UNISON is the UK’s largest public sector trade union with approximately 1.3 million members and a key campaigner for improving the pension system for the benefit of all.

We believe that all workers should be entitled to financial independence in retirement and should not be let down by employers and the Government failing to adequately regulate the pension system.

Executive Summary

1. The Pensions Regulator (TPR) has an array of powerful anti-avoidance powers but seems reluctant to fully utilise these
2. TPR is more often than not reluctant to fully engage and take action on issues reported to it
3. TPR has sufficient powers/oversight of scheme recovery plans and should treat each case on its own merits
4. TPR's duty on recovery plans should also take into account the quality and sustainability of the future pension offering and not just potential claims on the Pension Protection Fund (PPF)
5. More needs to be done to assist sponsors of defined benefit pension schemes and particularly with respect to discount rates and measuring liabilities
6. Schemes should not be able to enter the PPF without pursuing all options for full buy-out and without independent verification from TPR that all reasonable avenues for financial support have been vigorously pursued
7. Trustee Boards need greater member representation and should be encouraged to challenge both scheme and employer advisers for the collective good
8. Trustees and sponsoring employers need to take action to improve the investment performance of their funds a to help towards matching liabilities
9. It’s clear from cases like BHS that there’s a general lack of transparency in TPR, Trustee and sponsoring employer relationship which in many cases accentuates scheme funding problems to the detriment of members

Supporting Comments and Evidence

1. Adequacy of regulatory powers

1.1 In the particular case of BHS it’s clear that the pension scheme has effectively been dumped on the PPF and yet it’s difficult to fathom why given TPR’s anti-avoidance powers. These powers appear to be in the main sufficient for the purpose of chasing former owners to settle pension debts in full which in UNISON’s view was particularly evident in the Lehman Brothers and Nortel Networks cases where TPR issued Financial Support Directions (FSD’s) in 2010 requiring companies within the wider Lehman Brother and Nortel group to buy-out member benefits in full. The Nortel Group FSD was particularly notable in that it was issued against 25 companies in the Nortel Group in Canada, US, UK and Europe requiring them all to provide support to a UK pension scheme to cover a £2.1 billion deficit.
1.2 These cases promoted the interim Chief Executive of TPR at the time, John Soper, to say:

“The regulator has increasingly been required to engage its anti-avoidance powers to secure the retirement benefits of members and protect the PPF. This case demonstrates that the regulator’s anti-avoidance powers can be used effectively, even in highly complex international insolvency situations”.

1.3 UNISON would however question whether TPR exercises these powers frequently enough and is too wary over the implications of using these powers to no avail. Perhaps such caution is a result of having insufficient resources for full thorough investigations to be rigorously undertaken.

1.4 It is clear that the time has come for a clear message to be sent out to the effect that mergers and acquisitions cannot be used as a way out of pension liabilities and that all associated companies could be liable for these irrespective of geographical boundaries.

2. Level of Regulator engagement and willingness to use its powers

2.1 In May 2016 TPR reported that “in total we have progressed 16 cases to the point of issuing a Warning Notice” and “The Determinations Panel has chosen to exercise our Contribution Notice three times and FSD powers four times so far”. Given that TPR has been in existence for over 10 years and that over 800 schemes have transferred to the PPF since its creation in April 2005, this would suggest a huge reluctance to fully utilise its powers.

2.2 Why this is so is anyone’s guess. Particularly given that the Supreme Court effectively found in favour of TPR’s FSD’s in the Nortel and Lehmann Brothers cases.

3. Powers relating to scheme recovery plans

3.1 UNISON welcomes the requirement for statutory funding valuations to be approved by TPR. We believe this to be a key independent governance step. However it is vital that recovery plans are flexible and specific to each scheme. Each case is different in terms of scheme demographics, funding level, employer covenant, future profit expectations etc and hence we have to be careful that TPR does not apply a one size fits all style of approach across all schemes.

