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21 February 2013

TPR Policy Team
Pensions Protection and Stewardship Division
DWP
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Pensionsregulator.dwpconsultation@dwp.gsi.gov.uk

Dear Sir/Madam,

## PENSIONS AND GROWTH: Whether to introduce a new statutory objective for the Pensions Regulator

We are writing on behalf of the Association of Consulting Actuaries in response to the above-named call for evidence.

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes.

The ACA is the representative body for UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

To summarise our response (we answer the specific 'call for evidence' questions in the Appendix, attached) rather than introduce a new objective, we consider that it would be more productive to provide clarity around how the Regulator's existing objectives should be interpreted and to be clear about the success measures.

We would be very happy to discuss these points at a meeting with those responsible for technical support in this area if that would be helpful. They can contact me on 020 7432 6635 (david.everett@lcp.uk.com), or my colleague Deborah Cooper on 020 7178 7184 (deborah.r.cooper@mercer.com)

Yours sincerely

**David Everett**
Chairman
ACA Pension Schemes Committee

**NOTE: CHANGE OF ASSOCIATION ADDRESS FROM 1 MARCH 2013**

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## APPENDIX: ACA responses to Q6 – Q9 in Call for evidence

### Q6 – What would be the advantage of a new statutory objective for the Pensions Regulator to consider the long term affordability of deficit recovery plans to sponsoring employers?

We do not see that there would be any material advantage in adding this to the Pensions Regulator's (the Regulator's) existing objectives.

The Regulator has said that it already 'considers' affordability in developing its regulatory approach and we agree that this is the case. However, we are not confident that the way the Regulator acts as a result is consistent with what we understand to be the purpose behind the Chancellor's statement; that is, that he wishes the Regulator to insist that contributions should not be too high. Instead, our view is that the guidance the Regulator produces encourages trustees to expect employers to consider them first when deciding how to prioritise any discretionary spending and for the trustees to seek alternative security in the event the employer is not prepared to prioritise their interests when determining how to spend its income.

Companies and their investors have different priorities and expectations compared with those of the trustees, or the Regulator, and these are likely to change depending on circumstances. For example, where borrowing from financial markets is relatively straightforward, companies might be prepared to use a large proportion of their cash flow to spend down a pension scheme deficit; however, when it is more difficult, then they are likely to prefer to retain cash flow within the business (implicitly using the scheme as an alternative lender). This will partly be driven by economic pressures, but also by industry and size, so 'affordability' is unlikely to be an objective measure.

The Regulator's April 2012 Statement says "Irrespective of the current economic climate, recovery plans should usually be based on what is reasonably affordable without compromising the employer's long term ability to support the scheme. In the vast majority of situations, a strong and ongoing sponsoring employer is the best support for a scheme."

This seems to be the sentiment the Chancellor is trying to achieve. However, the Statement goes on to set relatively narrow instructions regarding the evidence trustees are required to gather to justify taking actions to, for example, reduce contributions relative to their previous position. This conflicting tone puts trustees in a difficult situation and sometimes encourages them to be more assertive about making demands on employers than might be required or necessary, in the context of the existing regulatory regime and the pension scheme's position.

Consequently, the proposed objective seems unlikely to achieve the desired result.

We are also concerned that it is too narrow – that is, it seems mis-guided to concentrate only on affordability (however interpreted) since it is also important to consider the measure against which deficit contributions are determined. Deficit recovery plans are driven by how technical provisions are set and, for some companies, increased shortfall contributions can seriously limit financial strength and restrict growth. So the way trustees have been encouraged by the Regulator to persistently reduce the degree of risk they allow for when setting their technical provisions should also be challenged.

### Q7 – What would be the disadvantages in creating this further statutory objective for the Pensions Regulator?

Generally, multiple objectives seem unlikely to create a better regulatory regime, particularly when they can be viewed as pointing in many directions. Already, the Regulator's objectives can be considered to conflict with one another. Unless the Regulator explicitly recognises this and is transparent about how it proposes to reconcile its conflicts, it seems likely to continue to pursue its narrow view of its one objective at the expense of other views.

The question in our mind is, who is it that regulates the Regulator?

