EXECUTIVE SUMMARY

The National Federation of Occupational Pensioners ("NFOP") represents individual pensioners and has 65,000 members, including former employees of BT, Royal Mail and British Steel. NFOP actively campaigns, inter alia, to protect and support pensioners and pensions.

NFOP are convinced that The Pensions Regulator ("TPR") needs more power to adequately protect pensioners who rely on Defined Benefit pension schemes ("DB schemes"). TPR must proactively define, monitor and enforce new, legally-binding requirements.

In particular, NFOP have seven “Pensioner Recommendations”:

1) **TPR to have the power to enforce DB scheme funding by specifying staged annual funding targets. These targets should be to increase funding to the Pension Protection Fund (PPF) level, then self-sufficiency. TPR to prioritise resources to:**
   
i) DB schemes with deficits that can be funded easily by the company
   
ii) Any financially-challenged company with a DB scheme deficit
   
iii) Any company with a deficit that is large enough to pose a serious risk to the PPF
   
iv) Any DB scheme with an unsatisfactory trustee board (failing independence/skills/pensioner representation)

2) **TPR to require better pensioner representation (and rewriting of DB scheme rules where necessary). This should include:**
   
i) Employees/officers of the company should not form a majority of the board of trustees
   
ii) There must be an independent trustee chair, an independent trustee formally representing pensioner interests, at least one expert financier trustee, and effective whistle-blowing mechanisms
   
iii) Equivalents of good corporate governance, including annual reporting to members, annual/extraordinary open meetings, informing members about risk (analysis/management)
3) PPF to retain existing level of cover for pensioners, plus inflation cover for older pensioners, all with interim government guarantee while the sector recovers. TPR to consider company-funded insurance to cover remainder of expected pension payout

4) Parent companies to be legally responsible for subsidiary pension funding obligations

5) TPR should provide pre-clearance for major transactions relating to a company with a DB scheme

6) TPR to prevent a company favouring other groups (eg shareholders/ management) ahead of pensioners

7) Consideration of whether it would be helpful to create a unified mechanism for evaluating the overall strength of a DB scheme

INTRODUCTION

8) The National Federation of Occupational Pensioners (“NFOP”) represents individual pensioners and has 65,000 members, including former employees of BT, Royal Mail and British Steel. NFOP actively campaigns to, inter alia, protect and support pensioners and pensions.

9) NFOP believes that DB schemes remain viable and must be secured for existing members. TPR has already determined that most companies can afford to maintain them, but have chosen not to. In 2015, FTSE 100 companies paid around 5 times as much in dividend payments as they did in honouring existing commitments to DB schemes. Vulnerable DB pensioners, who have contributed to DB schemes throughout their working lives, rely on the Government to ensure TPR can and does actively rebalance corporate priorities.

10) NFOP welcomes this inquiry and offers seven “Pensioner Recommendations” – see Executive Summary above. We make further comments on our recommendations below, together with some more general comments. We have arranged these within the headings provided by the Inquiry.

DEFINED BENEFIT (DB) PENSIONS REGULATION BY THE PENSIONS REGULATOR (TPR), INCLUDING THE ADEQUACY OF REGULATORY POWERS INCLUDING ANTI-AVOIDANCE PROVISION

11) Once workers retire, they are vulnerable and isolated. The Government and employers, which originally encouraged workers to participate in DB schemes, must protect them. Regulation must ensure that companies, often sophisticated and complex, do not evade or avoid existing responsibilities and obligations to their pensioners.
12) From the BHS case, it would appear that TPR did not have sufficient powers to prevent the final outcome or enforce restitution.

13) In order to adequately and effectively protect pensioners, TPR requires greater power including the power to stipulate legally-enforceable requirements and supervise compliance. Government must encourage proactive exercise of those legal powers.

14) TPR legal power is fundamental for anti-avoidance.

