Written evidence from The Pensions Regulator (PPF0091)

I. Introduction

1. The regulatory framework for defined benefit (DB) pensions is set out in the Pensions Act 2004, which also established an independent The Pensions Regulator (TPR) and the Pension Protection Fund (PPF). With the 2004 Act, Parliament took the decision to move to a flexible, scheme-specific funding framework with the safety for members of a robust PPF in the event that sponsoring employers of DB schemes become insolvent. Before 2005 no such safety net existed and members faced substantial losses when companies failed.

2. TPR’s statutory objectives and legal powers are set out in legislation. TPR has a number of areas of responsibility in addition to the regulation of DB pensions, including the implementation of automatic enrolment, regulating occupational defined contribution (DC) pensions (including multi-employer ‘master trust’ schemes), and the governance and administration of public sector pension schemes.

3. In this paper we respond to the Work and Pensions Committee’s call for written evidence on DB pensions. We welcome the opportunity to provide evidence and look forward to engaging fully with the inquiry in the weeks ahead. We have approached this submission by giving an overview of the DB landscape, setting out the legislation and framework governing DB pensions, and then providing more detail as to how we regulate this area in practice. Following our letter to the committee of 24 June this year, we have set out in more detail areas where, based on our experience of regulating DB schemes, we believe there is merit in Government and Parliament considering potential improvements to the legislative and regulatory framework, including the operation of TPR’s powers.

4. We acknowledge there is currently a wider debate on DB schemes amongst stakeholders and commentators: for example, the Select Committee has raised the question of intergenerational fairness. However, as per our role as a regulator, we have not sought to address any such broader questions of public policy in this submission.

II. Executive summary

5. The funding framework for DB pensions is intended to strike a balance between the interests of pension scheme members, the PPF and sponsoring employers. Pension trustees must ensure they have sufficient assets to pay benefits as they fall due, but both they and employers have flexibility over how they structure their funding plans.

6. In the vast majority of situations, schemes are able to agree funding plans which balance the needs of the scheme and its sponsoring employer. There is a minority of schemes where the sponsoring employer will struggle to support its obligations. TPR is prepared to work closely with trustees and sponsors of distressed schemes to secure the best possible outcome for members and the PPF.

7. Our role is to ensure DB schemes are well-run, have credible plans to pay members’ benefits over time and to step in to put things right when they go wrong. We aim to be proactive and prevent problems from developing and we have evolved our approach over time to become more interventionist. However, the framework establishes us as a regulator
not a supervisor, so, typically, we do not maintain an ongoing relationship with all schemes, but rather engage with them in connection with certain events. We have limited resources and focus our interventions on the areas where we perceive there to be the greatest risk to our statutory objectives. There will always be some schemes and events with which we are not able to engage.

8. We have strong anti-avoidance powers to prevent employers from avoiding their obligations and misuse of the PPF. We have recovered over £400 million for pension schemes through their use, including cases where exercising our powers has helped bring about a suitable settlement. This is in addition to our ongoing engagement with pension trustees, sponsoring employers, and the wider pensions industry which is helping to secure billions of pounds in deficit recovery contributions each year. We are also prepared to consider creative solutions in cases where employers are at risk of insolvency to try to secure a better outcome for members and to prevent schemes entering the PPF.

9. Our remit requires us to prioritise our work and the use of our resources effectively, both within DB and across all aspects of our work. We are confident that our staff have the right capabilities and experience to conduct complex investigations and the technical work involved in assessing scheme funding arrangements.

10. We believe that the system is broadly working as Parliament intended and that in the vast majority of circumstances pension scheme trustees and sponsoring employers are able to agree recovery plans that balance their respective needs, and that sponsors are able to make the required contributions. However, it is right that the funding framework for DB schemes and associated regulatory regime should be kept under review and, drawing upon our regulatory and operational experience over the last decade, we have identified a number of ways in which we believe that the current legislative and regulatory framework could be improved.

11. We have set out our high level views on how this might be achieved below, which we are also discussing with the Department for Work and Pensions (DWP), our sponsor department. These include:

- A further evolution of TPR’s operational approach to focus more intensively on the schemes that present the greatest risk.
- Enhanced information-gathering and investigatory powers.
- Greater flexibility over valuation periods, including requiring more regular valuations for higher risk schemes.
- Clarifying TPR’s scheme funding powers so that we can specify an appropriate level of funding and contributions.
- Mandatory clearance in a targeted set of circumstances where corporate activity may pose a material risk to a scheme.

