Department for Work & Pensions

Protecting Defined Benefit Pension Schemes

Cm 9591

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Presented to Parliament
by the Secretary of State for Work and Pensions
by Command of Her Majesty

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Cm 9591

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Ministerial foreword

People today are living longer and working more flexibly. Millions of people look forward to a more secure retirement because of their workplace pension as a result of diligent saving through their working lives.

We have already taken a number of important steps to strengthen the private pensions landscape: over nine million people are now automatically enrolled into an occupational pension scheme, we've given those aged over 55 greater choice in how to access their private pension pots and have taken forward a legislative framework for a new single financial guidance body, which will provide savers with more information and guidance on their retirement options.

And to achieve greater security, choice and dignity we have also introduced the new State Pension and we continue to provide benefits such as the Winter Fuel Payment.

Although most private sector Defined Benefit pension schemes are closed to new members and/or new accruals, the sector remains an integral part of the UK pensions system with around 10.5 million members relying on them. In addition, with roughly 14,000 employers currently supporting Defined Benefit pension schemes and around £1.5 trillion in assets held by these schemes, the Defined Benefit sector is of crucial importance to the UK economy. The Government is committed to ensuring that we do everything we can to protect pensions for those who have saved for their retirement, and to help employers to meet their promises to pension scheme members.

The UK already has a robust system in place to protect Defined Benefit pensions. We expect most people will get their pension paid in full. The Pensions Regulator offers support and guidance to trustees and can take action against employers who are not delivering on their legal obligations. In the event of an employer becoming insolvent, the Pension Protection Fund provides people with compensation so they do not see a substantial fall in their retirement income.

However, the pensions' landscape is evolving, as Defined Benefit schemes continue to close and be replaced by other forms of provision. This alters the relationship between the sponsoring employer and the scheme, bringing new challenges for trustees and employers. We are managing this change so that the Defined Benefit system continues to work in the best interests of those involved – for members and pensioners, for today's workforce and for employers.

This White Paper sets out our approach for the future of the Defined Benefit system, and supports the Regulator's ambition to be clearer, quicker and tougher. For all schemes and businesses we are clarifying the rules and expectations, for example through a clearer, enforceable Defined Benefit Funding Code, but otherwise not making fundamental changes to the existing system. For the small number of employers evading their obligations, we will put in place tougher, more proactive powers so that the Pensions Regulator can intervene more effectively to protect individuals. Finally, we will be consulting over the coming months on a framework for consolidation, offering industry the opportunity to innovate but ensuring there are robust safeguards in place so members' benefits are well protected.

Executive summary

Introduction

The government believes the system is working well for the majority of Defined Benefit schemes, trustees and sponsoring employers but accepts that we need a tougher approach for those few whose irresponsible decisions impact on their pension scheme.

The vast majority of UK employers run their business responsibly, displaying high standards in corporate governance and fulfilling their responsibilities to their employees and their pension funds. But the Government is determined to ensure we have a corporate governance framework that works for both employers and employees and wants to reduce further the risk of major company failures occurring through shortcomings of governance or stewardship.

The Defined Benefit system

A Defined Benefit pension is a promise made by the sponsoring employer to a scheme member that they will pay a predetermined level of pension, regardless of socio-economic factors.

There have been significant changes in the structure of the overall pension landscape recently, with the introduction of automatic enrolment and the growth of Defined Contribution schemes. This has meant that the Defined Benefit pension sector has changed over recent years. The majority of Defined Benefit schemes are now closed to new members;[1] however, with around £1.5 trillion assets held under management by Defined Benefit schemes and around 10.5 million scheme members[2] relying on Defined Benefit pensions for a substantial portion of their expected retirement income, they remain of critical importance. Furthermore, Defined Benefit pension schemes are also an important part of the UK economy as they can provide the investment needed to fund new businesses and finance public debt.

Despite a few recent high-profile cases, our findings, and most consultation responses,[3] suggest that there is no systemic problem in the regulatory and legislative framework that governs them. This framework is designed to respond flexibly to ever-changing conditions, and to provide employers and trustees with a wide range of options in how they manage their pension liability. However, there are examples of sponsoring employers misusing this flexibility and sometimes benefitting at the expense of

1 According to the Pension Protection Fund's Purple Book 2017, only 12% of private sector Defined Benefit schemes were still open to new members.

2 The number of memberships does not represent a precise number of people. In some cases, one person may be a member of two (or more) pension schemes.

3 In February 2017, we published a consultation: Security and Sustainability in Defined Benefit Pension Schemes. Our summary of responses has been published separately to this White Paper.

pension scheme members. When wrongdoing against the pension scheme takes place, the impact on individual members can be significant.

The system is designed to withstand the various economic and social events that may play out over the typical 80 year life of the average pension scheme. Some of these factors, including increasing longevity, a prolonged period of low interest rates, and expected low future investment returns mean that currently schemes are more expensive to maintain than was anticipated when they were set up. Defined Benefit schemes are now maturing, with pension payment obligations increasing and predicted to peak around 2020–2030.[4] It is important that we continue to improve and safeguard the system to ensure it is fit for the future for members, sponsoring employers and schemes.

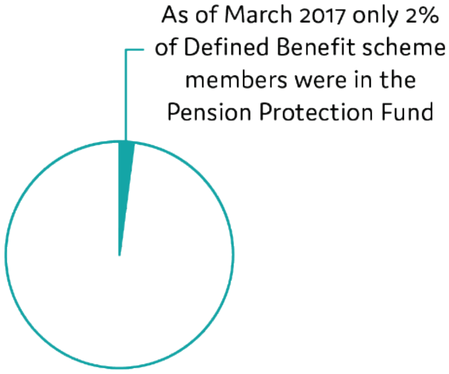
Protecting the system and improving the way it works

Regulating the Defined Benefit sector is a challenging job but the Pensions Regulator works with companies and trustees to get the right balance of interests as set out in the Pensions Act 2004. The Pensions Regulator is independent from government. Its role is to regulate the legislative framework which requires all Defined Benefit schemes to provide a valuation of their funding position at least every three years and, if a scheme is underfunded, to put in place an appropriate plan to rectify the deficit over an agreed length of time. In most cases, this flexibility within the framework works well to balance the needs of sponsoring employers with essential protections for members. Where abuse of the pension scheme has taken place, the Regulator can use its current powers to help protect members' benefits.[5] But we want to go further and ensure that, where necessary, the Regulator has the ability to get tougher.

In the natural course of business some employers will become insolvent. While we are putting in place measures to increase the protection of members' benefits, the proposals in this White Paper cannot prevent insolvency. Nor is it always in the interest of members of a pension scheme for the Regulator to force a company which is already struggling, to pay substantial pension contributions that risk worsening the situation. In the long-term, the best protection for a Defined Benefit pension scheme is a strong and solvent employer which works with trustees to put the needs of the pension scheme on an equal footing to other business considerations.

In the event of employer insolvency, there is a proven system in place to reduce potential losses to members. The Pension Protection Fund was established in 2005 to pay compensation to members of eligible Defined Benefit pension schemes where the sponsoring employer becomes insolvent. In such circumstances, when schemes do not have sufficient assets to secure pension benefits at the compensation level or above, the Pension Protection Fund, which is funded by a levy on all Defined Benefit pension schemes, steps in.

The level of protection afforded to members is high, regardless of the level of underfunding in the scheme. Compensation is broadly paid at 100% of accrued benefits to those over the scheme's normal pension age and 90%, subject to a cap, to everyone else. As at March 2017, around 130,000 members were in receipt of compensation. Another 110,000 deferred members[6] were in the Pension Protection Fund but with compensation not yet in payment. This is equivalent to only just over 2% of all Defined Benefit scheme members. The Government notes with concern that even those attempting to highlight the impact of business failure on pension scheme members do not always recognise the high level of protection the Pension Protection Fund provides.



[4] The Pensions Regulator (TPR), 'Corporate Plan 2014-2017' 2014: page 19, figure 2. Available at: http://webarchive.nationalarchives.gov.uk/20160105125821/http:/www.thepensionsregulator.gov.uk/docs/corporateplan-2014-2017.pdf
[5] TPR, 'Regulatory Intervention Reports'. Available at: http://www.thepensionsregulator.gov.uk/doc-library/regulatory-intervention-reports.aspx
[6] The Pension Protection Fund (PPF), 'The Purple Book', 2017.

Whilst the safety net provided by the Pension Protection Fund is a key feature of the system, this Government will not stand for employers evading their responsibilities and relying on this protection, which could lead to other sponsoring employers, playing by the rules, to foot the bill.

Proposed changes

Our ambition is to maintain confidence in Defined Benefit pensions by increasing the protection of members' benefits.

We know that the majority of schemes are managed well and will be able to meet their pension scheme liabilities. The Government's position on this is clear. Where employers can afford to pay, they should meet their liabilities without undue delay or evasion and put safeguards in place to protect members' benefits without relying on the Pension Protection Fund. For an employer whose behaviour puts their pension scheme at risk and threatens the likelihood of members receiving their pension benefits in full, we are improving existing powers as well as introducing new powers for the Regulator to get tougher.

Beyond this small group, we are improving the system for all employers and schemes by clarifying scheme funding principles so trustees can make more informed decisions, making it easier for the Regulator to intervene earlier, and creating the right conditions for schemes to consolidate so benefits of scale can be realised securely. We recognise that Defined Benefit liabilities can be expensive for some employers – our proposals balance the protection of members' benefits with the sustainability of the sponsoring employer's business.

Protecting private pensions – a stronger Pensions Regulator

Although most employers want to do the right thing by their pension scheme, we need to guard against the small minority of employers who may be content to put it at risk. Reckless behaviour can not only affect the value of members' benefits but as the Pension Protection Fund is funded by a levy, those businesses which abide by the rules bear the cost of those which avoid their pension liabilities.

To prevent employers seeking to avoid, reduce or limit their pensions liabilities, the Regulator was given a range of 'anti-avoidance powers' when the framework was set up. In general, these work well. However, there have been recent calls for Government to strengthen these powers so they can proactively prevent harm to pension schemes and punish reckless behaviour.

The Government's manifesto made a commitment to take action to prevent and punish those whose deliberate actions put pension schemes at risk. We will:

(i) Strengthen the regulatory framework and the Regulator's powers, as set out in the Government's 2017 manifesto, to:

- give the Regulator powers to punish those who deliberately put their pension scheme at risk by introducing punitive fines;
- legislate to introduce a criminal offence to punish those found to have committed wilful or grossly reckless behaviour in relation to a pension scheme and build on the existing process to support the disqualification of company directors; and
- work with the Regulator to strengthen the existing notifiable events framework and voluntary clearance regime so that employers have appropriate regard to pension considerations in any relevant corporate transactions. This includes improving the effectiveness and efficiency of the Regulator's existing anti-avoidance powers. We will work with the relevant parties to ensure that these measures do not have an adverse effect on legitimate business activity and the wider economy.

(ii) Provide the Regulator with the right tools to do their job, by:

- ensuring that they receive the information required to conduct investigations effectively and efficiently. These powers will be supported by penalties to drive co-operation.

Taken together, these new powers will strengthen the deterrent against and punishment for reckless behaviour and give the Regulator the ability to respond more quickly and decisively where they believe wrongdoing has taken place. Given the complexity of some of these measures, we will undertake further work with the Regulator and key parties and conduct further consultation where necessary to ensure that these measures are effective, workable and proportionate and that any risks of unintended consequences are appropriately mitigated.

Improving the way the system works – scheme funding

Our Green Paper concluded that most members are likely to get their pension benefits paid in full, and that, despite many schemes having funding deficits they are broadly affordable for sponsoring employers. We think the flexible nature of the current statutory funding objective works well to balance the security of members' benefits and the needs of the sponsoring employer, taking individual scheme circumstances into account. This works best when trustees and their sponsoring employers collaborate to follow the principles set out by the Regulator in its Funding Code of Practice, but not all do so. Together with a number of other factors, this can lead to increased risk to members' benefits where there are insufficient contributions from sponsoring employers or risk to employers' sustainability where contributions are higher than necessary.

Some schemes are already exemplars in managing their funding position. For most schemes the proposals below will align to existing practices. But, to improve decision-making and governance across the sector, we will implement a new package of measures to optimise scheme funding. As part of that, we will ensure that trustees and employers have the right support available to them, in order to deliver better outcomes for scheme members. Our measures will also ensure the Regulator has the right tools to respond to poor decisions and enhance public confidence in the pensions system. We will:

(i) Strengthen the Regulator's ability to enforce Defined Benefit scheme funding standards, through a revised Code, focussing on:

- how *prudence* is demonstrated when assessing scheme liabilities;
- what factors are *appropriate* when considering recovery plans; and
- ensuring a *long-term view* is considered when setting the statutory funding objective.

(ii) Require the trustees of Defined Benefit pension schemes to appoint a Chair and for that Chair to report to the Regulator in the form of a Chair's Statement, submitted with the scheme's triennial valuation.

These measures will support trustees and their sponsoring employers to make the best possible long-term decisions for schemes, by providing greater clarity on what constitutes good practice and encouraging greater accountability. The proposals will also ensure the Regulator can take effective and more efficient action where trustee or employer decisions do not lead to appropriate scheme funding outcomes.

Improving the way the system works – consolidation

Consolidation already takes place in various forms across the pensions market. In the Defined Benefit sector, consolidation can help schemes benefit from reduced scheme running costs per member, more effective and efficient investment strategies and improved governance.

Evidence suggests that, on average, small and medium-sized schemes are more likely to fail to meet the governance standards expected by the Pensions Regulator and have higher administrative costs than larger schemes.[7] Partly, this is a result of being unable to benefit from economies of scale. Raising awareness of existing forms of consolidation, as well as facilitating new vehicles to enter the market by putting appropriate safeguards in place could provide new opportunities for employers and schemes to overcome those issues.

There will always be a risk of employer insolvency and even when schemes are well-funded, the cost of insurance provision means it is unlikely that many schemes are able to buy-out in full. New consolidation vehicles, such as the Pension and Lifetime Savings Association's (PLSA) proposed Superfund model, could therefore offer a more affordable option than insured buy-out.

To encourage efficiencies and facilitate consolidation for the improvement of outcomes for members and employers, while ensuring sufficient safeguards are in place, we will:

(i) Consult this year on proposals for a legislative framework and authorisation regime within which new forms of consolidation vehicles could operate;

(ii) Consult this year on a new accreditation regime which could help build confidence and encourage existing forms of consolidation;

(iii) Work with the Regulator to raise awareness of the benefits of consolidation with trustees and sponsoring employers, though, for example, the Regulator's Trustees Toolkit and updating guidance; and

(iv) Consider some minor changes to guaranteed minimum pensions (GMP) conversion legislation to support benefit simplification, which will help reduce complexities in existing benefit structures.

Next steps

This White Paper sets out how we will implement those changes. We are proposing a phased approach which will enable us to take earlier decisive action in some areas and undertake further, considered work with the Pensions Regulator, the Pension Protection Fund, the pensions industry, business and other stakeholders on the development of other proposals before delivering changes.

There are some proposals which can be implemented now to strengthen existing systems. These are generally areas where we have a significant level of consensus about what needs doing and which do not need new primary legislation. In addition to the proposals explored here, the Regulator is already taking action in other areas which will complement the ambition of this White Paper, through their two programmes of work: *TPR Future*[8] and *21st Century Trusteeship*.[9] These recognise the significant shifts in the political, economic and social landscapes since the Regulator's creation in 2005 and support both this paper's ambition, and the Regulator's ambition to be more efficient, effective and adaptable.

There are a number of measures where, although we have agreement about what needs doing, more work is required to build a consensus about the best way to deliver our aims and to design the detail of our proposals. We will be consulting further on these areas.

In addition, many of these areas are also likely to require primary legislation to deliver them once the next phase of engagement and design has concluded. Where this is the case we intend to legislate at the earliest opportunity. Further detail of our implementation plan is included at chapter five.

7 TPR, 'Defined Benefit (DB) scheme running cost research', 2014, page 21, table 4.2. Available at: http://www.thepensionsregulator.gov.uk/docs/db-scheme-costs-research-2014.pdf
8 TPR, 'TPR Future'. Available at: http://www.thepensionsregulator.gov.uk/about-us/protecting-workplace-pensions.aspx
9 TPR, '21st Century Trusteeship'. Available at: http://www.thepensionsregulator.gov.uk/21st-century-trusteeship.aspx

The wider pensions context

In 2016, the Work and Pensions Select Committee outlined a number of recommendations for the Government, the Pension Regulator and the Pension Protection Fund. Some of these were followed up in our Green Paper, *Security and Sustainability in Defined Benefit Pension Schemes*[10] (February 2017). Our Green Paper was the first stage in the Government's approach to managing the challenges of the Defined Benefit system.

The Government has taken action to improve the wider occupational pensions' landscape. The automatic enrolment programme has helped more than nine million more people save for their retirement, and the introduction of a Master Trust authorisation framework and the single financial guidance body will ensure that schemes are sufficiently well governed and members will more easily be able to access information and guidance to help them make effective financial decisions. And increased action against pension scams will better protect private pension savings.

While not directly related to Defined Benefit pensions, there have been calls for Government to bring into force provisions which would provide an appropriate legislative framework for Collective Defined Contribution provision. Proponents of Collective Defined Contribution schemes see it as a better way of providing a regular income in retirement than is otherwise available through Defined Contribution pensions, but without the expensive guarantees of Defined Benefit pensions.

The Work and Pensions Select Committee has also commenced an inquiry into the potential benefits of Collective Defined Contribution schemes and we are expecting further recommendations later this year.

It is important to remember that Collective Defined Contribution does nothing to reduce the costs of providing Defined Benefit pensions that have already been accrued, but could provide members with fresh options to provide for themselves in later life. Provision was made for schemes run on a collective basis as part of a complete reframing of pensions legislation in the Pension Schemes Act 2015. Those reforms were far wider in scope than just Collective Defined Contribution and we have not seen a great deal of appetite amongst employers and pension providers for the major disruption that would follow the implementation of the 2015 legislation.

However, following the emergence of parties who are committed to developing Collective Defined Contribution pensions, we are exploring with them how this might be possible through a more modest change to legislation. This work is in its early days and the extent of changes necessary and the time it will take is unclear – but we are committed to working with those seeking to develop cost effective ways of providing members with security in retirement.

Finally, more widely than pensions, the Government is committed to reviewing the UK's corporate governance framework and has already made a number of improvements in some specific areas, including the voice of employees and stakeholders in the boardroom. We will continue building on the work that has already taken place on the wider corporate governance reforms in 2017 by strengthening corporate governance in companies that are in, or are approaching insolvency.

10 Department for Work and Pensions (DWP), 'Security and Sustainability in Defined Benefit Pension Schemes', February 2017. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/595103/security-and-sustainability-in-defined-benefit-pension-schemes.pdf

Chapter one: protecting private pensions – a stronger Pensions Regulator

We will:

- Strengthen the regulatory framework and the Regulator's powers, as set out in the Government's manifesto, in order to:
  - give the Regulator powers to punish those who deliberately put their pension scheme at risk by introducing punitive fines,
  - legislate to introduce a criminal offence to punish those found to have committed wilful or grossly reckless behaviour in relation to a pension scheme and, build on the existing process to support the disqualification of company directors; and
  - work with the Regulator to strengthen the existing notifiable events framework and voluntary clearance regime so that employers have appropriate regard to pension considerations in any relevant corporate transactions. This includes improving the effectiveness and efficiency of the Regulator's existing anti-avoidance powers. We will work with the relevant parties to ensure that these measures do not have an adverse effect on legitimate business activity and the wider economy.
- Legislate to give the Regulator some of the information-gathering powers already in place for automatic enrolment and Master Trusts to its Defined Benefit and Defined Contribution functions, including the power to compel any person to submit to an interview, the power to issue civil sanctions for non-compliance and an inspection power.

Summary of issue

1. We do not believe that there is wide-scale deliberate activity by employers to avoid pension scheme liabilities. However, the system must guard against the risk that a small number of people may take action detrimental to a scheme's prospects of paying full benefits. The Government is clear that where sponsoring employers are able to meet their pension promises, they should and must continue to do so without undue delay or evasion.
2. When the Pension Protection Fund (PPF) was established, it was accepted that there could be a temptation for sponsors to deliberately manipulate their affairs in order to transfer responsibility for their pension scheme's deficits to the PPF. The anti-avoidance provisions in the Pensions Act 2004 were introduced for a range of reasons, including to deal with such actions.
3. The Regulator's main anti-avoidance power is the issuance of a contribution notice. This requires those who, for instance, have been involved in a materially detrimental act, to pay money to the

pension scheme. This payment is up to the maximum amount of the scheme's section 75 deficit[11] at the time of act was undertaken. A contribution notice can target individuals as well as corporate entities but cannot be issued until the Determinations Panel has deemed it reasonable.[12]

4. The existence, and the Regulator's publicised use, of the anti-avoidance powers has, we believe, generally acted as a deterrent against deliberate avoidance behaviour. The measures set out in this chapter build on the Regulator's existing powers to enable them to be a stronger and more proactive Regulator.

The Government's manifesto commitments

5. Following a number of high-profile cases, the Government's manifesto proposed strengthening the regulatory framework and the Regulator's powers (including its anti-avoidance powers) in order to protect pension scheme members. The measures included: issuing punitive fines, disqualification of company directors, the introduction of a targeted mandatory clearance process for specific corporate transactions, and consideration of a new criminal offence for company directors whose actions put the pension scheme at risk.

6. There is a strong argument for making these changes so that the regulatory framework is tough enough to deal with abuses and ensure that pension scheme members are protected. In our Green Paper, we consulted on the introduction of punitive fines and a mandatory clearance regime. Many respondents to the Green Paper, including the Regulator, supported this aspiration as long as the changes are proportionate to the problems they seek to address.

7. Respondents were open to the idea of the Regulator being able to impose punitive fines on the back of proven misconduct, although views were mixed on this. Some thought contribution notices, which aim to restore funding to the scheme, were sufficient on their own; others argued that there is a case for fines to punish individuals where corporate activity has detrimentally affected a scheme, but that they would have to be proportionate.

8. Effective regulation is dependent on the prompt exchange of information and on compliance with rules and processes. Our consultation also sought views on whether the Regulator's existing powers for gathering information enables them to conclude enquiries and investigations in the timeliest manner. The Regulator's main legislative power for gathering information gives them the authority to issue a written notice requiring a person to produce information and/or documents which are relevant to the exercise of the Regulator's functions.

9. The Regulator reports its current tools can be cumbersome and inefficient when seeking information. There can be circumstances in which they would like to engage with a scheme because they have reasonable grounds for concern, but where their suspicions do not meet the criteria set out in legislation. The Regulator would be able to operate more efficiently with enhanced and consolidated information-gathering powers across its functions.