3.2 Having said this there is clearly a concern over the Regulator’s rather slow and perhaps too flexible approach in dealing with the BHS Pension Scheme’s recovery plan emanating from its 2012 statutory valuation. Our understanding is that the proposed recovery plan was submitted 2 months late, reporting a £200 million deficit to be repaid over 23 years.
4. The balance between meeting pension obligations and ensuring the ongoing viability of sponsoring employers

4.1 UNISON’s view is that many valuation assumptions and investment strategies being adopted by schemes are unnecessarily prudent and cautious. Coupled with historically low gilt and bond yields this is serving to artificially inflate deficits and future service costs meaning rising costs to both sponsors and members.

4.2 Sponsoring employers need to be more forthcoming in questioning some of these assumptions and investment strategies as do members and member representatives as in many cases these are leading to scheme closures or at the very least, moves to cheaper provision.

4.3 It’s also worth noting that even though pension costs have generally increased, so in many cases have profits so there’s often little justification for employers looking to consult on detrimental pension scheme changes when their percentage pension spend relative to operating profit and shareholder distributions remains broadly stable.

4.4 Although there are employers who are struggling to make repayments it should be overlooked that for many employers there is a capacity to make appropriate levels of contributions As set out in the TUC response recent figures from the Pensions Regulator that found that, even under the current regime, the ratio of deficit recovery contributions to dividends has declined over the last five years. For FTSE-350 companies, the median fell from around 17% in 2010 to less than 10% in the latest data, meaning more than half of FTSE-350 companies paid out ten times or more to shareholders than to their scheme. This suggests that many sponsors have more room for manoeuvre in meeting their pension promises over the long term.

5. Discount rates and the wider economic environment

5.1 UNISON’s view is that over prudent assumptions on discount rates is the fundamental reason that many defined benefit schemes are closing and are being regarded as unsustainable. Although other factors are important like the size of the assets and investment strategy, a dependence on gilts is becoming increasingly inappropriate for many schemes.

5.2 This is especially true where the employer covenant is strong. A recent study on the 2013 Valuation results on the LGPS England and Wales showed that if all the LGPS Funds had used the HNM Treasury discount rate for Public Service Schemes (that was at that time 3% above CPI) the size of the overall deficit would reduce from £48 billion to £27 billion.

5.3 More clearly needs to be done to assist sponsors of defined benefit pension schemes and particularly in the area of discount rates and measuring liabilities as it is this area in particular that has led to the relative explosion of cost within these schemes.

5.4 Where assets are not held predominately in gilts, Trustees should be encouraged to move away from Gilts plus method for assessing discount rates and move to Asset Based Returns model. It is an irony that for a sponsoring employer with a reasonable covenant, changing the discount rate to reflect their asset growth and investment portfolio would have a very significant effect on the deficit and amount needed by the employer needed in deficit recovery payment. We have heard of cases where the
funding level has increased by 30% when there has been a move to asset based methods

5.5 Not only does this mean the scheme is funding to continue as a going concern but also the burden on the employer will reduce and make it less likely pension liabilities will weaken the covenant and give better protection to the PPF.

5.6 The unprecedented period of historically low interest rates combined with Government economic policy such as quantitative easing has had very serious repercussions for defined benefit pension schemes and we would welcome any consideration of alternative liability measurement/discount rate approaches that can help to sustain and even encourage employers to offer good quality defined benefit pension schemes at an affordable cost.

5.7 Defined benefit pension schemes should provide one of the most economic and cost efficient forms of providing collective pension saving and this should not be forgotten amongst a period of unprecedented economic challenges.

5.8 Ultimately sponsoring employers and Trustees are often failing to adequately challenge the scheme actuary/advisers on various valuation assumptions with significant consequences. Discount rates are commonly the most significant. 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.

5.9 One should also be aware of the wider economic consequences of the current emphasis on a gilt-based discount rate and the regulatory emphasis on eliminating deficits. As set in the TUC submission it is driving schemes towards fixed interest assets and away from return-seeking assets. In the current environment this has the impact of potentially locking in negative real returns, making the funding of schemes more expensive and depriving the real economy of finance. There has been a move away from return-seeking assets. For instance, between 2006 and 2015, the equity share of total assets fell from 61.1 per cent to 33 per cent, while the gilt and fixed interest share rose from 28.3 per cent to 47.7 per cent

6. The Pension Protection Fund (PPF)

6.1 Schemes should only enter the PPF as an absolute last resort where it is crystal clear that there is no chance of any further money being obtained from the sponsoring employer or connected parties and there are insufficient assets to secure benefits at least equivalent to PPF compensation levels.

