Written evidence from Unite (PPF0093)

Unite is the UK’s largest trade union with over 1.4 million members across all sectors of the economy including manufacturing, financial services, transport, food and agriculture, construction, energy and utilities, information technology, service industries, health, local government and the not for profit sector. Unite also organises in the community, enabling those who are not in employment to be part of our Union.

Our members generally regard defined benefit (DB) schemes as being the preferred form of company pension provision and both regret and oppose the widespread moves away from providing them by private sector employers.

Members value the greater certainty as to the pension outcome and the generally better benefits which can result from the efficiencies realised through this form of collective provision.

Why DB provision has declined

Rising life expectancy, volatile financial markets and low interest rates do present a big challenge to defined benefit schemes but we do believe that those challenges can and should have been managed in a better way as would have allowed more schemes to continue on a sustainable basis and those continuing to provide better benefits than are often now provided.

Actuarial and accounting practices compounded by mis-guided regulation have compounded the economic and demographic challenges rather than helping schemes and employers to manage them. In particular the drive to de-risk investments has inflated pension deficits and hugely increased the cost of future service benefits.
This situation has been developing over many years with notable factors being the change to mark to market accounting and valuation of pension schemes on current market values, denying the opportunity to take a long term view, through to the current approach of gilts-plus methodology to determine investment returns, regardless of that market being grossly distorted.

If decent levels of pensions are to be provided then schemes necessarily must invest contributions in return-seeking investments over the long term. Without taking some risk there will be little reward and pension saving ceases to be viable. Yet all the pressure on defined benefit schemes has been to reduce risk.

Too great an orientation towards bond-based investment strategies results in excessive prudence and guarantees that the cost of benefits will be high. It represents a ‘solution’ which crystallises a problem rather than solving it.

We have experience of asking employers to withdraw proposals to close off DB schemes and them responding by saying they will only do so if the contributions they are prepared to provide are invested on a risk-free basis (generally defined as being gilts) and benefits are reduced to reflect what contributions invested on that basis will pay for. This generally means that the cost of providing pensions might double and so the future pension is halved. This then makes a defined contribution scheme look relatively more attractive.

The whole point of defined benefit schemes is that they are collective schemes which can and should be able to take more risk than an individually invested pension and so deliver better value. This, just as much as the employer underwriting them, is what makes scheme’s viable. The effect of de-risking makes the employer the first resort rather than the last resort.

**Changes in the law**

The debate about the future of defined benefit schemes has brought some key principles of law into debate, which it should not have done.
The employer debt legislation says that an employer is liable to fund pension schemes such that members will get their promised benefits. It was enacted to stop employers walking away from their pension liabilities by closing down schemes and leaving them in deficit. Only in the event of insolvency of the employer does this key safeguard break down.

Closely related to this is the legislation which prevents accrued pension benefits being reduced without the consent of the members. While many schemes prior to this had rules written so as to stop retrospective changes many did not and the extent of protection under common law (etc.) was questionable.

It is now being suggested in some quarters that the law should be changed so as to allow accrued pension benefits to be reduced without member consent in order to ease scheme funding problems and to relieve the cost burden on employers. In particular the idea of a CPI over-ride is being promoted. These arguments generally come from pension ‘experts’ whose main income is earned as retainers of the companies as might benefit handsomely from this.

A change to CPI indexation would generally be reckoned to result in a cumulative 1% p.a loss of value in a pension benefit, so it is more than just a technical adjustment to those affected. A pension scheme is akin to a contract between the member and the scheme, and its guarantor the employer. How can it be justified for the law to intervene in that contract to favour one party at the expense of the other?. Why should a pension ‘contract’ be different to any other contract which an employer has?.

There is some perverted logic argued here that it is in the best interests of the members to have this ‘haircut’ imposed on their benefits. Arguments about inter-generational fairness or it being in the interests of maintaining employment are advanced. If this approach has any validity this will often mean that it is in the interests of employees other than those affected by the reduction in benefits. If it is in the interests of those who will be affected then the case can be put and members consent can be invited.
In reality, of course, there is little reason to believe that allowing such a change would have the effect of improving the pensions or employment prospects of any employees. It may just serve to increase company profits. One consultancy firm (LCP), surprisingly, recently saw fit to combine a report that FTSE100 companies had paid out five times as much in dividends as they had in pension deficit payments with a call for a CPI over-ride.

The PPF

The introduction of employer debt legislation was followed by the establishment of the PPF, which was designed to provide a safety where, as is inevitable, some employers fail and leave behind under-funded pension schemes. The PPF was also driven by a Government obligation to protect employees pension savings in the event of company insolvency.

The PPF is a mutual insurance scheme, any government funding having been denied. The general idea of insurance is to allow risk to be taken or managed by those insured with the expectation those who call on it will get the compensation paid by the whole group’s premiums and reserves. The idea is that it allows life to go on.

With the PPF there seems to be a notion that strong action needs to be taken to ensure that no schemes/companies make claims on it. If the effect of that is that pension schemes have to be managed in a risk-free way which leads to their not being continued at all then an essential element of the rationale for the Scheme is lost sight of. It is a bit like keeping car insurance claims under control by speed limits and other restrictions which are such as to mean people stop driving cars at all.

If the PPF has to pick up responsibly funded pension schemes which come to it because the employer is insolvent then that should not be a problem as that is exactly what it was supposed to do.

The PPF itself sets a poor example to other schemes insofar as it adopts such a cautious investment strategy. If it took more investment risk it could allow its Levy to
be reduced and its benefit level to be improved, notably by providing higher increases in benefits in payment.

**The Pension Regulator**

The Pension Regulator is charged with a responsibility to protect the PPF. This has contributed to its attitude towards the regulation of defined benefit schemes. While to an extent this has, of late, been balanced off by a responsibility to consider the interests of employers (‘minimise any adverse impact on the sustainable growth of an employer’) it has not been balanced by an objective of seeking to maintain and promote quality (defined benefit) pension schemes.

It could be argued that for the Regulator the only good defined benefit schemes are those which are closed to further accrual and invested so cautiously that they might as well have bought out all their liabilities with an insurance company.

Rather than just intensifying pressure on schemes to de-risk all the time the Regulator should be promoting responsible approaches to managing risk as will allow schemes to continue on a basis which benefits their members and does not put employers under too much pressure. A key part of this is that pension schemes need to be allowed to focus again on the long term so as to ride out short term fluctuations in markets and to invest more in return-seeking assets to keep benefits affordable.

It is a sad fact that one of the biggest obstacles to the adoption of a changed approach is that it would necessitate the Regulator, and others, having to accept that its past strategy has been misguided and some responsibility for the unfortunate decline of DB provision.

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