

Work and Pensions Committee

Oral evidence: Defined benefit pension schemes, HC 1218

Wednesday 18 October 2023

Ordered by the House of Commons to be published on 18 October 2023.

Watch the meeting

Members present: Sir Stephen Timms (Chair); Debbie Abrahams; David Linden; Steve McCabe; Nigel Mills; Selaine Saxby; Dr Ben Spencer; Sir Desmond Swayne.

Questions 91 - 152

Witnesses

I: David Carson, Member of Steering Committee, Hewlett Packard Pension Association; Nick Coleman, Co-founder, BP Pensioner Group; and Robert Smith, Treasurer, Royal Ordnance Pensioners' Association.

II: Leonard Bowman, Partner and Head of Corporate DB Endgame Strategy, Hymans Robertson; Steve Hitchiner, President, Society of Pension Professionals; Harus Rai, Chair, Association of Professional Pension Trustees; and Janice Turner, Co-founding Chair, Association of Member Nominated Trustees.

Written evidence from witnesses:

[DBP0034 Treasurer, Royal Ordnance Pensioners' Association](#)

[DBP0080 BP Pensioner Group](#)

[DBP0029 Hewlett Packard Pension Association](#)

[DBP0039 Association of Professional Pension Trustees;](#)

[DBP0043 Society of Pension Professionals](#)

[DBP0045 Hymans Robertson.](#)

Examination of witnesses

Witnesses: David Carson, Nick Coleman and Robert Smith.

Q91 **Chair:** Welcome, everybody, to this meeting of the Work and Pensions Select Committee in our inquiry on defined benefit pension schemes. A very warm welcome to the three participants in our first panel. Can I ask each of you very briefly to tell us who you are, starting with Robert Smith?

Robert Smith: I am a Committee Member of the Royal Ordnance Pensioners' Association. That association tries to look out for the interests of two schemes, a main, pretty large scheme and a smaller senior staff scheme.

Nick Coleman: Good morning. Thank you for inviting us. I am an ex-BP employee and I am a BP pensioner. With a few others, I formed a group of pensioners six months ago that has now reached about 2,500, and growing at about 100 a week.

David Carson: I am a member of the Hewlett-Packard Pension Association.

Q92 **Chair:** Thank you all. Can I ask each of you, first of all, to outline for us the situation of the schemes that you have just referred to and the concerns you have about how those schemes are being run? Also tell us whether you think the particular concerns you have about those schemes are unique to your scheme, or whether they are of more general interest.

Robert Smith: The particular concern that we have fundamentally is around the senior staff scheme, which two years ago was put under the custody of a sole trustee. That obviously surprised and upset the members at the time because it was not, frankly, something that we expected to happen.

As to your question about the broader application of that, once this happened we started to read published material and understand the whole scenario around sole trustees. We found that the number of schemes being put into sole trusteeship is growing, and it is growing quite rapidly. I think it is up to about 14% of the DB population now, and expectations are that at the current rate of growth that could get to 28% to 30% within five years.

The key issue for us with a sole trustee is that it does away with the requirement for member-nominated trustees. If you remember, that was a requirement that was introduced in the 1995 Pension Act following Mr Maxwell, etc. Clearly, if you have a sole trustee on that level, you understand that you cannot have more than one trustee. Obviously, it removes all member input, member visibility and transparency from the scheme, and arguably reduces the diversity of decision making and so on.



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Q93 **Chair:** Do you think members have, in the past two years, been disadvantaged as a result of that change, or is it more what might happen in the future that you are worried about?

Robert Smith: I do not think we can say. We have been in there two years and I think we will only know if we are disadvantaged if and when there is a large decision to be taken, and perhaps that decision does not go the way we might expect it to. No, up to now it has just caused upset, concern and worry, but we can all live with that.

Q94 **Chair:** Thank you very much. Mr Coleman.

Nick Coleman: The situation with the BP Pension Fund is that it is extraordinarily well off. It has £20 billion worth of assets, a £6 billion accounting surplus, 60,000 members and an average pension of £18,000 a year. The position is that for decades the pension fund has always met the deal struck with employees when they were hired, paying pension rises in line with inflation. That all stopped suddenly two years ago. For the last two years—

Q95 **Chair:** How many years ago did that stop?

Nick Coleman: In the last two pension rise cycles, one 18 months ago and one six months ago. On both those occasions, the linking to inflation stopped. It is quite shocking. After many different excuses from BP as to why it was doing that, we are forced to conclude that the reason that BP is doing that was to get the fund off its books.

In brief, there was one world up until the scheme was closed and they stopped taking on new members, and it may be the same for thousands of other pension schemes in the country, DB schemes. There was one world in which everything was in balance, with alignment of interests between the company, the employees, the pensioners and the fund. That seemed to stop about a year or two ago when the scheme was shut to new members and new accruals.

We think that the scheme, in BP's eyes, has changed from one in which it is part of that compact to one in which it is something to be got rid of, to get the fund off the books, and get it off the books in the way that incurred the least cost. I think the word "de-risking" is being used. The first thing you do is you remove the linking to inflation because it will be cheaper to sell it that way. By the way, the more you do that, the more the surplus increases and the more BP can lay claim to the surplus. That is just a dispute between BP and its pensioners.

Q96 **Chair:** What was the increase that was awarded in those two?

