Written evidence from TUC (PPF0008)

1.1 The Trades Union Congress (TUC) represents nearly six million members organised in more than 50 unions. We are the leading representative consumer voice on pension policy issues. We also operate a network of pension scheme trustees.

1.2 The TUC is a strong supporter of the Pension Protection Fund which provides vital security for the many millions of people who have retirement savings in defined benefit (DB) pension schemes.

1.3 The importance of such protection is repeatedly illustrated, including in recent weeks, when an employer becomes insolvent or is seen as being at risk of insolvency. The existence of a robust PPF means that there is a limit on the pension losses sustained by workers who may have dedicated decades of their lives to serving a company.

1.4 When considering the challenges facing DB pension provision, it is important to seek to distinguish between issues that are directly related to the operation of workplace pensions and those that are to do with wider issues of corporate behaviour and responsibility.

1.5 We should not seek to deal with shortcomings in corporate behaviour and rules by placing excessive reliance on regulation of pension schemes. The ultimate consequences could be poorer quality workplace pensions. More DB schemes could close and workers offered typically less generous and efficient defined contribution (DC) alternatives in which greater risk is borne by the individual saver.

1.6 There remains, however, a strong argument for considering the wider stewardship responsibilities of company owners, in relation to the interests of creditors and staff, including occupational pension schemes.

1.7 There are also reforms that could be considered that allow the system of pension protection to operate more effectively.

DB pension saving

1.8 DB pension schemes pay out an income in retirement based on length of service and the member’s salary. For several decades, they were the mainstay of retirement provision across the public and private sectors.

1.9 In recent decades a number of factors, including changes to the labour market and government policy, have led to fewer employers offering DB schemes. Increasingly employers have provided (typically less generous) defined contribution schemes or have made no provision at all, until automatic enrolment placed more obligations on employers.

1.10 Nevertheless, DB pension saving remains at the centre of UK retirement savings. In 2015, occupational DB schemes represented 45 per cent of total workplace pension membership. Currently, more than 11 million people are receiving or will in time receive, benefits from a private sector DB pension scheme.

1.11 A number of layers of governance seek to protect the savings of scheme members including oversight by trustees, the requirements of the Pensions Regulator and, ultimately, the Pension Protection Fund.

The PPF

1.12 The PPF ensures that workers whose employers become insolvent receive a substantial proportion of their expected pension on retirement.

1.13 However, affected scheme members still suffer losses. Those who are not yet at retirement age will receive just 90 per cent of the pension they expected and with limited inflation proofing, which
undermines the value of their benefits in the long-term. Long-standing workers in schemes that enter the PPF can find pay-outs capped. Those already retired will lose out from limited inflation-linked increases.

1.14 The burden for financing the PPF lands on defined benefit schemes in general though industry levies. This means that the more cautious and conservative the PPF’s investment strategy, the greater the burden that is borne by schemes to ensure that it receives sufficient funding.

1.15 The TUC believes it is important to recognise the stability that the PPF has brought to workplace pensions by underpinning the retirement savings of millions of UK workers. Any proposals for reform should not undermine the current settlement, for instance by putting excessive burdens on scheme sponsors and members by requiring inefficient levels of funding or on pension funds in general by potentially requiring additional levy payments. This could reduce the provision of DB pensions and potentially lead to greater calls on the resources of the PPF.

Current issues

1.16 The TUC welcomes the attention that the Business Innovation and Skills Committee is giving, in its associated inquiry, to scrutinising decision making at the top of companies. We hope that this extends to the regard owners give to the interests of other stakeholders, in particular employees and pension scheme members.

1.17 There still appears to be scope for the small minority of unscrupulous company owners to take unreasonably large returns from their businesses while leaving pension schemes in a precarious financial position. The TUC is concerned that there few restrictions on the owners of privately-held companies, often managed as part of a portfolio of businesses, who seek to extract short-term value at the expense of a firm’s longer-term interests and those of other stakeholders. Likewise, when a privately-held business is sold it is not subject to Takeover Code stipulations requiring a potential new owner to disclose its plans for a target’s DB scheme. This puts workers at greater risk of reduced benefits in retirement if their employer becomes insolvent and their scheme enters into the PPF.

1.18 However, we believe it is very important that we do not attempt to overcome shortcomings in corporate stewardship by unreasonably increasing the regulatory burden on pension schemes.

1.19 Nevertheless, there are areas worthy of further investigation. For instance, we believe there is a particular need to examine the role of the Pensions Regulator when a business is sold. There may be a case for putting greater obligations on parties in a transaction to seek the permission of the Regulator to ensure that pension scheme members are treated fairly. But we would have to be confident that such a regulation was not a disincentive for employers to offer DB schemes.

1.20 Questions should be asked about the effectiveness of trustees in ensuring fair and realistic funding deals for scheme members. However, it is not clear that more robust trustee action would often prevent schemes ultimately entering the PPF.