10. Some of these powers already exist within the Regulator's automatic enrolment and Defined Contribution Master Trusts functions. Although separate to the Government's manifesto commitments, we believe that aligning the Regulator's information gathering powers, to the Defined Benefit and Defined Contribution system where appropriate makes sense. Having a simplified set of rules across the private pensions' landscape would make it easier for schemes and employers to understand and comply with the Regulator's requirements. This would enable the Regulator to administer the regulatory framework more efficiently and effectively, and to choose the most appropriate and proportionate information-gathering tool – with an expectation that this would increase levels of co-operation and encourage a compliance culture.

[11] Section 75 debt is the difference between the value of the assets and the liabilities of the scheme. This difference is treated as a debt due from the employer to the trustees of the scheme.

[12] The Regulator's Determinations Panel, as part of a legal process, makes the decisions on certain regulatory functions such as issuing a contribution notice or a financial support direction.

11. However, the majority of respondents, particularly employers and business organisations, were concerned that going even further with proposals for targeted mandatory clearance could stifle legitimate business activity such as corporate restructuring and could adversely impact on employment prospects. It was also suggested that the regulatory system of Defined Benefit pensions already makes the UK less attractive to investors. There was concern that any additional requirements would exacerbate these perceived problems.

Our approach

12. We will therefore deliver the Government's manifesto commitments, and other improvements to the Regulator's powers, by taking action in the following areas:
    - We will legislate to strengthen the deterrent against detrimental activity by introducing penalties against wrongdoing and giving the Regulator increased information-gathering powers. This will give a clear message that we will not tolerate reckless behaviour.
    - We will also strengthen the clearance regime so that sponsoring employers give sufficient regard to their pension scheme during corporate transactions, by building on existing processes and considering what new measures might be necessary. We will continue to work with the Regulator, industry and other relevant parties to understand how any new proposals might be introduced without inhibiting legitimate business activities.
    - And we will legislate to bring in a criminal offence to punish those found to have committed wilful or grossly reckless behaviour in relation to their pension scheme.
13. Some of these measures are complex. We will undertake further work with the Regulator and other key parties and conduct further consultation, where necessary, to ensure that these measures are effective, workable and proportionate.

Our proposals

Stronger deterrent against wrongdoing through punitive fines

14. We will legislate to introduce a proportionate and robust penalty regime to tackle irresponsible activities that may cause a material detriment to a pension scheme and may compromise the scheme's funding position.
15. This will strengthen the Regulator's existing anti-avoidance framework, and will give the Regulator an express power to penalise the targets of a contribution notice. This power will extend to individual company Directors.
16. The parameters of this new approach will be enacted in primary legislation.
17. To ensure members of Defined Benefit schemes are protected as far as possible and to deter activity that puts the security of members' benefits at risk, we will examine the feasibility of the penalty regime applying in respect of acts or omissions prior to enactment, in particular, after the date this document is published.
18. We will continue to work on the design of the new regime including the penalty levels, to ensure it remains proportionate and there are no unintended consequences. Although the details are still being developed, it is expected that the penalty will be linked to the contribution notice, effectively creating the possibility of a highly punitive fine being issued by the Regulator.
19. Through its operation of the regime over the last ten years, the Regulator has identified other ways in which its current anti-avoidance powers could be enhanced. We will take this opportunity to

review these powers more generally and, if needed, legislate to improve the Regulator's contribution notice and financial support directions[13] powers, further strengthening the regime.

Criminal sanctions for proven wrongdoing by directors of sponsoring employers

20. The Government's manifesto committed us to explore whether a new criminal offence against directors is required to protect Defined Benefit pension schemes. It is the Government's wider policy to use civil sanctions where it would help more proportionate and effective regulation and only move to criminal sanctions in the most serious cases.

21. Therefore, we will ensure that the Regulator has a comprehensive range of sanctions where wrongdoing has taken place, such as non-compliance with a contribution notice. These will include both civil sanctions, such as fines and, as a final back-stop, criminal sanctions also.

22. Currently, in cases where the Regulator has evidence of any criminal offence taking place, they are able to use existing powers to pass that information onto the appropriate law enforcement (or another suitable) agency to take action. This regime has worked well but following recent high-profile cases, we believe that enhancing the Regulator's existing powers, would enable the Regulator to be clearer, quicker and tougher in these situations.

23. We will therefore legislate to bring in a criminal offence to punish wilful or grossly reckless behaviour of directors (and any connected persons) in relation to a Defined Benefit pension scheme. To ensure this power is proportionate, we will work with the relevant parties and carry out a consultation over the coming months so that all associated impacts are considered.

Director disqualification

24. The current system includes a provision for the disqualification by the Insolvency Service of company directors whose behaviours do not meet the expectations of the role.[14]

25. In the course of its investigations into potential cases of mismanagement or systemic avoidance of pension obligations by sponsoring employers, the Regulator may come across information potentially relevant to the conduct of directors[15] which might be of interest to the Insolvency Service. Evidence can then be passed to Insolvency Service through the existing gateway for information sharing.

26. The Insolvency Service is able to investigate insolvent companies, and where it receives evidence suggesting serious corporate abuse, solvent companies too. Where sufficient evidence exists, and it is in the public interest to do so, they can take action. For example, the Insolvency Service can take action to close down a live company or seek the disqualification of the relevant directors. An individual can be banned from being a director or in any way being involved in the formation, promotion or management of a company for a period of between two and 15 years.

27. Information sharing and joint work between the Regulator and the Insolvency Service is one part of a wider strategy involving a large number of enforcement agencies and regulators.[16] The Regulator will continue to gather evidence (relevant to the exercise of its functions) using existing powers. Where evidence of more serious wrongdoing is found and where this appears to be of relevance to the Insolvency Service, the Regulator will continue to pass evidence to them to take appropriate action to disqualify a director if necessary.

28. We are not complacent about the efficacy of the current process of director disqualification and we will continue to work with the Regulator and the Insolvency Service to strengthen the existing

[13] Financial Support Directions are a provision within TPR's anti-avoidance framework. It requires the target to put financial support in place for a scheme. Available at: http://www.thepensionsregulator.gov.uk/regulate-and-enforce/anti-avoidance-powers.aspx#s24848
[14] Company Director Disqualification Act 1986
[15] Or 'persons with similar executive authority'
[16] HMRC, Insolvency Service, Financial Conduct Authority, Serious Fraud Office and Law Enforcement agencies

process to ensure that members continue to be protected and their interests are appropriately reflected in business decisions.

Building on the Regulator’s existing voluntary clearance process

29. The Government’s manifesto also committed us to “… build on existing powers to give pension schemes and the Regulator the right to scrutinise, clear with conditions or, in extreme cases, stop mergers, takeovers or large financial commitments that threaten the solvency of the scheme”.
30. It will be important to balance the need to protect pension scheme members and jobs with avoiding unnecessary burdens on business and levy payers, and harm to the economy.
31. The Green Paper sought views on whether government should give the Regulator the power to intervene proactively in certain corporate activities rather than deploying retrospective anti-avoidance powers. Responses were mixed, with many employers and their representative organisations strongly against giving the Regulator this power, and other commentators and pension scheme members in favour of it. This was a recommendation of the Work and Pensions Select Committee.
32. The Regulator’s current anti-avoidance powers are reactive and retrospective. A well-run company, which takes its pensions responsibilities seriously, will consider the impact that major business decisions have on their obligation to fund their Defined Benefit pension. However, when a small minority of employers or their parent companies do not think this way, giving the Regulator the ability to intervene before some major corporate transactions are finalised could help get the right outcome for pension scheme members in more cases.
33. This isn’t about stopping legitimate business activity. The Government is clear that businesses must be allowed to make the right decisions to allow them to develop and grow. However, the Government is also clear that employers, where they can afford to, must also meet their pension responsibilities without undue delay or evasion.
34. It is also right that the Regulator, as a risk-based regulator, should continue to focus its resources by looking at those transactions that pose the greatest potential risk to Defined Benefit pensions.
35. The existing processes – the ‘notifiable events framework’ and ‘voluntary clearance’ – work well to balance these different needs in most cases. We are therefore proposing to build on them to strengthen the existing clearance regime.
36. **The notifiable events framework** is designed to inform the Regulator of certain events in areas including scheme funding, employer solvency and the employer covenant and ultimately gives the Regulator early warning of a possible call on the Pension Protection Fund. Notifiable events fall into two groups: scheme-related (to be notified by trustees) and employer-related (to be notified by employers). Only schemes which are eligible for entry to the PPF, and their employers, are subject to the notifiable events duty.
37. Employers must inform the Regulator when they are going ahead with transactions which, for instance, could have a detrimental impact on the pension scheme and lead to a greater risk of a call being made on the Pension Protection Fund for compensation. The Regulator will use the information to assess the position of the scheme and may intervene to help the parties agree appropriate action to reduce the risk to scheme members’ benefits and the PPF. We believe this system is fundamentally sound. However there are a number of areas where we believe improvements could be made, in particular:
    - coverage of the notifiable events framework – we will review whether it covers all relevant transactions and widen these to include anything that is currently missing; and
    - timing of the notifiable events framework – the framework currently requires businesses to inform the Regulator as soon as reasonably practical but without further definition. In practice, in some cases, this has meant not until (or after) the events actually occur. We think that this

timing needs clarifying so that the Regulator is made aware at an earlier stage in consideration and can engage in discussions sooner.

38. The current **voluntary clearance** system is designed to give employers and/or potential purchasers comfort that when they are considering a particular transaction the Regulator will not use its anti-avoidance powers, including proposals set out in this paper, should they go ahead.

39. The Regulator has an interest in events which are materially detrimental to the ability of a scheme to meet its liabilities, for example a business restructure or the sale of an employer that reduces the strength of the covenant supporting the scheme. Other events that could be considered include, for example, a change in creditor priority to rank ahead of the pension scheme upon insolvency, a return of capital and other mechanisms which have resulted in value being removed from the employer.

40. Again, we will consider whether the whole framework can be made more effective, for example by reviewing the role of trustees and whistleblowing activity and asking the Regulator to review their clearance guidance to ensure it is clear and captures all appropriate transactions.

Further measures to support clearance

41. The following measures will act alongside other proposals set out in this chapter, such as fines and information gathering, which should act as a further deterrent for the small minority of employers who may put their pension scheme at risk.

42. **Declaration of impacts on the pension scheme**: we will put in place a requirement for sponsoring employers or parent companies to make a statement of intent, in consultation with trustees, prior to relevant business transactions taking place that they have appropriately considered the impacts to any Defined Benefit pension scheme affected. This statement will clearly set out how a sponsoring employer proposes to mitigate any detrimental impact caused by the proposed transaction on the scheme. It will then enable trustees to better engage with the Regulator if the pension scheme is subsequently put at risk as a result of the transaction. ‘Relevant’ business transactions will only include those which pose the highest potential risk to the Defined Benefit pension scheme, such as the sale or takeover of a sponsoring employer. We will work with the Regulator, business groups and other interested parties to determine our approach.

43. **We will also build on existing processes to scrutinise transactions.** We will consider how we can further strengthen existing processes from elsewhere in government to increase information sharing and co-operation between the Regulator and other relevant regulators, and increase the focus on the pension scheme.

44. Most increases in Regulator activity are likely to require a corresponding increase in operational costs, which is funded by a levy on business. However, we will explore how any new burdens and costs could be minimised, for example by using information and processes which already exist and working with other regulators.

45. Where difficult decisions need to be made, these new measures will ensure that trustees will be supported by a stronger Regulator to get the best possible outcome for pension members: it does not mean that pensions will always trump other interests.

46. **Reforms to corporate governance**: this Government has already taken steps to reform corporate governance and brought forward measures to address excessive executive pay, improve employee and stakeholder voice in the board room and improve governance in large privately held businesses. These measures aim to reassure the public that companies are being run with proper regard for the interest of all parties rather than just shareholders. The Companies Act 2006 already requires directors of a company to have regard to these interests in pursuing the success of the company and the Government will continue to ensure that the corporate governance framework is kept up to date.

47. In summary, this new package of proposals will ensure that pension considerations are better reflected in board room decisions as part of any corporate transaction and represents a strengthening of the current rules and protection for pension members. Our more detailed proposals will be carefully targeted to ensure that:
    - they do not damage legitimate business interests;
    - they do not harm the economy;
    - those who are already fulfilling their pensions' obligations do not face unnecessary burdens and costs;
    - they will genuinely help trustees to get the best deal possible for their pension members; and
    - the regime can be operated effectively and efficiently.
48. We will engage with interested stakeholders over the coming months as we design the system in more detail.

Information-gathering powers

49. An effective regime requires a clear and easy flow of information from trustees, employers and others involved with pension schemes to the Regulator. Whilst the Regulator's current information-gathering powers can be extremely effective in certain situations, these powers are sometimes difficult to exercise efficiently and also vary across the different pension sectors.
50. The Regulator is at times hindered from seeking information in circumstances where they would like to engage with a scheme because they have reasonable grounds for concern but can be challenged whether those suspicions do not meet the criteria set out in current legislation.[17]
51. We believe that increased harmonisation of powers across automatic enrolment, Defined Contribution Master Trusts, Defined Contribution and Defined Benefit schemes would enable the Regulator to be more proactive and drive increased compliant behaviours by relevant parties.
52. Harmonising these powers will require new primary legislation and will need to be proportionate and relevant to the Defined Benefit landscape. In the short to medium term, the Regulator will continue to make the best possible use of existing powers and will continue to measure its performance and effectiveness. In July 2017, the Regulator published its TPR Future report which set out a number of ways in which it is responding to today's challenges more effectively and efficiently.

A power to require attendance for interview

53. This standalone power would give the Regulator the ability to compel a relevant person to attend an interview and explain any facts, events or circumstances that are relevant to the Pensions Regulator's investigation or function, or to answer questions about information, records, or documents held.
54. This would be an extension (and enhancement) of an existing power under section 72(1A) of the Pensions Act 2004, which is currently available only in respect of automatic enrolment and Defined Contribution Master Trusts. This allows questioning of parties at an interview to furnish an explanation about any information or documents requested under section 72. As such, the power has a narrow application, to provide an explanation of any document or information required under a section 72 notice.
55. Extending and broadening the interview power beyond simply providing an explanation to a produced document would enable the Regulator to require employers, trustees and other relevant parties to attend an interview where they are not prepared to do so voluntarily. It would also provide

[17] Section 72 of the Pensions Act 2004

protection to others (for example professional advisers) who are willing to co-operate and attend an interview but are unable to do so unless compelled by statute, due to client confidentiality issues.

Civil sanctions (fixed and escalating penalty notices)

56. We will legislate to give the Regulator the power, at their discretion, to impose fixed and escalating civil sanctions as an alternative to the pursuit of criminal sanctions for non-compliance with a section 72 notice without a reasonable excuse. In respect of section 72 notices, legislation currently only provides the option of bringing a criminal prosecution in the event of non-compliance. The requirement for a successful criminal prosecution is an expensive and time-consuming process. It may also be a disproportionate reaction, in particular in cases of a lower level breach, which may not be sufficiently serious to justify imposing a criminal sanction.

57. Fixed and escalating penalty notices are currently available to the Regulator in respect of automatic enrolment and have proven to be an effective way of driving co-operation between schemes and the Regulator. They also provide the Regulator with more flexibility to ensure that potential action for non-compliance is commensurate with the breach. The Regulator will also have these powers in respect of Defined Contribution Master Trusts.

An inspection power

58. We intend to give the Regulator the power to inspect records, documents and electronic devices of parties at premises for purposes relevant to the Regulator's functions. The intention is that the Regulator would issue advance notice of an inspection, unless notice would work against the purpose of the inspection. Inspection powers for the purpose of 'compliance checks' already exist under section 73(2), (with regard to certain specified 'occupational scheme provisions' in respect of Defined Benefit and Defined Contribution schemes, including scheme funding and other specified duties) and under section 74 (with regard to 'employers' automatic enrolment duties).

59. The application of the current Defined Benefit power is restricted to the area of scheme funding compliance rather than providing a broader provision which would apply across all Regulator functions. We believe there is a clear justification for these powers to be widened in scope; inspections remain a well-established, important and proportionate compliance and investigative tool. We will, however, undertake further work and engagement to ensure that any changes implemented are proportionate.

The Pensions Regulator's inspection power in automatic enrolment

60. Across UK government departments, each Secretary of State is required to review the relevant powers of entry and relevant associated powers, for which they are responsible.[18] The purpose of the review is to consider whether or not to make an order to repeal any powers considered to be unnecessary or inappropriate, or to consider if any other amendments are required.

61. As part of the 2014 review,[19] we looked at the Regulator's inspection power within automatic enrolment.[20] The review recommended the need for this power 'should be reviewed in 2017' when the Regulator will have had practical experience of enforcing these duties. The review also specifically recommended that the Regulator's powers are amended to require the giving of notice to the employer 'unless such notice would defeat the purposes of the visit'.

62. The Regulator carries out inspections on a risk-based approach. In practice, the Regulator will usually issue a notice of inspection prior to carrying it out. The main purpose of the visit is to assure

[18] Established by Section 42 of the Protection of Freedoms Act 2012
[19] DWP, 'A review of powers of entry by the Department for Work and Pensions', 2014. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/380221/dwp-powers-entry-review.pdf
[20] As part of the 2014review, in relation to automatic enrolment the Department looked at S74 (A1) of the Pensions Act 2004, which provides that the Pensions Regulator (TPR), may enter premises liable to inspection, for the purpose of investigating whether an employer is complying with their duties to auto-enrol their employees.

employers are compliant, and to help them comply with the legislation if they are not doing so, through educating and enabling them to meet their duties.

63. As the roll out of automatic enrolment progresses, the Regulator will continue to need the flexibility to adopt a proportionate approach to ensure all relevant parties comply with their automatic enrolment duties. This includes the ability to undertake inspections of premises used for business purposes without obtaining a warrant. We propose to maintain the Regulator's inspection gathering powers for automatic enrolment without amendments.

An obligation to co-operate

64. The current information gathering process is reactive and can, as a result of criminal sanctions, be combative, whereas a duty to co-operate could help to shift the relationship dynamic, in particular with trustees and professional advisers.

65. As part of its drive to be more proactive, the Regulator may see a need to act early and sometimes in anticipation of potential difficulties in schemes, and address them before they arise. This could provide significant savings in time, cost and resource to both the Regulator and the relevant parties, by focussing and narrowing information requests at an earlier stage.

66. However, while this is a narrow and focussed duty to co-operate, we have established that giving the Regulator an additional power of civil sanctions (as set out above) would go a long way to diffuse the combative approach that often results from use of section 72 powers, and may achieve the desired goal of driving parties to increasingly co-operate. Having considered the issues carefully, we have decided against legislating for a "duty to co-operate" at this stage, but will give this matter further consideration as part of the wider discussions on a more proactive Regulator.

Conclusion

67. The Government's manifesto set out our ambition to protect the private occupational pensions of people who have diligently saved through their working lives and guard against the small minority of employers who may conduct detrimental activity and put their pensions' scheme at risk.

68. Taken together, the new powers discussed in this chapter significantly improve the Regulator's ability to act quickly and decisively and strengthens the deterrent against irresponsible employers putting their pension scheme at risk. Strengthening the Regulator's powers in relation to wrongdoing will complement the Regulator's ambition to be a clearer, quicker and tougher organisation by reinforcing the requirement to comply with the rules aimed at safeguarding pension benefits.

Chapter two: improving the way the system works – scheme funding

We will:

- Strengthen the Regulator's ability to enforce Defined Benefit scheme funding standards, through a revised Code, focussing on:
  - how *prudence* is demonstrated when assessing scheme liabilities;
  - what factors are *appropriate* when considering recovery plans; and
  - ensuring a *long-term* view is considered when setting the statutory funding objective.
- Require the trustees of Defined Benefit pension schemes to appoint a Chair and for that Chair to report to the Regulator in the form of a Chair's Statement, submitted with the scheme's triennial valuation.

Background

69. The statutory funding objective (SFO), introduced by the Pensions Act 2004, requires a scheme to be 100% funded on the basis of its technical provisions.[21] This is a scheme-specific arrangement, where key assumptions and methodology underpinning the technical provisions such as the discount rate[22] are agreed between trustees and sponsoring employers after taking professional advice. Where a scheme is less than 100% funded (i.e. there is a funding deficit because the scheme's assets[23] are less than the schemes liabilities), it is required to have a recovery plan in place under which deficit repair contributions agreed with the sponsoring employer are made to the scheme. The SFO valuation and the recovery plan are submitted to the Regulator at least every three years, a process known as the triennial valuation.
70. The valuation of Defined Benefit deficits is volatile but the majority of Defined Benefit schemes have an estimated funding deficit, and therefore recovery plans in place to get back to the SFO. The average duration is around eight years.
71. The scheme funding framework provides flexibility in setting recovery plans, and recognises the importance of ensuring contributions are not overly burdensome on the sponsoring employer given their individual circumstances. The flexibility of a scheme specific funding regime works well on the whole and enables trustees and sponsoring employers to balance affordability and considerations of employer growth with the need to meet the employer's pension promise to members.
72. Scheme deficits and long recovery plans may indicate scheme funding risk across the Defined Benefit landscape. Within the set of schemes which have very low funding levels, and/or longer recovery plans, there will be various reasons why individual schemes are not achieving required

[21] Reference to "technical provisions" means the amount required, on an actuarial calculation, to make provision for the scheme's liabilities
[22] An interest rate used to assess the value of the scheme liabilities due at a future date in today's prices
[23] A scheme's assets include pension contributions and investment returns

funding levels but various other factors, including the strength of the employer, would need to be considered by all parties when considering the scheme funding risk.

73. Severely underfunded schemes present a risk to members, the Pension Protection Fund (PPF), and ultimately other PPF levy payers. Left unmanaged, a very financially weak scheme can also become an increasing risk for the employer itself. It is therefore important that we take firm action to work with underfunded schemes and their sponsoring employers in order to improve their funding position.

74. Where a scheme's triennial valuation shows that the scheme is in a particularly weak position, the Regulator may work more intensively with the trustees and the sponsoring employer to improve the funding position and reduce the level of risk to the scheme. For example, the trustees and the employer may be encouraged to look more closely at the employer's deficit repair contributions in relation to other business activities and explore whether a change in this balance could be effective, without undue negative impacts on the business.

75. In its *TPR Future* report, the Regulator has emphasised the importance of tailored support to schemes where necessary. As a result, the Regulator will undertake more targeted work with schemes identified as being at higher risk, and has begun to make increasing, and more innovative, use of its powers to intervene where funding problems have emerged. The increased powers set out in this chapter and in chapter one will further help the Regulator to manage these schemes quickly and more effectively, giving them the improved regulatory oversight necessary to support the most underfunded schemes.

76. In some cases, the sponsoring employer may have funds available which could be used to manage the scheme deficit, but which it is choosing to use for other purposes. This decision may be justified by business needs. However, the Regulator can and does look at these kinds of decisions and will consider them with reference to its scheme funding statutory objectives. For example, the Regulator can encourage or require an employer to reduce dividend payments and increase deficit repair contributions if the scheme is not being treated fairly compared to other stakeholders.