12. However, it is important to emphasize we do not see evidence of a systemic problem with affordability – most employers will be able to support their schemes making use of the flexibility within the funding framework established by the 2004 Act.
III. Background

The DB landscape

13. The last decade has been extremely challenging for the trustees and sponsoring employers of DB pension schemes, as a result of the prevailing economic climate, including persistent low interest rates and market volatility. Alongside increased longevity, investment conditions have made it more expensive for employers to meet their pension promises. Large deficits do not by themselves mean that the system is not working. DB pensions are long-term commitments and many schemes will be paying out benefits for the better part of this century.

14. The proportion of schemes open to new members has fallen by two-thirds, and the DB landscape is now defined by a large number of closed schemes servicing legacy liabilities. As the landscape is maturing, and the cash payments required from schemes to pay promised pensions are increasing, schemes’ investment strategies have been on a long-term trend towards reducing risk and better matching the required pensions payments and liabilities (buying assets which change in the same way as a scheme’s liabilities).

15. There are a variety of different ways of measuring pension scheme liabilities for different purposes. Scheme Funding (also known as ‘technical provisions’) represents the amount that the particular scheme and its sponsor believe they need in order to ensure members’ benefits are paid. This is the measure used by schemes conducting their triennial valuations and is the most relevant figure to understand the current funding requirements in the DB universe.

16. The different methodologies for calculating liabilities are set out below:

- **Scheme Funding** (or ‘technical provisions’) is the measurement used by schemes to determine the amount of assets they should hold now to pay for member benefits in the future. The assumptions used to place a value on the promised member benefits are scheme-specific and agreed by trustees and employers. One of the key assumptions is the future growth of the assets held by the scheme now and in the future. Assumptions must be chosen ‘prudently’, a term which is not defined. TPR’s funding code of practice sets out that trustees and employers should reach agreement on the assumptions by understanding the risks they run, their appetite for these risks as well as the employer’s ability to underwrite them should assumptions not be borne out in practice.

- **Buy-out**: the buy-out, or s75, valuation estimates how much money would be needed to secure pension benefits in full by purchasing annuities with an insurance company. Buy-out figures illustrate how much it could cost to secure all benefits immediately, which is not usually something that we expect to happen. Buying out a DB scheme is expensive. Few schemes are funded on a buy-out basis, nor is there a requirement for them to be so.

- **Company accounting measures**: International Financial Reporting Standards exist which define a method by which companies calculate their pension liabilities for the purposes of reporting in their annual report and accounts. The accounting measure values assets and liabilities based on principles set out by the relevant accounting standards and they allow analysts and others to compare companies using a more
consistent measurement of their pension scheme liabilities that does not necessarily take account of scheme specific aspects.

- **PPF/s179:** valuation under s179 of the Pensions Act 2004 relates to the compensation offered by the Pension Protection Fund (PPF). The measure adopts assumptions based on PPF prescribed methodology and values the compensation that members would be entitled to receive in the PPF. The valuation shows the extent to which the scheme would have to call on the PPF, or not, in the event of insolvency.

17. The funding landscape has changed and we show a simplified view of the broad movement in the funding of the DB universe since 2006 in the chart above.

18. The chart illustrates the change in the Scheme Funding position relative to the PPF/s179 measure. The main drivers of the reduction in funding levels and increasing deficits has been the continuing fall in interest rates over much of this period.

<table>
<thead>
<tr>
<th>Estimates based on 31 August 2016 market conditions</th>
<th>Scheme Funding (technical provisions)</th>
</tr>
</thead>
</table>

1 This illustration of the development of the funding position of the universe of DB schemes is based on the PPF’s 7800 index and shows the assets and section 179 liabilities from that index along with technical provisions. The technical provisions are an approximation, based on highly summarised data, intended to indicate the broad movements of the two measures (PPF and technical provisions) over this period.