Nick Coleman: Since 1990, the BP scheme has had within the deeds and rules that it would track inflation, RPI in this case, but any pension rise above 5% required the consent of the company. There was guaranteed tracking of inflation up to 5%, and then above that required the consent of the company. BP has never withheld consent. Eighteen months ago it



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withheld consent. Inflation was 7.5%; the pensioners got 5%. Six months ago inflation was 13.4%; the pensioners got 5%.

Why did we write to you? This is just a dispute between a company and its pensioners, albeit a very large company and a blue chip. We wrote to you because we started to spot this coming from other companies too. We suggest that what is going on with BP might be an exemplar of what is going on elsewhere and, potentially, a blueprint for numerous other companies who are thinking, "How do we get out of our pension scheme now?"

In three particular respects, we think that this matters to others. First, it has exposed some sort of unseemly grab for the surplus. You have had many people in these seats, I think, explaining how they should have the surplus. I understand that the sum of the accounting surpluses of all the UK DB schemes is at about £440 billion at the moment. That is an enormous prize for someone. Secondly, we have seen that in this shift from the old world to the new world pension scheme, trustees are coming into quite unique and new conflicts of interest. Thirdly, we find that pensioners are impotent in this process and this transition that we are going through. We are just sitting there and watching this being sorted out behind closed doors.

If this can happen with a blue chip, number five on the FTSE, a company like BP of an enormous scale and enormous wealth, why would it not happen to hundreds of other companies? Indeed, Shell is now in lockstep with BP, we know.

Q97 **Chair:** Thank you very much. Mr Carson.

David Carson: I put a lot of detailed evidence in the written report. If I had to try and summarise it, the key issue for us is the lack of discretionary increases that we have had over the last 20 years. In our particular scheme, our discretionary increases for pre-1997 service have come to 5% over 20 years. You can imagine the impact that has on a pensioner who has been retired for a long time. Their pensions are effectively heading towards zero, in buying power, compared to when they retired.

The main issue, I believe, and what we would like to see the Select Committee try to influence, is to find a way to improve the collaboration between companies and trustees, especially when the company has sole discretionary power on discretionary increases.

Sorry, just one other thing I want to add. This applies not only to our company, this is a national issue, and I have tried to highlight that. Only two days ago we were contacted by another American company. I cannot say that fully, I do not know all the facts and it is hard to find out how many pensioners are in the same situation as us, but there are three or four other pension groups that have got in touch with us to say this is an issue for them as well.



Q98 **Chair:** Can you tell us which companies?

David Carson: Yes. Amex is one company that contacted us. FOSPEN is another pension group, Foster Wheeler, I believe. There was an American oil company; the name has gone out of my head but I can send that to you after the session. There are a number of companies. I believe that if you look at the stats in the Purple Book and if you did an analysis of maybe the top 200 pension schemes in size, that would give you a good insight into what is happening across the country.

Q99 **Nigel Mills:** I just want to ask what your views and your experiences are on trustees. We have a situation where trustees are meant to act in the interests of members and clearly be distinct from the company sponsor. Do you think that model works? Would you like to see changes to it?

Robert Smith: All trustees, of course, whether they be company-nominated or member-nominated, are required to act in the best interests of the members. Speaking only from my own experience, that has been my experience. That is what has happened. I have never felt uncomfortable in a meeting. Now, maybe we have been fortunate in that regard, I do not know. Maybe we have not come up against the issues that might provoke that sort of difficulty, but we have not experienced that difficulty.

The big problem with being an MNT is it takes a lot of time, a lot of hard work, and you need to accumulate expertise. Obviously, you have advisors, which are an enormous help, be they investment or whatever.

For me, the most difficult thing about being an MNT was that "acting in the best interests of members" is a very simple phrase, but in practice it is quite difficult to evaluate. You have to think of all the members, not sectionally. You have to think long term rather than short term. Around investment and these sort of things, which is the right way to go? Is that going to be in the best interests of the members? It is, in practice, quite complex. That is the part that I found most difficult. I hope I made a good job of it, but that is the part that made it difficult to be an MNT.

Q100 **Nigel Mills:** We have spent probably years gradually tightening the screw as the regulator limits trustees' discretion, and we now appear to be heading towards wanting one or more professional trustees on every board of trustees. Do you think that makes sense? Do you think lay or member-nominated trustees who do not have any kind of specialist knowledge bring something useful to the table that is worth keeping, or are we better off to have this tightly restricted and all done by very clever specialists?

Robert Smith: Again, just in my own experience, we did not have an independent trustee on the senior staff scheme but the chair of our main scheme is an independent trustee. I would certainly fully recognise that you need more expertise within the body of the board. I imagine you build up a mix of lay trustees and independent, professionally qualified trustees to get what that scheme needs at that particular time.



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My issue with a sole trustee, of course, is that in some ways we are going back to pre-1995, are we not? It is not a board of trustees but the company has the right under the rules of the scheme—and, I understand, many schemes—to have sole discretion to appoint a trustee. It is quite common. Now they have chosen to appoint an independent trustee, but as I said earlier, it wipes away all involvement of MNTs. I obviously think that MNTs have a part to play and no doubt you will hear that from the Association later.

I do not know if that answered your question, but that is where my head is.

Q101 **Nigel Mills:** It did. Nick, any views on that?

Nick Coleman: We were first alerted to the issue of conflicts of interest within the trustees, as I mentioned earlier, when, 18 months ago, the expected RPI-based increase did not occur. By the way, over the two—with the numbers I gave you, Sir Stephen, earlier—the whole future income of 60,000 trustees on £18,000 average has dropped by 11%. For many, many people, that is big.