77. Most schemes are well-managed and funding shortfalls are being addressed. We do not believe that the evidence supports a general affordability problem across Defined Benefit schemes as a whole[24] – and responses to the Green Paper largely agreed with this. However, we do believe that all schemes and employers will benefit from clearer scheme funding standards. Where schemes are well-managed and well-funded, we want trustees and employers to be able to make the best possible decisions now and in the long-term. Where schemes are less well-funded, and/or trustees or employers are less focussed, we want to drive improvements and increase members' security. We believe that for all schemes, the system can be made stronger to deal with future commitments and with external social and economic shocks.

Scheme funding issues

Decision-making and risk-management

78. As we set out in the Green Paper, trustee decision-making and risk-management does not always reflect good practice and the principles-based approach set out by the Regulator in its Funding Code of Practice.[25]

79. Through its assessment of Defined Benefit scheme risk, the Regulator has concluded that in a number of cases, the technical provisions for a scheme have not been set "prudently",[26] or the recovery plan for reducing the funding deficit has not been set "appropriately".[27] However, there is

24 As set out in DWP's Security and Sustainability in Defined Benefit Pensions Schemes paper, February 2017
25 TPR, Codes of Practice. Available at: http://www.thepensionsregulator.gov.uk/doc-library/codes.aspx
26 The Occupational Pension Schemes (Scheme Funding) Regulations 2005 Regs. 3–6, SI 2005/3377
27 Pension Schemes Act 2004,s226(3)

no clear definition for terms such as prudent and appropriate. This lack of definition means proving trustees have failed to comply with the legislation is costly, resource intensive and time consuming.

80. One of the important assumptions when setting technical provisions is discount rates. There have been concerns raised that many trustees are setting these either too high or too low. According to recent Defined Benefit research,[28] nearly a third of trustees (31%) and almost half of employers (46%) reported that 'the current funding regime makes it hard to set discount rates and take account of their scheme and employer circumstances'. This suggests a lack of clarity about setting the schemes technical provisions prudently.

81. The Regulator has identified other cases where schemes have a funding deficit and a long recovery plan in place, even though it appeared that the sponsoring employer could increase its contributions to reduce the length of its recovery plan without compromising their sustainable growth. The Regulator's analysis shows that for the group of FTSE350 companies who paid both deficit repair contributions and dividends in each of the previous six years, at the median level, the ratio of deficit repair contributions to dividend payments has declined from around 10% in 2011 to around 7% in the latest available employer accounts (from 2017). This is mainly driven by the significant increase in dividends over the period (2011–2017), without a similar increase in contributions.[29]

82. Although these concerns are not prevalent across all schemes, clearer funding standards and more effective regulatory enforcement tools will help achieve better decision-making across the Defined Benefit pensions' landscape.

Short-term focus

83. Both the Green Paper and some responses identified a perception that trustees' application of the triennial valuation process can result in them adopting a short-term focus on the three years to the next valuation, rather than thinking strategically about the desired outcomes for the pension scheme for the long-term.

84. We do not consider the valuation process itself as an issue; many schemes already have a long-term funding objective in place, reflecting good funding practice. But this is not evident for all schemes. According to the Regulator's Defined Benefit Research 2017,[30] 73% of trustees and 68% of employers responded that schemes closed to future accrual had in place a journey plan or long-term target. This leaves nearly a third that don't have one.

85. Some trustees and sponsoring employers may not be effectively setting an investment strategy and managing the long-term obligations of the scheme when setting the SFO, and therefore inadequately anticipating or managing scheme funding risks. To achieve the best possible outcomes the trustees and sponsoring employers need to work collaboratively on a shared long-term strategy for the scheme. Lack of employer engagement can lead to trustees being in breach of legislative requirements to submit their funding valuation within the 15-month timeframe.

86. A fully thought-out strategy agreed with the sponsoring employer may be more significant for closed Defined Benefit schemes, as the pension scheme liabilities for retired (and deferred) members become more remote to the sponsoring employer. Once an employer closes their Defined Benefit scheme (to new members and/or accruals), their focus may move to current employees' contributions to a Defined Contribution scheme.

87. It is therefore critical that trustees, in collaboration with the sponsoring employer, should set appropriate long-term objectives for the scheme, and then take those objectives into account when setting the SFO. For example, trustees and sponsoring employers of a mature closed scheme might

[28] IFF Research on behalf of TPR, 'DB trust based pension schemes research', 2017, page 56. Available at: http://www.thepensionsregulator.gov.uk/docs/db-research-summary-report-2017.PDF

[29] TPR, 'Tranche 12 analysis', June 2017. Available at: http://www.thepensionsregulator.gov.uk/docs/db-analysis-tranche-twelve-review-2017.pdf

[30] IFF Research on behalf of TPR, 'DB trust-based pension schemes research', 2017, p6. Available at: http://www.thepensionsregulator.gov.uk/docs/db-research-summary-report-2017.PDF.

determine that an appropriate long-term objective would be to secure members benefits through buy-out within a specified period. The SFO should then reflect this.

Lack of accountability

88. Engagement with stakeholders has revealed concerns that a lack of accountability and transparency can result in poor decision-making and investment outcomes. External commentators, including the Pensions Policy Institute[31] and Pension and Lifetime Savings Association,[32] together with the Regulator,[33] have noted that scheme governance, trustee behaviours and trustee knowledge appear to be below expectations in some schemes, particularly smaller schemes. Indirect evidence also suggests that good governance and compliance with guidance could lead to better relationships between the trustees and the sponsoring employer, which is crucial for ensuring the best outcomes. Six in ten actuaries felt the Defined Benefit Codes of Practice had informed negotiations with employers and trustees to some extent.[34]

89. Clearer requirements and more explicit accountability could also lead to positive changes in behaviours which in turn may contribute to delivering better outcomes for scheme members.[35] Whilst the Regulator's Codes of Practice and guidance set out how trustees are expected to comply with their legal obligations, it is not clear they are always adopting good practice and where collaboration with the sponsoring employer is needed.

90. In addition, not all trustees apply what may be acceptable standards of good funding practice. Requiring trustees to set out their scheme funding strategy clearly for themselves and explain it to the Regulator should lead to improved decision-making from trustees and employers.

Our proposals

Clearer funding standards, including taking a long-term view when setting the SFO

91. Good funding practice is for trustees and sponsoring employers to agree the funding, and the assumptions and methodology underpinning the technical provisions and recovery plans, in the context of a long-term objective. They will also set their investment strategy and test the resilience of their SFO to downside risk events, such as lower than expected investment returns. Trustees and sponsoring employers are expected to consider how these would affect delivery of the SFO, putting in place appropriate mitigation strategies and contingency plans. Together with the Regulator, we would like to see this good practice as the industry standard.

92. As the current Defined Benefit landscape moves to a new phase with the majority of schemes now closed to future accruals and with schemes maturing, the financial management of pension schemes also enters a new phase and such longer-term strategic thinking becomes increasingly important.

93. Trustees of closed schemes will have increasing amounts of pensions in payment. This means that the scheme assets will be converted into cash pension payments to be made over time. As more assets or investment returns are converted into cash to pay pensions, they will not be available to generate returns for the scheme itself. Therefore, schemes which are significantly 'mature' will want to limit their reliance on investment returns from existing assets to reduce a funding deficit, adjusting the investment strategy accordingly. As their liabilities continue to mature, the time-scales for

[31] Pensions Policy Institute (PPI), Briefing Note No.89 – 'Defined Benefits: the role of governance', 2017. Available at: http://www.pensionspolicyinstitute.org.uk/briefing-notes/briefing-note-89---the-role-of-governance

[32] PLSA recommended a Chair's Statement as a useful tool to overcome some of the behavioural biases against consolidation

[33] TPR's discussion paper 21st century trusteeship and governance. Available at: http://www.thepensionsregulator.gov.uk/docs/21st-century-trusteeship-governance-discussion-2016.pdf

[34] IFF Research on behalf of TPR, 'Research report on 2015 (Tranche 10) Defined Benefit annual funding statement and other publications', 2016. Available at: http://www.thepensionsregulator.gov.uk/docs/research-report-funding-statement-2015.pdf

[35] IFF Research on behalf of TPR, 'Defined benefit trust-based pension schemes research', 2017, Fig 6.2. Available at: http://www.thepensionsregulator.gov.uk/docs/db-research-summary-report-2017.PDF

eliminating a funding deficit will be shortened, and increased employer contributions may be necessary. Schemes which currently have large deficits will need to take into account the potential future calls on the sponsoring employer's cash-flow and plan appropriately.

94. If a scheme remains open to new members, the trustees may need to consider whether the level of new entrants is likely to be materially different than in the past, and how this might affect the scheme's cash-flow. This is particularly important if future entry numbers are anticipated to be lower than in the past. Alternatively, a scheme's profile may include a relatively larger cohort of members of a similar age who will all retire at roughly the same time. Therefore, depending on the scheme's cash-flow profile, the risks of using assets for both paying pensions and to eliminate a funding deficit will be similar to that of maturing closed schemes.

95. It is therefore important for all schemes (open or closed) that funding practices and risk management systems evolve to keep pace with these changes, and to deal with social and economic shocks.

96. We propose that the Regulator should include in their Code a description of how the trustees and sponsoring employers should set their SFO in the context of a long-term objective. Trustees should then use the triennial valuation process to report how they have used this long-term objective to inform the setting of the scheme's technical provisions and the recovery plan, as agreed with the sponsoring employer. The triennial valuation submissions would be staging posts or steps on a journey plan towards achieving the long-term objective embedded in the SFO.

97. We believe that focusing trustees on the long-term objective for the scheme will give both the trustees and the scheme sponsors greater clarity about the actions and the timeframes in which to meet the SFO, for example through a journey plan. The Regulator will produce further guidance in their Funding Code of Practice on how trustees can set their SFO in line with their long-term objective and the specific circumstances of their scheme.

98. This will ensure that all schemes are better prepared to pay members' benefits as they fall due in the coming decades and to do that in a more cost-efficient way.

99. Examples of a suitable long-term objective could be to:

- run-on with employer support (for open schemes);
- reach self-sufficiency with low-risk investment strategy and run-off with minimal call on the sponsor employer;
- buy-out by a set time; or
- enter a consolidator vehicle within an agreed timeframe.

100. In chapter three, we explore options for employers and schemes for which consolidation could provide increased security for members' benefits and permit the sponsoring employer to alleviate their future responsibilities to the scheme.

Clearer funding standards: consultation

101. The Regulator will consult[36] on clarified funding standards through a revised Defined Benefit Funding Code of Practice, focusing on how prudence and appropriateness can be defined to better balance employer commitments with risks to members and the PPF.

102. The consultation will also consider what further help trustees may need in order to make sure they take a long-term perspective when they set their SFO (for example through a Code and guidance), as well as how trustees can best assess their SFO's robustness against external risks.

[36] Sections 90 and 91 Pensions Act 2004

103. The Regulator's engagement as part of this work will also focus on ways in which trustees can demonstrate and explain how they have met prudence and appropriateness requirements, in collaboration with the sponsoring employer.

104. The clearer funding standards and supporting guidance will set out how all trustees can improve their awareness and decision-making on scheme funding issues, which in turn is expected to lead to better risk management and better outcomes for members.

105. They will also help the Regulator identify funding risks earlier. The Regulator works closely with the most severely underfunded schemes and their sponsoring employers in order to improve the funding position and mitigate risks to members and to the PPF and levy payers. Early identification of scheme funding problems is crucially important to improving a scheme's long-term financial position.

106. These clearer standards support the Regulator's TPR Future ambition, working with its key stakeholders to 'set clear expectations', and demonstrate the importance attached to scheme funding and the willingness to impose consequences if requirements are not met.

107. Starting this year, the Regulator will carry out a programme of further research, initial testing and extensive informal consultation with the industry to inform a revised Defined Benefit Funding Code of Practice and guidance. Evidence gathered during the Regulator's consultation will also shape our policy on making compliance with the Code, or key principles within the Code, a statutory requirement.

108. Although the Regulator's Codes of Practice already have significant evidential weight, we intend to supplement and strengthen the proposed new Defined Benefit Funding Code of Practice by legislating at the earliest opportunity to require trustees and sponsoring employers to comply with some or all of the clearer funding standards. We also intend to legislate to ensure the Regulator can enforce them or take action in the event of non-compliance (e.g. through sanctions or fines and improved funding powers putting beyond doubt that it is the responsibility of scheme trustees and sponsoring employers to demonstrate compliance with funding standards or any statutory Code. This will require changes to section 231 of the Pensions Act 2004.[37]

A Chair's Statement

109. The Green Paper consultation identified that some schemes can suffer as a result of poor or uninformed decision-making by some trustees, which can increase the financial risk to the scheme or the sponsoring employer. We will therefore legislate to require the board of trustees of Defined Benefit pension schemes to appoint a Chair and for that Chair to report on their key scheme funding decisions in a Statement from the Chair of a Trustee Board. We anticipate this will encourage a greater focus on long-term thinking and sound risk management.

110. The Chair's Statement is intended to drive improved accountability and to demonstrate collaborative decision-making between trustee and sponsoring employer. Trustees will be required to inform the Regulator about their approach to managing risks to the scheme, including information on how the trustee is meeting the clearer funding standards and how the SFO is being set in line with a long term funding objective. The Chair will also be required to reflect on and learn from past decision-making to ensure their plans are optimal. This will also enable the Regulator to get better information to assess risk, and to provide appropriate support or take enforcement action if necessary.

[37] Section 231 of the Pensions Act 2004, in relation to the clearer funding standards.

111. A Chair's Statement was introduced for all DC pension schemes in 2015.[38] Whilst evidence from practitioners and stakeholders has been positive, the Regulator has identified some lessons to be learnt from the DC Chair's Statements (such as evidence of variations in the quality[39]) which will be incorporated into the design and implementation of the Defined Benefit Chair's Statement.

112. Wider evidence coming from behavioural, economics, management, and psychology related disciplines suggest clarification, commitment and external monitoring tends to lead to positive outcomes when it is proportionate, clear and well-targeted. For example, the Financial Conduct Authority's Behaviour and Compliance in Organisations study[40] suggests that review by another organisation can often identify inherent weaknesses (known as 'bias blind spot'). The introduction of a Chair's Statement will help inform the Regulator's risk assessment process. Further, some trustees tend to spend only a short amount of time on their trustee duties (a third of schemes indicated that trustees typically spent less than 5 days a year on these duties),[41] which may not give sufficient time to properly consider the issues before making decisions. Requiring trustees to prepare a Chair's Statement should assist them to focus on the key risks to their funding strategy and achieving the best possible outcome for members.

113. The consultation on the funding standards will inform the content of the Chair's Statement. The Statement is expected to set out the scheme's long-term financial destination and a description of the scheme's strategic plan for reaching the SFO. This should demonstrate how the clearer funding standards are being implemented for the scheme. The Statement will also show the key risks to meeting the SFO (covenant, actuarial, investment and governance) and how trustees have chosen to mitigate and manage them. The statement may also include a narrative setting out how trustees will meet key governance standards achieve value for money from their running costs and investment decisions. We will work with the Regulator to ensure trustees and sponsoring employers are given the support and guidance they need to produce a Chair's Statement.

114. The statement will be first and foremost a scheme management tool for the trustees, supported by appropriate written policies on key functions, but will also assist the Regulator for the reasons discussed. The Chair will be required to submit the Chair's Statement with their triennial valuation.[42] An annual Chair's Statement was considered but we have decided to require it alongside existing valuation requirements to mitigate burdens on schemes and the Regulator. However, if the Regulator had concerns they could request an 'out of cycle' statement.

115. Along with the triennial valuation, a Chair's Statement could be used to explain how trustees and sponsoring employers plan to manage the risks of being in a particularly weak position financially. As now, the Regulator can work intensively with the trustees and the sponsoring employer to improve the funding position and reduce the level of risk to the scheme. For example, the trustees and the employer may be encouraged to look more closely at the employer's deficit repair contributions in relation to other business activities and explore whether a change in this balance could be effective without undue negative impacts on the business. Higher employer contributions may be necessary in the short-term in exchange for lower contributions later. However, this would likely be confined to a small minority of employers who are stretching scheme specific flexibilities in a way that was not intended by the legislation. Equally, some employers could reduce their

[38] The Occupational Pension Schemes (Charges and Governance) Regulations 2015

[39] TPR, 'DC and DB research response', 2017, p4. Available at: http://www.thepensionsregulator.gov.uk/docs/dc-db-research-response-september-2017.pdf

[40] Financial Conduct Authority (FCA), 'Behaviour and Compliance in Organisations', 2016. Available at: https://www.fca.org.uk/publication/occasional-papers/op16-24.pdf

[41] TPR, '21st Century Trusteeship and Governance', 2016, p15. Available at: http://www.thepensionsregulator.gov.uk/docs/21st-century-trusteeship-governance-discussion-2016.pdf

[42] FCA's Behaviour and Compliance in Organisations study states that 'one of the lessons of the psychological literature on behavioural biases is that the 'bias blind spot' means that it is easier to spot such biases in others than it is to spot in oneself'.

contributions in the short-term because they are able to demonstrate they are meeting the clearer funding standards and can adjust commitments accordingly.

116. We will legislate to require a Chair's Statement from Defined Benefit schemes and to give the Regulator the necessary powers to ensure compliance with this new requirement (similar to the existing powers in relation to non-compliance with the requirement for a Defined Contribution Chair's Statement, e.g. a fixed penalty notice).[43] We will work with the Regulator to review existing reporting requirements on scheme funding to avoid duplication and minimise burden on schemes.

Other scheme funding areas

Governance

117. In the Green Paper, we discussed the concerns raised about the quality of some trustees' decision-making and approach to governance. The majority of respondents suggested that more could be done to support trustees.

118. Trustees should ensure there is a good system of governance with effective internal controls that are appropriate for their scheme. This should include a proportionate and timely process for identifying risks and mitigation strategies which trustees would keep under review, and which are considered when decisions are made about the scheme.

119. The Pensions Regulator has a statutory duty to promote good administration of work-based pension schemes. To support this duty, the Regulator has produced an Internal Controls Code of Practice and code-related guidance[44] to ensure trustees promote a good system of governance with clear internal controls framework – such as maintaining trustee knowledge and secure record keeping.

120. To further improve governance standards across all occupational pension schemes, over the past two years, the Regulator has been undertaking a programme of work focusing on supporting trustees. For example, increasing clarity around its expectations of trustees and stepping up its regulatory and enforcement activities against non-compliance. In September 2017, the Regulator launched a 21st Century Trusteeship communications campaign focusing on the fundamentals of good governance, in such areas as trustee competence, strategic planning, roles and responsibilities and managing conflicts. It outlined how trustees can take action to meet expected standards, and what action the Regulator will take where standards do not improve. In addition, the Regulator is reviewing its operational practices so that it can more effectively engage with the larger number of smaller schemes in the landscape.

121. Together with proposals on scheme funding, including the Chair's Statement, these steps aim to improve the effectiveness of scheme governance, risk-management and wider trustee decision-making.

122. The measures on scheme funding and the Chair's Statement will be subject to review by the Regulator. In addition, the Regulator will monitor the impact of this programme of work and their findings will inform whether reasonable steps are needed to improve standards of governance and trusteeship.

[43] Section 40 of the Pensions Act 2008
[44] Code of practice 09. Available at: http://www.thepensionsregulator.gov.uk/codes/code-internal-controls.aspx

Greater transparency of Defined Benefit costs

123. The Green Paper posed a question on whether costs and charges in Defined Benefit schemes are too high. Some responses suggested that there is scope for improved cost efficiency and that there should be more transparency. While efficiency savings would not in themselves be sufficient to transform a scheme's funding position, awareness of costs and cost efficiencies is an important part of managing a scheme well.

124. There is increased focus around the costs and charges incurred by pension schemes in relation to the management of scheme assets. The Financial Conduct Authority[45] referred investment consultancy and fiduciary management services to the Competition and Markets Authority in September 2017. It has also established an Institutional Disclosure Working Group to develop a standardised template for reporting costs and charges to their clients, including trustees of Defined Benefit schemes. The European Union's recast Markets in Financial Instruments Directive (MiFID II)[46] which came into force on 3 January 2018 also requires fund managers to disclose both implicit and explicit costs to their clients.

125. We will work with the Regulator and other parties to consider what more could be done to promote greater transparency of costs and charges in Defined Benefit schemes to help drive efficiencies.

Supporting individuals to understand the funding position of their scheme

126. In the Green Paper, we asked whether schemes should be doing more to keep their members informed about the funding position of their scheme. Most respondents were in favour of simple scheme communications that enable members to understand the scheme funding position, and the effect of this on their pension. The flow of information between a Defined Benefit scheme and its members is important. Schemes should encourage members to engage with the scheme, in particular about their personal expected outcome from the scheme.

127. Currently, trustees are required to send their members a Summary Funding Statement[47] at specific points during their period of scheme membership, such as when the member is close to retirement or upon request. We will work with the Regulator to consider how best to support trustees to ensure such Statements are clear and informative to help members understand the role their Defined Benefit pension plays in their wider retirement income planning.

128. Trustees may choose to draw on information included in the Chair's Statement, but this is intended to be an internal governance and reporting tool for trustees to articulate the scheme's overarching approach to funding and risk. It will enable trustees to transmit information to the Regulator and support their assessment of risks to scheme members, the PPF or to the sustainable growth of the employer.

Raising awareness of other funding measures

129. In the Green Paper we said that more might be done by both government and industry to help improve people's understanding both of valuation and deficit data and the degree of certainty and risk in the regime overall.[48]

130. There is a range of funding measures in common use in addition to the SFO, such as references to accounting standards or solvency measures. Each is designed for a specific purpose. Despite the

[45] FCA. Asset Management Market Study Final Report. 2017. Available at: https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf

[46] The MiFID II is the EU legislation that regulates firms who provide services to clients linked to 'financial instruments' (shares, bonds, units in collective investment schemes and derivatives), and the venues where those instruments are traded. Available at: https://www.fca.org.uk/markets/mifid-ii

[47] The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations. Available at: http://www.legislation.gov.uk/uksi/2013/2734/contents

[48] DWP, Security and Sustainability in Defined Benefit Pension Schemes, 2017, p58. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/595103/security-and-sustainability-in-defined-benefit-pension-schemes.pdf

evidence in the Green Paper that the Defined Benefit pensions sector as a whole is not in crisis, there is a perception amongst some groups that many employers are unable to sustain their contributions that deficits are substantial, and that member benefits are very much at risk. This perception is, in part, due to a lack of understanding of the purpose and basis of the other funding measures.

131. To address these issues, the Regulator will publish on their website a factsheet which explains the main ways of measuring the assets and liabilities of schemes. The aim of the factsheet will be to help improve the understanding of the Defined Benefit scheme funding methods amongst members, journalists, commentators and the general public. The Pensions Advisory Service will adapt the factsheet in order to meet the needs of individuals.

Valuation cycles

132. Some commentators argue that the triennial valuation cycle is focusing some trustees and employers on managing the position from the current to the next valuation date, rather than taking a longer-term approach to scheme funding.