6.2 We would not expect any scheme to enter the PPF without independent verification from TPR that there really is no realistic alternative that presents a better outcome for scheme members and beneficiaries.

7. The role and powers of pension scheme trustees – 50% MNT’s

7.1 Requiring Trustee Boards to have at least 50% member representation would go a long way to ensuring better objectivity and accountability in the Trustee/sponsoring employer relationship. Part of the failing in the BHS case appears to be a lack of
transparency in information and a collective reluctance to challenge the sponsoring employer and to hold them to account.

7.2 Increasing member representation on Trustee Boards can only serve to encourage greater debate and help to ensure that the interests of members are fully represented and not lost to the need to make profit and satisfy shareholders with ever increasing dividend payments.

8. Trustees and sponsoring employers need to take action to improve the investment performance of their funds

8.1 The UK suffers from a disaggregated fund structure with few funds of any significant size. Academic and practical evidence and practical supports the creation of large funds, something the government has recognised and is implementing into the Local Government Pension funds in England and Wales.

Generally larger funds they have lower administration and fund management charges by employing internal fund management staff committed to the broad economic and social ambitions of the fund members.

8.2 However, scale and size of pension funds are but one element in a strategy to improve performance. One of the world’s leading experts on governance and pension fund performance, Keith Ambachtsheer, Director, Rotman International Centre for Pension Management, states that funds can improve performance if they meet the following criteria:

1. They align interests with scheme members
2. They have strong governance
3. Sensible investment beliefs – long term patient capital
4. Right-scaled, from $30bn+ of assets under management
5. Competitive compensation for fund staff

8.3 In our view one of the most effective models for pension fund performance is the Canadian public pension fund system. Their well-developed governance structure is one of the main reasons the funds are emulated by their peers internationally.

9. The relationship between TPR, PPF, trustees and the sponsoring employer

9.1 Cases like BHS point to a clear failing in transparency of information and the regulatory system as a whole. For example Lesley Titcomb (the Chief Executive of The Pensions Regulator) claimed that she was only made aware of the sale of BHS to Retail Acquisitions via the media.

9.2 Furthermore, Sir Phil Green has subsequently claimed he had very little to do with the pension scheme and was largely kept in the dark over the investment strategy of the pension fund and deficit. In relation to communications with the Trustee Board he stated that “there wasn’t the right dialogue and there wasn’t the right communication. If there was we wouldn’t be here”.

9.3 As economic conditions have deteriorated for defined benefit pension scheme sponsors over the years there is clearly likely to be an increase in the breakdown of relationships between sponsoring employers, the Trustee Board and TPR.
Sponsoring employers by and large routinely have to invest more money into the pension scheme at each valuation and yet deficits are still growing.

9.4 As mentioned above there needs to be more flexibility on assumptions and more engagement with the sponsoring employer but crucially, as illustrated by BHS, there must be better guidance from TPR for trustees on how to assess the employers covenant accurately and pick up any material change in good time.

9.5 It is equally important for the future of adequate DB schemes that the Trustees and members do not accept at face value that the employer weakened without firm evidence and thorough assessment. We are already picking up cases of employers and schemes making vague claims that the affect of Brexit will reduce the covenant and to try and use this as yet another excuse to rush through detrimental changes to benefits.

9.6 UNISON would question whether many sponsoring employers are effectively challenging the valuation assumptions and investment strategies adopted by Trustees and their advisers. Or meekly accepting what they are told prior to consulting on detrimental changes with a view to protecting profit and dividend distributions.

9.5 Sponsoring employers and Trustees also need to question the value for money they are receiving from scheme advisers and this is an area TPR could perhaps play a greater oversight role of.

September 2016