We were alerted to that because a few pensioners wrote to the trustees and said, “What is this 5% thing?” and the answer they got back was that the trustees contacted the sponsor company, BP, and said, “Inflation is at 7.5%, would you be minded to approve an extra 2.5%?” The message they seemed to get back was, “Do not even ask”. The trustees then did not even propose it.

Much the same happened a year later, where the trustees were, in our case, intensely embarrassed, we suspect, and felt that they really ought to get something with 13.4% inflation going on. They seemed to reach some arrangement with BP that they would give everyone 9%. Then come March, suddenly that disappeared. It sounds like BP made a U-turn and said, “No”. You put that together with these conversations going on with the sponsor company and the trustees about saying, “What should they do? Should they even ask?” It does not sound very independent.

We started to look at the composition of, in our case, our trustee board. About three or four years ago we had four member-nominated directors plus the chairman, and they had 13 years’ experience. They all actually had meat in the game. They had pensions, or they were members of the scheme but were not yet drawing on their employers. They have all gone.

We now have four new company-nominated directors. They are inexperienced. If we are moving towards a buyout—we think we are heading that way—do they regard this as a temporary assignment, part-time at the best of times? Of course, like many trustees in many companies, they are paid according to the success of the parent company. They do not have pension. They are not members of the fund.



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We began to think about what has shifted in terms of motivations. I am sure that in everything our trustees have done, they are scrupulous in complying with the law. I am sure they are completely correct. However, we started to see a few other things.

I will not go into any depth but, for example, in normal due diligence we checked the pension fund company's annual returns to Companies House the other day and found that for the first time ever, they had added some words saying the duty of the directors, among the normal things you would expect, was also to maximise BP's long-term shareholder value. We found this astonishing. You started your question with, "Is the duty of the trustees not clear and simple? it is for the benefit of the members". We found this in the Companies House submission. We thought maybe it was a mistake. It struck us as another example of the conflicts going on. Remember that, of course, BP is the sole shareholder in the fund as a company.

I already had notes about our wish list on this. Our point is that in this new world, where thousands of DB funds could be surging towards realising the surplus, terminating the fund and transferring them to the insurance industry, you suddenly have these new conflicts arising where the parent company, the sponsor company, wants to get out maximum financial return. The trustees have to serve the beneficiaries. They are in a very difficult position, with conflicts of interest that are unprecedented.

We are saying that the solution here is to somehow reinforce the requirement that trustee boards are demonstrably and fully independent. For example, the majority of members should be demonstrably independent rather than, in our case, the majority being company employees.

They also need to be expert. Some of them have only been hired by BP two years ago and they are now trustees of the Pension Fund. They know very little about pensions, whereas they replaced people with 12 years' experience. Expertise is a very big deal.

The last point is that it would be very good to require the chair to be independent. Our chair was a BP Main Board non-executive director for 10 years or something.

Q102 **Nigel Mills:** Your contention is that the BP pension scheme could have paid you an inflation rise without having to make a call on BP, that there is a sufficient surplus in the scheme to have paid it?

Nick Coleman: That is correct. It was within its financial capacity to have paid the scheme's rise. The rules of the fund for the last decades were that they would pay, or they told employees that when they were recruited. When you are recruited by a company, you go to HR, they give you the employment contract and they say, "And by the way, here is the pension brochure". If any employee says, "This salary is not really market rate", they say, "I know, but you get the pension".



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I will get back to your point in a minute, but we know that when BP shut the scheme and transferred existing employees out of the scheme to the alternatives, they raised everyone's salary 20%. That means that the employees in general had been paid 20% less over decades because BP was putting that money into their pension fund.

Q103 **Nigel Mills:** David, anything?

David Carson: Remind me again, your original question was around the role and effectiveness of member-nominated trustees?

Nigel Mills: Trustees in general.

David Carson: It is around trustee effectiveness and it then begs the question: how exactly do you measure? How would you decide you have a high-performing board? From my perspective, it is the success and effectiveness of the plan and the positive outcomes delivered to members.

If I take that factual position and I look at our plan as an example, I do not want to contrast with BP because there is only one year with no discretionary increase, as an example, and in 20 years we have only had 5% discretionary increases. What is the cause of that problem? It is a very complex problem to fix. The trustees are put in between a rock and a hard place, especially when they have very limited power and the company has sole discretionary power.

There are two things. On the issue of a member-nominated trustees, you have Janice Turner from the Association of Member Nominated Trustees speaking later on and the Association would say it is a responsible role that encourages a diverse and different perspective, ensuring that members' voice is heard. For that to happen, you need some kind of engagement with members to know what their voice is and what their issues are. In our particular case—I cannot speak for other companies—that gap is filled by an organisation like us, which is having to campaign for a particular issue.

On member effectiveness, I think it is the mindset of the employees and how they interpret their role. Yes, they have a fiduciary duty to members. They have absolutely no fiduciary responsibility to the company. Making that separation, I think, can be very difficult for them to execute on a year-by-year basis.

Q104 **Nigel Mills:** Finally, could the scheme you are a member of afford to pay these discretionary rises, or do they need money from the sponsor to do that?

