Institute and Faculty of Actuaries

Pension Protection Fund and Pensions Regulator inquiry

IFoA response to the Work and Pensions Select Committee

23 September 2016

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

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and Faculty
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Mr. Frank Field MP
Work and Pensions Select Committee
House of Commons
London
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23 September 2016

Dear Mr Field

IFoA response to Work and Pensions Committee's Pension Protection Fund and Pensions Regulator inquiry

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the Committee's inquiry into the Pension Protection Fund (PPF) and the Pensions Regulator (tPR).

General Comments

2. Given our Royal Charter requires the IFoA to promote actuarial science in the public interest, we have not set out any preferred option on some issues. Deciding between competing public interest issues is, in our view, a matter for Parliament to decide. The IFoA highlighted this tension in our opening comments in response to the 2013 consultation about a new objective for tPR.[1] While it is possible to focus narrowly on the security of DB benefits, such a focus may affect contributions to DC schemes for a younger cohort of members.

3. In relation to the Committee's current inquiry into the regulation of Defined Benefit (DB) pension schemes, we consider those competing interests to include:
   - Reducing the risk that scheme assets are inadequate to pay the promised benefits (both to protect members directly and to minimise the burden borne by the Pension Protection Fund); and
   - Limiting the burden on sponsoring employers in supporting their pension funds, in order to encourage investment in growing their businesses. Such growth supports employment, the wider economy and also strengthens their support over the longer term for their pension funds, including contributions to money purchase schemes.

4. It is not possible to give equal prominence to these competing interests. By necessity, increasing employer contributions to DB pension schemes will reduce available capital to reward shareholders, remunerate employees and expand businesses. It is within that tension that the current debate sits.

5. Although our members advise trustees and employers of schemes, as an organisation we do not have details of particular schemes. The IFoA does not collate data from schemes, but our

[1] https://www.actuaries.org.uk/documents/consultation-response-pensions-and-growth-whether-introduce-new-statutory-objective

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members would be able to provide anecdotal (anonymous) evidence in respect of individual schemes.

6. There has been an increased concern about the funding of pension schemes as the low gilt yields of 2008 onwards have become ever lower and are increasingly viewed as likely to remain low for some time. This concern arises both in the context that pension schemes are placing an ever increasing burden on employers and also because the security of members' benefits is deteriorating as funding levels fall. Low yields are only one challenge for DB pension funding; therefore, while it is important not to consider the regulatory framework solely though the lens of low yields, nonetheless this is the context in which trustees and employers currently have to consider how to fund their schemes.

The adequacy of defined benefit pension scheme regulation and regulatory powers, in general and specifically in relation to the pension schemes of complex and multi-national companies.

7. It is worth noting the strengthening of protection afforded to members' benefits since 2005. This has continued the trend over the last 30 years or so, of granting greater rights to members in respect of pension benefits. However despite these changes in the large majority of pension schemes the solvency funding levels have deteriorated significantly over the same period – thus reducing the security of pension benefits for many members. Measures introduced include:

- The introduction and subsequent strengthening of legislation requiring employers to pay a debt to the pension scheme on insolvency, winding-up, or when they cease to participate in a multi-employer scheme.
- The introduction of the Scheme Specific Funding requirements. This introduced new requirements for trustees to agree the level of contributions to the scheme. Previously, in many schemes employers could unilaterally determine the level of employer contributions, subject only to the Minimum Funding Requirement. However, for many employers the Scheme Specific Funding requirements are less onerous than the previous Minimum Funding Requirement (which had also previously been weakened on a number of occasions).
- The indexation of pensions in deferment and in payment.
- The creation of the Pensions Regulator.
- The creation of the Pension Protection Fund.

8. These measures have altered the balance between the competing priorities of members and employers. This balance did not mean members would have protection in respect of all benefits at all times. We would urge the Committee to consider whether strengthening the security of DB members would alter the balance at the cost of shareholders and other stakeholders. As some submissions to the inquiry will have a bias towards employers and others towards members, the Committee's impartial recognition of these tensions may lead to a better outcome, bearing in mind the current compromise may be the best available.