133. The green paper stated that there is no compelling evidence to suggest that the triennial cycle of valuation is a significant problem for schemes, nor that it is impacting on the funding and investment strategy chosen by trustees.[49] However, we sought views during the consultation period on whether shorter valuation reporting cycles would be more appropriate, such as nine or 12 month cycles.

134. Of those who were in support of that approach, most respondents favoured a reduction to 12 months. However, because there will be a revision of the Regulator’s Funding Code and new guidance on scheme funding we have decided to retain the current 15 month completion time period.

135. This is intended to support all trustees who will have new requirements placed on them and will give them time to prepare for the changes. We believe no change to the cycle is reasonable in this case, and we wish to avoid placing further burdens on schemes that already adopt good practice principles. Further, we are strengthening the powers of the Regulator (as set out in chapter one), encompassing increased information gathering powers for the Defined Benefit sector, which could be applied in the event of valuations submitted late or should the Regulator need to find out more about a scheme’s funding position.

Conclusion

136. We want all Defined Benefit schemes to be run as efficiently and effectively as possible. Well-informed and considered decision-making from both trustees and the sponsoring employers is expected to result in better funding outcomes, which will benefit everyone: employers are more likely to meet their obligations in the most efficient way, while members are more likely to get the pension they are expecting. The proposals in this chapter address the most important scheme funding issues raised in the green paper, and will help all schemes to approach their funding requirements in the most effective way possible.

137. Our proposals build on the scheme-specific nature of the existing regime, supporting trustees through clearer guidance on the funding standards that all trustees are expected to deliver, consistent with the TPR Future report which emphasises the importance of tailored support to help schemes where necessary. The Regulator will be enabled to take efficient action to improve the funding approach taken by trustees and employers to protect members’ benefits and mitigate risk to the PPF. Where schemes are well-funded, trustees and employers may benefit from our new approaches through efficiency improvements; where there are funding problems, all parties will be given the support and tools they need to work together to improve outcomes.

[49] Ibid pp. 44–45

Chapter three: improving the way the system works – consolidation

We will:

- Consult this year on proposals for a legislative framework and authorisation regime within which new forms of consolidation vehicles could operate;
- Consult this year on a new accreditation regime which could help build confidence and encourage existing forms of consolidation;
- Work with the Regulator to raise awareness of the benefits of consolidation with trustees and sponsoring employers, through, for example, the Regulator's Trustees Toolkit and updating guidance; and
- Consider some minor changes to guaranteed minimum pensions (GMP) conversion legislation to support benefit simplification, which will help reduce complexities in existing benefit structures.

Summary of issue

138. Consolidation (where administrative functions and/or assets and liabilities are pooled in some form) already takes place in various ways across the pensions market. In Annex A, we set out the advantages pension scheme consolidation can bring in reducing scheme costs per member, enabling more effective investment strategies and improving governance. The Green Paper also discussed the challenges facing schemes that want to consolidate, such as multiple benefit structures and the risks associated with trustees and employers passing responsibility for a scheme over to a consolidator.

139. The work done by the Pension and Lifetime Savings Association (PLSA) Defined Benefit Taskforce[50] outlined a framework in which a Superfund consolidator vehicle might operate. It suggested how a new form of consolidation could offer an alternative option for those businesses seeking greater certainty around their future pension liabilities, but who are unlikely to be able to meet the cost of securing members' benefits through insurance buy-out. This proposal would represent a sea-change in the way that Defined Benefit pension schemes have traditionally been managed.

140. We are already aware of proposals for potential new consolidation vehicles which would facilitate consolidated risk transfers within the existing Defined Benefit regime. It is important that we set clear expectations regarding the protections needed to ensure any such transfers are in the best interests of members, sponsoring employers and the wider economy.

[50] Pensions and Lifetime Savings Association (PLSA), 'DB Taskforce', 2016. Available at: https://www.plsa.co.uk/Policy-and-Research-Defined-Benefit-DB-Taskforce

The Defined Benefit Pension landscape and consolidation

Lack of scale

141. Within the Defined Benefit sector, there are high levels of fragmentation. Most schemes are relatively small in terms of members and assets but over 60% of all assets are held by big schemes of over 10,000 scheme members. According to the latest figures published in the Pension Protection Fund's '*Purple Book 2017'*, 36% of schemes have fewer than 100 members and another 44% fewer than 1,000 members.[51] Evidence suggests that small and medium-sized schemes fail to meet the governance standards expected by the Regulator more than larger schemes, and that trustee decision-making could often be improved.[52] Additionally, a lack of opportunities to benefit from economies of scale means that small schemes tend to have higher administrative costs per member and are less likely to benefit from quality investment opportunities, for which advice comes at a premium.

142. On the asset side there is a growing body of evidence to demonstrate the benefits of scale that can be achieved through consolidation. However, the evidence comes from some of the very largest funds both in the UK and overseas and may not reflect the circumstances of many UK Defined Benefit schemes in terms of being either being open to new members or future accrual, or stage of maturity:

    a. The Local Government Pensions Scheme (LGPS), a public sector Defined Benefit arrangement, is part-way through their own consolidation process with 89 authorities collaborating to create eight large asset pools. As part of the LGPS consolidation process, APG Asset Management and Unison conducted research[53] which found that a substantial improvement in investment performance could be realised by increasing the size of funds through a combination of lower expenses and higher returns.

    b. Analysis from CEM Benchmarking, which collects cost and performance data from approximately 500 pension schemes all over the world, shows that larger funds' investment return (from a similar portfolio of assets) is better than smaller funds' because of lower investment costs relative to assets. One of the reasons might be that larger funds achieve better efficiencies due to increased use of internal investment management and decreased use of external management and Fund of Funds.

143. The asset mix of larger funds also tends to differ from smaller funds through increased investment in alternatives (such as infrastructure, property and private equity) and decreased investment in fixed income (such as bonds). Although alternatives are more expensive to manage, the potential returns from them can be greater and they provide further diversification, which could lead to improved or less volatile investment outcomes. However, we acknowledge that asset mix can also be dependent on scheme specific factors such as maturity and level of funding relative to liabilities.

Current forms of consolidation

144. There are already several different options available to Defined Benefit schemes to bring them within larger bodies and therefore benefit from shared functions and improved governance. Responses to the Green Paper were generally positive about these existing vehicles, recognising the benefits they can provide. For many Defined Benefit schemes, these methods of consolidation already offer a viable solution which could help them achieve benefits of scale whilst still maintaining responsibility for their scheme. Examples of existing options include:

[51] PPF, 'Purple Book', 2017, p.15, Figure 3.11.

[52] TPR, 'DC and DB Research', September 2017. Available at: http://www.thepensionsregulator.gov.uk/docs/dc-db-research-response-september-2017.pdf

[53] APG Asset Management and Unison, available at: http://www.google.co.uk/url?url=http://www.unisonoldham.co.uk/wp-content/uploads/2012/12/UNISON_Response_to_DCLG_PE_infrastructure_consultation.docx&rct=j&frm=1&q=&esrc=s&sa=U&ved=0ahUKEwjinbDftc3YAhXDCpoKHSC-DCwQFggcMAI&usg=AOvVaw2_YJFFOb2WK-rsIfP1VDSY

- shared administrative services;
- asset pooling;
- fiduciary Management; and
- Defined Benefit Master Trusts.

145. As the second report of the PLSA's Defined Benefit Taskforce[54] notes, these consolidation methods can already help schemes to realise lower administrative and investment costs, improve governance and provide easier access to expertise and improved investment strategies. This is supported by Green Paper responses from Defined Benefit Master Trusts, who estimate that certain pension scheme operating costs can be reduced by around 30% in a Master Trust.

146. Many smaller schemes may have been set up as insured schemes. This means that if the insurance company still continues to collect contributions and invest them in their own funds, and handle retirements and all other benefit claims, these schemes may already be benefitting from some form of consolidation and a streamlined approach to governance.

147. However, there is a limited uptake of existing methods of consolidation. This may be due to an established practice of trusteeship and sponsorship wanting to retain full control of a scheme, regardless of the potential cost savings and increased security to members. Green Paper responses suggested that more should be done to publicise the wider benefits of consolidation, including educating trustees and scheme sponsors about its potential long-term advantages. It was suggested that the Regulator's Trustee Toolkit could be a useful and impartial way to educate trustees and sponsors about the benefits of consolidation, which could help raise awareness and prompt them to consider whether consolidation or buy-out might be a viable option.

148. Defined Benefit Master Trusts have also suggested that improving transparency around costs and charges would act as a useful prompt in encouraging schemes to consider consolidation. As chapter two notes, the Government is supportive of work being undertaken to promote greater transparency of costs and charges and is working with interested parties on this.

149. Small-to-medium-sized schemes might be expected to benefit most from consolidation. However, the design and circumstances of Defined Benefit schemes are many and varied, and consolidation may not be an appropriate destination for all schemes. For those who could benefit from consolidation, it is important that there is a range of viable models available to meet the diverse needs of different situations. For other schemes, it may simply be a case of encouraging trustees to seek further efficiencies from their existing arrangements and providers.

Securing members' benefits

150. All pension schemes face the same risks: inability of the sponsoring employer to sufficiently fund the scheme (covenant risk), investment risk, and longevity/other demographic risks. Even for relatively well-funded Defined Benefit schemes with strong employers, there remains an inherent risk to members' benefits. Our analysis suggests that a sponsoring employer with an investment grade credit rating[55] might have up to a 3% chance of company insolvency within 30 years.

151. As set out above, existing forms of consolidation could increase the ability of trustees to more effectively manage investment risk and may give access to better investment options. Where this is

[54] PLSA, 'The Case for Consolidation', March 2017. Available at: https://www.plsa.co.uk/portals/0/Documents/0622-The-Case-for-Consolidation.pdf

[55] For illustrative purposes only: we assume sponsors in Levy Band 1–4 of the PPF insolvency risk table to be a close proxy for investment grade employers, which have an 'insolvency risk' of up to 0.1113% per year.

combined with dissolving the sponsoring employer relationship through buy-out, covenant risk in the original employer could also be removed, albeit at a significant premium to the employer.

152. Pension schemes may have different long-term funding objectives, but it is expected that most trustees will ultimately be aiming to secure members' benefits with an insurance company. In this case, the funding objective will therefore be focussed on when and how it might be realistic to achieve this. Although there is an established market for bulk annuity transactions, the annual average (on a mean basis) volumes being traded has been around £7–8 billion[56] and are mainly restricted to buy-in of pensioner liabilities as a means of transferring some, but not all of, a pension scheme's investment and demographic risk. However, activity has broadly been increasing over recent years with certain commentators expecting this trend to continue.

153. There were over 100 insurance buy-out deals in 2016. Of those, around 40% of transactions were less than £10 million, indicating that there is a market for transactions on the scale that smaller Defined Benefit schemes may seek.' This view is reinforced by the fact that of the eight insurers currently active in the risk transfer market, as of June 2017 five of them had an appetite for transactions below £50m.[57]

Table 1: Number of deals in 2016, by deal size

Deal size (£m)	Number of deals
<10	40
10–100	41
>100	23

Source: Settlement Watch, Willis Towers Watson, April 2017[58]

154. However, research carried out by Lane Clark and Peacock[59] indicates that there has been a 20% reduction in the number of transactions below £100 million, and across the market up to 40% of quotation requests are declined by insurers. This might suggest a preference for insurers to write larger transactions, leaving smaller schemes to potentially be crowded out of the market.

155. As noted at the beginning of this chapter, new forms of consolidation are being put forward by industry to operate alongside traditional consolidator vehicles. One area gaining interest is the idea of 'commercial consolidation' as a more affordable way of risk transfer. Under this model, a private company would set up a new Defined Benefit pension scheme and take over the responsibility for meeting the liabilities of other pension schemes in exchange for a one-off payment or structured payments by the previous sponsoring employer. The company then acts as the 'sponsor' with a new board of trustees responsible for scheme governance. The covenant is provided by additional capital supplied by external investors who expect a return for their investment.

156. There may be considerable potential benefits for employers through commercial consolidation. Some employers find that they are constrained from focussing effectively on their core business because of the need to support a closed legacy pension scheme, the liabilities of which may be volatile and unpredictable. But many are not in a position to be able to secure members' benefits through a buy-out with an insurance company, and some are unlikely to be able to in the future. If an employer can afford entry they could exchange their covenant support through transfer to a consolidator and know exactly how much they had to pay, making planning for their future business easier. If at the same time members' benefits were likely to be more secure, then this would create a more beneficial situation for all parties.

56 DWP average of estimates from Hymans Robertson's 'Risk Transfer Report', August 2017.
57 Hymans Robertson, 'Risk Transfer report, Hymans Robertson', August 2017.
58 Available at: https://www.towerswatson.com/en-GB/Insights/Newsletters/Europe/uk-settlement-watch/2017/Insured-transactions-market-review-of-2016
59 Lane Clark & Peacock, 'Pensions de-risking report', 2016

157. Trustees would need to be satisfied that the resulting funding level of, and security in, the consolidator effectively covers the on-going support expected from the original sponsoring employer, as well as that it increases the likelihood of members receiving their benefits in full. We accept this will not be an easy decision for trustees to make. In particular, it must be recognised that employer covenant risk is swapped for scheme default risk within a consolidation vehicle. In addition, some trustees may still feel that buy-out is a realistic prospect in the medium to longer-term consistent with their long-term funding objective and strength of employer covenant.

Our approach

158. Respondents to the Green Paper called for government action to remove the barriers which currently stifle innovation and prevent wider consolidation taking place; recent proposals for ‘commercial’ style consolidator vehicles also demonstrate an appetite in the industry for innovation in this area.

159. With more Defined Benefit schemes approaching maturity and their sponsoring employers seeking to secure members’ benefits or transfer risk, there appears to be a space that new commercial consolidators could fill. There is the PLSA’s Superfund approach; however, other organisations may also have innovative ideas of how consolidation vehicles might work. These could supplement the existing insurance market, rather than being a direct competitor, although each might be competing for the same capital, investment and hedging opportunities.

160. Offering industry the opportunity to innovate and create a number of different models with a variety of target markets could, in future, offer a more affordable way of risk transfer. However, it is important that this is done in a safe way, with clear parameters for vehicles to operate within and to provide members with reassurance that funds are meeting a set of clearly defined standards.

161. Despite the work already done within the industry on commercial consolidation vehicles, there is much more to do to develop this policy to a point where it could be successfully delivered. When the current Defined Benefit legislative framework was designed, it was always intended that an employer would stand behind the scheme, or that the scheme would buy-out with an insurance company subject to strict funding and capital requirements. We therefore need to ensure that exchanging sponsor covenant and moving into a commercial consolidator improves the expected outcomes for members in order to realise the benefits that consolidation could bring.

162. We are therefore developing proposals for a legislative framework and authorisation regime to enable consolidation in which an employer no longer sponsors their Defined Benefit pension scheme.

163. There is a delicate balance to be struck. If the legislative framework is too restrictive, then the consolidator vehicles may not be commercially viable but if the vehicle is under-protective of members, then the risks to members’ benefits will be unacceptable. We have therefore identified a number of areas that will need to be considered (as set out below), which will be subject to further consultation this year.

164. As noted above, respondents also thought that more could be done to publicise the wider benefits of consolidation. We are therefore considering ways to raise awareness around existing forms of consolidation such as Defined Benefit Master Trusts.

Our proposals

New commercial consolidation vehicles

165. Commercially run consolidation vehicles would be a major shift in the Defined Benefit sector – but if designed properly we believe that they could both reduce some inefficiency within the system and

have the potential to offer better long-term outcomes for certain scheme members whilst offering an alternative strategy for managing legacy Defined Benefit schemes.

166. Subject to consultation, we do not propose that commercial consolidators should be required to fund schemes at the level required of insurance companies offering buy-out arrangements. However, in recognition that these vehicles would not be operating as a traditional Defined Benefit scheme, funding requirements would be likely to be at a higher level than is typical of schemes with a continued attachment to their employer.

167. For schemes choosing to enter a commercial consolidator, this would in most cases be in exchange for a significant contribution to improve the funding level of the scheme. The PLSA's Taskforce's Superfund model suggests that the funding level could be around 80–85% of the cost of full buy-out.[60] This might equate to around 110%–120% of technical provisions for a typical scheme. However, the way in which the entry cost is determined would be dependent on the type of consolidator model and the approach to setting funding and capital requirements.

168. Any transfer to a consolidator vehicle would require the consent of scheme trustees who would need to take legal, actuarial and covenant advice and to assess, in detail, the impacts of a transfer.

Areas for future consultation

169. In developing our proposals, we have identified the following areas that will need to be included in a legislative and regulatory framework for a commercial consolidation vehicle. The following paragraphs set out our initial thinking, which we propose to consult on in detail this year.

(i) Establishing a commercial consolidator

- Under current models being proposed, new consolidation vehicles would operate within the existing occupational pension scheme regime. We therefore envisage that the Regulator would be best placed to authorise and supervise such vehicles, including ways to mitigate any risks or potential abuses. This was also suggested in the PLSA's Superfund model. At present, the Regulator has no power to set the terms under which a Defined Benefit consolidator is established. An appropriate authorisation and supervisory process would therefore need to be established in legislation to ensure commercial consolidators meet all the framework requirements we put in place for the operation of such vehicles.

(ii) The criteria that need to be met in order for a scheme to be eligible for entry into a commercial consolidator

- Any legislative framework would need to establish and set the conditions a transferring scheme would need to meet to be eligible to enter a commercial consolidator. Clearly, there will be a 'price'; however, we would expect both the framework we put in place, and market competition, to affect the entry price for individual schemes in much the same way as the insurance bulk annuity market operates. In most cases, we would expect the sponsoring employer and trustees to take separate and independent legal and actuarial advice, and also separate and independent from the advice received by the commercial consolidator. We would also expect trustees to consider taking independent covenant advice. Statutory guidance or Codes of Practice could also assist sponsors and trustees in their decision making. We may also wish to set certain other conditions to ensure all data, equalisation, and administration risks are minimised and to allow the commercial consolidator to achieve the efficiencies that consolidation can bring.

[60] PLSA, 'Opportunities for Change', September 2017. Available at: https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2017/DB-Taskforce-third-report-Opportunities-for-Change.pdf

(iii) The on-going relationship with the sponsoring employer

- The PLSA model presumes breakage of the sponsoring employer link in return for additional funding and capital investment in the consolidation structure. Therefore the security offered through the funding level of the scheme post transfer together with the capital structure of the consolidation vehicle would need to be demonstrably higher than it was under the sponsoring employer. The market may also design other models where the consolidation vehicle retains some form of attachment to the sponsor of a scheme entering the consolidator vehicle, for example in the form of an equity stake or debt repayment arrangements to fund any shortfall in assets transferred. The framework will therefore need to be sufficiently flexible to cope with different models without allowing member security to be compromised.

(iv) The long-term funding objective for the consolidator

- As a starting point, we would expect a commercial consolidator to have a long-term funding objective which ensures its long-term viability and an adequate level of security given that the consolidator could enable severance of the sponsoring employer. We therefore expect that we will need a stricter set of funding standards than currently apply to ensure members are adequately protected given that one purpose of the fund is to provide a financial return to those providing capital to the commercial consolidator. This is a considerable move away from the established structure of having an on-going employer.

(v) The amount of capital buffer that is required

- To mitigate the loss of individual sponsor covenant following a transfer to a commercial consolidator, we also expect that an additional capital buffer will be required within the structure of the consolidator. The capital buffer would provide further security to members in the event that the funding position of the consolidator falls below a minimum funding level. We also intend to investigate further “stress tests” or a “value-at-risk” assessment to test the adequacy of, and access to, the capital being provided by a consolidator sponsor. The strength and scope of the tests will reflect a minimum additional level of security the capital is intended to provide over and above the long-term funding strategy; failure would determine when regulatory intervention may be required in the operation of the commercial consolidator.

(vi) The investment strategy that should be adopted

- We would expect the authorisation regime, funding framework and capital adequacy requirements will require or encourage consolidators to adopt a low-risk or cash-flow matching investment strategy, and to hedge unrewarded risks. As an example, this could be done by making the capital requirements dependent on the investments held, together with some overarching principles or rules setting the approach to prudence.

(vii) The circumstances in which third-party capital providers can extract profits

- It would be reasonable for a provider of risk capital to be able to profit from the provision of that capital. We will need to consider setting limits on the charges a sponsor could make to prevent excessive profits being made at members’ expense and to the risk of their benefits. A potential consolidator sponsor may also wish to extract surplus at some future date or even as it emerges. Again, we will consider the extent to which this will be possible unless the consolidator is in a position to buy out at least some portion of the fund’s liabilities consistent with the current scheme funding regime.

(viii) The level of funding below which the fund cannot fall and be permitted to continue to take on new schemes

- This area will need further consideration. The consolidator might be required to close to new business at the point where its assets fell below the long-term funding objective and the sponsor was unable to meet future recovery plan payments and minimum capital requirements without further investment being available. It should be noted that schemes might not be required to wind-up at this stage if a turnaround might still be possible without new business funding a potential shortfall.

(ix) Interaction with the Pension Protection Fund (PPF)

- One key issue that will need to be resolved is what happens in the event a consolidation vehicle 'fails' and what constitutes failure (for example, is there a given funding level or other measures below which the consolidation vehicle must wind up). One aspect of this is whether a commercial consolidator would be eligible for the PPF in a failure scenario. Members and trustees of transferring schemes may well be reassured by PPF eligibility. However, depending on how funding and wind up requirements are defined, PPF protection may not be necessary (for example, if provisions are constructed in such a way to ensure that – in the event of failure – the consolidator is always able to buy out member benefits above PPF levels of compensation). It will also be important to consider the risks that a consolidation vehicle(s) could present to the PPF. Again much depends on the wider funding requirements that are put in place, but consolidation of a large number of schemes into one sizeable consolidation vehicle would clearly pose a very different, concentrated risk to the PPF than the current position (where risks are dispersed across schemes with different employers and different investment strategies). Government will also need to decide whether it is appropriate for PPF members and levy payers to effectively underwrite a commercial, profit making venture. If PPF eligibility is provided for consolidators then both Government and the PPF will need to take action, including reviewing the relevant legislation, to ensure an appropriate levy can be charged (perhaps building on the PPF's existing methodology for schemes without a substantive sponsor) and that entry to a PPF entry period can be triggered at the right point.

(x) Governance and alignment of interests

- A consolidation vehicle could potentially be responsible for the benefits of hundreds of thousands of members, managing assets in excess of tens of billions of pounds. The standards of governance the consolidation vehicle would need to meet would have to be set at an appropriately high standard. As a minimum, we would look at how we apply a similar governance structure as currently applies to Defined Contribution Master Trusts and in particular the "fit and proper" tests that would need to apply to those responsible for the governance of a consolidation vehicle.
- Inevitably there will be some tension between the managers of the consolidation vehicle (whose principal duty should always be to ensure members' benefits can be provided in full) and the capital investors (who may look to exert some control over the important decisions being made on their behalf such as the investment of assets). However, there will be some alignment of interests: the managers of a consolidation vehicle will not want to face having to reduce member benefits in the event of a failure of the consolidation vehicle; the investors will not want to see depletion in their capital and a corresponding reduction in their returns. We need to ensure that a fair balance is achieved in the operation of the consolidation vehicle to provide sufficient protection to members but recognise the interests of investors.