David Carson: Within our particular scheme, whenever a decision is made, the company has to put the money upfront at that point in time. In 2022 we had a surplus. The 3% increase we got in 2022 came out of the surplus with no contribution from the company. That is my understanding. We had the LDI crisis, we lost £1.5 billion across the two



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schemes in our fund and we went to a deficit. That is going to make it a more bleak future. The 2021 Act says that trustees have to develop a strategy for pensions and other benefits. That means collaboration between the company to come up with a strategy for discretionary increases.

Q105 **Debbie Abrahams:** Good morning everyone. I want to start with Mr Smith, if I may. I understand that the Royal Ordinance Senior Staff Pension Scheme now has a sole trustee.

Robert Smith: Yes.

Debbie Abrahams: Could you tell us a little bit about how that came about and what you think the benefits and pitfalls of that are?

Robert Smith: From the perspective of the members, it came about through receiving the letter from the company that said that a sole trustee had been appointed. That letter also contained a statement from the outgoing trustees and the incoming sole trustee. That is how it came about. From a member perspective, we had no notice or otherwise warning of that situation.

Q106 **Debbie Abrahams:** This came completely out of the blue to yourselves?

Robert Smith: Yes.

Debbie Abrahams: It must have been an awful shock.

Robert Smith: Yes. We did not expect it because—and the company acknowledged this in the letter—the scheme had been well run. It complimented the previous board, if you will, on the results that they achieved for the scheme. It is in a strong position, it had been able to do a buyout, and so from our point of view it was a surprise.

That said, in the rules the company has done absolutely nothing wrong. It has the power to do what it has done and it is not required to inform, consult or otherwise notify anyone of its intentions. That is something we would probably like to see changed.

As we said in our submission, we think there are a whole raft of issues around the question of sole trusteeship. When you put them all together you start to think we need to look at these in the round, because, as I said earlier, a relatively large number of schemes are going into this situation.

Q107 **Debbie Abrahams:** Not everybody will have read your submission. Could you tell me what the three main issues of having a sole trustee are?

Robert Smith: The first one—it is often quoted and it is, to be honest, the first one that exercised our member's minds—was: can a sole trustee, selected and appointed by the company, be truly independent?

David Fairs at the TPR two or three years ago was alive to at least one aspect of that, and that is: can a sole trustee offer sufficiently robust



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challenge in discussions they have with the company, be it about valuations, recovery plans, going to a buy-in or whatever? There was an expressed intention to look into that. I know Covid intervened for all of us but I am not aware that the regulator has done a lot of work in that area. It does acknowledge in its paperwork that the appointment of a sole trustee has potential risks for the members. It does not articulate what it thinks those risks are.

There are so many, really. There is a lot of consolidation going on in the sole trustee industry and you do worry that in the end we will have a small number of firms, maybe with a 'one size fits all' approach, I do not know, but there is a lot of consolidation. There have been instances of sole trustee groups being bought by asset management businesses, and you think, "What is that about?" But the other big one for the members, obviously, is that we lose all visibility. We have no say and no voice in any decision taken by the trustee.

Q108 Debbie Abrahams: There is a transparency issue as well?

Robert Smith: Yes. The trustee can make decisions, and we will learn about those decisions when we get the report and accounts, which is seven months after the end of the financial year. He is not obliged to say anything to the members under current legislation. That is why we feel the loss of the MNTs, who were, certainly in our tiny scheme, personally known and trusted by the members. Obviously, they have lost that.

Q109 Debbie Abrahams: Are there any circumstances when you think it is justifiable for a sole trustee? What are those circumstances?

Robert Smith: Yes, there are. The most obvious one is if you simply cannot get enough MNTs to fill the quota, which is a minimum of a third. I know there are problems with getting MNTs, and indeed, the number of MNTs in the system has dropped by about a half in five years. Now, that is not all down to sole trustees; lots of other things are going on in there. If a scheme cannot get the MNTs to meet the quota, then there is no choice if they exhausted all avenues. That is one example.

Sole trustee companies will tell you they can be more agile and they can be more expert. Circumstances alter cases. It depends on the size of the scheme and the sort of technical issues they are currently dealing with. The trustees of our scheme, with advice—and you have a lot of advice—negotiated a buy-in and I do not feel that an independent trustee or a sole trustee generally would have done it any better. I would say that, would I not? I think it is horses for courses.

Debbie Abrahams: That is very helpful. I do not know if anybody else wants to add to that. Thank you so much.

Q110 Selaine Saxby: Thank you. Good morning. David, my questions are coming to you. What impact does non-indexation of pre-1997 benefits have on scheme members?

David Carson: I had a diagram in my submission to you. It was an iceberg diagram. There is obviously the financial impact of non-



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indexation. For the majority of our members all of their service is pre-1997, so they will see a decline in the buying power of their pension over time. For older members who have been retired for a while, their buying power is now approaching close to zero with the current rates of inflation. We have feedback from members that they are relying on help from their families, and some of them are now having to take Government support to keep themselves in a reasonable—well, to survive, basically. There is also the non-financial impact which it has on their mental health.

My submission had an iceberg diagram that reflected statements from our members. They just do not have a life in many cases. They have stress, frustration, their health is beginning to deteriorate and their mental faculties, and they really struggle to cope. For some of them, the fear is: how will their spouse survive on a much reduced pension that has not grown over time?

Q111 Selaine Saxby: Thank you. What changes to indexation, if any, do you think would be fair to scheme members and sponsoring employees? What mechanism, maybe guidance or legislation, would be needed to introduce these changes?