2 The figures provided in the table above are based on scheme valuation data supplied to the TPR by schemes. This data is then updated to a common date using changes in market indices for principal asset classes. Changes in liability values are determined solely by changes in bond yields. The approximation makes allowance
<table>
<thead>
<tr>
<th>Number of schemes</th>
<th>c.5,800</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of members</td>
<td>c.11.2m</td>
</tr>
<tr>
<td>Assets</td>
<td>£1,600bn</td>
</tr>
<tr>
<td>Liabilities</td>
<td>£2,000bn</td>
</tr>
<tr>
<td>Deficit</td>
<td>£400bn</td>
</tr>
<tr>
<td>Funding level</td>
<td>80%</td>
</tr>
</tbody>
</table>

19. The DB landscape is very diverse. Of the 5,800 schemes, only 7% (c.400 schemes) are large with over 5000 members; 35% (c.2000 schemes) are small, with less than 100 members. As well as variation in size and design, schemes also use diverse assumptions in funding based on their particular circumstances. Whilst the flexibility in the system can accommodate and is designed to recognise this diversity, it may be worthwhile exploring ways in which consolidation and bringing scale to the DB universe could improve efficiencies for small schemes, or bring greater control of risk to stressed schemes.

*TPR's objectives and responsibility for DB schemes*

20. TPR works to ensure that DB pension schemes are adequately funded and run in the best interests of members. Responsibility for the management of schemes rests, in law, with the scheme trustees. Trustees have a wide range of responsibilities and it is required that they have the necessary knowledge and understanding to fulfill their role effectively and to challenge employers over funding plans, acting as the first line of defence for scheme members.

21. Our statutory objectives are set by Parliament and those relevant to our regulation of DB pensions are:

- To protect the benefits of members of occupational pension schemes.
- To promote, and to improve understanding of the good administration of work-based pension schemes.
- To reduce the risk of situations arising which may lead to compensation being payable from the PPF.
- To minimise any adverse impact on the sustainable growth of an employer.

22. Parliament gave TPR the last objective in the Pensions Act 2014 in respect of scheme funding arrangements. At this time it was felt that, in the context of difficult economic conditions, deficit reduction contributions could be a barrier to employer growth and, working with trustees and employers to regulate funding arrangements, we should have specific regard to the effect of proposals on the long-term sustainability of sponsors. Our view is that

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for deficit repair contributions and an assumption for hedging strategies, but no other scheme experience or net income. There are other data and methodology simplifications which we do not cover in detail here.
this change provided helpful additional transparency and made explicit the flexible approach already built into the funding framework.

23. TPR has to strike a balance between its different objectives and the stakeholders whose interests they reflect. Members and the PPF are best-protected by well-funded schemes, but this has to be balanced against the need to ensure sponsors are able to invest adequately in the sustainable growth of their business and thus the health of the wider economy. We would emphasise that over the long term, the best security for any DB scheme is to have a sustainable and ongoing employer. It is in the scheme’s interest that the employer survives and, ideally, flourishes in order for the scheme to meet its pension promises to members.

**Scheme specific funding**

24. The Pensions Act 2004 sets out specific duties for employers in respect of the schemes they sponsor and introduced a more flexible and scheme-specific approach to DB funding in contrast to the previous rigid, rules-based framework. Under the pre-2004 regime, employers were only required to meet a minimum funding requirement (MFR). MFR was a rigid and weak approach and resulted in some employers contributing the minimum possible, rather than making contributions appropriate to the specific circumstances of their scheme. In the most severe cases, this underfunding left members facing significant losses in the event of a scheme wind-up.

25. Under the current scheme-specific framework, schemes are required to have sufficient assets to pay out benefits as they fall due. Funding rules require pension trustees to carry out a valuation at least every three years to assess whether they have sufficient funds to meet members’ benefits, and, where the scheme is in deficit, they must put in place a plan to repair any deficit, known as a recovery plan. Pension trustees can choose the effective date at which they carry out valuations and have up to 15 months to agree their valuation and recovery plan with the scheme sponsor and submit these to TPR.

26. As explained above, valuations are based on assumptions agreed by trustees and employers, and any recovery plan will need to reflect the needs of the scheme and the strength and plans of the employer. In practice, this provides significant flexibility, enabling trustees and sponsoring employers to agree assumptions, funding targets and recovery plans that are right for the scheme and sponsor. It enables them to smooth out changes in valuations over the period of the recovery plan and results in the level of deficit recovery contributions paid remaining far more stable over time than the volatility in valuations would suggest.

