Department
for Work &
Pensions

Pensions and Growth

Whether to smooth assets and liabilities in scheme funding valuations

Whether to introduce a new statutory objective for the Pensions Regulator

Government response to the call for evidence

May 2013

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Summary

The Chancellor of the Exchequer announced in the Autumn Statement last year that the Department for Work and Pensions (DWP) would consult on:

- providing the Pensions Regulator (the Regulator) with a new statutory objective to consider the long-term affordability of deficit recovery plans to sponsoring employers of private sector defined benefit schemes; and
- whether to allow sponsoring employers of such schemes undergoing scheme funding valuations in 2013 or later to smooth asset and liability values.

The calls for evidence[1] ran from 25 January 2013 to 21 February 2013 (for the statutory objective) and 7 March 2013 (for smoothing). There were 89 and 99 responses respectively, with 52% favouring an additional objective for the Regulator, and 11% favouring a change in the law to allow smoothing.

The Government is very grateful to all those who responded - a list of all respondents is provided in the annex.

In his Budget Statement of 20 March, the Chancellor announced that the Government would bring forward legislative proposals later this spring to “provide the Pensions Regulator with a new objective to support scheme funding arrangements that are compatible with sustainable growth for the sponsoring employer and fully consistent with the 2004 funding legislation.”

He also confirmed that Government was not proposing legislative changes on asset and liability smoothing, as the call for evidence had not revealed a strong case for pursuing such measures.

This document

This document outlines the main points made by respondents to the call for evidence and provides the Government’s formal written response.

The original call for evidence and this response are available on the Department’s website: http://www.dwp.gov.uk/consultations

[1] Pensions and Growth. Whether to introduce a new statutory objective for the Pensions Regulator. A call for evidence. ISBN 978-1-78153-327-7

A new objective for the Pensions Regulator

The Government asked: whether a new objective for the Pensions Regulator to consider explicitly the long-term affordability of deficit recovery plans to sponsoring employers is needed in addition to the current references in the Pensions Regulator's Code of Practice.

Respondents' comments

89 responses were received on a new objective for the Pensions Regulator.

The majority (46) of respondents favoured a new objective. Overall, these respondents felt that a new statutory objective is necessary to provide some balance to the Regulator's other objectives in respect of scheme members and the Pension Protection Fund (PPF) by explicitly raising the profile of employers' needs.

In particular, employers felt that a new objective would draw out the flexibilities in existing legislation; help to ensure the long-term health of the sponsoring employer; and support investment and private-sector growth, all within the wider context of difficult economic conditions.

Of those in favour, the majority favoured a new objective to deliver a wider scope than the wording proposed in the call for evidence, which had focused on the affordability of deficit recovery plans for sponsoring employers. Some of these respondents suggested that the new objective needed to be wide enough to encompass consideration of the full range of flexibilities available in the scheme funding legislation and how funding arrangements impact on sponsoring employers' ability to invest and grow. The thinking behind this appeared to be that a thriving employer would benefit both scheme members and the wider economy. Most of the business community fell into this group of respondents.

However, some respondents felt that any new objective should focus on promoting good pension provision and prolonging the longevity of schemes. Most trade unions who responded and the National Association of Pension Funds favoured this type of objective

Not all respondents agreed that a new objective was needed. 42 respondents, mostly trustees and scheme members, opposed a new objective. Many of the trustees felt that a reasonable balance between member protection and the employer's ability to prosper was already being struck in funding negotiations as both parties recognise that a healthy employer is in the members' best interests. They also felt that such considerations were already encouraged by the Regulator. Many respondents feared that a new employer-focused objective would tip the balance of power in funding negotiations too far towards the employer, weakening the position of trustees to

negotiate on behalf of the scheme, and thus weakening the overall strength of the scheme.

1 response was neutral on whether a new objective was needed.

Government response

Having considered the responses, the Government announced in the Budget that a new objective to support scheme funding arrangements “that are compatible with sustainable growth for the sponsoring employer and fully consistent with the 2004 funding legislation”, would be developed. This announcement reflected the opinion of many respondents that the objective should go beyond the consideration of recovery plans to explicitly mention impacts on potential growth by the sponsoring employer.

