Dear Adam,

I was asked if I would submit a brief note, further to my comments given in evidence to the Committee on the 12th October 2016, on the matter of stressed DB pension schemes. That note follows:

Prior to 2004, if a sponsoring employer became insolvent or a company chose to wind up their pension scheme, leaving insufficient funds to cover the pension promises, members of the scheme simply received less than they were promised, and in many cases little or no pension at all. Parliament determined that state of affairs was unacceptable and the Pension Act 2004 came into effect, which has brought positive benefits for members (more than 11 million) of pension schemes.

The Pension Protection Fund was created in 2005 to give beneficiaries of qualifying schemes a level of protection where a qualifying insolvency occurred, by paying compensation to beneficiaries when there are insufficient funds in the pension scheme to cover specified levels of compensation. Around 225,000 such beneficiaries have already entered the Fund or are in assessment.

Furthermore, rules introduced in 2003 have provided safeguards for members when a solvent employer seeks to wind up a scheme; the Pensions Regulator was given important anti-avoidance powers and the scheme funding regime was strengthened.

Those reforms have been very beneficial. Ten years on or more, and with the benefit of working experience of the current framework, various opinions have been offered, including from both the PPF and the tPR, on aspects of current practice in the operation of that framework which the WPSC inquiry may wish to consider.

In my view, to ensure that schemes are sufficiently funded, the evidence suggests that a more interventionist/supervisory role is required for the Pensions Regulator, together with targeted improvements in her powers or the deployment of her powers. Such a strengthening of the funding regime should include restrictions on both the length of recovery plans and back-end loading of deficit payments during the recovery period. There should be an early focus on schemes with the largest deficits.

Some schemes will be unable to meet a new, strengthened regime because the pension benefit promises will be unaffordable, having regard for the state of the employer covenant and the level of funding. The current RAA process applies at the point a sponsoring employer is going into insolvency. There is a case for considering whether a special measures process could be put in place at an earlier stage, particularly for smaller employers. It may be possible to define a clear set of stringent criteria for identifying schemes that are demonstrating stress, with the employer at clear risk of market failure, criteria which if met could trigger entry into a ‘stressed scheme’ process.

A stressed scheme process could provide for a number of special measures:
- a period of detailed scrutiny of the scheme by the tPR in consultation with the PPF;
- a full viability review over, for example, a 3-year horizon;
- consideration of improving scheme funding around a menu of options, including consolidation;
- the appointment of an independent trustee, with appropriate skills, from a tPR approved panel;
- compulsory wind up if agreement between tPR and PPF to do so;
- no prejudice to the level of member protection under PPF level of benefits.

Such a process would require a significant increase in engagement by tPR and would therefore carry resource implications.

Consideration of any such proposal and associated revised legislation would need to ensure that robust and suitable safeguards existed to avoid moral hazard and to prevent companies creating business models solely for the purposes of qualifying for the stressed scheme process. It should not weaken the Pension Regulator’s anti-avoidance powers or her ability to issue CNs or FS directions.

Yours sincerely
Jeannie, Baroness Drake

November 2016