Protecting defined benefit pension schemes

Government white paper published

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The government has issued its pensions white paper – somewhat sooner than expected.

The paper, 'Protecting defined benefit pension schemes', takes the view that the current system works well for most schemes and employers but that a tougher approach is needed for those failing to act responsibly.

Against that background, it proposes changes in three main areas:

- Strengthening the Pensions Regulator's powers
- Improving the scheme funding regime
- Consolidating schemes

Whilst it may be years before some of the proposals, particularly those requiring primary legislation, have formal effect, we expect that the white paper will nonetheless drive immediate behavioural changes amongst pension scheme sponsors and trustees.

Strengthening the Regulator's powers

The Pensions Regulator has sought powers that it can use quickly and more readily to add to its armoury in situations where the current powers are too cumbersome. The white paper proposes:

- Heavier fines and the introduction of a new criminal offence to punish those who have been reckless in relation to their pension responsibilities
- A stronger regime for notifying the Regulator of key corporate and scheme events
- A requirement in some corporate transactions to involve trustees in advance and issue a "statement of intent"
- Stronger information-gathering and inspection powers for the Regulator

"...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.

Improving scheme funding

The Defined Benefit Funding Code of Practice will be revised in order to provide more direction and strengthen funding for schemes that don't meet the Regulator's standard. This will include:

- How to demonstrate prudence when assessing scheme liabilities
- Setting appropriate factors when considering recovery plans
- A requirement for an explicit long-term funding objective, such as self-sufficiency or buy-out

Changing the Code will not require legislation. However, compliance with the Code will be made a statutory requirement.

Statute will require appointment of a chair of trustees and submission of a Chair's Statement with the triennial valuation.

"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.

Consolidation

The white paper supports the consolidation of smaller pension schemes, justified by better governance, lower costs and better investment returns.

But it lacks concrete proposals, instead promising more work in a number of areas that would facilitate more consolidation options and vehicles.

"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.

Kicked into touch

The white paper rejects (at this stage) proposals which had been floated to over-ride scheme rules on pension increases and to relax the rules for Regulated Apportionment Arrangements.

Next steps

Many of the measures (e.g. corporate clearance and scheme funding standards) can be achieved quickly, without the need for legislation. Where primary legislation is needed (e.g. new legal powers and penalties), this is likely to happen only in the 2019-20 parliamentary session at the earliest.

However, we expect that employer and trustee behaviour will change immediately on the basis of the aims spelled out in the white paper. The threat of retrospective penalties will certainly give many employers pause for thought!

KPMG view

The white paper strongly endorses the Pensions Regulator's desire for real teeth to crack down on those not playing fair with their defined benefit scheme. The broader range of proposed powers will have a lower hurdle to bring them into play and so might be used more frequently – offering a scalpel to replace the sledgehammer the Regulator has today to crack a few 'nuts'.

The new funding measures should help to drive greater transparency and ultimately more security for members. However, scheme trustees and sponsors will need to get used to the Regulator sitting at the table on funding negotiations from now on. The scheme specific regime risks being sacrificed for a 'one-size fits all' approach.

Whilst it is disappointing that the white paper contains little action on benefit simplification, we welcome its support for scheme consolidation – although superfunds that allow a sponsor to untie itself from a pension scheme will need to be implemented very carefully.

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