An updated version of the objective will be brought forward for Parliamentary scrutiny shortly, as part of the forthcoming Pensions Bill.

The Government believes that it is appropriate to make clear via a new objective the vital importance of economically viable and healthy sponsoring employers to defined benefit pension schemes. A new statutory objective would provide employers with reassurance that in these difficult economic times their position will be taken into account by the Regulator in undertaking its functions in relation to Part 3 of the 2004 Pensions Act (scheme funding). Supporting employers in this manner is in line with the Government’s wider objective to support economic private-sector led growth.

The new objective would build on the Pensions Regulator’s existing Code of Practice, including considerations of the effect of scheme funding decisions on the pension scheme, the risk to the Pension Protection Fund and impact on the sponsoring employer.

The Government notes the concerns raised by members and trustees in respect of a new employer-related objective. The Regulator’s existing objectives, including those to protect the benefits of members and the Pension Protection Fund, remain fully in place.

The Government also appreciates the concerns of those respondents who feel that there is a need for an objective “to promote good pension provision and to ensure the health and longevity of pensions”. The Regulator’s existing objectives mean that it already seeks to promote good scheme administration and to protect members’ benefits. The new objective will also ensure that impacts on the employer are now recognised explicitly by the Regulator in undertaking its funding-related functions. The Government believes that these objectives, combined with the Government’s wider strategy to reinvigorate work-based pensions, for example, by reducing red-tape and the introduction of auto-enrolment, will improve opportunities for current and future generations to save for retirement via work-based schemes.

Smoothing assets and liabilities when setting the discount rate

The Government asked: whether legislation to explicitly allow the ‘smoothing’ of asset values and liabilities in funding valuations (i.e. averaging asset prices and discount rates over a longer period of time, instead of using current market spot rates) is necessary in order to counter the effects of the current economic situation.

Respondents’ comments

Of the 99 responses, only 11% of respondents felt that smoothing was appropriate, while 85% were opposed; the remainder were neutral.

There was a strong feeling that the current legislation provides sufficient flexibility in setting the discount rate, although in practice many schemes took an overly-prudent approach. Many respondents cited a widespread belief that the Regulator has in the past appeared to encourage a gilts-based approach, even though legislation provides flexibility in this matter.

Nevertheless the majority of respondents felt that smoothing was not the answer. They feared that entrenching smoothing in legislation risked unintended consequences, as one respondent put it by prolonging “the pain of low discount rates should yields rise”. Another thought that it could further complicate already complicated negotiations and generate extra expense; leading to less transparency and a loss of objectivity.

There was a clear view that the flexibilities within the existing legislation need to be reflected in practice:

- “… if [the Regulator] were to apply a more flexible reading on … the setting of discount rates … this would allow the degree of smoothing that we believe sponsors and trustees are seeking”;
- “… [the Regulator’s statements have] led many trustees, advisers and employers … [to overemphasise] …gilts based measures”;
- “… actuarial advice can … be a barrier to using flexibilities. Actuaries are advising … clients that … [the Regulator will take issue] … if they select a figure … different from the gilts-based rate…. Actuarial advice appears to favour the giving of consistent rather than tailored flexible advice based on professional judgement. A change in approach from [the Regulator] could encourage the actuarial profession to provide more flexible advice”.

Government response

The call for evidence did not reveal a strong case for changing legislation to permit smoothing, with the overwhelming majority of respondents against the proposals. Instead, respondents favoured greater use of existing flexibilities within the funding legislation. Many felt that this, combined with an employer-related objective for the Regulator, accompanied by an updated code of practice and funding statement, would deliver a proportionate response to the difficulties highlighted in the call for evidence.

The Government has listened to these concerns. It confirmed, in the Budget, that it will not be pursuing measures to allow asset and liability smoothing.

Next Steps

The Government would like to thank all the organisations who have offered their views and advice in response to this consultation.

Updated wording of the Regulator's new objective will be set-out in the forthcoming Pensions Bill which will be subject to Parliamentary scrutiny.