(xi) The regulatory framework and levies charged

- The Regulator would need significantly enhanced powers in relation to the on-going supervision of a consolidation vehicle. In particular the Regulator would need to be able to monitor the on-going funding and governance. As consolidation will be a substantial change to the current regulatory system, the Regulator would need to have more resources to regulate this type of vehicle. This would be likely to have cost implications for the Regulator, and for the industry levy which funds it. Some of these costs could be offset by savings across the system as a whole resulting from consolidation.

Benefit simplification

170. Defined Benefit structures can be complex. Responses to the Green Paper on the influence that complex benefit structures can have on consolidation were polarised. For instance, some respondents argued that simplification was necessary for consolidation and that the current legislation which allows schemes to simplify benefits is prohibitively complicated and precarious for trustees who might fear legal challenges from those members who may lose out. Others argued against simplification as a prerequisite for consolidation and that any changes to legislation would be unnecessary, noting that such changes could weaken member protection. Additionally, some noted that off-the-shelf IT systems are currently capable of running hundreds of complicated benefit structures and that simplification, if required, may in some cases deter consolidation due to potentially high one-off costs of simplifying benefits.

171. Where high levels of consolidation have taken place abroad (in the Netherlands and Canada for instance), the ability to reshape or convert accrued benefits has been important. Similarly, where there has been forms of consolidation within the UK sector (for example, insurance providers and the PPF), benefits are often simplified prior to entry.

172. Initial estimates, informed by discussions with industry, suggest that adopting a simplified benefit structure may reduce total on-going costs by around 10–15%.[61] While this is a significant saving, it would have to be offset against the up-front cost of the process of simplifying all benefits, which could be very expensive.

173. Any legislative change which allowed trustees to simplify members' benefits without consent, potentially overriding scheme provisions, would require a strong body of evidence to justify change. At this point, although there is evidence that benefit simplification could be advantageous to schemes hoping to consolidate, we are not yet convinced that we could justify a change to the legislation relating to benefit simplification.

174. Existing Guaranteed Minimum Pension (GMP) conversion legislation can simplify much of the complexity in providing benefits, reducing administration costs and paving the way for consolidation, as well as offering schemes a means to address the gender inequalities that arise from GMPs. We are however aware that the Pensions Industry working group set up to address inequalities caused by GMPs has suggested some small changes to the GMP conversion legislation and we are considering some minor changes for the near future.

175. Respondents to the Green Paper highlighted that, where gender inequalities from GMPs are addressed through GMP conversion, members might be negatively affected by the Lifetime Tax Allowance (LTA) and/or Annual Allowance (AA) due to an increase in the underlying pension amount. We are working with HMRC to investigate the potential tax implications and whether changes to tax legislation might be needed and feasible.

176. Concerning the issue of gender inequalities arising from GMPs, respondents to a recent Department for Work and Pensions consultation on how pension schemes may equalise benefits for the effect of GMPs have suggested that any action should be delayed pending the outcome of the upcoming case in the High Court brought by the Lloyds Banking Group pensions trustees. Whilst DWP remains of the opinion that schemes must equalise pension benefits to account for inequalities caused by GMPs, we will consider our position in the light of any legal decisions resulting from that action.

[61] Extrapolated from consultation responses

Raising awareness of consolidation

177. As outlined above, there are significant potential benefits for employers and schemes through consolidation. Responses to the Green Paper suggested more should be done to publicise the wider benefits of consolidation, including educating trustees and sponsors about its potential long-term advantages. We will therefore work with the Regulator to consider how their Trustee Toolkit could be used to enhance trustee and sponsor awareness of their consolidation options.

178. We are also considering ways to address behavioural and decision-making issues that may sometimes prevent consolidation. In particular, we are looking at how a new accreditation regime could help encourage existing forms of Defined Benefit consolidation through offering members, trustees and sponsors confidence that these vehicles meet or exceed a set of clearly defined standards. We will look to consult on these proposals later this year. In addition, the Chair's Statement, which is discussed in chapter two, could require schemes to consider whether consolidation would be beneficial under certain circumstances.

Conclusion

179. The characteristics of Defined Benefit pension schemes are wide-ranging with varying membership levels, objectives and trustee governance approaches. We do not believe there is a "one size fits all" approach to consolidation but, following consultation and engagement with the industry, we are convinced of the significant benefits that consolidation can bring if legislative and regulatory frameworks are designed properly and risks mitigated.

180. There are already several options open to Defined Benefit schemes to benefit from shared functions and improved governance. Ultimately, it will be for sponsoring employers and trustees to decide on the merits of consolidation. However, we would expect them to critically assess the benefits of consolidation and come to a considered view on whether consolidation could improve outcomes for their scheme members. Raising awareness of the benefits of consolidation along with the introduction of a Chair's Statement will help prompt trustees and encourage them to consider whether consolidation would be beneficial under certain circumstances.

181. As well as providing an opportunity to improve outcomes for Defined Benefit scheme members, consolidation could benefit sponsoring employers and the PPF. By allowing the market to innovate to deliver different vehicles, a range of solutions could be available for Defined Benefit schemes. There is a role for the government to put in place a robust legislative framework for consolidator vehicles to operate and ensure members' best interests are protected.

182. We will continue to work closely with the industry in a further consultative process to determine the detail of a legislative and regulatory framework which meets the needs of members, schemes, potential investors and operators.

Chapter four: British Steel Pension Scheme and other live areas

British Steel Pension Scheme

183. In May 2016, the Government launched a consultation to explore what might be done to help the British Steel Pension Scheme (BSPS) in the wider context of efforts to protect the UK steel industry.

184. The consultation ran for four weeks and we received over 5,000 replies, amounting to 4,509 individual respondents (taking account of duplicate responses). Further responses and comments continued to be submitted throughout 2016 and 2017.

185. The consultation asked for views on four options:

- **option one**: use existing regulatory mechanisms to separate BSPS from the sponsoring employers (Tata Steel UK Limited and other associated companies);
- **option two**: payment of pension debts – the existing sponsoring employer 'buys-out' of the scheme;
- **option three**: reduction of the scheme's liabilities through new legislation which would allow the trustees to reduce the indexation and revaluation on future payment of accrued pension rights; and
- **option four:** legislating to permit a bulk transfer without member consent to a new scheme which would offer lower indexation and revaluation but pay benefits equal to or greater than the compensation paid by the Pension Protection Fund (PPF).

Summary of consultation responses

186. Many respondents were in favour of legislative changes which would allow the scheme to reduce its liabilities by reducing the level of indexation and revaluation on accrued pensions. In particular, the majority of BSPS members who responded were in favour of this option, which was also the trustee's preferred option. A large number explicitly indicated that they considered it preferable to the alternative of the scheme entering the PPF.

187. Respondents from the pensions industry, however, were more cautious about any legislative change, arguing that allowing one individual scheme to make changes in this way would be unfair, and that it was likely to set a precedent for other schemes to push for similar changes. A significant number of individual scheme members and organisations representing them also opposed any legislative change which would make it easier for schemes or their sponsoring employers to reduce benefit levels. One large campaign group expressed widespread concerns that making changes to the BSPS would set a worrying precedent that other Defined Benefit schemes would follow. These concerns also applied to option four which would have permitted bulk transfers to a new scheme which provided lower revaluation and indexation without the need to obtain member consent.

188. During the green paper consultation period, the BSPS and Tata Steel UK Limited continued to be a live issue. A small number of respondents cited Tata Steel UK Limited as an example when expressing concern about employers evading their responsibilities to members and questioning whether the current system provided an appropriate level of member protection.

The outcome for the BSPS and Tata Steel UK

189. The Pensions Regulator, the Pension Protection Fund (PPF) the BSPS trustees and both Tata Steel UK Limited and Tata Steel Limited worked through 2016 and 2017 to secure the best possible outcome for the BSPS considering the difficult circumstances, using existing legislation.

190. On 11 September 2017, the Regulator confirmed its approval of the Regulated Apportionment Arrangement (RAA). As part of this, Tata Steel UK Limited paid £550m to the trustee and transferred a third of its equity into the BSPS.

191. The RAA was approved by the Pensions Regulator and not objected to by the PPF under existing rules, because the alternative would be the inevitable insolvency of Tata Steel UK Limited and the other employers leading to a worse outcome for the pension scheme.

192. A new British Steel Pension Scheme (BSPS2) has now been set up. It is sponsored by Tata Steel UK Limited.

193. Transfer to BSPS2 has not been automatic. Following a consultation period, scheme members had a choice of remaining in BSPS, or transferring to BSPS2. This exercise was known as 'Time to Choose'. Members who did not choose to move to BSPS2 will remain in BSPS. BSPS will enter a PPF assessment period at the end of March 2018 and members will receive PPF compensation.

194. There are various differences between the benefits provided in BSPS2 and the PPF. This position is most complex for those who have not yet started drawing their pensions – for example, if they opt for the PPF they will need to weigh up a reduction in their starting pension against more generous early retirement and cash lump sum options. Which option is more financially beneficial will depend on the member's personal outlook and their retirement choice.

Bulk transfer of BSPS members

195. We recognise that BSPS members were faced with sometimes difficult choices as to whether to transfer to BSPS2, stay in the BSPS, or transfer their benefits out of BSPS completely and into an alternative pensions arrangement (a right non-retired members have anyway and not specific to the Time to Choose process). The Government was asked by the trustees and others to apply option four (the bulk transfer of members to BSPS2, without consent, where it would be in their interest to do so).

196. Also, the Work and Pensions Select Committee, in its sixth report of the current session (British Steel Pension Scheme) said at paragraph 30: "*We recommend that, in its forthcoming white paper on Defined Benefit pension schemes, the Government bring forward proposals for a system of deemed consent. This should enable the bulk transfer of members from a Defined Benefit scheme certain to enter the PPF into an alternative scheme providing unequivocally better benefits than the PPF to those members. It should be used for future cases similar to BSPS.*'"

197. The Government has considered this very carefully throughout the period since the consultation in 2016. We accept that, for some members, the current system may lead to sub-optimal outcomes. However, the alternative is to place trustees in the position of determining exactly who should move and applying a power to transfer them without consent. Whilst an opt-out of the move would provide some mitigation for individual members, we believe that providing such a wide power in future cases is undesirable because:

- Member choice is a key part of pensions protection. It would not be appropriate to move people into a new pension scheme without their expressed consent unless the individuals concerned are clearly not worse off;
- It is not always possible to be sure who will be better off in the new pension scheme. Outcomes will depend on personal circumstances and on members' plans for the future. For example, in the case of BSPS someone planning to take their pension early might be better off in the PPF

due to different calculation factors used by PPF. Similarly, some members may be able to secure a better survivor's benefit for their spouse by moving to the PPF;

- While for many members it may be possible to calculate arithmetically who would be better off in a new scheme rather than the PPF, this is not the only consideration in members' decision making. For example, members may have lost trust in the sponsors or trustees of the scheme and may wish to make decisions on that basis. Where the financial difference between options is small, and this is the case for the vast majority of pensioner members in the BSPS, emotional factors may become more important for members; and
- While we have confidence in the trustee and advisors who are managing BSPS, any change made to legislation to allow pension scheme members to be moved to a new scheme would have to apply to similar schemes in similar circumstances. Measures put in place for BSPS might be misused by others, either by accident or design, with unwelcome consequences more widely for the protections scheme members enjoy.

198. Although we are not pursuing the deemed consent recommendation, we strongly believe that there are lessons to be learned from all aspects of this case. We will seek to better understand the circumstances and motivations of members who made choices during the Time to Choose exercise. We will be dependent on access to data held by others but will work with the trustee of the BSPS, the Pensions Regulator, the Financial Conduct Authority and The Pensions Advisory Service to inform future decisions in any future situations with similar characteristics.

Conclusion

199. We believe that the agreement to separate the BSPS from Tata Steel UK Limited and its other employers through an RAA, together with Tata Steel UK Limited's agreement to sponsor the new pension scheme, and thereby providing members with the option to transfer into a new Defined Benefit scheme a very positive outcome considering the difficult circumstances.

200. Concerns that Tata Steel UK Limited would unreasonably avoid its liabilities have proved unfounded as Regulator has been able to secure an outcome that is better for pension scheme members than if it had become insolvent: all without the need for changes to pensions legislation. As a result, we have concluded that it is not necessary or appropriate to bring forward new legislation either to permit the trustee to reduce the pension scheme's liabilities by reducing future increases (option three in the consultation paper), or to allow the transfer of members to a new scheme paying lower benefits without individual member consent (option four in the consultation paper).

201. While Tata Steel UK Limited and the BSPS were arguably an exceptional case, lessons can and will be learned to the benefit of other employers, schemes and their members.

Regulated Apportionment Arrangements

202. We have made it very clear throughout this White Paper that we will act firmly to prevent employers from attempting to avoid their responsibilities to their scheme. However, we also know that some schemes have a sponsoring employer who is themselves experiencing very significant financial difficulties and where insolvency is imminent. If the employer does become insolvent, jobs and value will be lost and the scheme will be likely to enter the Pension Protection Fund (PPF). But commentators have suggested that the existence of a large, underfunded Defined Benefit scheme can itself act as a deterrent to the investment needed to prevent an employer becoming insolvent, as external investors may be reluctant to engage with a business with significant pension liabilities. The scheme itself may not be particularly poorly funded, on a technical provision basis, but being underfunded on the PPF basis means the scheme can be faced with wind-up and likely entry into the PPF if the employer becomes insolvent.

203. Under current scheme funding arrangements, an employer faced with impending insolvency can apply to use the Regulated Apportionment Arrangement (RAA) process to separate themselves

from their Defined Benefit scheme. An RAA can be considered where the scheme trustees believe that there is a reasonable likelihood of the sponsoring employer becoming insolvent within 12 months. The employer separates itself from the scheme; in exchange, they generally pay a capital sum upfront and surrenders an equity stake in their business to the scheme. The scheme then either enters the PPF assessment period or in exceptional circumstances, a new successor scheme can be created (or some combination of the two). Requiring the employer to provide an equity stake ensures that the PPF or the scheme benefits from financial upside should the employer recover.

204. RAAs can only take place with the consent of the Pensions Regulator and if the PPF do not object. Their criteria for allowing an RAA to proceed have the effect of ensuring that the pension scheme does better out of an RAA than if insolvency occurred or through the use of the Regulator's anti-avoidance powers.

205. Use of an RAA has allowed some struggling employers to restructure and avoid insolvency. Recent high-profile cases have demonstrated that an RAA can be an effective way of managing a difficult situation, and can lead to a more positive outcome for both the employer and the scheme than could otherwise have been the case. In a recent example, an RAA has provided an opportunity for the employer to restructure and continue as a viable business, therefore preserving jobs, while keeping the pension scheme out of the PPF with many members receiving better than PPF-level benefits.

206. However, an RAA is an expensive process due to the need for expert analysis and advice.

207. We discussed the idea of making changes to the RAA process in the Green Paper. Around half of the respondents suggested that the current process is too complex, and that this complexity can prevent employers from making use of an RAA even where it would be in both the employer and the scheme's interest. They argued that making the process simpler could enable more businesses who would otherwise fail due to loss of investment or restructuring to benefit from RAAs, leading to better outcomes for current and future employees.

208. However, the other half of respondents were opposed the idea of any changes to the RAA process. Respondents argued that making it easier for employers to go through an RAA increased the risk that unscrupulous employers could seek to manipulate their circumstances in order to be able to separate themselves from their scheme.

209. We have given careful thought to whether, and how, we should make any changes to simplify the RAA process. We believe that an RAA can be helpful for both employers and schemes in some circumstances. We want to ensure that RAAs can be accessed by the right employers at the right time where an objective assessment suggests that they are at risk of insolvency and are not likely to be able to continue to support their Defined Benefit scheme.

210. However, we recognise that there is a risk in allowing more employers to go through an RAA process. It is important that we do not increase the risk to members by making changes.

211. We are therefore committing to working closely with the Regulator, PPF, stakeholders and the pensions industry to look at whether it is possible, without increasing risk to scheme members, to make improvements to the RAA process, thereby increasing the potential for positive outcomes for businesses which might otherwise fail.

Indexation of pensions

212. We are committed to protecting members' pension benefits, and are presently ruling out measures which would override provisions in scheme rules and allow employers, or schemes, to change the measure of inflation used to calculate annual increases. However, we will continue to monitor developments in the use of inflation indices.

213. In the Green Paper we discussed possible changes to the measure of inflation used by schemes to calculate annual increases. Presently, 73% of Defined Benefit schemes index their post-97 pension

liabilities using the Retail Prices Index (RPI),[62] despite public sector and State Pensions having switched to the Consumer Prices Index (CPI) in 2011. Many schemes will specify RPI as the measure of inflation in their scheme rules, with trustees either unable or unwilling to amend rules to follow CPI.

214. This has led to regular calls from employers and their advisors for legislation enabling the trustees and/or the sponsoring employer to override the scheme rules. It is argued that many scheme rules require RPI as a result of drafting decisions that pre-date the introduction of CPI, with 'RPI' used as a proxy to mean 'the Government's specified measure of inflation' and that the scheme has now become unintentionally locked into a higher inflation measure.

215. In the Green Paper, we stated that there was no case for across-the-board cuts in indexation on affordability grounds but asked for views on whether we should permit an across-the-board change from RPI to CPI on the separate grounds of rationality and fairness. We sought views on whether we should introduce a power to override scheme rules to allow this to happen. Consultation responses were highly polarised. A large proportion of sponsoring employers and their advisors would like schemes to be able to switch from using RPI. It was argued by some respondents that those employers whose schemes cannot switch to paying lower increases suffer a competitive disadvantage. However, other responses were far less supportive. Individual members and those representing them were clear that savings for employers would be at the expense of the members in the form of lower pension increases. Many respondents argued that the Government should not interfere with the pensions promise made by a scheme, as this would set a damaging precedent for further erosion of member rights.

216. The financial impacts of allowing schemes to move to CPI as the measure of inflation would be significant. It would reduce some schemes' liabilities – possibly by as much £90 billion[63] across all affected pension schemes against an aggregate Defined Benefit deficit of over £200 billion[64] on a scheme funding basis in March 2017. This would result in direct savings to employers, as scheme deficit repair contributions and on-going employer contributions would be reduced. However, reducing a scheme's liabilities by reducing inflation increases would also have a long-term effect on members' pension incomes. By illustration, the average annual Defined Benefit pension payment is £8,000:[65] a pensioner on this average pension receiving RPI increases on all their pension could expect their annual pension to be approximately £300 lower after three years following a switch from RPI to CPI than they would be if the pension had continued to be uprated using RPI (assuming CPI is at 2% and RPI at 3.2%). This loss would be proportional to the size of the pension, so the lowest income pensioners would be likely to see a lower absolute impact on their incomes (although one pound lost is more damaging for those on lower incomes than those on higher incomes). Based on similar assumptions, we estimate that on average the impact per member over their lifetime, on average, could be a reduction of broadly £12,000.[66] This could be a significant proportion of a member's planned retirement income.

217. Having carefully considered the financial impacts and the consultation responses we have concluded that we cannot accept any reduction in the value of member benefits and are therefore ruling out provision of a power for employers or trustees to change scheme rules so that schemes can apply inflation increases using CPI instead of RPI.

218. Any across-the-board change would allow sponsoring employers to reduce their liabilities at members' expense even if the employer had no difficulties in meeting their existing liabilities. Some people have argued that reducing the liabilities in this way would save employers money they could

62 Source: TPR, data (cut-off) point: end March 2017

63 DWP's calculations; the same figure is published in the Defined Benefit Green Paper: Security and Sustainability in Defined Benefit Pension Schemes. Note that the figure is indicative and the exact reduction will depend on future differences between RPI and CPI, and other circumstances.

64 TPR, 'Tranche 12 Analysis', June 2017, Figure 4. Available at: http://www.thepensionsregulator.gov.uk/docs/db-analysis-tranche-twelve-review-2017.pdf

65 DWP's analysis based on the Pensioner Income Series 2015/16

66 Source: DWP/GADs calculations. This figure is based on certain assumptions and simplistic calculations and is indicative/for illustrative purposes only.

then use to invest or to increase the pay and/or pensions of existing employees. However, it is not practicable to ensure the benefits of any reduction in liabilities are shared in this way and the Government is not prepared to countenance a reduction in employer liabilities which might simply facilitate a transfer to shareholders of cash members are relying on to support them in retirement.

219. We are therefore not persuaded by the view that employers or trustees should be able to override scheme rules on grounds of rationality and fairness, given the lack of consensus on what constitutes fairness in this circumstance. We are of course aware that RPI is no longer endorsed by the Office for National Statistics (ONS) and that ONS now counts CPI(H), which includes housing costs, as its preferred measure of inflation. We are also aware that moving from RPI to CPI can in some rare cases be the least worst option for scheme members – for example, if the alternative is scheme failure. Therefore, while we will not be providing an override of scheme rules at this time, we will continue to monitor developments in the use of inflation indices across Government, in pensions, and more widely.

Existing employer debt provisions for multi-employer schemes

220. The legislation requiring employers to pay debts (which include a share of any orphan liabilities in the scheme) is common to all multi-employer schemes.[67] This legislation was originally introduced to protect members' pensions, and forms an important part of that protection. The legislation was strengthened in 2005 to stop employers simply walking away from their obligation to ensure that their employees receive the pension they have been promised and worked for. Since 2005, the legislation has required employers to pay an amount sufficient to secure members' pensions in full (a section 75 debt).

221. In a single employer scheme, this would be through buy-out with an insurance company. The similar arrangement in a multi-employer scheme is the payment of an employer debt equivalent to that employer's share of the total buy-out deficit. This helps meet the objective that members receive the pensions they have worked for and been promised, even if their own or former employer ceases to participate in the scheme.

222. The current regime is also designed to help protect those employers who remain in the scheme and who would otherwise be left to fund any shortfall left by departing employers.

223. We have been talking to and listening to stakeholders about aspects of the operation of the employer debt regime for some time. The Government has a made a number of significant changes to this legislation since 2005 in response to representations made by employers. Following consultation, a number of mechanisms have been made available through Employer Debt Regulations whereby only part of the debt, or no debt, may be payable. There are currently nine such mechanisms in legislation: this reflects the wide variety of circumstances that can arise, the diversity of scheme structures, and the equally diverse range of types of employer.

224. The Government has continually kept this area of legislation under review. We recently announced that new legislation, allowing employers to enter into a deferred debt arrangement, will come into force on the 6th April 2018. This legislation will provide further flexibility in this area. The deferred debt arrangement allows employers in multi-employer schemes that have ceased to employ active members of a scheme to defer their section 75 debt, provided that the trustees consent and that they continue to provide support to a scheme on an on-going basis. The regulations[68] and responses to the consultation in respect of these changes also provide further clarity on the difficulties encountered by employers in using some of the existing mechanisms. We have therefore clarified the definitions underpinning the restructuring arrangements in the regulations.