David Carson: That is not an easy one to answer. In the old days people said, "We want full RPI indexation". Very few companies do that and it is hard to issue. I make a comparison in my report with us at one extreme, 5% over 20 years. For people like me, who are recently retired, that is the future that faces me and all the other people who are at my age of retirement, heading to retirement, the 50% or 40% who are deferred.

How would you do it? I make the comparison to IBM. IBM, since 2006, has been giving 50% of RPI for pre-1997 service; our company, effectively zero. In terms of other companies, it is hard to find out what actually happens in the industry.

This is why we are putting forward the need for a code of ethical practice that says companies and trustees have to work out what they can do and what is affordable, which does not create risk for the company but gives a sustainable income for pensioners. I am not advocating that you have to make a legislation that says it must be a figure. That would be ideal, if you could influence that, but in the absence of that happening, you have to find a middle ground that says, "Companies, you cannot refuse not to collaborate. You have to work together to agree a strategy". That is what the Pensions 2021 Amendment says: trustees agree a strategy for pensions and other benefits. For me, that means discretionary benefits.

Q112 Selaine Saxby: In the absence of getting to that point, how effective do you think a voluntary solution could be, given that employers could take a collaborative approach now?

David Carson: A voluntary solution might become a bit more effective if you put a spotlight on how these companies are operating and behaving. I have said in my report that DWP and TPR have absolutely no idea how these companies are giving discretionary increases to pensions for pre-



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1997 service. You do not collect that data. I think if you started collecting that data you would form a view that says, "We have valuable information and we can now craft and shape legislation that creates better corporate citizenship behaviour". Without you putting in formal legislation, that may have an impact. Does that answer the question?

Selaine Saxby: It does, thank you very much.

Q113 **Dr Ben Spencer:** Thank you, David, that was a really interesting answer to Selaine's questions. Presumably we would have to put something in legislation to force the data collection to happen, because if there is going to be a collaborative barrier, companies are going to be resistant to sharing the information on this. We have had information from all the panel where there has been overall concern about two-way flow of information in terms of decisions that have been made.

David Carson: I would ask: why would you have to put in legislation for the TPR and DWP to collect this data? I believe they have things called annual returns today where information is given. I put in an FOI request to the TPR a couple of years ago asking for information on discretionary increases for pre-1997 service. The Purple Book already tells you that 78% give indexation of a whole range of different types, and 22% do not. There is a gap. I believe you do not need legislation. You could ask for them, I believe, to start collecting that data and that would give you valuable information to inform maybe what you put in your final report. Have I answered that question or is there something else to it?

Dr Ben Spencer: That is really helpful. Thank you for clarifying.

Q114 **Chair:** Can I just pick up one point? You made the point that, as a relatively recent retiree, this could be the future that faces you. But post-1997—

David Carson: Ninety-eight percent of my service in this particular plan is pre-1997. There will be many people like me, having left that company. I know from our member feedback that not many of them found the same kind of good jobs in the IT and electronics industry. What happened to them afterwards will be very different to every member, but for the majority of people in this particular scheme, all their service is pre-1997. Whatever happens outside of that, I think, is immaterial to how they are being treated within this particular plan.

Chair: Yes, that is clear. Thank you.

Q115 **Sir Desmond Swayne:** I was going to ask Mr Coleman why he thought that buyout might be a concern to members, but I think you have given us a pretty good taster of that already in what you have said. Is there anything you would like to add on that score?

Nick Coleman: To make it plain, we have nothing against buyouts. They could be great. They could be disastrous for the pensioners. It is all to do with the terms and conditions of the buyout.



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There are going to be hundreds of details in a buyout arrangement—we are not pension professionals—but the biggest one could be: is the buyout saying, “You will take over the pension scheme and, by the way, you will never have to pay more than 3% or 5%”, or does it say, “By the way, you are going to have to pay what the pensioners have been led to expect in their literature and so on for decades”, ie inflation? That would be an enormous difference. It would not be in the terms and conditions, it would be in the details.

If the buyout will honour what the pensioners have been led to expect in the last decades, buyout could be great. It could be better than the sponsor company because it may perhaps have more security, although BP is pretty secure. However, if it was the other one, that would be awful. Of course, that negotiation takes place behind closed doors.

Q116 Sir Desmond Swayne: What about the trustees? Is that not what the trustees are for, to represent your interests?

Nick Coleman: Of course. Absolutely. The way it works in our instance is BP takes a Main Board decision to exit the fund, wind up the fund. The message is sent to the trustees, “Wind up the fund via a buyout”, and it is the trustees’ job to do it. That negotiation, between the trustees and the insurance companies, is completely behind closed doors. We will never know the answer until it comes out.

Q117 Sir Desmond Swayne: What will happen to the surplus? Is that not, in a sense, the surplus of the members?

Nick Coleman: Absolutely. This is where it comes to the crunch. Just back up a second here. Where did the surplus come from? What is it? The surplus is merely the total of the assets that have been built up over decades, minus the liabilities measured on the day. You have many accounting versions of surplus every day and they change. The total asset base came from the company saying to new employees, “We will feed the pension fund such that it can give you an inflation-linked pension by so many hundred million a year, we will take holidays when it is doing well and we will feed it when it is short, and the employees will put their own money in through AVCs and so on”. The total of the asset value of the fund belongs to the pensioners. Fine, that is OK.