**APPLICATION OF THOSE POWERS BY THE PENSIONS REGULATOR, INCLUDING IN SPECIFIC CASES, OTHER THAN BHS**

15) NFOP draws the Inquiry’s attention to specific cases where TPR powers were inadequate to deal with the complicated structure/restructuring of sophisticated companies:

   i) Tata Steel, “one of the world’s pioneering companies”, claimed it could not afford to fund its deficit UK DB scheme, despite being solvent multi-nationally. TPR had no power to force pension-funding by the parent company.

   ii) In 2011, Halcrow, a UK international engineering consultancy, was sold to CH2M, a profitable US international engineering consultancy with a $5.88 billion revenue (2013). Sale proceeds went to Halcrow shareholders, not to reducing Halcrow DB scheme deficit, despite pensioner request. Moreover, neither the 2011 nor 2014 triennial DB scheme valuations were agreed, contrary to requirement. TPR had no power to require that existing obligations to pensioners were given priority over windfall payments to shareholders.

16) Further comment on “Pensioner Recommendation” 1 (enforcing DB scheme funding):

   i) When TPR defines DB scheme funding targets, TPR should specify amounts, mechanisms and dates.

   ii) Compliance with TPR targets should be reviewed regularly (at least annually).

   iii) TPR to have legal power to limit company payments to shareholders/senior management/board members where targets are not being met

   iv) TPR should consider “naming and shaming” worst-performing companies, and/or select them for “carrot and stick” incentive schemes.

   v) Information about TPR targets, strategy/meeting of TPR targets, compliance/non-compliance with other TPR/PPF requirements should be set out in company annual reports as well as in trustee annual reports.
THE LEVEL AND PRIORITISATION OF RESOURCES FOR TPR

17) Increased spending by TPR (creating new rules and then pushing to get schemes funded) will result in reduced expenditure by PPF (paying pensioners of insolvent DB schemes).

18) Sharing human resources between PPF and TPR appears to be a sensible proposal.

19) Where exceptional activity must be assessed (eg major reorganisation/disposal) responsive skilled expertise will be required either in-house or external. The relevant company should pay the costs arising from this.

20) NFOP encourages the Inquiry to push for the resourcing necessary to help TPR enforce better funding of the DB sector. Costs of an inefficient sector are mounting in terms of government time/money/credibility.

21) Simplified annual reporting (in addition to the triennial reporting) will help TPR to re-assess and reprioritise resources where necessary

22) Regards “Pensioner Recommendation” 7 (a unified mechanism for evaluating the overall strength of DB schemes), NFOP would point out that information provided to pensioners is currently limited and based on triennial figures. It includes:

   i) A solvent deficit figure: the difference between cash-equivalent assets of the scheme and expected cash-payouts of the scheme, if the company remains solvent. This deficit is funded by a company payment obligation.

   ii) An insolvent deficit figure (the “buyout deficit”): the difference between cash-equivalent assets of the scheme and expected future cash-payouts of the scheme, if the company goes insolvent. Any deficit is funded by limited compensation from the PPF, with no guaranteed level.

   iii) A statement of whether or not the trustees deem the payment obligation from the solvent company to be sufficient, based on a “covenant review” by advisors, and reassurance from the company. Despite the importance of this decision (the payment obligation may be for £ billions with payment dates many years ahead), no detail is given.

23) Pensioners consider this information insufficient and unreliable, due to conflict of interest concerns. Pensioners need an annual, clear and comparable overall measurement to evaluate the strength of their DB schemes, and detail of how it was determined.

24) This valuation, and a second measurement of deficit against company value, would help TPR prioritise resources.

WHETHER A GREATER EMPHASIS ON SUPERVISION AND PRO-ACTIVE REGULATION WOULD BE APPROPRIATE
25) Yes. See the seven specific “Pensioner Recommendations” in the Executive Summary

26) All parent companies (direct, ultimate, in-between) should be made legally responsible for a subsidiary company’s DB scheme funding obligations, regardless of jurisdiction.

27) TPR pre-clearance should apply to major transactions by all such parent companies.

28) Whether companies are state-owned or private-owned, new regulations should apply. All pensioners deserve the same protections.