**TPR’s anti-avoidance powers**

27. TPR has been given strong anti-avoidance powers to stop employers from walking away from their liabilities and leaving them to be met by the PPF, which is funded by a levy on other DB pension schemes. Where we suspect that action has been taken, or an action has failed to be taken, with the intention of an employer avoiding their legal obligations to a DB pension scheme, we can step in to secure redress for members and if appropriate the PPF.

28. Our anti-avoidance powers are, in brief:
• **Contribution Notice:** this allows us to direct that, where there is a deliberate attempt to avoid a statutory debt, those involved must pay an amount up to the full statutory debt either to the scheme or to the PPF.

• **Financial Support Direction:** this requires financial support to be put in place for an underfunded scheme where we conclude that the sponsoring employer is either a service company or is insufficiently resourced at the relevant time. There is no requirement for there to have been an act or failure to act.

**Clearance**

29. Clearance can be sought by employers, and those associated or connected (companies and individuals), involved in any transaction which is ‘materially detrimental’ to the ability of a DB pension scheme to meet its liabilities. This could be a transaction that affects either an employer (for example a merger or acquisition) or a scheme (such as an agreement to compromise the employer’s liability toward a scheme).

30. Clearance is voluntary and the onus is upon the applicant to approach TPR if they wish to benefit from clearance. There is no obligation on a company to submit a clearance application for any transaction, or other relevant situation.

31. Where clearance is sought, the employer or relevant party will submit details of the transaction, along with details of the measures proposed to mitigate the detriment. We will then consider whether the proposed mitigation is sufficient (this may be in the form of cash, guarantees or any other security) in light of the detriment that the scheme would experience. The applicants and the trustees should have discussed the transaction and the proposed mitigations before approaching us.

32. Where applicants provide us with all the information we need to make an informed decision we are able to turn around requests for clearance quickly. If TPR is minded to grant clearance, we will issue a statement that we will not use our anti-avoidance powers in relation to the particular transaction described in the clearance application.

**IV. TPR’s regulation of DB schemes**

**Our regulatory approach to scheme funding**

33. TPR’s approach is to educate and enable schemes, trustees and employers to do the right thing but we are prepared to intervene and enforce through the use our regulatory powers where necessary. TPR works to educate and enable pension scheme trustees to perform their role, through the provision of published codes of practice, guidance and educational tools, and raising issues directly with trustees via our casework.

34. Responsibility for agreeing appropriate funding levels lies with trustees and employers. TPR’s role is to support them in doing so and for many schemes we only need to intervene where they fail to agree, or reach a decision where we believe that the assumptions are not prudent, or the recovery plan is inappropriate.

35. We expect trustees and employers to work together to ensure a scheme is taking an acceptable level of risk and secure the best and fairest outcome for both the scheme and the employer.
36. Generally speaking, schemes benefiting from a strong employer covenant (the sponsoring employer’s ability to support the scheme) can afford to take more risk. However, TPR encourages schemes to put in place integrated plans to ensure that funding, covenant and investment risks are properly understood and managed in the round, and to have contingency plans in place to better manage any downside events.

37. Over time we have refined our approach to be more focused, responsive and proactive, including:

- Focusing our resources on those recovery plans we consider of greatest risk to not providing good outcomes for members, and the protection of the PPF, allowing us to engage in a more robust way.
- Using our risk assessment framework to identify a group of high-risk schemes to approach in advance of schemes submitting their triennial valuations, every year since 2012. The criteria for identifying these schemes are reviewed each year.
- Publication of an updated DB code of practice and supporting guidance on integrated risk management and employer covenant, as well as online educational material on DB investment and valuations.
- Publication of an Annual Funding Statement setting out our expectations to schemes and sponsoring employers currently undertaking valuations, every year since 2012.

38. Engaging proactively with higher-risk schemes ahead of their valuation being submitted allows us to influence the outcome more robustly than waiting for valuations to be formally submitted to us. Over recent years we have increased the proportion of our resources dedicated to this type of casework, and these cases now constitute around a third of our scheme funding work.

39. Whilst some schemes and sponsoring employers face considerable challenges, at the other end of the spectrum there are companies paying out dividends that are multiples of their deficit recovery contributions, or that have considerable cash reserves. Based on our analysis of the DB landscape and our casework, we believe that, in the majority of circumstances, trustees and sponsors are able to agree recovery plans that balance their respective needs. We do not believe there is compelling evidence of a systemic affordability issue and believe most schemes will be able to pay benefits as they fall due.