Now, when the music stops and that accounting surplus becomes a real surplus because the buyout’s occurred and billions of pounds are being handed over to an insurance company to take on the liabilities of paying the pensions, how much money is left on the table? At the moment, in BP’s example, there will be £3 billion left on the table because they tell us what the buyout surplus is. That £3 billion probably assumes that the deal will be not inflation-linked, it will be 5% max. The question then becomes who owns that £3 billion.

Now I do not think the pensioners are saying, “Give me the £3 billion because we put all the money in in the first place as deferred pay or as AVCs”. That is not fair because it could be that on the day, actually, the



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markets are in great shape and BP had perhaps temporarily over-helped the fund. But, on the other hand, it is completely unfair for the sponsor company to say, "That is all mine".

Now, the devil is in the detail of the deed and the rules, and in BP's case it says that when you get to that surplus, the trustees can choose whether to use that surplus to improve the benefits of the beneficiaries because it is their money. It does not say that bit. It could be the trustees could use that to say, "We will bump you back up to RPI", or, "We will pay more to the insurance company so that they can give you what you were led to expect".

However, in the BP deed and rules it says that the trustees cannot decide that because BP has to agree it. BP can veto that decision. BP is an enormous company but the prospect of £3 billion lying on the table if a tight deal can be done on the sell-off in a buyout, that matters. That is a serious amount of money to try to pocket, at the disbenefit to the pensioners who earned it in the first place.

That is just the BP exemplar, this blueprint I talked about earlier. There is £440 billion of accounting surplus sitting out there. This is going to be a feeding frenzy in the financial markets over the next 10 years, everyone wanting a bit of this.

David Carson: Can I say something on that? I would be against a buyout. Our position, which we have said to our trustees, is that we would resist a buyout. Every scheme will be different. In our particular case, if a buyout does not deal with the discretionary increase, then the responsibility to members has been abdicated. You need to find a solution because as soon as a buyout takes place, then the possibility of influence and future discretionary increases will never happen. You even have a head of actuaries saying trustees need to tread very carefully in this particular area.

The issue of surplus is a tricky one because company and members have contributed. I believe, Sir Stephen, you participated in a recent seminar with Sir Steve Webb and they did a survey. Some of the money should go back to members, some of it should go back to the company who contributed, and some of it should go to DC schemes. It is very complex. For my children, I would say, "Yes, if there is a lot of surplus in the pensions world, make sure it is appropriately and evenly spread to be equitable and fair, for both current people and the younger generation". It is not an easy answer, but in our particular scheme we would resist a buyout unless that problem is fixed.

Q118 **Chair:** Thank you. Mr Coleman, a final point.

Nick Coleman: Sorry to interrupt you. I am watching the clock too. Can I give you a wish list at this point?

Chair: Briefly, if you would.

Nick Coleman: I will be brief. We are clearly very worried about the surpluses being sequestered, and we are very worried about this change



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in the world from the old sort of pension to the new sort of pensions, and the challenges to conflicts of interest that suddenly become enormous. If we had a wish list of three things that could occur, and I suppose this is a wish list on behalf of—I am presumptuous—9 million pensioners who are in DB schemes, there are three things.

One is to reinforce the requirement that trustee boards are demonstrably independent and expert. If ever it matters, it matters now.

Secondly, that when we come to the surplus, the split of the money is fair. If there is a surplus, if we are in a period of high surpluses, it should be equitable. We found, and it may be the same in other cases, that the deeds and rules do not go into how to make that distribution demonstrably, transparently fair.

Thirdly—and this is a new one—at the point of buyout, we are suggesting it could help the financial markets, and it could be an open and new thing, if all of the members who are subject to the buyout had the choice about whether to go along with the buyout or whether to transfer their share of the fund into an alternative pension arrangement, an annuity somewhere.

This is exactly the same choice they had at the last seminal major point in their pensions when, at the point of leaving the company, for 30 days they could decide whether to go with the flow of the company pension scheme or retrieve their share of the assets and take them to another provider in a tax-free flip. If that option were offered to members of the pension scheme at the point of buyout, it could have an enlivening effect on them and would give them more control. It could help the markets. It could have many benefits.

Q119 **Chair:** Thank you.

David Carson: May I speak quickly on that subject?

Chair: Very quickly, if you would.

David Carson: I think the thinking is changing around buyouts through the Mansion House reforms. Certain companies will now be looking at this idea of sharing surpluses and so on, and taking more risk approaches. It is something that might change attitudes over the near future.

Chair: Thank all of you very much for the very interesting information and perspective you have given us. It is very helpful for our work. One or two points came up that I think you were going to send us details of subsequently, so please do, or if anything else occurs to you, do please email it through and we will be very interested to hear further from you. Thank you all very much, and we would ask you now if you would step down so that the next panel can take their seats. Thank you very much indeed.

Examination of witnesses

Witnesses: Leonard Bowman, Steve Hitchiner, Harus Rai and Janice Turner.

Q120 **Chair:** A warm welcome to all of you. Thank you. I think you have all been listening to the first session, so thank you for joining us early. Can I start by asking, as I did with the earlier panel, each of you just to tell us very briefly who you are, starting with Steve Hitchiner?

Steve Hitchiner: I am the President of the Society of Pension Professionals. We represent a full range of those providing advice and services to pension schemes. I will not do the full list, it is quite long, but for the context of this discussion, it is important to note that we represent actuaries and consultants as well as investment managers, those providing consolidators, and insurers, so really the full remit of advisers.