29) Further comment on “Pensioner Recommendation” 5 (pre-clearance for major transactions):

i) If there is to be a major reorganisation/disposal\(^1\) of a company or its major assets, and that company has a DB scheme which is not fully funded, or remains open to new members, then TPR pre-clearance should be required. Costs, including of sufficient expert advice, to be paid for by the companies involved. TPR/trustees should be fully informed about the proposed transaction by the company, in advance.

ii) TPR (consulting with the trustees) shall assess:

   a) current and proposed DB scheme funding and commitment to funding

   b) whether any other group is gaining advantage as a result of the transaction (eg shareholders, officers, senior management) in a way that is unfair to pension scheme members

iii) If TPR considers that the DB scheme value will fall after the transaction or the transaction is unfair to pension scheme members, TPR shall have power to prohibit the transaction.

iv) The Takeover Code, designed to avoid unfair treatment, might be extended to reflect and support these proposals.

\(^1\) Note: “reorganisation/disposal” includes mergers, takeovers, sales, buybacks, special dividends and linked transactions – an appropriate description of all such major transactions should be developed
30) If TPR has new regulatory powers it will have an impact on company commercial decision-making/operation, since companies would be required to prioritise commitments to DB schemes ahead of other, more recently-determined, commercial aims.

31) This would be appropriate. The companies set up their DB schemes and should honour their commitments if they can. TPR has assessed that most of them are able to do so.

THE PENSION PROTECTION FUND (PPF), INCLUDING THE SUSTAINABILITY OF THE PENSION PROTECTION FUND

32) Further comment on “Pensioner Recommendation” 3 (PPF to retain existing level of cover):

i) NFOP want a securely funded PPF to protect vulnerable pensioners.

ii) Some companies may think that the existence of the PPF is a reason for companies to avoid funding DB schemes. It is not. Forceful requirement by TPR that companies fund their DB schemes will make this clear. As TPR fulfils its new role, the burden on the PPF will ease, and it will become, as intended, a last-resort safety-net.

iii) In addition, DB schemes could be given greater priority in company insolvency, leaving less to be funded by the PPF.

THE FAIRNESS OF THE PPF LEVY SYSTEM AND ITS IMPACT ON BUSINESSES AND SCHEME MEMBERS

33) Companies should continue to pay the levy. Companies with weaker schemes should pay relatively larger levies, as this is fair and incentivising - they represent larger risk to the PPF. However levies should be adjustable by the PPF, liaising with TPR, where companies face particular difficulties.

34) PPF should liaise with TPR on potential “name and shame” policies and incentive schemes.

THE ROLE AND POWERS OF PENSION SCHEME TRUSTEES

35) DB schemes often manage greater assets than the company itself. This means governance of DB schemes is no less important than governance of the company.

36) Further comment on “Pensioner Recommendation” 2 (better pensioner representation and corporate governance):

i) Most trusts (charitable, family, etc) involve one person locking up cash for another, with careful restrictions by the donor on how and when the beneficiary can access the cash. DB scheme trusts are different. The cash is contributed by employees (or pursuant to
obligations owed to them in their employment contracts) and ultimately it is returned to them.

ii) Transparent and accountable governance structures and practices, such as those that benefit investors in companies (e.g., UK Code for Corporate Governance) must be introduced, to give pensioners assurance and knowledge that their assets are being safely managed.

iii) Company advisors drew up DB schemes, protecting the company. TPR should assess existing sector standards, requiring any changes necessary to protect pensioners.

iv) In particular, many trust boards currently have a chairperson and a majority of trustees who are employees or officers of the company, dependent on the company for their career and income. They are unavoidably aligned with interests of the company and its current employees. When the trustees appoint advisors, the interface with those advisors is often company employees. This has the potential to damage the objectivity of the advice.

v) As a result, boards will suffer fundamental conflicts of interest that pervade all discussions/decisions.

vi) Bias towards the interests of the company/current employees cannot be overcome with the formalities of ‘declarations of interest’ by conflicted trustees.

vii) New regulations should work towards ensuring a better balanced board of trustees.

viii) Trustee numbers should better represent the portion of their members who are no longer employed by the company.

ix) Trustees should be able to liaise with TPR, eg if a DB scheme is in serious deficit. Trustees should be able to “whistle-blow” to TPR where necessary.

