Pensions and Lifetime Savings Association

We need to talk about DB

From parliamentary inquiries into high-profile company collapses, crises in strategically important industries and detailed examinations of market failing in the provision of services, the past two years has seen the UK's £1.5 trillion defined benefit (DB) pension sector come under enormous scrutiny. Against this complex, and politically-charged backdrop the UK government has been exploring how to best secure the future of the 10.5 million members in private sector schemes and whether to 'stick or bust' with the existing framework.

In its white paper, published on the 19 March, the government has mostly decided to stick, stating its intention to focus on consumer protection, but to make no fundamental changes to the existing system – which has been in place since 2004, and proven to be relatively robust, but not perfect.

AS THE UK'S DEFINED BENEFIT SECTOR FACES INCREASING SCRUTINY, WHAT ARE THE CHALLENGES AND WHAT IS THE GOVERNMENT DOING ABOUT THEM?

Notwithstanding broad statements of intent, there is quite a lot happening beneath the surface in the proposals. In particular, to strengthen The Pension Regulator's powers, to amend the way in which the UK scheme funding regime operates, and to introduce new forms of commercial consolidation vehicles into the existing framework.

New powers for the regulator were always likely, as a result of Conservative Party Manifesto promises, but also the significant public outcry following the collapse of BHS, and the subsequent exposure of poor practice in Parliamentary inquiries.

The government has shied away from proposals for mandatory clearance of corporate transactions, instead choosing to create significant penalties, and criminal sanctions against company directors who 'recklessly' endanger their pension schemes. Combined with strengthened information-gathering powers, the regulator should have greater leverage to act, and be in a position to react more proactively than it has appeared, and been criticised for in the past.

Some of the big challenges facing the sector have been persistent scheme deficits, which have not been helped by wider macro-economic challenges, but that have also barely improved despite £400 billion of employer contributions over the past 10 years. An issue that becomes more important, as schemes mature, close to new accrual, and many head towards a cashflow negative period where they will potentially paying out more than they are getting in (via contributions or returns).

This will be addressed through a new DB funding code, to be consulted upon this year, and where we can expect a shift toward a more directive approach to funding levels, and added focus and pressure put on trustees, schemes and their sponsors to articulate their long-term strategy. This will include identifying whether they intend, for example, to target running on, seeking to buyout or to consolidate (potentially with one of the new commercial providers). Alongside this, the continued ratcheting up of the focus on scheme governance will continue, and be supplemented by a DB Chair's Statement – reporting how effectively the fund is run.

Perhaps the biggest change to the status quo is the proposed introduction of commercial consolidators in the occupational pensions framework. Vehicles, or superfunds, that would consolidate DB schemes under pensions legislation and provide a new option to funds at circa 85 per cent the cost of insured buyout. A model explored in some depth by the PLSA's DB Taskforce in two reports last year – and where, post the publication of the White Paper some industry providers have already expressed an interest in creating similar models.

It is important to note however, that there won't be any legislative changes coming soon. The government timetable is already booked up, mostly, and understandably with Brexit – and as a result we won't see a pensions bill until 2019 at the earliest, with legislation following in 2020.

That feels some time away, given the backdrop we are in now, and how quickly things can change, but the lack of immediacy does however give DWP and the wider industry time to consider and consult properly before introducing any significant changes. With the white paper committing the government and regulator to significant programmes of work this year, we should expect that process to begin in earnest in the months ahead. ■

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