1.21 We should not view every call on the resources of the PPF as a failure. If we accept that an efficient method of funding DB pension schemes is below the level necessary to facilitate its buy-out by an insurance company, combined with an employer covenant (and this is accepted in scheme funding legislation), then occasional calls on the resources of the PPF, if an employer becomes insolvent, are to be expected.

1.22 Present valuations of pension liabilities continue to increase as an (artificial) function of the yield on gilts. Depression of this yield has resulted in ever-increasing deficits. We suggest that the committee seek expert opinion on the role discount rates and gilt yields have played in current funding issues and consequent impact on pension scheme funding and the businesses that sponsor these schemes.
1.23 Excessively conservative funding requirements carry risk. They can place an excessive burden on sponsors and contributing members. This brings with it the danger that more schemes are closed or that pension funding requirements draw resources away from investment in businesses, thus threatening jobs and undermining corporate profitability.

1.24 If DB schemes were obliged to be funded at buy-out levels, they would become so expensive to provide that there could be no schemes left in the private sector. Some employers would be driven into insolvency. This is not an efficient system of pension funding.

1.25 The requirement on the Pensions Regulator “to minimise any adverse impact on the sustainable growth of an employer” is welcome and should be maintained. It is important that businesses facing significant deficit funding requirements continue to invest in company growth, while protecting members’ pension benefits.

1.26 The PPF itself has a highly conservative investment approach despite having liabilities that extend many decades into the future. The TUC believes that consideration should be given to a greater role for growth assets in the PPF’s portfolio. This would have the potential to improve funding levels in the PPF thus allowing it to reduce the burden of levies on pension schemes or facilitate improved benefits to those whose schemes fall into the PPF. It would also allow PPF assets to help the growth of the UK economy.

1.27 Concerns remain about the way in which the risk-based element of the PPF levy is determined with some trustees viewing the system as opaque and unduly volatile with insufficient regard given to a sponsor’s long-term credit-worthiness. Poorly targeted levies can put strains on schemes or the sponsors behind them.

1.28 The compensation cap on pensions payable by the PPF, and the absence of inflationary increases fund on pension accrued before April 1997, reduce benefits for scheme members. This can have a major effect on an individual’s retirement plans. For instance, we have seen the example of a 54 year-old pilot, with 25 years’ service until the date his scheme entered the PPF, who instead of receiving an expected annual pension at age 55 of £46,500 received £26,500.

1.29 In passing the 2014 Pensions Act, Parliament accepted that the PPF compensation cap could have a disproportionate effect on workers who have been members of a scheme for a long time. The Act provided for the compensation cap to be increased by 3 per cent for every full year of service a worker has above 20 years. It was expected that the relevant Commencement Order and other changes would be made to enable implementation by April 2015. This deadline has passed and no timetable set for implementation.

**Recommendations for reform**

1.30 The TUC’s foremost priority is to ensure that laudable concern about the interests of scheme members does not lead to a greater regulatory burden, including on funding, that could undermine DB pension schemes and the employers that stand behind them.

1.31 However, there are a number of reforms that, implemented over time, could improve the operation of pensions regulation and the PPF, in particular.

1.32 There should be a formal role for recognised trade unions in the information and consultation process for transferring a DB scheme into the PPF. This would ensure that employees have a voice in the process.

1.33 PPF rules should be revised to include as a strategic objective the improvement of PPF-covered pensions. This includes future improvements to the indexation of payments. Members receiving PPF
compensation are also likely to see much of their pension fail to keep place with prices, as the fund does not pay inflationary increases on pension accrued before April 1997.

1.34 Consideration should also be given to the level of the compensation. As a first step, the government should proceed with implementing provisions in the 2014 Pensions Act that will allow adjustments to the compensation cap for long-serving scheme members.

1.35 However, to proceed on improvements to PPF benefits without putting heavier burdens on levy-paying schemes, consideration will have to be given to the appropriate investment strategy for PPF to pursue. The PPF has the ability to invest for the long-term because its liabilities are long-term. There is a strong case for the Fund to invest in a diversified pool of assets expected to produce long term positive real rates of return.

1.36 There should be a renewed focus on those who seek to exploit the pension protection system, including highly solvent owners of technically insolvent companies who seek to off-load their pension liabilities into the PPF or previous owners who have not given due consideration to the future of the pension scheme when selling a business. Recent events suggest that the Pensions Regulator lacks the powers and/or the resources to deal with situations involving moral hazard when a company is mismanaged for the short-term benefit of its owners and the scheme left with the PPF. We would like to see full use of moral hazard powers such as Financial Support Directions and Contribution Notices.

1.37 It is also advisable to address concerns about the opacity, fairness and effectiveness of the risk-based element of the PPF levy by reviewing the means by which it is determined and considering whether a more effective assessment of a sponsor’s credit-worthiness could be implemented.

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