37) There should be annual reporting to members which should include (in a TPR-stipulated format):

i) Any valuations pursuant to Pensioner Recommendation 7.

ii) Other information about valuation/risks/strategy, deficits, TPR targets, strategy/meeting of TPR targets, compliance/non-compliance with any TPR/PPF requirements.

iii) Comparison to other peer DB schemes.

iv) Details of trustee experience, period of service, responsibilities.

v) Any proposed modification to the DB scheme - with sufficient notice ahead of any decision.
vi) Information about a mechanism for members to voice concerns to the trustees and/or whistle-blow about trustees to TPR.

vii) Notice and reporting of open annual meeting/any extraordinary meeting.

viii) Whether the DB scheme qualifies for PPF support and details of the support.

RELATIONSHIPS BETWEEN TPR, PPF, TRUSTEEs AND SPONSORING EMPLOYERS

38) When interest rates were high and equity gains were easy, many companies did not honour their relationship with members. They took pension contribution holidays rather than build up prudent pension reserves. The Government, which had encouraged companies and members to set up the schemes, taxed DB scheme surpluses (discouraging funding) and did not take sufficient measures to encourage funding. These schemes are now in deficit.

39) Companies may complain that it is now unreasonable to be expected to maintain their obligations to the schemes they themselves set up. They may prefer to prioritise other aims, such as maximising shareholder value, which can bring praise and windfalls to management. Retired workers, isolated and passive, can be repeatedly disadvantaged, without the company risking retaliation.

40) History and experience suggest that companies will continue to make funding choices that disadvantage silently trusting pensioners unless the Government actively steps in, through TPR, pushing companies to fund schemes and representing, informing and protecting pensioners.

41) NFOP notes the role of pensioners is not specifically cited in the Committee’s terms of reference. NFOP suggests it should be.

42) Classic DB schemes give pensioners limited voice and limited oversight of their own pensions. The structure of most DB schemes fails to protect members from dominance by a powerful company.

43) Most pensioners are not incapacitated or irresponsible. To expect them to remain isolated, silent and unquestioningly submissive to decisions of others, is inappropriate and wasteful.

44) If the seven Pensioner Recommendations are followed, pensioners will be better informed, better represented and better protected. They can then help TPR ensure that companies provide pensioners with strong, secure pensions. Government will have reinforced confidence in the pension sector.
THE BALANCE BETWEEN MEETING PENSION OBLIGATIONS AND ENSURING THE ONGOING VIABILITY OF SPONSORING EMPLOYERS, INCLUDING:

TPR'S OBJECTIVE TO "MINIMISE ANY ADVERSE IMPACT ON THE SUSTAINABLE GROWTH OF AN EMPLOYER"

WHETHER THE CURRENT FRAMEWORK IS GENERATING INTER-GENERATIONALLY FAIR OUTCOMES

WHETHER THE CURRENT WIDER ENVIRONMENT, INCLUDING VERY LOW INTEREST RATES, WARRANTS AN EXCEPTIONAL APPROACH

45) Transferring money into DB schemes does not remove it from the economy – DB pension schemes invest their assets in business and government services, providing employment to younger workers. Government might therefore see the current situation as an opportunity: an opportunity to support infrastructure investment schemes and to provide reasonable and secure earnings for DB schemes whilst improving UK business generally.

46) Although some companies will need to explain to trustees and TPR that they have a problem increasing deficit funding, most (according to TPR) have sufficient financial strength and capacity to manage their obligations. Most have closed DB schemes to new members and many now require existing members to place future savings elsewhere. They are learning to hedge exposures and implement long-term planning that will take account of interest-rate patterns etc. Their DB schemes are sustainable.

47) The implementation of regulation that enforces better deficit funding by the majority of DB schemes would not generally impair performance of British industry. Companies routinely accept constraints on their activities, such as rigorously monitored and enforced obligations on banks. There is no reason why similar discipline should not apply to prioritising outstanding financial obligations to pensioners. Pensioners, unlike younger workers, do not have time to restructure their earnings and their lives. They depend on DB schemes.

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