40. In cases where weak schemes are supported by businesses at material risk of insolvency, our aim is to work closely with the pension trustees, sponsoring employer and PPF to manage the risks and reach the fairest outcome in challenging circumstances.

41. A mechanism called a Regulatory Apportionment Arrangements (RAA) may be used in rare circumstances where the employer’s insolvency is inevitable. An RAA involves the link between the sponsoring employer and the scheme being severed. TPR applies a stringent set of criteria to avoid RAAs being abused through employers’ responsibilities being inappropriately passed to the PPF. The PPF has its own criteria which are consistent with those of TPR.

42. In most cases involving an RAA, the pension scheme enters the PPF. However, we have demonstrated that by exploring options and working collaboratively with the pension

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3 See TPR guidance statement ‘Regulated apportionment arrangements (RAAs) and employer insolvency’ http://www.thepensionsregulator.gov.uk/docs/regulated-apportionment-arrangements-statement-august-2010.pdf
trustees, sponsoring employer and PPF in cases such as Halcrow and Uniq, it is sometimes possible to reach outcomes that balance the interests of the parties concerned and avoid PPF entry, for all or part of the scheme.

**TPR’s regulatory approach to avoidance**

43. In a limited number of cases we become aware of situations where employers are seeking to avoid their responsibilities. In most cases, we succeed in achieving the best possible outcome for pension scheme members through discussion and negotiation without having to resort to an adversarial enforcement process. But we will not hesitate to investigate and, if appropriate, invoke our regulatory powers where it is the right thing to do.

44. Our Financial Support Direction and Contribution Notice powers, explained at paragraphs 27-28, are strong powers and TPR is required to make its case for their use to our Determinations Panel, a committee of the regulator that makes decisions on the exercise of a range of TPR’s major powers. The decision is then appealable to the Upper Tribunal (known as a ‘reference’). There is no doubt that our anti-avoidance investigations can be long and complex and the decision and appeals processes can add further time, although checks and balances are undoubtedly appropriate in such significant cases. We do not have the power to fine the targets of our powers, nor do we have the ability to recover our costs. In the majority of cases, settlement has been achieved to secure satisfactory redress without progressing through the full process. We will not be pushed into doing bad deals which would not secure appropriate levels of redress for members and/or the PPF, but we also have to balance considerations of the length of time cases take, the costs involved and the uncertainties inherent in the legal process, in deciding whether and when to settle.

45. Use of our anti-avoidance powers has led to the recovery of over £400m for pension schemes, including through settlements, without the need for formal proceedings. The largest settlement to date was in the Lehman Brothers case, sufficient to cover the scheme’s estimated £184 million buy-out deficit, and enabling members to receive full benefits. TPR has used its power under Section 89 of the Pensions Act 2004 to publish a report on this case, in addition to other cases which have involved settlements such as Great Lakes, MF Global, Carrington Wire, and MG Rover.

**Our capability and resources**

46. Our work often requires us to engage with large, well-advised companies and/or engage on technically complex questions around funding and valuation. We are confident that we can and do employ people with the right capabilities, skills and experience to regulate DB pensions and conduct complex investigations in this challenging environment. We have case teams with deep experience of the pensions and insurance industries, as well as experts with a background working in major accountancy firms, investment consultancy, and large actuarial and legal firms. In addition, we buy in additional specialist experience, as required, for particular cases or other work.

47. However, regulating DB schemes is only one aspect of TPR’s work. We have a number of other regulatory responsibilities which also require a considerable commitment of resource. We are responsible for maximising the compliance of employers with their duties under

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automatic enrolment, for regulating the governance and administration of public service pension schemes, for combating pension scams and for regulating DC schemes and 'master trusts'.

48. At present TPR has around 500 staff in total. About 200 people work on the levy-funded regulation of pension schemes, of which approximately 150 staff are focused on the regulation of DB pensions. This includes case teams, supported by expert advisers, such as lawyers, actuaries, business analysts and investment consultants. Staff in our policy, regulatory transactions, customer support and communications teams also spend a significant share of their time on DB, in particular education and guidance. In addition, around 140 people work on automatic enrolment and a further 160 on back office functions.

