

# Technical Bulletin

20 February 2017

## DWP Green Paper - Defined Benefit Pension Schemes

On 20 February, the Department for Work and Pensions (DWP) published a [Green Paper](#) on 'Security and Sustainability in Defined Benefit Pension Schemes'. This bulletin sets out the context in which the Green Paper has been published and summarises some of the key areas where DWP are seeking views.

### The Defined Benefit pension scheme environment

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Defined Benefit pension schemes in the UK private sector (DB schemes) remain a significant source of retirement income, with around 11 million members and assets of £1.5 trillion. Recent issues concerning the pension provision of high profile employers have led to renewed interest in the funding and regulatory framework of DB schemes. In an era of historically low interest rates and volatile investment returns, some commentators have declared that there is a fundamental problem with DB schemes.

DWP's Green Paper has been informed by a number of sources, including DWP's own informal consultation with industry stakeholders last summer and also including the following reports:

- The Work and Pensions Select Committee's December 2016 [report](#) on Defined Benefit pension schemes set out a number of recommendations to government.
- The Pensions and Lifetime Savings Association's [DB Taskforce](#) is undertaking its own review of the DB environment. Their [interim report](#) identified areas where policy intervention could focus. The final report, expected in March 2017, will set out recommendations for action and policy solutions.

### The Green Paper

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The Green Paper presents a wide-ranging review of the current framework, posing a number of questions about issues and options for the future. Whilst the government understands people's concerns, it does not recognise 'fundamental problems' with the pensions system. DWP is keen to understand why, for some, confidence in the pension protection framework is being undermined and to identify what can be done to restore it. The government is not yet making firm proposals for consultation but some views are shared in the Green Paper on how reasonable or proportionate certain responses may be. DWP is seeking input from all those concerned with the efficient operation of DB schemes and their sponsoring employers.

DWP's paper relates only to private sector DB schemes and is not concerned with other types of pension provision such as public service pension schemes (usually set up under statute) or Defined Contribution schemes. It begins with a summary of how the current framework protects and regulates DB schemes. Evidence is presented on the DB landscape, including the results of modelling carried out by the Pension Protection Fund (PPF). The final section of the Green Paper discusses issues and options in four main areas, as follows.

### Funding and investment

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A scheme's deficit is the shortfall in the value of the scheme's assets compared to the value of its liabilities, at a point in time. Whilst volatile, in recent years the value of liabilities has tended to increase faster than the value of assets, driving an increase in reported deficits. This is predominantly attributed to:

- falls in expected future investment returns and hence lower discount rates used in funding valuations
- increased life expectancy, extending the length of time that benefits are payable for

The PPF's modelling supports the view that, at the aggregate level, schemes will be sufficiently well-funded that the majority of scheme members will receive their benefit entitlements in full, as long as employers continue to meet their scheme funding requirements. It is, however, acknowledged that there is a distribution of outcomes at the scheme level and actual outcomes could differ from the modelling.

Some commentators have suggested that the current regulatory environment, and the valuation and funding arrangements in particular, is causing trustees to take an overly-cautious approach to the investment of pension

scheme assets. DWP are keen to understand whether, and why, investment choices might be sub-optimal and if this is unduly shifting the balance of funding from investment returns towards increased sponsor contributions.

DWP is also interested in views on whether the current valuation measures are fit for purpose and sufficiently flexible. Amongst other topics in this section, the paper discusses how to communicate risks and expectations to members, how discount rates are set and possible changes to the triennial valuation cycle.

### Employer contributions and affordability

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The Green Paper refers to a number of sources which indicate that the expenditure on DB pension contributions appears generally affordable. Some of this evidence primarily concerns FTSE 100 or 350 schemes but some evidence looks at all companies. On average, deficit contributions are significantly lower than dividends or profit before tax. There are, however, a significant minority of employers for whom deficit contributions appear unsustainable. DWP focus on this struggling group of 'stressed' schemes and employers:

- Should special arrangements be introduced for such schemes - for example allowing changes to reduce pension indexation or developing mechanisms to separate schemes from their sponsors?
- How should 'stressed' schemes be defined and identified?
- How to avoid sponsoring employers taking advantage of any special arrangements?

Conversely, some employers have significant resources. DWP ask whether they should consider measures to require such employers to repair significant deficits more quickly.

### Member protection

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The current DB funding framework and wider regulatory system is intended to balance the protection of scheme members with the interests of sponsoring employers and PPF levy payers. Whilst DWP's assessment is that the significant majority of members can expect to receive their pensions in full, there are risks around this outcome.

The questions in this section focus on the powers and approach of the Pensions Regulator (TPR) and the role of trustees - should these be altered to better protect member interests? If so, what changes can be made that will not unduly affect the interests of sponsoring employers and PPF levy payers? Topics for discussion include:

- Whether certain corporate transactions should require compulsory proactive clearance by TPR.
- Should TPR and/or trustees be granted stronger powers to gather information?
- Whether trustees of underfunded schemes should be consulted before sponsors pay dividends.

### Consolidation of schemes

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There are a large number of small DB schemes – in a universe of around 6,000 schemes, 10% of membership is spread across 81% of schemes. TPR data suggest small schemes have higher proportionate costs and tend to have less effective governance and trusteeship. The Green Paper considers the challenges and practicalities involved in consolidation of smaller schemes, looking at various options available.

- Should government encourage, incentivise or, in some cases, mandate consolidation of small schemes?
- What are the barriers which currently prevent schemes from consolidating?
- Should scheme benefits be subject to modification to assist the consolidation process?
- Can consolidation provide a cheaper, more efficient form of buy-out, discharging sponsors and trustees?

Following on from a 2015 [call for evidence](#), DWP also confirms its intention to consult on a new option for non-associated multi-employer DB schemes to manage the employer debt following an employment cessation event.

### Consultation and timetable

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The Green Paper invites written submissions before 14 May 2017. We understand DWP will also be consulting extensively with stakeholders throughout this period, with roundtable events and further meetings.

If you would like to discuss any of these issues in more detail or have any questions please get in touch with your usual GAD contact.