225. In the Green Paper, we sought to understand whether it was possible to relieve the pressure that some employers face from their obligation to pay section 75 debts, while ensuring that the likelihood

67 Multi-employer scheme means a scheme in relation to which there is more than one employer.
68 Available at: https://www.gov.uk/government/consultations/the-draft-occupational-pension-schemes-employer-debt-amendment-regulations-2017

of members in these schemes receiving the benefits that they worked for and have been promised is not compromised.

226. In particular the Green Paper asked:

- should employer debt legislation for multi-employer schemes require full buy-out and for the actuary to assess liabilities for an employer debt by estimating the cost of purchasing annuities?
- how else could historic orphan liabilities be met if they were not shared between employers?
- are new measures needed to help those trustees of an association or employers who could be held individually liable for an employer debt?

227. The majority of respondents to the Green Paper were silent on these issues. Of those who responded, many felt sympathy for those who could be personally liable for an employer debt but they did not feel there was a solution which didn't risk leaving schemes underfunded and thus unable to meet their pension promises to members. There are nearly 1,000 'last man standing' multi-employer schemes and any changes in legislation would apply to all, regardless of whether they sought this change or not. Most respondents felt that the buy-out basis is a clear and fair way to calculate the amount that an employer should pay to the scheme when it ceases to participate. The Government cannot consider amending an important area of legislation just to address one particular scheme's problems. We therefore have no plans to change the current method for calculating employer debts.

228. Some respondents who are particularly affected by the issues that arise when employers are personally liable for section 75 debts suggested these debts could be passed to the PPF or that a scheme could collect a lesser amount of debt without compromising its PPF eligibility. The Government has already made its position clear that it would not be fair to simply pass the burden onto the PPF as the cost would then need to be met by its levy payers.

229. The existing legislative framework does give trustees some flexibility to collect reduced employer debts as they arise although entering into a compromise agreement can affect the scheme's eligibility for the PPF. It is important that schemes are funded above PPF levels when they consider accepting a lesser amount in settlement of an employer debt. Where the trustees decide it is appropriate to agree a debt compromise, the PPF has the power to validate an actuary's estimate of the effect the compromise would have on scheme assets. However this is only one factor in relation to PPF eligibility. A validation does not guarantee entry to the PPF.

230. The Government considered proposals to exclude orphan liabilities from the calculation of an employer debt very carefully. We looked closely at the impact any such changes to legislation would have on the security of members' benefits and the additional burden that would be placed on remaining employers. Our assessment showed that any changes of this nature could significantly weaken the security of members' benefits and increase the risk of schemes with high levels of orphan liabilities transferring to the PPF with an increased deficit. It also showed that simply excluding the pre-2005 orphan liabilities from an employer debt calculation would not necessarily solve employers' affordability issues.

231. Having reviewed all the responses to the Green Paper and after considering all the available evidence, we have found that there is insufficient justification to warrant amending the measure of calculation of these debts. The Government believes that the existing arrangements provide sufficient flexibility for employers to manage their section 75 debts and that maintaining the current calculation method is the most viable way of ensuring that members receive their pension benefits over the longer term.

232. The existing arrangements now provide a sufficient range of mechanisms to enable employers, including those who could be personally liable for the debt, to provide for and meet their pension liabilities. Chapter three discusses consolidation which could also offer an alternative solution for those schemes that can afford to provide more than PPF benefits but cannot afford to buy-out.

Chapter five: delivering the White Paper reforms

233. The pensions' landscape has seen a great deal of change in recent years. The introduction of automatic enrolment and Master Trusts, has resulted in major changes for all parties in the system; employers, trustees, advisers and the Pensions Regulator.

234. As we concluded in our Green Paper, the Defined Benefit system is broadly working as intended. But there are a number of improvements that we can make to maintain confidence in the system by better protecting members' benefits. This White Paper sets out a number of measures which aim to achieve this goal.

235. The Defined Benefit system is complex and some proposals require careful design to ensure they do not foster unintended consequences. In some cases, further discussion across the industry is needed to shape the design of the proposals.

236. Together, all proposals form a programme of work which will take a number of years to implement and which will require a phased approach to delivery.

Stage one: taking decisive action

237. Some measures can be implemented quickly, or are already underway. These are generally more straightforward, and/or do not require new primary legislation.

- As the Pensions Regulator has stated via their *TPR Future* report (published July 2017), they are already taking steps to become a clearer, quicker and tougher regulator. They have identified key areas in which they are changing to ensure that they continue to meet the challenges of a future pensions and economic landscape. These include setting clear expectations for schemes and improving the way they engage; increasing their regulatory oversight and using a broader range of approaches; using a wider range of regulatory interventions and using the full range of legal powers currently available and being more adaptable to the challenges faced in the future. Measures set out in the White Paper support these aims further, in the first instance by ensuring that members are protected as far as possible via well-run and managed schemes; where this isn't the case, and wrongdoing is suspected, the Regulator will be able to take tougher action when it is proven.
- One element of strengthening the Regulator's powers involves building on the existing process for director disqualifications. The Government's manifesto committed to taking action in this area and we will work with the Regulator and Insolvency Service to ensure that the current system is as efficient as possible. The Pensions Regulator will build on existing procedures to strengthen the deterrent against wrongdoing. Any administrative changes that may be required will be put in place at the earliest opportunity.
- We are also working with the Regulator on a number of other areas, such as increasing sponsor and trustee awareness of their consolidation options, supporting members to understand the funding position of their scheme and raising awareness of funding measures.

Stage two: involving others and legislating

238. This White Paper sets out the direction of travel for Defined Benefit policy. However, most of the proposals are complex and some require further work before proceeding to legislation to ensure the exact parameters of the proposals are effective, proportionate and workable and do not lead to unintended consequences. During the rest of 2018 and into 2019, DWP and the Regulator will be carrying out a number of consultative exercises on particular policies, before moving to legislation when parliamentary time allows.

239. It may be possible to take some measures forward with secondary legislation but primary legislation will be needed in most cases.

240. Where primary legislation is required, this is unlikely to be before the 2019–20 parliamentary session at the earliest.

241. These policies include:

1) Strengthening the powers of the Pensions Regulator

- The introduction of new powers for the Pensions Regulator will enable it to undertake a tougher and more proactive role.
- To support the ambition to be a tougher Regulator, we will legislate to introduce a penalty regime to work alongside the existing contribution notice framework, which is both proportionate and sufficiently robust to make misconduct as far as possible a risk not worth taking. We will also consider whether further legislative changes are required to improve the effectiveness and efficiency of the Regulator's current anti-avoidance powers (contribution notices and financial support directions) to further strengthen the regime.
- To ensure the Regulator has the right powers to intervene in certain corporate transactions, we will also legislate to strengthen the existing corporate clearance framework, and, where necessary, introduce new measures to ensure sponsoring employers give due consideration to their Defined Benefit scheme. Further consultation will shape the specific design of this strengthened framework.
- We will also legislate to bring in a criminal offence to punish reckless behaviour in relation to a pension scheme.
- And to enable the Regulator to be a more proactive body, we will legislate to bring forward measures including the power to require attendance at interview, civil sanctions for non-compliance with section 72 notices (in addition to existing criminal sanctions) and inspection powers, harmonising powers the Regulator already have for automatic enrolment and Master Trust schemes that would apply at the discretion of the Regulator to drive compliance with requests for information.

2) Scheme funding measures

- Starting this year, the Regulator will carry out a programme of further research, initial testing and information consultation with the industry with the objective of informing a revised Defined Benefit Funding Code of Practice, which will then be consulted on. the Regulator's ongoing engagement will provide DWP with a clear view as to whether further legislative change (via primary or secondary legislation) is needed to complement and support the Regulator's Defined Benefit funding code and will help determine what information should be reported in a Defined Benefit Chair's Statement.

- The new Defined Benefit code will continue to set an expectation that trustees should document their decisions and their approach to funding integrated risk management. We will consult on what good practice looks like. This will help inform the forthcoming legislation on the Chairs Statement and help industry prepare for the change ahead.
- Many of these measures will need primary legislation in order to make them mandatory, widely complied with and enforceable (i.e. to give the regulator the power to require trustees to deliver these improvements).

3) Consolidation

- Towards the end of 2018 we will consult with the pensions industry and stakeholders to develop the design of a legislative framework and authorisation regime applicable to all forms of commercial consolidation. We will continue to work closely with the industry to design a framework which meets the needs of potential investors, operators and provides an appropriate level of protection for members.
- We will also consult on proposals for a new accreditation regime which will apply to existing forms of consolidation, so that members, trustees and sponsors can be confident that these vehicles meet or exceed a set of clearly defined standards.

Stage four: reviewing and going further

242. There are some measures which we have raised in the White Paper as potentially good ideas, although we think that other, perhaps existing or easier-to-implement measures elsewhere in this paper could potentially deliver the same outcome. We will keep these measures, including the current Regulated Apportionment Arrangement, under active review and introduce them if it becomes clear that they are needed.

Annex A: background information and additional evidence

Introduction

1. The main purpose of this annex is to provide some additional background information to put our White Paper proposals into context.
2. In the White Paper, we indicate that there will be a number of further consultation exercises focusing on specific measures. A fuller consideration of evidence and analysis, including of the equality impacts of any final policy proposals, and informed by these consultations where necessary, will form part of a full and published impact assessment on the policy options.

Chapter one: protecting private pensions – a stronger Pensions Regulator

Imposing a punitive fine

Background

3. We will introduce a proportionate punitive fines regime to tackle irresponsible behaviour that might have a detrimental impact on the pension scheme.
4. Currently the Pensions Regulator can issue contribution notices and financial support directives to circumvent avoidance of pension obligations.[69] These notices have been quite rarely used so far as, among other reasons, negotiations often led to satisfactory outcomes without the need to take matters further. However, as the table below shows, avoidance cases exist, demonstrating that there is a case for improving the deterrent effect.

Table 1. Current open avoidance cases (contribution notice and financial support directions) as at 31 Dec 2017

Case stage	Number of cases
Pre-investigation	12
Investigation	10 (5 are contribution notice cases with approx 12 separate targets)
Warning Notice	1 (contribution notice case with 9 separate targets)
DP or Upper Tribunal	2 (1 is a contribution notice case – BHS – with 2 separate targets)
Other action / closing	4 (1x no action, 1 x clearance provided, 2 x settled)
total	29 (7 identified contribution notice cases)

Source: The Pensions Regulator management information

69 http://www.thepensionsregulator.gov.uk/regulate-and-enforce/anti-avoidance-powers.aspx

5. These fines would seek to target, among others, the company directors who are proven to have committed the wrongdoing. The introduction of fines is expected to have a wider deterrent effect.

Criminal sanctions

6. The design of this regime will be subject to further discussions, and impacts on businesses and the Regulator will be considered in detail at that point.

Director disqualification – background and scope

7. There is provision for the disqualification of company directors whose behaviours do not meet the expectations of the role, including where a pension scheme and its assets are poorly managed. We will build on the existing processes between the Pensions Regulator and the Insolvency Service.
8. Over the last five years, around 1,000 director disqualifications were obtained per year,[70] on average (across all UK companies).[71] Data on how many of them were from Defined Benefit sponsoring companies is not available to us at this stage. Approximately, 0.5% of all UK companies are sponsoring at least one Defined Benefit scheme.
9. The policy proposal is to build on existing processes, including information sharing, between the Regulator and the Insolvency Service, thus strengthening this deterrent to wrongdoing further. As it is targeted specifically to tackle deliberate wrongdoing we do not expect it to worsen general business conditions in any way.

Building on the Regulator's powers to intervene in corporate transactions

10. The design of this regime will be subject to a further consultation, and impacts on businesses and the Regulator will be considered in detail at that point.

Information gathering powers, including interview power and civil sanctions for non-compliance

Information gathering powers – background

11. The Regulator's view is that the enhanced powers would drive efficiencies in their operational teams and would be cost efficient from an operational and administrative view. In general, cost efficiency is likely to be derived from the following:
    - Most of the powers proposed already exist in Defined Contribution and automatic enrolment and some exist in relation to specific Defined Benefit activity. Aligning the Regulator's powers across all Defined Benefit schemes with those in Defined Contribution and automatic enrolment sectors is expected to increase their flexibility and optimise operations, for example by standardising investigative tools.
    - The enhanced powers are expected to reduce the amount of time it takes to gather the information the Regulator would need to gather by formal notice, for example allowing alternative routes where currently it may have to approach trustees or sponsoring employers multiple times before it get what it needs.

[70] The Insolvency Service, 'Insolvency Service Enforcement Outcomes 2017/18', 2018. Available at: https://www.gov.uk/government/statistics/insolvency-service-enforcement-outcomes-201718
[71] Total of orders and undertakings

- More timely and accurate information is expected to improve the Regulator's prioritisation of cases, for example by helping to determine earlier in the process whether to proceed with a full investigation or to conclude that no further action is needed.

12. There are two expected benefits – efficiency (both for the Regulator as outlined and for the regulated community) and effectiveness (quicker investigations, better access to information and greater deterrent). Going forward, we will be looking to understand what benefits the improved efficiency and effectiveness will deliver to scheme members and sponsoring employers.

A power to require attendance for an interview

Interview power – background

13. This power would give the Pensions Regulator the ability to compel a relevant person to attend an interview and explain any facts, events or circumstances that are relevant to an investigation.
14. The Regulator provisionally assess, based on their casework experience, that the use of this power would be likely to be considered in every future avoidance case. In particular, in relation to undertaking initial discussions with trustees and receiving factual accounts directly from professional advisers.
15. According to the Regulator, a current section 72 notice process can take approximately three to six months. Attendance at an interview in the first few weeks would be expected to reduce this timeframe. The forthcoming impact assessment will consider this in more detail.

Interview power – costs to businesses

16. Businesses already incur costs associated with time and resources needed to respond to formal information gathering notices. Accordingly, costs that business will incur by their representatives attending interviews and any time and resources needed to prepare for the interviews may be similar.

Interview power – benefits to TPR and businesses

17. Where the Regulator can obtain relevant information in a more timely and accurate manner they are likely to be able to take more effective and efficient action. This is expected to help increase the security of member benefits; and at least in some cases benefit sponsoring businesses by reducing uncertainty during the investigation period. The benefits derived will be case-specific and, at this stage, we do not seek to quantify them.

Civil sanctions (fixed and escalating penalty notices)

18. Broadly speaking, the Regulator currently has a binary choice of either not imposing a sanction or imposing a criminal sanction for failure to comply with section 72 information-gathering notices. We will give them the power to issue fixed and civil sanctions as an alternative to criminal sanctions for non-compliance.
19. Based on experience of having both civil and criminal sanctions available in the automatic enrolment sector, the Regulator advises that cases without court involvement will take on average, around half the time than cases where court is involved.

20. Also, behavioural theories and evidence tend to suggest that proportionality in sanctions may be important in order to achieve desired outcomes.[72] Introducing civil sanctions will fill in the gap where the absence of a sanction is suboptimal but criminal sanction is disproportionate.

An inspection power

21. We intend to give the Regulator the power to inspect records, documents and electronic devices of a relevant party at relevant premises for relevant purposes connected with their functions.

22. The impacts of this power depend on exact detail, which will be set out in legislation. As an illustration, while difficult to accurately estimate the number of cases in which inspection might be relevant (as each case is different and may have different challenges), the Regulator would (provisionally) estimate using the power in around a quarter of cases at early stages of an investigation, and its exercise might be linked to early engagement meetings.

23. It is also difficult to isolate the impact of an inspection power to the length of time to complete a case (as each case is different). However, based on the Regulator's experience it could be expected to reduce the time that information gathering processes take within the overall investigation phase. For example, over the course of the BHS investigation, the Regulator issued a total of 123 separate section 72 notices over 18 months. It is possible that this timeframe could be reduced significantly through a combination of early use of an interview power and an inspection power. The forthcoming impact assessment will consider this in more detail.

Chapter two: improving the way the system works – scheme funding

24. Chapter two of the White Paper proposes to strengthen the Regulator's ability to enforce Defined Benefit scheme funding standards through a revised Code which will help trustee decision-making and achieve better outcomes. It also requires trustees to appoint a Chair and for that Chair to report to the Regulator via a Chair's Statement.

Background – scheme funding, sustainability, and affordability

25. The Green Paper included a detailed discussion of the current situation of scheme funding and affordability. In this section we provide an update as well as add some additional points but without going into the same level of detail.

26. There are over 5,500 Defined Benefit schemes in total. As at 31 March 2017, about 80% of them were estimated to be underfunded on the SFO basis, with about 5% of all schemes funded below 60%. Around 20% of schemes were in surplus.

Table 2. Defined Benefit scheme distribution by SFO based funding levels

	Proportion of Defined Benefit schemes	Proportion of Defined Benefit memberships
Less than 50%	1%	-
50% to 60%	4%	1%
60% to 70%	9%	4%
70% to 80%	18%	16%

[72] As far as our awareness and interpretation go, behavioural economics and other disciplines suggest that proportionate and well-targeted fines tend to deter misbehaviour. However, impacts of disproportionately high fines are ambiguous. On one hand, its a big deterrence, on the other hand rather than being deterred those misbehaving may seek to maximise the benefit they are seeking to gain from misbehaviour to cover the high cost if fined. As the FCA's report (Behaviour and Compliance in Organisations, 2016) illustrates the point: *if thieves face execution for stealing £5 then they may as well steal £5 million instead.*

	Proportion of Defined Benefit schemes	Proportion of Defined Benefit memberships
80% to 90%	25%	35%
90% to 100%	24%	31%
100% to 110%	14%	11%
110% to 120%	4%	1%
120% or greater	2%	-

Source: The Pensions Regulator

Note: Tranches 8–10 as a proxy of all Defined Benefit schemes.[73]

Data (cut-off) point: 31/01/2017.

27. Findings from the latest Pension Protection Fund's (PPF) Purple Book 2017 publication,[74] which reports on the universe of schemes eligible for PPF compensation, show that:
    - overall the level of funding (for PPF compensation levels) improved in the year to the end of March 2017;
    - in the year to 31 March 2017, 43 new schemes entered PPF assessment. This is similar to the number in the preceding two years, and well down on the levels seen between 2008 and 2014; and
    - average insolvency rate of (PPF eligible) Defined Benefit sponsoring businesses has continued to decrease from 0.8% in 2006 to 0.3% in 2017. Among the whole population of UK businesses (i.e. not only those sponsoring a Defined Benefit scheme) liquidation rate stood at about 0.4%[75] in 2016.
28. A study by the Bank of England[76] found that while Defined Benefit pension deficits have had substantial effects on the spending of some individual firms, they have only had small effects on the macroeconomy as a whole; and that Quantitative Easing (QE) is estimated to have boosted the level of GDP by in the region of 1.5–3%, while the negative effects of Defined Benefit deficits are only estimated to have reduced GDP by around 0.1% since 2007. The findings suggest that the regulatory approach undertaken by the Pensions Regulator has balanced the need to close growing deficits with the aim of allowing businesses to continue operating in a sustainable way.
29. At the same time, there is also a study suggesting that not all corners of the Defined Benefit sector are free from impact. The Resolution Foundation argues that Defined Benefit deficits payments resulted in some wage reductions.[77]
30. About 80% of schemes are underfunded and have a recovery plan in place. There is a variation in recovery plan lengths across the sector with the average recovery plan length totalling about eight years, but about 7% of schemes have recovery plans of over 15 years.

[73] In relation to Defined Benefit scheme funding valuation, 'tranches' are the set of schemes which are required to carry out a scheme-specific funding valuation within a particular time period
[74] The Pension Protection Fund, 'Purple Book 2017'. Available at: http://www.pensionprotectionfund.org.uk/Pages/ThePurpleBook.aspx>
[75] The Insolvency Service, 'Insolvency Statistics – April to June 2016'. Available at: Available at: < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/541078/Q2_2016_statistics_release_-_web.pdf>
[76] Bank of England, 'Growing pension deficits and the expenditure decisions of UK companies', February 2018. Available at: https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2018/growing-pension-deficits-and-the-expenditure-decisions-of-uk-companies.pdf?la=en&hash=EA0932B619DC438C363E16D5DD4985E2D644C30D
[77] Resolution Foundation, 'The Pay Deficit', May 2017. Available at: http://www.resolutionfoundation.org/app/uploads/2017/05/The-pay-deficit.pdf

Table 3. Distribution of recovery plan lengths

	Recovery plan length				
	Less than 5 years	**5 to 10 years**	**10 to 15 years**	**15 years & +**	**No DRC (surplus)[78]**
% of all Defined Benefit schemes[79]	26%	30%	15%	7%	22%

Source: The Pensions Regulator

Data (cut-off) point: 31/01/2017

31. At the aggregate level, special contributions (of which we expect the majority to be DRCs) have been broadly £15 billion per annum over recent years, on average.[80]

32. On the other hand, there is evidence that many employers are still able to pay (high) dividends despite paying DRCs. Table 4 below, which contains figures based on a sample of 810 employers, shows that of all the sampled businesses paying DRCs about 85% are also paying dividends. Dividend payment is not necessarily something ‘wholly discretional’ as companies need to be paying some to attract capital and for other good reasons, but it still signals that many may have the potential to pay higher amounts to fix their Defined Benefit deficits if required.

Table 4. Distribution of company DRC and dividend payments[81] [82]

Group	2011	2012	2013	2014	2015	Latest
DRCs and dividends both non-zero	67%	62%	67%	70%	67%	69%
Dividends and nil DRCs	12%	14%	13%	14%	14%	16%
Nil DRCs and nil dividends	5%	11%	7%	5%	7%	3%
DRCs and nil dividends	16%	12%	13%	12%	12%	12%

Sources: DWP analysis based on the Regulator’s Tranche 12 analysis publication[83]

33. The Green Paper[84] presented an analysis of Defined Benefit sponsors’ DRC payment to profit before fax (PbT) ratios. It showed[85] a mixed picture – where PbT data was available around 50% of all employers with Defined Benefit schemes were either paying no DRCs or paying DRCs which, taken as a ratio, are less than 20% of their reported PbT. On the other hand, again where PbT was available, 20% of employers were paying DRCs that were in excess of 100% of their PBT or were loss-making employers.

34. In general, our assessment of the state of Defined Benefit funding remains that the sector as a whole is not in crisis; but that there is scope for improvements across the board and issues to be addressed in the margins.