9. One of the biggest challenges for tPR is the practical application of its regulatory powers. Company regulation will not recognise the interests of other stakeholders, including DB scheme members. Also, pensions law is not a comfortable bedfellow with company law. This may be one area where reliance on pensions knowledge alone is insufficient. It is likely that the risks posed by DB schemes are not always fully understood by companies. It is also likely that the risks posed by DB schemes are not always fully understood by members. We would welcome discussion of changes to help members better understand the risks attaching to their benefits and of changes to corporate governance that reflected those risks.

10. One additional issue the Committee may wish to consider is the potential impact of the UK leaving the EU on tPR's ability to pursue European parent companies for additional funding for pension schemes.

Use of these powers by the Pensions Regulator in recent cases, including BHS

11. As noted in paragraph 5, we do not collate data, but our members could comment (anonymously) on individual schemes.

12. If the Committee intends to consider the overall adequacy of the powers afforded to tPR, we would recommend the Committee takes the following into account:

- The sometimes complex processes tPR must follow before it can exercise its powers. Reviewing those processes may indicate whether tPR is unduly constrained before it exercises its powers;
- In the same way as any organisation facing challenges in choosing how to deploy resources between competing objectives, tPR is subject to resource constraints. It must decide how to allocate resources between competing priorities.
- tPR cannot scrutinise all schemes and must carefully select the criteria for identifying individual schemes for more intense scrutiny and possible intervention. tPR may wish to consider what data it collects and what analyses it performs on that data.
- One basic question worth considering is in relation to tPR exercises its functions. While many schemes have benefitted from tPR's encouragement for trustees and employers to work constructively together, other schemes could have benefitted from tPR taking a stronger position and exercising its own powers rather than just using encouragement.

Resourcing and prioritisation of TPR supervisory work

13. As we noted in our previous paragraph, the resource constraints for tPR will ultimately result from a political decision reflecting priorities. The amount of change in pensions over the last decade will mean that specific policies will have greater political importance at different times.

Implications of the regulatory approach for company behaviour, including whether it mitigates or incentivises moral hazard

14. Over the last decade, sponsoring employers will have been aware of their requirements to fund their schemes appropriately. Introducing the new objective for tPR in 2013 may have given the impression that companies could be more aggressive in negotiations about the pace of funding.

15. We would encourage the Committee to recognise that some employers are already contributing as much as they can afford. However, despite those contributions, the falls in gilt yields and increasing longevity have led to schemes' liabilities increasing more quickly than their assets. For such schemes and employers, the best outcome is the employers' continuing survival.

The sustainability of the Pension Protection Fund

16. The PPF appears to have established robust risk processes to prevent it from falling into financial difficulties. As with any uncertain financial undertaking, it is impossible to state the exact conditions under which the PPF would fail to meet its funding targets.

17. While any long-term financial undertaking is subject to uncertainty, the IFoA considers the PPF has taken a suitable approach to its long-term sustainability. This takes into account the flexibilities in the PPF's legislative framework for managing the amount of levy received and compensation provided. As such, we would suggest the Committee should not recommend any significant change to the PPF and its operations. However, the PPF's operations should be subject to regular review. Such reviews should consider whether the rules offer unfair benefits to certain types of scheme members.

The fairness of the PPF levy system and its impact on businesses and scheme members

18. The PPF has continually worked hard to improve the fairness of its levy system. In particular, we would draw attention to:
    - The new levy framework introduced for the levy year 2012/13 onwards following industry consultations over 2010 and 2011; and
    - The new approach to the calculation of insolvency risk, less open to possible manipulation by employers, introduced for the levy year 2015/16 onwards following the appointment of a new provider and industry consultation during 2014.

19. The IFoA will support continuing efforts by the PPF to deal fairly with all relevant stakeholders for the next levy triennium by engaging in a collaborative discussion.

20. Should you wish to discuss any of the points raised in further detail please contact Philip Doggart, Technical Policy Manager (Philip.Doggart@actuaries.org.uk / 01312401319) in the first instance.

Yours sincerely

Fiona Morrison
Immediate Past President, Institute and Faculty of Actuaries