49. We prioritise, across all areas of responsibility, on the basis of risk, focusing our attention on those areas which represent the greater risk to members' benefits and to our other objectives. We are continually refining this approach on the basis of experience and to reflect the emergence of new risks, and movements in our relative ranking of risks. Further information on our budget and resources is set out at the Annex.

V. Looking to the future

50. The pensions landscape has evolved significantly since the Pensions Act 2004. Economic conditions, in particular ongoing low interest rates, have changed the terms of the challenge that DB pensions and their sponsors are facing. Despite these challenges, we believe that funding arrangements and the associated regulatory framework are broadly working as Parliament intended, and that in the long term most schemes will be capable of paying members their promised benefits. We have, however, identified a number of areas where, based upon our operational experience over the last decade, we believe that there would be merit in exploring potential improvements to the legislative and regulatory framework, including the operation of TPR’s powers.

Evolving TPR’s approach

51. We continue to evolve our regulatory approach to meet the challenges of the prevailing environment. The funding framework set out under the Pensions Act 2004 is now well-established. Hence, over the last decade, we have moved towards a more interventionist approach with a number of those schemes that we have identified as posing the greatest risks to members' benefits or to the PPF, as evidenced by our proactive engagement with higher risk DB schemes ahead of their triennial valuations being submitted.

52. We believe that this journey should continue with TPR focusing heightened attention on high risk schemes. Part of this is for us to take forward internally, but there are areas where we believe legislation could be reviewed and improved. Further to our letter to the Select Committee of 24 June, we have set out below some areas we believe there is value exploring whether there are potential improvements to the funding framework, including TPR’s powers, which would enable us to regulate DB schemes more effectively.

53. It is important to highlight that if Government and Parliament wishes TPR to adopt a more interventionist approach, for example through more frequent engagement with a wider range of schemes on funding issues, we do not believe this could be successfully delivered with
the current level of resources, or regulatory tools available to us. It is also essential that, where TPR is been given significant additional responsibilities (such as with automatic enrolment, regulation of public service schemes and as is anticipated to be the case with the supervision of ‘master trusts’), the need to increase our budget and headcount is understood and addressed, in order to maintain and, ideally, enhance our effectiveness as a regulator.

**Information gathering**

54. In order to further strengthen our ability to act swiftly, before things go wrong, we believe that some improvements to our powers could be considered by Government and Parliament, including:

- More flexible information-gathering powers and an enhanced duty on parties to provide TPR with information and cooperate with TPR during our ongoing engagement with schemes.

- Enhanced investigatory powers when we move into enforcement mode – compelling parties to submit to interview, civil penalties for refusing to divulge information, and the ability to ‘seize and sift’ relevant documents as appropriate.

55. Information flow from schemes to TPR is critical to targeting our interventions and acting quickly. It is a key tool in assessing risk and focusing our resources and would be a key component of any change in our approach. We believe that such powers would be similar to those available to many other regulators and would ensure we have the right information at the right time to enable a more targeted regulatory approach.

**Valuations**

56. We believe the basis of the valuation process could be revisited in light of improvements in technology and to take advantage of real time information. Measures that could be considered include:

- Greater flexibility over valuation periods – allowing us to require more regular valuations from higher-risk schemes whilst allowing a longer period between formal valuations for well-run/funded schemes.

- Staged reduction of the statutory valuation period from 15 months (which runs from the date of the valuation to the point at which it has to be agreed and where appropriate submitted to TPR) facilitated by improvements in technology and industry understanding.

57. Valuations are a vital part of the scheme funding process as they set the groundwork for understanding the position of the scheme and making decisions on risk and funding strategies. At present, schemes carry out formal valuations once every three years with annual updates, although many will also receive much more frequent monitoring reports. We encourage schemes to take a more ‘ongoing monitoring’ approach to managing their scheme. A more risk-based and segmented approach to the timing of valuations and/or updates could make this process more effective.

**Scheme funding**
58. Improvements to TPR’s scheme funding powers which could be considered include:

- Clearly specifying desired outcomes and acceptable parameters for scheme funding, taking account of scheme specific circumstances and market conditions. Acceptable outcomes could be centred around funding strategies with appropriate levels of risk rather than individual parameters such as length of recovery plan.

- Shifting the focus of funding powers where assumptions are not prudent or recovery plans are not appropriate, so the burden of proof is on schemes to justify their approach.