78 In most instances due to scheme being in surplus, but note there may be some cases where DRC data is missing.
79 Population: c. 5,700 schemes, based on Tranches 8–10.
80 Office for National Statistics, ‘Investment by insurance companies, pension funds and trusts (MQ5)’, 2017. Available at: https://www.ons.gov.uk/economy/investmentspensionsandtrusts/datasets/mq5investmentbyinsurancecompaniespensionfundsandtrusts
81 Proportion of around 810 employers including nil DRCs and/or nil dividends) -employers (FTSE350 & non-FTSE350) who paid at least one dividend over the period 2011-latest available accounts
82 The estimates provided are a weighted average of the distribution based on the differentiated sample of 210 FTSE350 and 600 non-FTSE350 companies, as was provided in TPR’s Tranche 12 analysis in Table 5 and 6 respectively.
83 TPR, ‘Tranche 12 analysis’, 2017. Available at: http://www.thepensionsregulator.gov.uk/docs/db-analysis-tranche-twelve-review-2017.pdf
84 DWP, ‘Security and Sustainability in Defined Benefit Pension Schemes’ 2017. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/595103/security-and-sustainability-in-defined-benefit-pension-schemes.pdf
85 See paragraphs 102 to 111 in the green paper for more detail.

Clearer funding standards

Prudence and appropriateness – background

35. Currently, where the Regulator believes a scheme's technical provisions and recovery plan are imprudent and inappropriate respectively they may open a case for further investigation – table 5 below illustrates the scale of open funding cases. However, the number of open cases also reflects the Regulator's resources and should not be taken as an indication of the total number of schemes where the Regulator believes the technical provisions are imprudent and/or recovery plan inappropriate.

Table 5. Open cases that the Regulator's funding team had as at 31 December 2017

Funding Cases	Current
Reactive (after valuation submitted)	55
Proactive cases (prior to valuation being submitted)	53
Governance issues	10
Valuations not submitted on time	8
Enforcement (proceeding to or have already issued a Warning Notice)	3
Total	126

Source: The Pensions Regulator

36. The three current enforcement cases, as at January 2018, have been open for at least four and a half years (including the pre-enforcement stages) and it is likely that, barring settlement, these cases will continue for at least another 12 months. These long time-scales are reflective of the level of scheme-specific evidence, analysis and modelling required for the Regulator to generate a persuasive case as to why the Regulator considers the technical provisions imprudent and/or the recovery plan inappropriate.

37. For each of the three cases, the legal and independent expert costs alone have been hundreds of thousands of pounds and in the Regulator's view, are likely to continue to increase as the cases progress, particularly if the decision of the Determination Panel is challenged and the case is referred to the Upper Tribunal.

38. Also, according to the Regulator's Defined Benefit Research 2017,[86] about 30% of the interviewed trustees reported that the current funding regime makes it hard to set discount rates to take account of their scheme and employer circumstances (however, only 2% of employers and a negligible number of trustees 'felt confused' by the current regime). This finding also supports the case for consulting on reviewing the requirements and guidance of assessing scheme liabilities.

39. The Regulator's view is that setting clearer lines on prudence and appropriateness will mean trustees and sponsoring employers will, at the outset of their funding discussions, understand how to meet the Statutory Funding Objective. A further possible beneficial outcome is that the costs of producing a valuation may be reduced because advisory fees will be lower.

[86] IFF Research on behalf of TPR, 'DB trust based pension schemes research', 2017, p56. Available at: http://www.thepensionsregulator.gov.uk/docs/db-research-summary-report-2017.PDF

Prudence and appropriateness – indication of potential impacts on the Regulator

40. To indicate the potential efficiency improvements for the Regulator we have considered the Regulator's current stock of open cases as at 31 December 2017. As shown above, there are 55 open reactive cases (cases opened after the Regulator receives the SFO valuation summary). Due to the scheme specific nature of scheme funding and its complexity, it can take the Regulator between six and nine months to work with the trustees and sponsoring employer(s) to analyse and understand the specific details of the valuation, funding and investment strategies and address any issues. Setting clearer funding standards is expected to save all parties time and deliver a more efficient process:
    - the trustees/employer will be required to also submit compelling evidence (at the same time as submitting the valuation in the Chair's Statement) to explain to the Regulator why the particular circumstances of their scheme mean they are compliant outside of the published framework; or
    - the Regulator could move more quickly to the investigation stage and prepare for enforcement action.
41. This should significantly reduce the overall time, cost and resource burden of bringing regulatory action, including enforcement. The exact design of this approach will be subject to further consultation, but as an illustration, if the setting of clearer funding standards reduces the initial analysis stage by just three months per current open reactive case this is a total time saving of nearly 14 years. This additional time could be used to directly engage with a much wider section of the whole pension landscape, with no increase in resource requirement. It is also likely additional time saving will be achieved in the investigation and enforcement stages but this is harder to assess at this stage.

Prudence and appropriateness – indication of potential impacts on schemes and sponsors

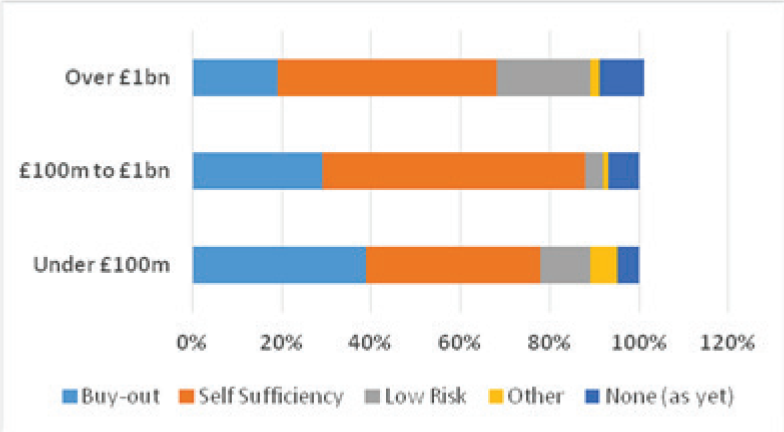
42. As a result of the clearer funding standards we expect potential reduction in advisory costs, particularly for small schemes.
43. However, for some sponsors the proposed changes may result in increasing contributions in the short-term (bringing the contributions forward not increasing them overall). We will model the impacts as clearer requirements are developed.

Taking a long-term view – current state of play

44. The Regulator's Defined Benefit Research 2017[87] showed that 73% of trustees and 68% of employers responded that schemes closed to future accrual had in place a journey plan or long-term target; leaving nearly a third that did not.
45. According to AON's survey, which interviewed 185 schemes, only 5% to 10% of them (depending on size band) did not have a long term plan – see figure 1 for more detail.

[87] IFF Research on behalf of TPR, 'DB trust based pension schemes research', 2017, p56. Available at: http://www.thepensionsregulator.gov.uk/docs/db-research-summary-report-2017.PDF

Figure 1. Distributions of long-term objectives by scheme size



Source: AON, Global Pension Risk Survey 2017[88]

46. However, schemes may well have a long-term plan but for some the plan may be largely aspirational and does not drive funding and DRC commitment). Hence formalising the setting of a long-term objective may have an impact on them as well.

Taking a long term view –indication of potential impacts on schemes

47. Considering many schemes already set a long-term funding objective we would not expect major changes in the costs for the majority of schemes. For the minority that currently do not have a long-term objective there may be a cost of setting it; mainly in the form of their trustees' time and any cost associated with seeking advice. Whether external advice is needed, and whether the additional task could be absorbed by the trustees within their existing duties (and hence associated costs) will directly depend on the exact requirements involved in setting the long-term view. The Regulator's initial sense, based on their experience, is that the governance costs of setting a long-term objective will be relatively low for those already adopting good practice and applying the principles set out in the Defined Benefit funding code.

48. Some schemes may need to revise their funding and investment strategies to account for their long-term objectives set.

Appointment of a Chair and Chair's statement

Appointment of a Chair and Chair's statement – background and scope

49. Currently, having a Chair of a Defined Benefit trustee board is not a legislative requirement but may be a requirement in individual scheme rules. According to the Regulator's 21st Century Trustee Survey,[89] 85% of Defined Benefit schemes (and 92% of hybrid schemes) already have Chairs, but the proportion varies by scheme size – 74% for small, 87% for medium, 97% for large.

50. We will require all Defined Benefit schemes to appoint a Chair of their board and for that Chair to submit a Chair's Statement to report on their key scheme funding decisions.

88 Available at: http://respond.aonhewitt.com/UK_2017FORM-GlobalPensionRiskSurvey
89 OMB on behalf of TPR, 'Trustee Landscape Quantitative Research', October 2015. Available at: http://www.thepensionsregulator.gov.uk/docs/trustee-landscape-quantitative-research-2015.pdf

Appointment of a Chair and Chair's statement – indication of potential costs to schemes / sponsors

51. Within Defined Contribution, the requirement already exists. Our impact assessment on the new Defined Contribution Chair's Statement requirement,[90] which was introduced in 2015, concluded that there may be some costs associated with establishing a chair of a trustee board. Evidence provided by pension providers in response to the consultation suggest that where a chair does not already exist the associated costs with establishing a chair would be minimal – as a chair could be appointed from amongst the existing trustees."

52. According to PwC Trustee Survey 2017,[91] for schemes that pay trustees, the average annual pay of the chair of trustees varies from about £25,000 to £60,000 (depending on fund size – small to large respectively). For board members, it varies from about £5,000 to £20,000. At this stage we have no evidence whether Chairs of Defined Benefit schemes, after making them mandatory, would be paid more or less than that.

53. Cost of producing the Chair's Statement will fall into two groups:

    - Those trustees already complying with the current Defined Benefit Code will already take a long-term view of their funding strategy, manage risks in an integrated way and document their approach. This means the costs of formalising what they already have in place should be less than if they are not already compliant with current expectations. The Regulator's Defined Benefit Survey[92] results say 92% of trustees are in a position to evidence how they have taken an integrated risk management approach (but note not all of them actually apply all integrated risk management principles to its full extent).
    - Those who are not complying with the current Defined Benefit Code may have higher upfront costs to reach the level of compliance already expected. From the Regulator's case experience and their latest Defined Benefit governance survey we know that the Defined Benefit Code principles are not universally applied: a) two thirds (61%) of trustee boards reported that they carried out all five activities asked about with the aim of managing funding, investment and covenant risks, b) the proportion of schemes that are closed to future accrual that had in place a journey plan or long-term target (in addition to legally mandated technical provisions) stood at 73% among trustee boards and 68% among employers.

54. When a Chair's Statement requirement was being introduced for Defined Contribution schemes, the Regulator estimated that the additional cost of producing and attaching this statement to the audited report and accounts could be between £350 (for micro scheme) and £3,250 (for large scheme) per scheme per annum on average.[93] However, Defined Benefit is a different context and costs will depend on exact requirements for Defined Benefit schemes.

Appointment of a Chair and Chair's statement – indication of potential benefits to schemes and sponsoring employers

55. The Chair's Statement is expected to lead to better management practices and decision making. In essence, it is a form of accounting for decisions made and actions taken, and is expected to (a)

[90] Minimum Governance Standards for DC trust-based schemes – Impact Assessment. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/364324/better-workplace-pensions-impact-assessment.pdf
[91] PwC, 'Trustee Survey', July 2017. Available at: https://www.pwc.co.uk/pensions/insights/pwc-trustee-survey.pdf
[92] IFF Research on behalf of TPR, 'DB trust based pension schemes research', 2017, p26. Available at: http://www.thepensionsregulator.gov.uk/docs/db-research-summary-report-2017.PDF
[93] Source: Minimum Governance Standards for DC trust-based schemes. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/364324/better-workplace-pensions-impact-assessment.pdf

'remind' about, and (b) trigger compliance with the requirements and adequate amount of effort put in when making decisions such as investment decisions.

56. While evidence from practitioners and stakeholders in the Defined Contribution sector has been positive, the Regulator has identified lessons to be learned and are taking steps to provide guidance on what a good Chair's Statement would comprise. However, wider evidence coming from behavioural, management, and psychology related disciplines suggest clarification, commitment and external monitoring do tend to lead to positive outcomes. For example, the Financial Conduct Authority's Behaviour and Compliance in Organisations study[94] says that 'one of the lessons of the psychological literature on behavioural biases is that the 'bias blind spot' means that it is easier to spot such biases in others than it is to spot in oneself'. In this context, the Chair's Statement is expected to enable the Regulator or others, such as the sponsoring employer, to spot those 'bias blind spots'.

57. In some cases trustee decision-making can be seen as a behavioural bias. This is where problems such as loss aversion can lead to decision makers becoming attached to poor practices.[95] One way of correcting these sorts of biases is to use decision making tools such as a checklist or a Chair's Statement to increase internal scrutiny. Some psychologists argue that these work through increasing reflective decisions (those that are slow, deliberate and with effort) over intuitive decisions (those with minimal preparation, effortless and instinctive) which can help to reduce these biases. A Mckinsey study[96] found that improving a company's decision-making process improved its Return on Investment by 6.9 percentage points.

58. The Regulator's 21st Century Trustee Survey[97] asked whether Defined Benefit schemes should be required to produce a Chair's Statement. Many respondents were in favour of aligning the requirement to report on compliance with governance requirements across trustees of DC and Defined Benefit schemes. However, there were some respondents who thought trustees of Defined Benefit schemes should not be required to report on governance, as it would be an unnecessary burden on those who are already performing well.

59. In the course of their 21st Century Trustee engagement exercise the Regulator heard evidence from practitioners and stakeholders that the Chair's Statement in Defined Contribution was having a positive impact – the requirement has helped focus trustees on governance and make improvements (transparency drives accountability). Impacts of better governance in general are discussed below.

Impacts of better governance

60. In general, the proposed measures aim to improve scheme governance. We know that in turn better governance does tend to have positive impacts on scheme outcomes and is worth pursuing. For example:

    - A study by Willis Tower Watson[98] concluded that they 'believe the investment case for improving governance is, for most funds, overwhelming'.

[94] FCA, 'Behaviour and Compliance in Organisations', December 2016. Available at: https://www.fca.org.uk/publication/occasional-papers/op16-24.pdf>

[95] Definition based upon FCA behaviour and compliance in organisations.

[96] McKinsey, 'The Case for Behavioural Strategy', March 2010. Available at: https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/the-case-for-behavioral-strategy.

[97] TPR, '21st Century Trusteeship and Governance'. Available at: http://www.thepensionsregulator.gov.uk/docs/21st-century-trusteeship-governance-discussion-2016.pdf

[98] Willis Towers Watson, 'The investment case for better asset owner governance', October 2016. Available at: https://www.willistowerswatson.com/en-GB/insights/2016/10/The-investment-case-for-better-asset-owner-governance

- Clark and Urwin[99] have shone the light on the benefits of good governance and illustrated that their sample of 'best-practice' schemes achieved at least 2% per annum more return than their benchmarks.
- Ambachtsheer et al found a positive statistical relationship between good governance and investment performance (in a sample of 81 schemes from around the world). Schemes with good standards of governance (self-assessed by schemes and with size of scheme controlled for) added 1–2% per annum in investment performance when compared to less-well governed schemes.[100]
- A study by Ammann and Ehmann 2014[101] constructed objective governance scores for Swiss pension funds (sample of 139) based on organisational structure, target setting and investment strategy, investment process, risk management, monitoring and transparency. The scores were then compared to investment performance and found a positive relationship.

Chapter three: improving the way the system works – consolidation

61. We propose to introduce a legislative framework and authorisation regime, within which new forms of consolidation vehicles could operate. We will also consider how a new accreditation regime could help encourage existing forms of consolidation. Both avenues aim to increase efficiency and facilitate consolidation for the improvement of outcomes for members and employers, while ensuring sufficient safeguards are in place.
62. The evidence presented in the first part of this section highlights the fragmentation within existing Defined Benefit schemes and the benefits consolidation might bring in reducing on-going costs; allowing access to more diversified and sophisticated investment strategies; and improving the standards of governance through existing forms of consolidation for example Defined Benefit Master Trusts. However, we accept that some of the evidence presented on asset consolidation is in respect of some of the very largest funds in the UK and overseas and may not be directly relevant to many UK funded Defined Benefit schemes within existing forms of consolidation vehicle. It also presents evidence regarding the scope of insured buy-ins and buy-outs to enable some form of consolidation and risk transfer.
63. Separately, many commentators have discussed the possible on-going savings within a 'Superfund' structure without considering the potentially significant upfront costs of transferring schemes to such vehicles. We have completed some provisional basic analysis in the second part of this section looking at the costs and savings of such exercises; however, we accept that new consolidation vehicles are potentially being set up to facilitate consolidated risk transfers and as such are not in response to the fragmentation issues and cost inefficiencies inherent within the existing system. We have also sought to segment Defined Benefit schemes to assess the scope for consolidation based on size and covenant group.
64. Our analysis will continue to develop and we will set out the latest in our upcoming consolidation consultation later this year.

[99] Clark G & Unwin R (2008), Best-practice pension fund governance; secondary source: PPI Briefing Note 89. Available at: http://www.pensionspolicyinstitute.org.uk/briefing-notes/briefing-note-89---the-role-of-governance
[100] Source: Ambachtsheer et al 2006, link; secondary source: PPI Briefing Note 89, Available at: http://www.pensionspolicyinstitute.org.uk/briefing-notes/briefing-note-89---the-role-of-governance
[101] Source: Ahmmann M & Ehmann C (2014) Is Governance Related to Investment Performance and Asset Allocation? Secondary source: PPI Briefing Note 89. Available at: Available at: http://www.pensionspolicyinstitute.org.uk/briefing-notes/briefing-note-89---the-role-of-governance

Fragmentation of Defined Benefit universe

65. Defined Benefit schemes are highly fragmented. Only around 5% of all schemes have more than 5,000 members, but they hold about 75% of all Defined Benefit assets and liabilities; on the other end, more than a third of all schemes have less than 100 members, but they hold just 1% of total assets.

Table 6. Fragmentation in Defined Benefit

Number of members	2–99	100–999	1,000–4,999	5,000–9,999	10,000+
% of all schemes	36%	44%	14%	3%	3%
% of all members	1%	8%	16%	12%	63%
% of total assets	1%	9%	17%	13%	61%

Source: the percentages derived based on the Purple Book 2017, figures 2.1 and 2.2

Scheme running / administrative costs

66. Evidence suggests that on average, larger schemes are able to benefit from economies of scale and have lower administrative and total scheme running costs per member.

Table 7. Typical yearly administration and total scheme running costs for the scheme per member, by scheme size

	Small schemes (2–99 members)	Medium schemes (100–999 members)	Large schemes (1,000–4,999 members)	Very large schemes (5,000+ members)
Median admin fee per member, £	301	140	68	42
Median total cost per member, £	905	411	259	177

Source: The Pensions Regulator, Defined Benefit scheme running cost research, 2014, page 21, tables 4.2 and 3.4

67. Further evidence on possible administration and total scheme running cost savings can be inferred from Defined Benefit Master Trusts, which are a form of aggregating schemes. We have received responses on the advantages of Master Trusts and Superfunds from two anonymised providers – a provider of a holistic service which pools assets, and a provider which takes over as trustee and provides a single investment platform. Both estimate that certain pension scheme operating costs can be reduced by around 30% in a Master Trust, with a payback period of roughly three to four years.

Investment impacts

68. Evidence suggests that larger schemes (on average and assuming a similar asset mix) have superior investment performance over smaller schemes, due mainly to lower investment costs.

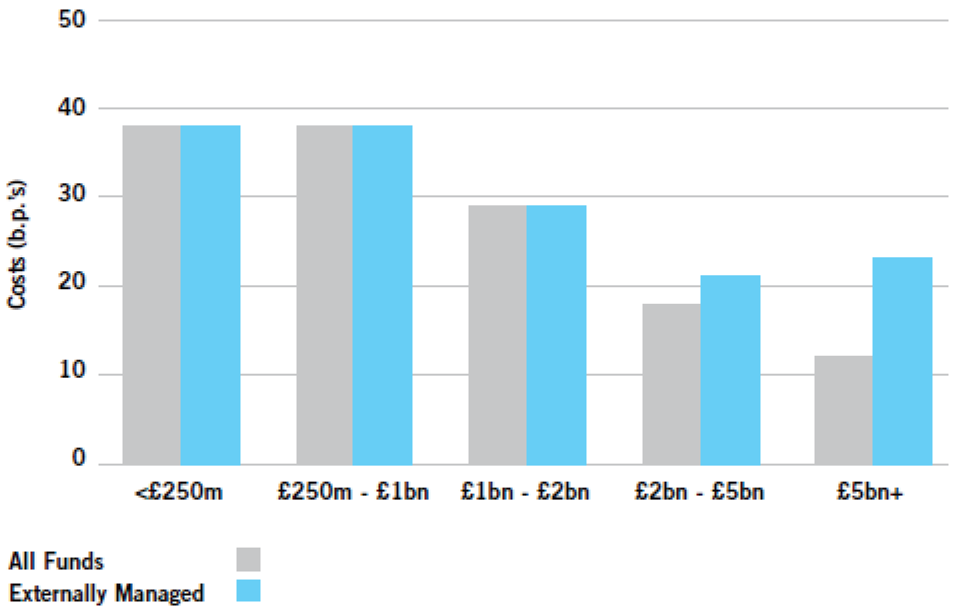
69. For example, CEM Benchmarking[102] suggests that larger schemes tend to be more efficient with their investing This is because they allocate a greater proportion of their investment to in-house management, in addition to their scale giving them the purchasing power to negotiate better

[102] Information/insights provided to DWP by CEM Benchmarking

management fees and providing them direct access to certain attractive private equity deals which are not available to smaller schemes.

70. A study by State Street,[103] published in 2013, also found that internally managed funds (which are much more common to big institutions – as set out above) had better investment outcomes. According to the study, the median externally managed 'less complex' fund had a risk of 10.6% per annum with a return of 9.9% per annum; whilst the internally-managed funds were better still with a risk and return over the period of 9.4% and 10.6% respectively per annum.

Figure 2. Range of investment costs by fund size



Source: State Street, Do Larger Funds Perform Better? September 2013, chart 8

71. Also, the asset mix of larger funds does tend to differ from smaller funds through increased investment in alternatives (such as infrastructure, hedge funds, property and private equity) and decreased investment in fixed income (such as bonds). Although alternatives are more expensive to manage, the expected returns from them tend to be greater and they provide further diversification, which may lead to improved or less volatile investment outcomes. However, we acknowledge that asset mix can also be dependent on scheme specific factors such as maturity and level of funding relative to liabilities.

