers with an ability to impose punitive fines. The range of targets will extend to individual directors and acts and omissions occurring after 19 March 2018 may be covered.

The Regulator will be given the power to compel those who are reluctant, or confidentiality-bound, to attend interviews and answer its questions. Its existing information-gathering capabilities will be bolstered by new fining powers, whereas currently its only option in cases of non-compliance is to pursue resource-intensive criminal prosecutions. The Regulator's powers to enter premises and inspect documents and electronic devices will also be extended. Advance notice of inspection is likely, unless it would prejudice the success of the investigation. The Government has, for the moment, decided not to specifically oblige cooperation with an investigation, reasoning that the new sanctions will be sufficient incentive.

[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/691286/protecting-defined-benefit-pension-schemes.pdf.

The notifiable-events framework will be reviewed and may be extended to other transactions. The timing of notifications will be clarified to ensure that the Regulator is informed *before* events take place. The effectiveness of the clearance system for business activities will also be scrutinized. Companies, in consultation with trustees, will have to state how they intend to mitigate the adverse effects to schemes of potentially risky transactions such as sales or takeovers.

As a 'back-stop' to the Regulator's power to fine, in the worst cases there will be a new criminal offence for those who engage in wilful or grossly reckless behaviour in connection with their DB scheme. The Government also wants to strengthen the links between the Regulator and the Insolvency Service, to ensure that action leading to disqualification of directors is considered in appropriate cases of serious wrongdoing.

Consolidation

The Government will develop a framework for the authorization, supervision and governance of new commercial consolidation vehicles that may emerge and into which sponsoring employers may transfer their liabilities (and off-load their risks). Its current thinking is that the funding requirements would be somewhat higher than for schemes with a sponsoring employer, but not so onerous as those for insurance companies offering buy-out products. It is expected that an additional capital buffer would be required to off-set the loss of the employer covenant. Sponsors and trustees would be expected, separately, to obtain expert, independent advice before transferring to a commercial consolidator. The terms upon which such consolidation vehicles could enter into the Pension Protection Fund (PPF) in the event of insolvency—if indeed that will be allowed—will be an important consideration.

The Government plans to work with the Regulator to raise awareness of current consolidation options, such as DB master trusts. It is considering how a new accreditation regime might help existing vehicles to advertise their high standards.

As a means to reduce complexity and smooth the path to consolidation, the Government is also considering making minor changes to the facility that allows conversion of guaranteed minimum pensions (GMPs) into 'ordinary' scheme benefits. Her Majesty's Revenue and Customs (HMRC) will consider the potentially negative lifetime and annual allowance consequences. The Government will consider its position on the need to equalize for GMP difference in light of an upcoming legal judgment on the matter.

Timing

Steps that do not require legislation can be taken more or less immediately, or have already begun. These include the Regulator raising its game in the ways that it oversees, intervenes in, and communicates its expectations to schemes; and the aforementioned work promoting awareness of existing consolidation possibilities, and greater understanding of scheme funding methodology.

Changes that require legislation—the bulk of the proposals—will take much longer. Most of them entail an Act of Parliament. The White Paper cautions that time for that is unlikely to be found '*before the 2019 – 20 parliamentary session at the earliest.*' In the meantime, during the remainder of 2018 and in 2019, there will be several consultation exercises.

As seemed inevitable in light of recent developments, there will be a tightening of the funding regime. The emphasis on clarity of objectives and integrated risk-management is pleasing, and to some extent the new chair's statement is where trustees should 'show their working'. If the Regulator's approach to the DC chair's statement is anything to go by, it will be rigorously scrutinized. It is also unsurprising that the Regulator is being 'tooled up' to cope with the more-interventionist approach expected of it.

We have been saying for a while now that no change is needed to reap some of the potential rewards of consolidation, so it is good that it has been recognized. It will be interesting to see how the commercial-consolidator concept develops.

Finally, there are some notable omissions from the policy paper. There is no statutory override allowing RPI-to-CPI switches, no change to the employer debt calculation, and no reduction to valuation production deadlines.

London | Birmingham | Glasgow | Edinburgh T 020 7082 6000 | www.hymans.co.uk | www.clubvita.co.uk

This communication has been compiled by Hymans Robertson LLP based upon our understanding of the state of affairs at the time of publication. It is not a definitive analysis of the subjects covered, nor is it specific to the circumstances of any person, scheme or organisation. It is not advice, and should not be considered a substitute for advice specific to individual circumstances. Where the subject matter involves legal issues you may wish to take legal advice. Hymans Robertson LLP accepts no liability for errors or omissions or reliance upon any statement or opinion.

Hymans Robertson LLP (registered in England and Wales - One London Wall, London EC2Y 5EA - OC310282) is authorised and regulated by the Financial Conduct Authority and licensed by the Institute and Faculty of Actuaries for a range of investment business activities. A member of Abelica Global.
© Hymans Robertson LLP.