I think it is important to add that my own background is providing actuary advice to trustees in defined benefit schemes, but I am here to represent the SPP and not the views of my firm. It is important to make that clear.

Harus Rai: Good morning and thank you for inviting me. I am the managing director of Capital Cranfield, which is an independent professional trustee firm. I am also the chair of the Association of Professional Pension Trustees, which is a representative voice of over 450 accredited professional pension trustees here in the UK.

Janice Turner: I am a member-nominated trustee of a small pension scheme. I am also the founding co-chair of the Association of Member Nominated Trustees, which was set up in 2010 and currently has about 800 members who are all member nominated trustees.

Leonard Bowman: I am an actuary and partner at Hymans Robertson. I head up our corporate advisory team to the private sector, so I advise companies on their DB arrangement, strategy and future retirement provision.

Q121 **Chair:** Thank you all very much for joining us. Can I put my question to you? It is a year now since the LDI debacle. What do you see now as the main challenges and opportunities for DB schemes that trustees need to be alert to, and do you think the right lessons have been learned from what happened with LDI?

Steve Hitchiner: To answer your question, first of all, I think lessons have been learned from the LDI crisis. It is easy to do that once a risk has already transpired, of course, but now resilience has generally improved, collateral is much better. Schemes are much better placed to tolerate the risks that the LDI crisis presented.

In terms of where we are, and the horizon and the main challenges, the other thing that happened alongside the LDI crisis is that funding levels improved considerably because of the rises in interest rates, but also off the back of 2021, which had seen some excellent investment



performance too. Schemes are in a much, much better financial position than they have been for a very, very long time. This means that schemes are approaching the bulk annuity buy-out market in record numbers. Schemes are looking to secure their liabilities with insurers, which is a good place to be in comparison to where we were a little time ago, where we were battling with deficits and poorly funded schemes.

Transferring defined benefit liabilities is very complex. It is very difficult to get the complexities across in a forum such as this, but it is a very time-consuming act. It takes many, many years and it is very complicated to do. On the whole, the bulk annuity market is functioning very well, that process is operating well and members' benefits are being secured in a good and correct fashion.

One point I would make on this topic—and this is something I will come back to, perhaps, in some of the answers to other questions—is that the DB landscape is extremely diverse. Generalisations are quite dangerous and it is difficult not to make generalisations when responding to your questions. Most schemes are now very well funded, but not all. There are some poorly funded schemes out there. Most schemes are very resilient to the kind of risks that we saw in the LDI crisis, but not all. Most schemes are closed and trying to secure their liabilities with insurers, but not all. I think it is really important to bear that in mind and not to make generalisations.

The market is very big, it is very diverse and there are large numbers of schemes falling into niche groups, but on the whole, you are looking at a lot of closed funds, very well funded, approaching the insurance market in record numbers and looking to secure their members' liabilities.

Q122 **Chair:** Thank you. Harus Rai?

Harus Rai: I would agree with everything that Steve has said. Just to add a couple of points on the collateral issue, what we saw was the Bank of England testing around about 100 basis points, and that was not sufficient because of the sheer speed of the crisis that we had last September or October. Schemes are now looking at testing to around about 300 basis points, and some schemes are going further than that.

Trustees are also looking across their investment portfolios, in terms of their strategies, to see where best to invest the funds should something happen again. There are always rises and falls in gilts. What we saw last time was an unprecedented speed in that. They are looking again with scenario testing. Should that happen again, is there enough liquidity for a future collateral? That will change, and we have seen changes in investment strategies across the board.

Q123 **Chair:** Do you see new opportunities that scheme trustees need to be alert to?

Harus Rai: In terms of investments?



Chair: Yes.

Harus Rai: Again picking up on the point that Steve has quite rightly raised, funding positions for many schemes did improve. If the goal of a scheme—and this is not the goal for every single scheme out there—was to buy out that pension scheme and secure those benefits with the insurer, for lots of schemes that goal may have been, for example, five to seven years; it may now have been brought forward. They are looking at that and obviously then looking across the board to say, “What is appropriate for the scheme members?”

Q124 **Chair:** Thank you. Janice Turner.

Janice Turner: I would also agree with both previous speakers. Given that a lot of pension schemes have found themselves in a position of quite a big surplus, we are now facing consultations from the Government on what to do with these surpluses. Should we be returning the surpluses to the employers? I would express caution on that. People need to recognise, I think, what happened in the days when pension schemes had substantial deficits because it was not just the employers that put the contributions in.

When DB schemes were set up, it was quite common for them to require a member’s contribution rate of, for example, 5%, and they might have had an accrual rate of sixtieths. In other words, for each year you are in the scheme, you accrued 1/60 of your final salary as a pension. After 40 years in the scheme, you would have accrued a pension entitlement of 40/60ths or two-thirds of your final salary. That was not uniform and there were many differences between schemes. But when schemes went into deficit and the regulator was pressuring trustees and employers to pay it off as fast as possible, many scheme members ended up paying a lot more for their pension while their accrual rates reduced. Basically, they were paying more for a worse pension.

For example, people paying 5% of their wages into the scheme might quite likely have endured a 60% increase to paying in 8% of their wages, and that is their contribution, not the employer’s contribution. Instead of accruing at sixtieths, it might have been reduced to eightieths, which meant that if all of your pension was accruing at eightieths, then after 40 years in the scheme, instead of getting a two-thirds final salary pension, you only got a pension worth half your salary.