[103] State Street, 'Do Larger Funds Perform Better?' September 2013. Available at: http://lgpslibrary.org/assets/cons/lgpsew/20130621Res.pdf

Table 8. Asset mix by total portfolio size

	Actual global average				
Asset type / Portfolio Size	**£1bn**	**£10bn**	**£20bn**	**£50bn**	**£100bn**
Stock	46%	44%	40%	35%	44%
Bonds	43%	36%	37%	32%	25%
Real Assets	8%	9%	10%	18%	17%
Hedge Funds	1%	5%	4%	4%	4%
Private Equity	2%	5%	6%	11%	11%

Source: CEM benchmarking

72. And as part of the Local Government Pension Scheme (LGPS) consolidation process, APG Asset Management and Unison conducted research which found that a substantial improvement in investment performance could be realised by increasing the size of funds.[104]

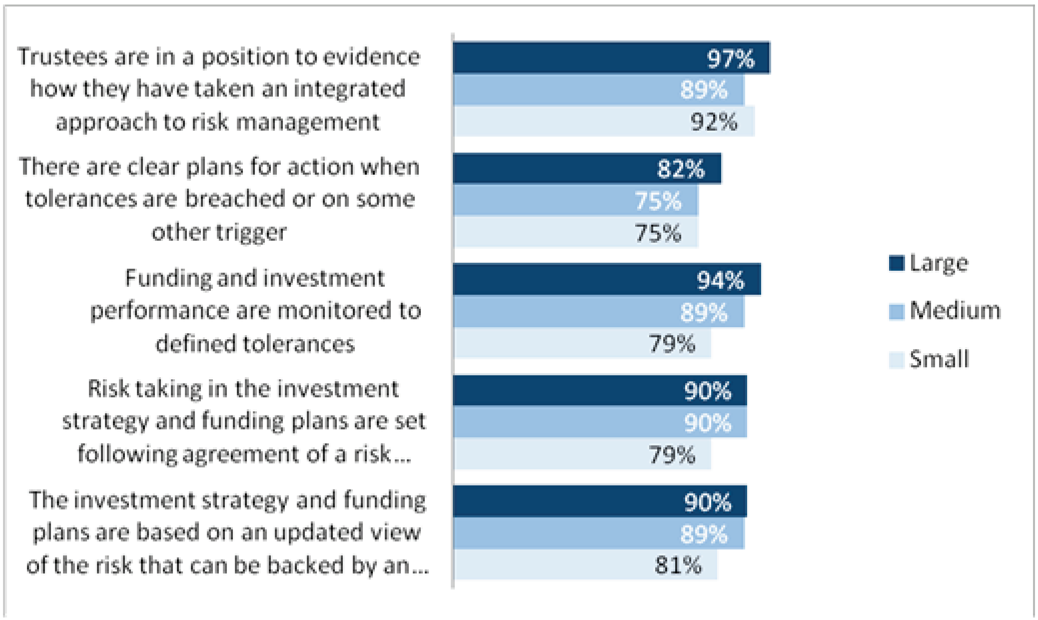
Quality of governance

73. Evidence tends to suggest that on average bigger schemes are likely to have better quality of scheme governance.
74. According to the Regulator's research[105] on trustees, larger schemes were more likely to have:
    - trustee boards that meet more frequently (46% of small, 63% of medium, 93% of large schemes reported to have boards that meet at least every quarter);
    - a trustee training plan and log (20% of small, 46% of medium, and 61% of large);
    - in place a documented policy to assess the fitness and properness of new trustees (49% of small, 61% of medium, and 74% of large);
    - read the guidance on how to assess employer covenant (small 79% / all trustees 90%) and the guidance on integrated risk management (small 65% / all trustees 83%); and/or
    - in general, 'higher self-reported trustee knowledge and skills'.
75. One expectation that the Regulator has in relation to managing risk is that schemes carry out a number of activities to ensure that funding, investment and covenant risks are managed in an integrated way between valuations. The five activities are shown in the figure below.

[104] APG Asset Management and Unison, available at: http://www.google.co.uk/url?url=http://www.unisonoldham.co.uk/wp-content/uploads/2012/12/UNISON_Response_to_DCLG_PE_infrastructure_consultation.docx&rct=j&frm=1&q=&esrc=s&sa=U&ved=0ahUKEwjinbDftc3YAhXDCpoKHSC-DCwQFggcMAI&usg=AOvVaw2_YJFFOb2WK-rsIfP1VDSY

[105] IFF Research on behalf of TPR, 'Defined benefit trust-based pension schemes research', 2017. Available at: http://www.thepensionsregulator.gov.uk/docs/db-research-summary-report-2017.PDF> and TPR, 'Trustee Landscape Qualitative Research', July 2016. Available at: http://www.thepensionsregulator.gov.uk/docs/trustee-landscape-qualitative-research-2016.PDF

Figure 3. How schemes manage funding, investment and covenant risks between valuations



Source: The Pensions Regulator research

76. As the figure above shows, generally a slightly lower proportion of trustees from smaller schemes engage with the listed five activities relative to their counterparts in larger schemes. This may imply that on average trustees of larger schemes tend to be relatively better equipped to assess and manage the three key risks relating to Defined Benefit pension schemes – funding, investment and covenant. This is not to say that all small schemes do not manage their risks or that all large schemes better manage their risks. In fact anecdotal evidence suggests that there are certain small schemes who do engage in bespoke activities such as integrated risk anagement at a reasonable off the shelf price. However on average larger schemes tend to engage more effectively with integrated risk management, which forms an important part of good scheme governance.[106]

77. So in general trustees of larger schemes are more likely to be better engaged with their schemes, meet more frequently, work together with their scheme's sponsor in an open and transparent manner and implement an approach which integrates the management of employer covenant, investment and funding risks. Although the listed qualities are not exhaustive when it comes to measuring the quality of governance, it does indicate that larger schemes are, on average, better governed relative to their smaller counterparts. This implies that a potential consolidator, which would be a large scheme by nature, has a higher probability of being well governed.

78. And we have some evidence that better governance leads to higher investment returns or lower costs – see paragraph 60 of this annex.

The cost versus savings of consolidation in a 'Superfund'

79. We have completed an initial cost versus savings analysis on potential consolidation across the Defined Benefit sector within one or more 'Superfunds' based on the following method and assumptions:

- The Regulator has provided to us, for the purpose of this exercise, summary information on reported buyout expenses which we are using as a proxy for the winding-up cost of

[106] Further guidance on Integrated Risk Management on TPR's website. Available at: http://tpr.gov.uk/guidance/guidance-integrated-risk-management.aspx

consolidating schemes split by covenant group (CG1 strong to CG3 tending to weak) and size of scheme.

- We have decided to exclude CG4 schemes from the analysis on the basis they form a smaller group (<10% of the overall liabilities) and arguably are not potential targets for consolidation within a new consolidation vehicle.
- We have used this information to assess the average winding-up costs within each data group. For this purpose we have compared the assessed winding-up costs with the potential on-going cost savings (administration, actuarial, and other advisory costs including investment advice) implied by the Regulator's expenses survey to determine a simple breakeven period.[107] This is also based on potential on-going costs within a consolidation vehicle of broadly £75 per member per annum.
- For each data group, the number of members and broad proportion of reported technical provisions are shown, as well as the average breakeven periods in the table below.

80. Results are summarised in the tables below.

Table 9. Break-even periods.

Size/covenant group		**Small (<100 members)**	**Medium (100 to 4,999 members)**	**Large (5,000 to 49,999) members)**	**Super (50,000+ members)**
CG1	No. of members	10k members	400k members	935k members	1,320k members
	Broad % of TPs	0%	5%	12%	12%
	Average break-even periods	8 years breakeven	14 years breakeven	21 years breakeven (grouped as per member expenses split not available)	
CG2	No. of members	25k members	855k members	1,800k members	1,265k members
	Broad % of TPs	0%	9%	18%	16%
	Average break-even periods	5 years breakeven	14 years breakeven	28 years breakeven (grouped as per member expenses split not available)	
CG3	No. of members	15k members	590k members	945k members	310k members
	Broad % of TPs	0%	6%	10%	4%
	Average break-even periods	5 years breakeven	13 years breakeven	26 years breakeven (grouped as per member expenses split not available)	

Source: GAD and DWP internal analysis based on data inputs from the Pensions Regulator records[108]

81. We might provisionally expect buy-out to be a more realistic aim for CG1 and many CG2 schemes and so would be less likely to engage in consolidation through a new consolidation vehicle, and for the very largest schemes buy-out and possibly even consolidation may not be possible due to size.

[107] The break-even period is the amount of time needed for the benefits to exceed the costs.

[108] Note: a scheme will be categorized by covenant rating generally once every three years. Covenant Grades are not available for all schemes, particularly schemes that are in surplus. Although such schemes are not included in the tabulated analysis it does not mean we hold the view that schemes in surplus will not be attracted to any potential commercial consolidator in the future. We have simply restricted the analysis to schemes where a Covenant Grade was available.

Similarly, the smallest schemes might not (but not necessarily) be immediate targets for consolidation if we assume that new vehicles will be targeting the bigger schemes in order to achieve the benefits of scale more rapidly.

82. The table below summarises the average winding-up expense estimates and potential on-going savings based on scheme size only and again uses these to derive a simple breakeven periods.

Table 10: Average buyout estimates and potential savings by size of scheme

	Small (<100 members)	**Medium (100 to 4,999 members)**	**Large to Super (5,000+ members)**
Average buyout expenses	£270,000	£3.0m	£53m
Estimated on-going savings	£50,000 pa	£0.23m pa	£2.2m pa
Simple breakeven period	5 years	13 years	24 years

Source: GAD and DWP internal analysis based on data inputs from the Pensions Regulator records

83. Note that the analysis/figures above are for illustrative purposes only.

Accessing buyout

84. As part of our considerations of the merits of consolidation, we have explored whether smaller schemes currently are able to buy out or whether there is a lack of supply amongst this group. We broadly conclude that although this is not necessarily the case there may potentially still be scope for consolidation to improve the situation.

85. Regarding buy-ins and buy-outs, the UK buy-in and buy-out market for Defined Benefit schemes has evolved since June 2007 from a market worth around £2.9 billion to a peak of around £13.2 billion in 2014.[109]

86. Based on the 100-plus deals in 2016 (see table below), around 40% of transactions were less than £10 million. This indicates that there is a market for transactions of the size that smaller schemes may seek.

Table 11. Number of deals in 2016, by deal size

Deal size (£m)	**Number of deals**
<10	40
10–100	41
>100	23

Source: Settlement Watch, Willis Towers Watson, April 2017[110]

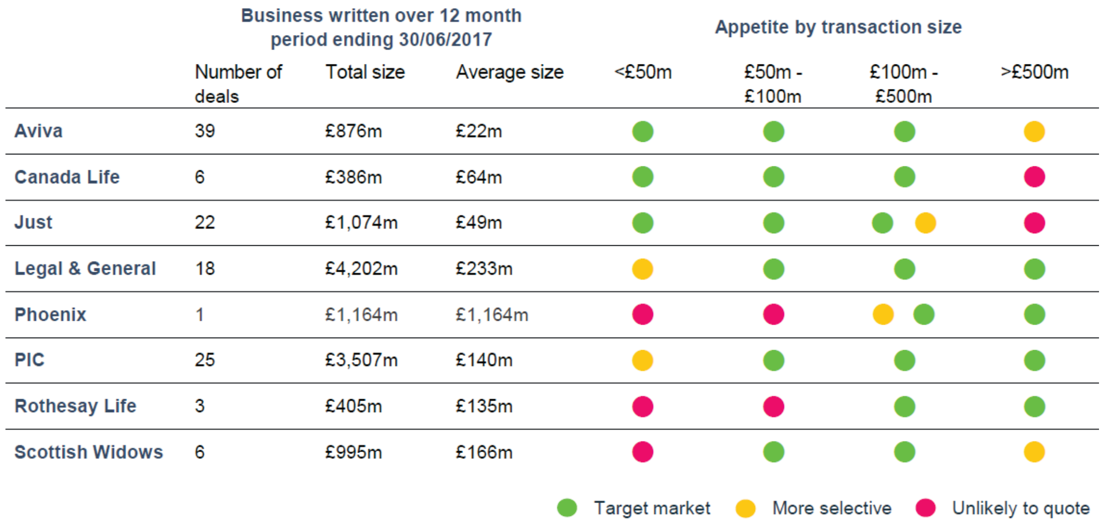
87. This view is also enforced by the fact that five of the eight current insurers active in the transfer market, as at June 2017, reported to have appetite for transaction below £50 million.[111]

[109] Lane Clark & Peacock, 'Derisking Report', January 2018. Available: at: https://www.lcp.uk.com/deriskingreport/

[110] Available at: https://www.towerswatson.com/en-GB/Insights/Newsletters/Europe/uk-settlement-watch/2017/Insured-transactions-market-review-of-2016

[111] Hymans Robertson, 'Risk Transfer Report'. August 2017. Available at: <https://www.hymans.co.uk/news-and-insights/research-and-publications/publication/hymans-robertsons-2017-risk-transfer-report/

Figure 4. Current Insurer 'appetite'



Source: Hymans Robertson, November 2017[112]

88. On the other hand, research carried out by Lane Clark and Peacock,[113] indicates that there has been a 20% reduction in the number of transactions below £100 million since 2013 and until 2016, and across the market up to 40% of quotation requests are declined by insurers.

89. Although this by no means is a definitive conclusion, the above may indicate that in principle buy out tends to be accessible to some smaller schemes but not all. And we think that there could potentially still be some scope in the market for a consolidation vehicle where the price for consolidation is potentially less prohibitive relative to insuring the liabilities with an insurance company.

Further work

90. The evidence above supports the case for consolidation in principle. A more in-depth assessment of costs, benefits, and risks will be included in the consultation.

Chapter four – other Defined Benefit areas

RPI override

91. Over two thirds of all Defined Benefit schemes are indexed with some reference to RPI for post 97 accruals and 38% of schemes for pre 97 accruals.[114]

92. As set out in the green paper, across the board CPI to RPI override could reduce liabilities by around £90 billion,[115] based on an aggregate deficit for Defined Benefit schemes of around £200 billion as at March 2017, potentially reducing the overall Defined Benefit deficit by up to 50%.

93. However, a broad change from RPI to CPI would be a direct cost to members. We estimate that if all changed from RPI to CPI the impact would be broadly a £12,000 reduction in the value of pension income per affected member, on average over their lifetime.[116]

112 Available at: <https://www.hymans.co.uk/news-and-insights/research-and-publications/publication/hymans-robertsons-2017-risk-transfer-report/
113 Lane Clark and Peacock, 'Pensions de-risking report', 2016. Available at: https://insight.lcp.uk.com/acton/form/20628/0030:d-000e/0/-/-/-/-/index.htm
114 Source: TPR; data (cut-off) point: end March 2017.
115 Secondary source: Defined Benefit Green Paper
116 Source: DWP's / GAD's calculations.

94. Hypothetical losses per member with £8,000 annual pension, which is the median level of private Defined Benefit pension, are illustrated in table 12 below. Note that they are based on the assumption that CPI will be at 2% (in line with the formal Bank of England's target) and RPI at 3.2% (as can be implied from some forecasts).

Table 12. Effect of an RPI to CPI override on pension value

	Increase in the value of an annual pension of £8,000		
Indexation	**Year 1**	**Year 2**	**Year 3**
RPI	8,256	8,520	8,793
CPI	8,160	8,323	8,490
Difference to RPI (benefit reduction)	*-96*	*-197*	*-303*

Source: DWP/GAD calculations

Annex B: glossary of terms

Active members	Current employees who are contributing (or having contributions made on their behalf) to an organisation's occupational pension scheme.
Annuity	An annuity is where the money in a pension pot is used to buy a regular income. Annuities can be flat-rate, increased in line with inflation or by a set amount, be guaranteed for a set time and/or joint-life.
Anti-avoidance powers	The Regulator's powers to ensure that a pension scheme is not abandoned, such as where there is a deliberate act to avoid the employer's debt to the scheme or an act which will detrimentally affect the likelihood of accrued scheme benefits being received.
Average salary scheme	A Defined Benefit scheme that gives individuals a pension based on a percentage of the salary earned in each year of their employment (rather than the final year).
Bond	A debt investment with which the investor loans money to an entity that borrows the funds for a defined period of time at a specified interest rate. Corporate bonds follow a similar structure to gilts, paying a fixed amount to the owner following a given schedule.
Consumer price index (CPI)	Index issued by Office for National Statistics which measures changes in the price level of a market basket of consumer goods and services purchased by households.
Contribution Notice	A notice issued by the Regulator requiring individuals (directors) or employers to pay money into a pension scheme where it believes that their actions (or failure to act) was 'materially detrimental' to the likelihood of a person receiving their accrued scheme benefits.
Deemed consent	Where the member's consent to a change to their rights in a scheme or a transfer to a less generous scheme is treated as having been given unless the member specifically objects.
Deferred member	A member of an occupational pension scheme who has accrued rights or assets in the scheme but is no longer actively contributing (or having contributions paid on his behalf) into the scheme and hasn't reached pension age yet.
Deficit Repair Contributions (DRCs)	Contributions made by sponsors to make up the deficit in an underfunded scheme over a specific period of time.
Defined Benefit (DB)	A pension benefit related to a member's salary or some other value fixed in advance, and independent of investment returns.
Defined Contribution (DC)	A pension benefit where the individual and (often) their employer contribute into a pension pot, and the benefit received by members depends on the totality of contributions and its investment returns.

Determinations Panel	The Regulator's Determinations Panel, as part of a legal process, makes the decisions on certain regulatory functions such as issuing a contribution notice or a financial support direction.
Discount rate	An interest rate used to reduce an amount of money at a date in the future to an equivalent value at the present date. Discount rates are at the heart of most actuarial calculations and this especially applies to calculating the liabilities of Defined Benefit schemes no matter the valuation method.
Employer Covenant	Ability and willingness of the employer to support the scheme.
Employer debt	Broadly the amount the employer must pay into the scheme when it ceases to participate at a time when there is a shortfall between the scheme's assets and liabilities, calculated on a buy-out basis (also known as section 75 debt).
Employer	The employer who sponsors a Defined Benefit scheme and so is the ultimate guarantor of scheme benefits.
Equity	Share or any other security representing an ownership interest.
Final salary scheme	A Defined Benefit scheme that provides a pension based on the number of years of pensionable service, the accrual rate and final earnings as defined by the scheme.
Financial support direction (FSD)	An FSD requires support arrangements to be put in place where the Regulator believes an employer is insufficiently resourced or is a 'service company'. It is enforceable by means of a contribution notice.
Fiduciary management	Fiduciary management involves outsourcing some or all the day-to-day management of a pension scheme. A high degree of transparency allows the manager's decisions to be easily scrutinised. Overall control, however, is retained by the trustee board. This enables trustees to focus attention on the key strategic issues that affect the pension scheme and ensure its long-term goals are met.
Gilts	'Gilt-edged securities', also known as government bonds. These are bonds issued by the UK Government. Gilts are generally considered to be one of the safer forms of investment so generate a correspondingly lower return than some more risky assets such as corporate bonds or equities. Some gilts make payments which are fixed in cash terms, whereas others make payments which go up or down in line with inflation.
Gross Domestic Product (GDP)	A measure of economic activity in a country. It is calculated by adding the total value of a country's annual output of goods and services.
Hedge funds	An investment fund where the fund manager can use financial derivatives and borrowing. This allows them to take more risk than equity or bonds fund, in the hope of providing a higher return.

IAS19	This valuation method is used when companies report their annual financial accounts. The methodology is set on a common basis and facilitates international accounting standards. It is intended to be a best estimate of the costs of a scheme; and is based on high quality corporate bonds.
Index-linked	Bonds, gilts, annuities and other financial products can be linked to an index. The income and/or capital values will increase in line with that index.
Large firm	A firm with 250 or more employees.
Life expectancy	Life expectancy (or the expectation of life) at a given age, x, is the average number of years that a male or female aged x will live thereafter.
Longevity	Length of life.
Mean	The average value of a group, calculated as the total of all the values in a group and dividing by the number of values.
Median	The median of a distribution divides it into two halves. Therefore half the group are above the median value and half below.
Medium-size firms	A firm with 50–249 employees.
Micro-employer/ micro-business	A firm employing fewer than five employees or a firm employing fewer than nine employees.
Multi-employer scheme	Multi-employer scheme means a scheme in relation to which there is more than one employer.
Notifiable events framework	A duty on the trustees of schemes and their sponsoring employers to notify the Pensions Regulator when certain events, as set out in regulations, occur.
Occupational pension	A pension which is provided via the employer, but the pension scheme takes the form of a trust arrangement and is legally separate from the employer.
Pension accrual	The build-up of pension rights. In a Defined Benefit scheme this may be based on the number of years of contributions.
Pension Protection Fund (PPF)	Established in April 2005 to pay compensation to members of eligible Defined Benefit pension schemes, when there is a qualifying insolvency event in relation to the employer and where there are insufficient assets in the pension scheme to cover PPF levels of compensation.
The Pensions Regulator (TPR or the Regulator)	The UK regulator of work-based pension schemes.
Price-indexed	Increasing each year in line with inflation.
Regulated Apportionment Arrangements (RAA)	A regulated apportionment arrangement is a statutory mechanism which allows a company to free itself from its financial obligations to a pension scheme in order to avoid insolvency, provided that certain conditions are met and the RAA is approved by both the Pensions Regulator and the PPF.[117]

[117] Out-Law.com, *Regulated apportionment arrangements 'no magic bullet' for struggling schemes, says expert,* 2016. Available at: http://www.out-law.com/en/articles/2016/march/regulated-apportionment-arrangements-no-magic-bullet-for-struggling-schemes-says-expert/

Rate of return	The gain or loss of an investment over a specified period, expressed as a percentage increase over the initial investment cost. Gains on investments are considered to be any income received from the asset, plus realised or unrealised capital gains.
Real terms	Used in relation to figures which have been adjusted to remove the effect of increases in prices over time (i.e. inflation), usually measured by the Retail Prices Index. Thus if something shown in real terms increases then it is rising faster than prices, whereas if it is constant, it rises at exactly the same pace as prices.
Retail Prices Index (RPI)	Index issued by Office for National Statistics but not a National Statistic. An average measure of the change in the prices of various goods and services, including housing costs, bought for consumption by the majority of households in the UK, but excluding many pensioner households.
Risk Based Levy	The levy for the PPF based on the risk of the pension scheme entering the PPF. It takes account of the scheme's liabilities in relation to its members, the scheme’s level of funding and the risk of the sponsoring company becoming insolvent.
Small and Medium Enterprises (SMEs)	Firms with 249 or fewer employees.
Small firm	A firm with 49 or fewer employees.
State Pension Age	The age at which an individual can first claim their State Pension.
Statutory funding objective (SFO)	This is the funding measure used for the purposes of Part 3 valuations under the Pensions Act 2004. Such valuations are often referred to as technical provision (TP) valuations, scheme specific funding (SSF) valuations, or Part 3 valuations.
‘Time to choose’ exercise	Exercise run by British Steel Pension Scheme (BSPS) whereby members could choose to transfer to a new scheme paying lower increases rather than remain with the BSPS as it moved into the PPF.
Technical provisions	A scheme’s own measure of its liabilities; each scheme will have its own way of calculating its liabilities taking into account investment strategy, mortality and inflation expectations and the strength of the employer covenant.
Tranche	In relation to Defined Benefit scheme funding valuation, the set of schemes which are required to carry out a scheme-specific funding valuation within a particular time period. Schemes whose valuation dates fell from 22 September 2005 to 21 September 2006 (both dates inclusive) were in Tranche 1, from 22 September 2006 to 21 September 2007 were Tranche 2 (both dates inclusive).
Voluntary clearance process	Businesses can seek a clearance statement from the Regulator that it will not use its anti-avoidance powers to issue a contribution notice or financial support direction in relation to a particular event, such as a change in the control structure of the employer. The Regulator will only issue a clearance statement where it is satisfied that all appropriate mitigations have been put in place.

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