The greatest good for the greatest number

An examination of early intervention strategies for trustees and sponsoring employers of stressed defined benefit schemes

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Agenda

- Overview
- Findings
- Proposals
- Update

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Overview

Overview

- Current regulatory framework assumes:
  - employer's business will survive long enough to pay members' DB benefits in full
    - even where the scheme has a large deficit.
  - PPF plays low-key role, only stepping in if, in a small number of cases, things go badly wrong and:
    - it takes over any remaining scheme assets
    - and pays compensation to members
  - TPR believes most firms can pay pensions
    - since dividends exceed deficit contribs

Overview

- But reality is that many trustees are trying to manage impossible conflicts of interests between various stakeholders when:
  - pension scheme is significantly underfunded
    - relative to value of sponsor’s business
  - trustees cannot rely on financial support needed from sponsor
    - because its covenant is weak
- Timing of report prescient in the light of BHS, Tata Steel, Austin Reed, Halcrow etc

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Findings

Findings

- **Up to 1,000 private-sector defined benefit (DB) schemes are 'stressed' and unlikely to pay member pensions in full.**
  - **In some cases – about 400 schemes – the employers' businesses might be viable, but will not survive if scheme deficit remains on corporate balance sheet.**
  - **Up to 600 schemes will *never, ever* pay full benefits.**
- **15-17% of total**

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Findings

- In aggregate, these 1,000 schemes have:
  - Liabilities estimated at £225bn
  - Assets estimated at £180bn
  - Deficits estimated at £45bn
- Includes 25 of largest schemes in the UK:
  - each with £1bn+ in liabilities
- If this situation is not addressed urgently
  - businesses that might be saved will be lost to the UK economy.
  - more members will only receive PPF compensation

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Findings

- TPR's 2014 'sustainable growth' objective is in direct conflict with its role to support trustees in their primary duty to:
  - protect scheme members' benefits
  - protect the PPF
- Imposes conflicts of interest on trustees of stressed schemes, which can lead them to put off taking essential actions.

Findings

- The PPF compensation structure is arbitrary and unfair for younger members.

- It could be ‘gamed’ by pre-normal retirement age (NRA) directors with large pension entitlements.

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Findings

- Lay trustees in stressed schemes are unlikely to have level of expertise needed to deal with complex corporate issues.

- Corporate and debt restructuring skills were not in the job description.

Findings

- Some directors may not be candid with trustees about planned corporate actions that would weaken the scheme's position as a creditor.
- They may also not be candid with shareholders and creditors about the real risks of the volatility of the DB deficit and future funding requirements for the business's prospects.

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Proposals

Proposals

- **Change TPR's remit for trustees of stressed schemes from**
  - **'protection of member benefits'**
- **to**
  - **'protection of member interests'**
    - 'doing the right thing in the financial and economic circumstances'
    - which might mean reducing indexation and/or capping benefits, for example.
- Govt. proposed reducing indexation as option for Tata Steel

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Proposals

- **Make non-statutory pension increases contingent on the scheme's funding level**
  - **i.e., introduce conditional indexation.**
- There are two possible ways of doing this:
  - trustees are given the ability to apply to TPR for such a power (as in Ireland)
  - TPR should have the power to direct trustees to restrict pension increases to the statutory minima
    - where scheme significantly underfunded.

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Proposals

- **Introduce a PPF ‘pre-assessment’ period to facilitate early intervention.**

- Where covenant strength does not improve and funding position continues to deteriorate:
  - TPR could intervene and require trustees to take appropriate advice and action.

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Proposals

- **Change PPF's cliff-edge compensation rules for pre- and post-NRA to a phased approach, based on age and/or length of service.**
- This would introduce greater equity between member cohorts.
- Might also eliminate concerns about potential gaming of compensation rules by high-liability directors in failing businesses
  - who are holding on in order to reach NRA.
- Govt expected to proceed with higher long-service PPF cap

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Proposals

- Provide specific guidance for trustees of stressed schemes on the appointment criteria for specialist advice.

- Provide a rapid fee-check calculator to reassure trustees that they will not contravene the regulator's guidance on 'proportionality'.

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Proposals

- Introduce requirement for TPR to alert trustees and sponsors when:
  - it identifies that a sponsor's covenant is 'weak' (its lowest ranking)
  - or is on a rapid downward trajectory towards this ranking.

Proposals

- As part of each funding review, employers should be required to provide an annual statement to the trustees about the prognosis for the business over the next three to five years
  - including any plans for corporate actions.
- This would align regulation and governance of sponsoring employers with concerns of trustees.

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Update

Update

- Report taken seriously after BHS, Tata Steel and Austin Reed
- Prompts W&P Select Committee to look at DB
- TPR now accepts inadequate sharing of information about the state of the company between company, trustees and TPR.
- TPR currently relies on public information
  - eg from company accounts.
- Needs some form of ‘early warning system’ of problems brewing well before 12 months of a crisis developing

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Update

- Deficits are now affecting companies adversely
  - £450bn – funding ratio of 76%
- IHS Markit estimates FTSE350 will reduce dividends by £3.6bn in 2017
- Pension Insurance Corp estimates FTSE100 share price is lower by £340bn
  - Equals size of DB deficits valued at risk-free rate
  - Or 20% more than companies own ests of liabilities

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Update

- Reiterate our proposal that for c400 weak schemes, all parties work together to produce a ‘second best’ outcome
  - by agreeing to reduce the benefits equitably for all members (but above PPF)
    - accompanied by a fair compromise on the s75 debt
  - while allowing sponsoring companies to be restructured in a way that gives them a greater chance of survival
  - but avoids sponsors gaming members

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Update

- Some suggestions that have been proposed:
  - Cutting guaranteed benefits
    - e.g., future pension increases
  - Introducing risk sharing
    - Via DC top-up

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http://www.pensions-institute.org/reports/GreatestGood.pdf