Our expectation has been that the National Audit Office (NAO) would bring these points out, for example, in its report of the Pensions Regulators (,,,), but this hasn't been the case. Partly, this is because, when the NAO carried out its report, the Regulator was new and so there was little to measure. But the NAO seems to have misinterpreted the Regulator's objectives as being to reduce risk in pension schemes, rather than just to ensure that risk is more properly understood. For example, in its report it implies that the Regulator being 'successful in reducing or eradicating pension deficits' would be a success measure. However, although we agree it is likely to be the case that some trustees expose scheme members to greater risk than is ideal, risk reduction at a macro level is not what the legislative regime requires and is not explicitly one of the Regulator's objectives.

So, the main disadvantage we see is that it would just further complicate the existing regulatory regime, without making any clearer what exactly is intended and what is expected from the Regulator itself.

### Q8 – Is the consideration of the long term affordability of deficit recovery plans to sponsoring employers already implicit in the existing objectives and requirement for the Pensions Regulator? If so, is this sufficient?

Yes: in our view, affordability and taking a more holistic view about the continuing health of sponsoring employers are already implicit in the Regulator's existing objectives. If this were explicitly recognised, so that the Regulator was encouraged to amend some of its current regulatory behaviour, it could be sufficient.

For example:

- The Regulator's first objective is to protect benefits under occupational pension schemes. The consultation recognises that this relies on continuing employer solvency, generally in conjunction with 'a properly funded scheme'. However, provided the employer remains solvent, benefits will be paid, and so sponsor solvency is key to achieving this objective and should be given at least equal prominence to funding;
- Its third objective is to reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund (PPF). The situation that leads to compensation being payable from the PPF is employer insolvency. So,

ensuring the ongoing solvency of sponsoring employers should clearly be viewed as part of meeting this objective.

It appears to us that, whilst the Regulator does not ignore employer insolvency, it has concentrated its regulatory power on encouraging trustees to ensure schemes are 'properly funded'. Further, it has chosen to take a general stance that schemes in general need to de-risk and increase funding, when it could have considered these as objectives only appropriate to some; in some of its communications to the industry, it has interpreted this to be targeting buyout.

Unfortunately, enforcing the 'proper funding' part of the objective ultimately conflicts with the 'employer solvency' part, an issue that we do not believe the Regulator has properly addressed.

Another side effect of the Regulator concentrating on only one part of its objective is that it encourages trustees to steadily de-risk the pension scheme, both in terms of investment strategy and the funding targets they set for employers. Whilst we accept that the PPF, for example, will be better protected if pension schemes are less risky, the legislative regime does not seem to us to provide for this. That is, apart from its partial interpretation of its objectives, the Regulator has no regulatory grounds for directing trustees to de-risk pension schemes. (Of course, if trustees consider it is appropriate for them to de-risk, then they should be able to do so provided that it is done in accordance with their duties under the scheme.)

So, our view is that the objective is implicit in the existing objectives and that this could be sufficient provided it was made clear that this was the standard against which the Regulator will be measured.

**Q9 – Are there other options (including legislation) which would ensure that the Pensions Regulator carries out its functions in a way with appropriately balances protection of members, the Pension Protection Fund and sponsoring employers?**

Our replies to the previous questions have indicated that we do think that some steps need to be taken to make sure that the Regulator fully meets its statutory objectives.

Since its inception, the Regulator has set a very strong agenda that, from the outset, included strengthening trustees' standards of governance, particularly to ensure that the risk environment in which schemes were operated was more clearly understood. These were very legitimate goals and, it seems to us, the Regulator has been very effective in encouraging changed behaviour along its desired path.

However, at the same time the Regulator set itself the goal of 'improving scheme funding' (for example, in its Medium Term Strategy published in 2006) and it has continued to reinforce this view (for example, in its 2008 Corporate Strategy document). That is, the risk management agenda the Regulator started with seems to have evolved into a risk reduction agenda that affects all the areas in which it operates.

We agree that, at its outset, it was reasonable for the Regulator to start with a presumption that improvement was needed, in terms of trustee knowledge and understanding generally and, more specifically, in relation to the risks taking in financing scheme liabilities. However, now that the Regulator has had time to raise both behavioural and financial standards, it seems that its 'corporate objectives' should be reviewed. Our view, for example, is that increased contributions to pension schemes and de-risked investment strategies are not necessarily the appropriate response to its objectives, albeit they might be appropriate in some cases.

Consequently, rather than introduce a new objective, we consider that it would be more productive to provide clarity around how the Regulator's existing objectives should be interpreted and to be clear about the success measures. For example, accelerating the demise of defined benefit pension provision does not seem to be the outcome that was expected in 2004, when the Pensions Bill was being debated.

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