In addition, the Regulator will be consulting on revising its Code of Practice to reflect the new objective. Again, this revised code will be subject to Parliamentary scrutiny.

On the smoothing of assets and liabilities in scheme funding valuations, no further action is being taken as the responses to the call for evidence did not reveal a strong case for changing legislation to permit smoothing.

Annex A: Respondents to the consultation

Akzo Nobel Ltd	Allan Martin
Andrew McKinnon FIA	Anthony Stern
Aon Hewitt	ARC Benefits Ltd
Ashok Gupta	Association of Consulting Actuaries
Association of Electricity Supply Pensioners	Association of Member Nominated Trustees
Association of Pension Lawyers	Association of Professional Pensions Trustees
Atkin Trustees Limited	AXA UK Group Pension Scheme
Barclays Bank Barclays Pension Fund	Barnett Waddingham Actuaries and Consultants
Barnett Waddingham LLP	BBC
Biffa Pension Scheme Trustees	BlackRock
British Airways PLC	BT Group
BT Pension Scheme Management Limited	Buck Consultants
Cable and Wireless PLC	Capita
Cardano	CBI
Charity Finance Group (incl NCVO & NAVCA)	Charlton Frank
Co-operative Group	Deloittes
Derek Scott	Deutsche Bank
Diageo Pension Scheme	EDF Energy Generation and Supply Group
EDF Energy PLC	EEF
E.ON UK Trustees Ltd	Ernst & Young LLP
European Federation of Financial Analysts Societies (EFFAS)	FDR Limited Pension Scheme Trustee
Financial Reporting Council	First Actuarial LLP
Freshfields Bruckhaus Deringer LLP	GMB

Henry Lander	Hoover Candy Group
Hundred Group Pensions Committee	Hyams Robertson LLP
ICAS Pensions Committee	ICI Pension Fund
Insight Investments	Institute and Faculty of Actuaries
Iqbal Owadally	Jackal Advisory
JLT Benefit Solutions	John Ralfe Consulting
Kingfisher	KPMG LLP (UK)
Lane Clark & Peacock LLP	Law Debenture Pension Trust Corporation
Law Society of Scotland	Lincoln International Pensions Advisory Ltd
Little & Co Consultants	Lloyds Banking Group
Lloyds TSB Group No 1 Pension Scheme and the Lloyds TSB Group No 2 Pension Scheme	Long-term Practical Perspectives Ltd
Macfarlanes LLP	Mercer
Merchant Navy Officers Pension Fund (MNOPF) and Merchant Navy Ratings Fund (MNRPF)	Mott McDonald Group
NAPF	National Grid PLC
Nationwide	Nick Foster FIA
Northern Ireland Electricity Ltd	Paul Boyle
Pearl Group Staff Pension Scheme	Penfida Partners LLP
Pension Insurance Corporation	Pensions Trust
PGL Pension Scheme	Philip Spain
Philip Whittome	PMI
Pricewaterhouse Coopers	Progap Consulting
Prospect	P-Solve
Punter Southall Consulting Actuaries	Punter Southall Transaction Services
RBS Pension Trustee Ltd	Redington Ltd
Reed Smith	Rolls Royce Pension Fund
Ros Altman	Russell Investments Ltd

SA Brain & Company Limited Group Pension Scheme (& Crown Buckley Limited Pension Scheme and Stuart Price FIA.)	Sacker & Partners LLP
SAUL	Scott Bader Retirement Benefit Scheme
Shane Tedford	Smiths Group PLC
SPC	Squire Saunders LLP
Stagecoach Group PLC	Syngenta Ltd
Tandem Group	Tesco PlC
The Co-operative Group	The Law Debenture Pension Trust Corporation PLC
Thomas Cook Pension Plan	Towers Watson
TUC	TUI Pension Scheme
UK Power Networks Group	UK Power Networks Group of the Electricity Supply Pension Scheme
Unison	Unite Union
Universities and Colleges Employers Association	University and College Union
University of Bath	Universities Superannuation Scheme Ltd
Xafinity Consulting Ltd	Zurich