My conclusions are:

1  **Pension funding rules should be strengthened to give better protection to scheme members and to the PPF**

1a  Since the Pensions Act 2004 set up a new system of pension regulation, including the PPF and Pensions Regulator, the combination of “flexible” funding regulations and the PPF safety net has led to complacency, and even “moral hazard”, on a grand scale for both employers and trustees.

1b  Furthermore, in practice, weak legal funding rules have been applied weakly by the Regulator, which has bent its own rules in a number of high profile cases.

1c  The current “DIY” statutory funding objective should be replaced with a tougher rule-based funding standard, with prescribed deficit recovery periods, to be enforced consistently and transparently by the Regulator.

1d  The PPF s179 valuation, calculating a deficit using the value of smoothed and “stress-tested” pension assets and liabilities, and which all schemes already produce, could easily be used as the new funding standard.

1e  Companies would be required to put in extra cash over, say, 10 years, with, say, 5 years to reach 90 per cent funding.

1f  The Regulator should become more interventionist with companies with high risk pension schemes, well before they face imminent bankruptcy.

2  **Parliament should be cautious about allowing companies to give just the legal minimum annual pension increases**

2a  The rules of about three-quarters of pension schemes give annual pension increases in line with RPI. The suggestion that hard-pressed companies should be able to break their pension promises by giving annual pension increases at CPI, not RPI, with no increases at all for pensions earned before 1997, breaks two fundamental principles:

-  companies can change the terms of new pension promises, but they must pay past pension promises.
- government cannot interfere with any legal contract agreed by two parties, except in exceptional circumstances.

2b Parliament must think long and hard before breaking these two principles, and, if it does, build in watertight safeguards for members. If not, the transfer from pensioners to company shareholders, would amount to “legalised robbery” of pensioners.

2c I do believe that, in extremis, a company should be able to temporarily suspend, but not stop, pension increases above the statutory minimum, but only with the Regulator’s agreement, and crucially, if it stopped dividend payments.

2d If the company’s financial position improved, then the unpaid amount should be paid to pensioners (or their estates) before dividends could be resumed.

3 When acquiring a company with a pension scheme, the new parent should be required to guarantee the scheme

3.1 BHS has reminded us that under the principle of limited liability companies are not automatically liable for deficits in a pension scheme sponsored by its subsidiary.

3.2 The law should be changed to require any company buying another company which has its own pension scheme, to guarantee the scheme. This would encourage the parent to make sure it was properly funded.

3.3 There is a strong argument that this guarantee should also apply to existing subsidiaries. Although this would be retrospective legislation, to be used sparingly, it may be justified by the public policy imperative on pension protection.

4 There is no “crisis” in UK DB pensions, and no need for “crisis” measures

4a Those calling for companies to be able to move to statutory minimum annual pension increases justify this by warning that the Bank of England’s extraordinary monetary actions to kick-start the economy are undermining the whole system of companies’ defined benefit pensions.

They claim that the latest round of QE pushing long-term interest rates even lower, means bigger pension deficits and bigger deficit contributions, forcing perfectly good
companies into bankruptcy, with lost jobs hitting the real economy.

4b But, I believe this is just scaremongering, and that there is no crisis in DB pensions, so there is no need for crisis measures.

4c Subject to my other comments, I believe the regulatory system of companies funding their schemes to pay all pension promises, with compensation for members if they cannot, is working pretty much as it was intended to work.

4d The UK would face a pensions crisis only if the PPF risked being swamped by big schemes with big deficits it could not fund through increasing its levies. But the PPF’s 2016 annual report shows a healthy £4bn surplus and it expects to be self-sufficient by 2030.

4e Crucially, Parliament set up the PPF with a built-in safety valve to handle the risk of being overwhelmed. In extremis, it can cut the compensation it pays to balance its books, freezing pension increases and, if necessary, going further, cutting nominal compensation.

Yours sincerely,

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Further briefing by John Ralfe is available at this link