Written evidence from EEF (PPF0072)

Who we are

EEF, the manufacturers’ organisation, is the representative voice of UK manufacturing. We work with policymakers to create policies that are in the best interests of manufacturing, which ensure a high growth industry and boost its ability to make a positive contribution to the economy.

EEF members have a long tradition of providing pension benefits, manifest in the wide incidence of high quality pension schemes, including Defined Benefit (DB) schemes.

The recommendations of the Committee’s wider inquiry into DB schemes are of material importance in the manufacturing sector

Summary

One of our objectives is to ensure well-managed companies are not stymied by the activities of poorly run or rogue companies. We therefore share the concerns raised by the Select Committee into BHS and welcome the wider inquiry into the Defined Benefit pension space.

One of the ways we pursue our objectives is to make representations about various legislative and quasi-legislative protective mechanisms, to make sure they are proportionate, well-targeted and fit for purpose.

We are concerned that at this critical juncture, there is a risk that the Committee will feel compelled to recommend more onerous legislative protections at precisely the time when many DB schemes and, therefore, their sponsoring employers are especially stressed. Good employers need a more benign and more flexible regulatory framework not less flexibility if they are to weather the economic storms ahead.

The economic shockwaves following the EU referendum result have thrown into even sharper relief the effect on the UK of DB schemes in deficit, and have made worse those deficits.

We urge the Committee to take a holistic view in making its recommendations, one that balances the need for members to be protected by rogue employers and the need for the vast majority of good employers sponsoring DB schemes to have the economic space to ensure the health of their company, secure a future for their workforce, as well as meet their pension promises.

In this submission, therefore, we focus on the need for a broad inquiry into the future of DB schemes and their impact on the UK economy and suggest the time is ripe to look at all options, including, examining some sacred cows.

The challenge

Following further QE measures, designed to stabilize the economy, the falls in bond yields since the EU referendum result, which are used to calculate DB liabilities, have forced many DB schemes into deeper deficit.
The scale of the deficits is hindering the potential of many companies to make a positive contribution to the economy. The cost of running these schemes has a direct bearing on profitability in manufacturing, an important sector of the UK economy, and affects companies’ abilities to invest and attract external investment, including from abroad, at a time when we need to be doing everything to enhance the attractiveness of UK companies.

Next steps

The scale of the crisis caused by stressed DB schemes requires an urgent and deep review of the policy options, looking at what can be achieved in the near and medium/long term to relieve the overhang on individual companies, the whole economy and reduce the uncertainty in the public mind about the security of their pension arrangements.

There must be a return to coherent and stable pension policy development with no surprises.

In the past EEF has cautioned the Government about the potentially significant knock-on effects and unintended consequences of introducing a framework to permit a smoothing approach to calculating the value of assets and liabilities. We maintain this view, and believe there are other options that would have a potentially less stabilising impact, including within the current legal framework in the near term.

We advocate a review of the approach to valuing assets and liabilities for DB schemes which will include revisiting some of the ‘sacred cows’ of the current approach.

Calculation of liabilities - bond yields

DB schemes are locked into an obligation to purchase long-dated bonds to match their liabilities and this obligation, and the demand it creates, has partially driven yields to historically low levels.

Government should give urgent consideration to creating higher yielding assets for pension schemes to purchase, to help sponsoring employers out of this black hole.

EEF welcomed the Government’s recent decision to amend the Pension Regulator’s (tPR) statutory objectives to take into account expressly the long-term affordability of deficit recovery plans for sponsoring employers. We urge the Committee to question how this change is operating in practice focussing on why, if flexibilities in the calculation of liabilities and assets are available, they are not being used more widely. Our members tell us they are currently being overstated given actual practices.

Part of the inflexibility in the system is the emphasis on one measure in setting the discount rate. Our member employers are deeply frustrated by this inflexibility and the prevailing view is that it unjustifiably, and with damaging economic consequences, inflates the deficits. In light of continuing deterioration in gilt yields it should be made easier for the approach to calculation of assets and liabilities to take account of a scheme’s actual investment strategy, if it is reasonable and prudent. Currently it is overly prudent. Companies are locked into a cycle where the actuaries continually advise Trustees that they must use this measure and the Regulator will come down on them if they do anything else.

We need a much more nuanced approach to setting of recovery periods and enhancing the flexibility in setting them. The scale of the challenge, and the current practice of tPR in
getting as much cash in the shortest time frame, needs to be stress-tested against the current economic imperatives.

The review should revisit the Code of Practice on Incentivised Transfers to ensure it is not unnecessarily preventing employers undertaking legitimate de-risking activities. EEF have supported the Code but believe the time is ripe to check it is not setting a mood that discourages incentivised exercises particularly in the light of historically low gilt yields and the profound effect of the 2014 Budget pension freedoms.

Return to the 'Defined Ambition' agenda

We recommend the Committee urge Government urgently resurrect the investigatory work undertaken by the Government in the last Parliament on new so-called Defined Ambition schemes:

1. developing alternative risk-sharing models for pension schemes, and
2. in particular to include investigations into facilitating the movement, in certain situations, of past accruals into 'DB-lite' arrangements, where the requirement to provide for example automatic indexation and survivor benefits is amended,
3. collective arrangements into which SMEs can pool their assets and liabilities, maximising the benefits of economies of scale
4. collective decumulation products, which again have advantages in terms of risk pooling, cost sharing and overall governance.

CPI/RPI

Providing for indexation and revaluation of pension benefits to keep pace with inflation is a significant cost of running a DB scheme.

Currently many schemes are locked into an RPI-linked approach. Government has been reluctant to facilitate the switch to a CPI formula, by providing an override, on the grounds that it would be destabilising to previously negotiated arrangements. However, many schemes, particularly those operated by SMEs, only provided indexation and revaluation because in 1995 legislation was introduced requiring them to do so.

It is notoriously difficult (and in some cases not possible) to change pension scheme rules. Many schemes are not in a position to update their indexation/revaluation method and switch to CPI. There is now, therefore, what has been called a 'small print' lottery as to which schemes can take advantage of this change.

For those schemes that have not yet been able to take this route, we ask the Committee to urge Government urgently to consider introducing a statutory override or, even, a statutory amendment power, to make it easier to switch inflation measure. The practice of using CPI as the main measure of inflation is now well embedded in other spheres and that benefit should be extended to all those companies operating DB schemes, to smooth out the effect of the so-called ‘legal lottery’.

These measures are important steps in helping good employers sponsoring DB schemes to manage their liabilities and obligations in a sustainable way, which is in the interests of pension scheme members, employees and shareholders.
We believe tPR urgently needs further resources. Currently it is overseeing vast activity in relation to auto-enrolment at precisely the time it needs to be more vigilant because of the impact of the economic conditions on DB schemes and sponsoring employers. It is obvious that tPR needs more resources.

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EEF

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