59. In our view, the subjectivity in legislation, specifically around what ‘prudence’ or ‘appropriate’ mean, can be a barrier to TPR achieving acceptable outcomes from our interventions.

60. We are not proposing a return to the days of the MFR, which did not properly account for employer covenant or market conditions, nor undermine the flexible and scheme-specific nature of the system. Clearly specified outcomes for schemes in different sets of circumstances could help enable us to ensure that schemes are funded appropriately and that those that should pay more do pay more.

61. In our 2014 consultation on the DB code we raised the possibility that we could make public our own internal risk indicators and criteria to assess the risks schemes pose to our objectives and thus to specify outcomes. The responses were finely balanced but at that time we felt it could have led to unhelpful ‘herding’ behavior for TPR to be seen to be setting one or more benchmarks in a scheme-specific regime.

62. While we can look again at this, we do not have the power to set rules. Parliament may wish to lay down such requirements in law so there is no doubt as to the position. This is the case for scheme funding in many other countries and in other areas of financial services.

63. Use of our powers requires interpretation of ‘prudence’ and ‘appropriateness’ and it can be difficult for us even to get schemes and employers to engage with us where we consider that they are failing to meet these fairly subjective criteria. Shifting the burden of proof so they are required to demonstrate that they meet the requirements may make regulation of this area more effective.

**Corporate actions**

64. New obligations for employers to approach TPR for clearance could be considered by Government and Parliament, such as:

- Mandatory clearance where a corporate action significantly weakens the scheme sponsor and the scheme is not sufficiently funded.

- Enhanced notification requirements and whistle blowing requirements to ensure we cannot be deliberately excluded from discussions.

65. TPR’s anti-avoidance powers are designed to operate retrospectively to seek redress. While they act as a powerful deterrent, they cannot prevent avoidance activity on the part of employers prepared to take the risk. At present, employers can apply to TPR for clearance, but this is a voluntary process for the benefit of the applicant, as at paragraphs 29-32.

66. Moving forward, we believe it may be appropriate for Government and Parliament to consider making it mandatory for employers to approach TPR for clearance in certain
circumstances, and for TPR approval to be required before an action can go ahead. This has the potential to be a significant burden on employers and impact on corporate activity, therefore we believe any such a proposal would require further discussion and engagement with stakeholders and should only be taken forward in a targeted and proportionate way. Clear criteria as to when approval should be sought would be necessary. This could include circumstances where the action weakens the scheme sponsor, not just the sale/purchase of a business but in circumstances including where support (covenant) for the scheme is weakened through corporate activity such as dividend payments, change of control, share buy-backs and loans. If the scheme is sufficiently well-funded, then adding the burden of requiring approval from TPR may be unnecessary.

67. For such measures to work, we believe that enhanced requirements on employers to engage with trustees and provide them with the relevant information when required would also be needed. This would allow them time to come to an agreement over any required mitigation for the scheme. We note that there are already similar requirements in law that TPR should be approached for clearance in respect of the separation of investment and retail banks, where there are shared DB pension arrangements.

Conclusion

68. We have set out above the background and operation of the scheme funding framework and our views of areas where, based on our experience of regulating DB pensions, we believe there is merit in exploring potential improvements to the legislative and regulatory framework. We look forward to discussing these areas further with the Select Committee in coming weeks.

September 2016
Annex – TPR budget and resourcing

Budgeted resource distribution by directorate 2016-17

<table>
<thead>
<tr>
<th>Category</th>
<th>2016-2017 agreed budget (£000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income (interest)</td>
<td>(24)</td>
</tr>
<tr>
<td>Salaries</td>
<td>36,540</td>
</tr>
<tr>
<td>Non-Payroll staff costs</td>
<td>1,007</td>
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<tr>
<td>Other staff costs</td>
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<tr>
<td>Consultancy</td>
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<td>Professional services</td>
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<td>Communications</td>
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<td>Outsourced contracts</td>
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<td>Accommodation/general costs</td>
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<td>Depreciation</td>
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<tr>
<td>Fixed asset costs</td>
<td>950</td>
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<tr>
<td>Total</td>
<td>79,527</td>
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</tbody>
</table>

* This includes Corporate Secretariat, the CEO office, PA support for the organisation, and administration support for the Determinations Panel

Diagram based on FTE split by total budget for directorate