

# **How the Pension Regulator will regulate the funding of defined benefits**

## **Response to the consultation by Amicus**

### **Introductory remarks**

Amicus is a major trade union with the largest membership of all trade unions in the private sector.

The majority of our members are contributing to funded final salary pension schemes which will be subject to the new funding regime and in many of these schemes our members are serving as trustees.

Pensions are a priority area for our members and their concern are focused on the security of their benefits and on the continuation and future benefit quality of their schemes.

In relation to this Consultation it is important to emphasise this dual basis of their concern. We do not believe that Regulator, in bringing forward proposals, has paid sufficient attention to the desirability of high quality final salary benefits continuing into the future.

Whilst sound funding and increased security is important, the regulatory regime needs to be flexible and to recognise that there can and will be a direct trade-off between requiring more money to back-up accrued benefits and the amount of money employers will make available for future benefits.

Recognition of this should lead to a flexible and measured approach which avoids placing undue burdens on employers as it recognises that those burdens may simply be passed on to active members. If this were not done the Regulator may find that most of the defined benefits schemes will either become closed schemes or be greatly reduced in quality.

Our comments on questions posed by the Consultation Document are as follows

### **Q.1 Key Risks**

The risks identified by the Regulator are valid in themselves but need to be balanced against another key risk. This is that an emphasis on discontinuance measures and short recovery periods will lead to employers taking measures to increase employee contributions and reduce future service benefits.

The analysis in the document fails adequately to acknowledge that forcing employers to improve the security of past benefits will impact directly on their ability and

willingness to fund future benefits. This means that active members of schemes will bear the impact

One of the Regulator's statutory objectives is to protect members' benefits. We do not believe that this should be construed as a narrow definition of accrued rights but should extend in some measure to future service benefits. One key limitation of a narrow definition of accrued rights is that it does not include the threat to members past service benefits which derives from their losing the final salary link, whether by schemes being closed to further accrual or by measures being adopted which compromise the growth of pensionable pay on which final salary pensions are calculated.

## **Q.2 Principles guiding the Regulator's approach**

'Protecting members' – We believe it should be made clear that the expectations should extend to future service benefits and the final salary link of past service benefits

'Scheme specific' - we do not believe it is in the scheme members' interests for all actuarial funding assumptions to be scheme-specific. It would be better if standard assumptions were prescribed and scheme specific deviations from them allowed. This would empower trustees in helping them to ensure that all such deviations were justified

'Proportionate' – We do not accept an approach which encourages trustees or the Regulator to press strong employers to make good deficits over a shorter period. The likely sufferers from this will be the active scheme members who will see their future benefits reduced as employers/schemes are forced to depart from, what may be for them, sound long term funding plans. What is the point of introducing an insurance scheme (the PPF) to cover a risk, if companies/schemes have to adjust their funding to cover that risk anyway ?

## **Q3. Triggers for funding targets and recovery plans**

We would take issue with the statement in 3.3.4 that 'it is not necessarily imprudent to include some measure of equity out-performance relative to bonds if the employer's covenant is strong enough'. This is a misconceived sentiment which suggests that equity investment is not really a good thing and one which could prejudice the future provision of final salary benefits. The Regulator should recognise unequivocally that a prudent strategy could encompass a measure of equity out-performance in respect of pre-retirement liabilities. Failure to do so will grossly enlarge deficits and inflate the cost of future benefits. The Regulator should, however, be concerned if the measure of out-performance was excessive or the extent of investment in equities was too far out of line with the nature of the scheme's liabilities. But to suggest that any measure of out-performance over bond returns is imprudent smacks of encouraging reckless conservatism which would often lead to reductions in future benefit promises

We would question the arguments in relation to recovery plans (see comments under 'proportionate'(above). The Regulator should acknowledge that trustees might accept

that a stronger employer should be given more latitude provided their long term funding plan is sound.

In general we would accept that triggers filters are a useful way for the Regulator to identify funding risk but it is important that they are not applied in too mechanistic a way

#### **Q4. Are the technical provisions triggers appropriate ?**

The language used in Section 4.1 is a little confusing and the intentions of the Regulator were obscure until clarified in the 'statement' later in the document. There is a big difference for example in using FRS17 'as a trigger' and using it as 'the basis of a trigger'. The former suggests that any FRS17 deficit would trigger the Regulator's concern, the latter means that FRS17 is a measure to be looked at and the trigger is going to be defined using it .

The approach of setting the triggers in relation to a scheme falling below the range of general practice in other schemes would seem to be a reasonable one.

We would suggest that the Regulator needs to complement the proposed measures by considering an ongoing funding measure more typical of trustees current practice. This would admit a higher investment return related to the nature of the scheme's liabilities. We acknowledge that the Regulator intends to use the triggers as an initial filter and to subsequently look more closely at the circumstances of the schemes but it would surely help to introduce this particular factor at the trigger stage in order to emphasise the acceptability of a sound long-term funding basis

Where companies seek to plan future pensions on the basis of FRS17, we find that their intention is usually more about justifying a cut in future benefits than it is about planning an increase in their contribution levels i.e it is used to decide what they can afford to promise rather than directly determining what they actually pay.

#### **Q.5 Are the recovery point triggers appropriate ?**

A ten year recovery period would seem reasonable in respect of an initial trigger, as long as it is made clear that there are circumstances in which a longer period may be deemed as being reasonable.

We do not agree that a shorter trigger would be appropriate for financially strong employers.

#### **Q.6 Contingent assets to justify longer recovery periods ?**

We would support a flexible approach to the recognition of contingent assets as a basis for justifying longer recovery periods. This adds to the security of members benefits in the short-medium term and allows the demands on company cash flow to be smoothed.

Insofar as this provision encourages parent companies to give legally binding guarantees in respect of subsidiaries pension schemes, this would seem to be particularly desirable

### **Q.7 Impact of the Regulator's proposals**

We would argue that the PWC analysis in respect of employer's ability to address FRS17 deficits through higher contributions is of limited value as the main impact of FRS17 pressure may not fall on employer contributions but on member benefits and contributions

(We have no further comments on the remaining questions)