We would quite strongly argue that we are now in a situation where many pension schemes have a surplus, and so rather than looking at “Shall we return this to the employer?” the first point is obviously in relation to the trust deed and rules. I think that pension schemes could be looking at those surpluses in relation to looking at what has happened to the pensions and the contributions, and seeing if there is something that could be done about that.

Q125 **Chair:** Thank you. Leonard Bowman.



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Leonard Bowman: Thank you for the opportunity today. I, again, would echo a number of the comments that have been made, and particularly the point that there is no 'one size fits all' scheme or company that we can apply across the piece.

In terms of the challenges and opportunities of where we are at the moment, following the events of the last year and a number of schemes being in a better funding position, from our perspective we feel that there probably is a way of bringing these key areas together around use of surplus productive assets and so on, but it is about the debate about future retirement provision. I think we all agree that the levels that younger generations are achieving at the moment are deeply concerning.

If you go back to the time when these DB schemes were open, a lot of the principles around uses of surplus and discretionary increases were on open, long-tail, long-timeframe liabilities and the ability to smooth out a number of these challenges. We feel the policy debate needs to be broadened out. Yes, it is right and proper to talk about this new situation of surpluses emerging, how that is used and the fairness of that between members and the employer, but more fundamentally, in the world that we are entering, is there an opportunity to broaden out the policy and look at the regulator's mandate, which has been excellent over the last 20 years? Is there an economic opportunity here to reinvigorate other forms of future retirement provision? That might be some new form of DB in some cases, probably not at the levels that we used to see of sixtieths and eightieths, et cetera, but more of baseline that just guarantees a minimum level of income for some of the younger generations, or collective DC, or more innovation.

As you have heard from the committee before, whilst we stay focused on the security of existing benefits, and that is the gold standard and that is the absolute focus, I think that will limit a number of these conversations. It will cause challenges for the type of discretionary increase conversations that we were hearing from the first panel session. It will cause challenges to trustees and companies to look at these surpluses and think about how they could creatively use that, whether that is from an investment perspective or win-win solutions. The opportunity here is to move the debate on to the future, in the context that we are in this much better place, albeit not universally for every scheme.

Finally, it is worth bearing in mind that even with improved funding positions for schemes—we talk about surplus—of course a number of schemes are just in a better position. They still have deficits. Perhaps their timeframes to getting to a buy-out funding level are much shorter than they were a year ago, but they are not there yet. It is not like all these schemes are suddenly in surplus and against a buy-out basis. Some are, but there are an awful lot that are just in a better place, and there is still cash being paid in to address deficits. It is more about the future.



I think the challenge is: is that clarity of policy going to emerge in a timeframe that is going to encourage companies, who ultimately write the cheques for the future, to engage in some of these areas? Are the advisors going to be brave with innovation in looking at new approaches? A lot of that needs to come from the direction of policy and the regulatory environment.

Q126 Sir Desmond Swayne: Have defined benefit schemes been overly cautious, particularly in light of the exhortations from Mansion House?

Leonard Bowman: I personally do not think so. You need to look at it through the lens of the quite correct regulation and the mandate of the Pensions Regulator. If we go back 20 years ago and look at the scale of deficits that were there and the events of the last 20 years, I think it was quite right and proper that the fundamental focus was making sure that the benefits members were promised were secured, with more money going into the schemes. Of course, those schemes have been on a journey over those 20 years. They were taking considerably more investment risk 15 to 20 years ago because of the length of the timeframes that we were talking about, and that risk has gradually dialled down over time as the timeframes have come in.

The fundamental problem, which I am sure you have heard multiple times, is that if you are not talking about reinvigorating design for the future, it is a closed world and you are just trying to get to the end of the journey, even if that includes generating surplus, that is still a defined end point. If you are not building up any benefits it will always limit the ability to take risks. I think trustees have done an exceptional job over the last 20 years of responding to those challenges. I think companies have had advice over that period to say, "Your job is to fund what you have promised members as their benefit", and that has been the driver, but we are now entering a period where that could be revisited.

Harus Rai: May I add to that? As a trustee—both Janice and I are trustees—we need to remember that we have been asked by both the Department for Work and Pensions and by the Pensions Regulator to de-risk strategies as the scheme matures. If you look at the proposed new funding code, it states that at a level of maturity, a de-risking programme is then expected. We wait to see what the final code will look like, but at the moment that is what the draft says in terms of what we have seen.

I absolutely agree with what Leonard has said. Picking up on the point that Steve quite rightly mentioned, a number of schemes in the DB world are now closed, either to just new members or to new members and future accrual. As those schemes become more mature, invariably what trustees are then doing is locking in the investment gains to ensure that members' benefits are paid in full, as much as we possibly can, and to remove any risk associated with the weakening sponsor covenant. That is what we are trying to achieve.



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Steve was absolutely right when he mentioned this, and Leonard echoed it: there is no one size fits all when it comes down to pensions. If you look at open schemes, where there are new contributions coming in, schemes may take a certain type of risk that a closed scheme may not take. It does vary from one scheme to another.

Janice Turner: You were asking whether pension schemes have been too cautious. I think the cautious nature of pension scheme decisions and activities is entirely down to the kind of regulation that we have been working through. The pressure that we have had from the Pensions Regulator over many years, coupled with the imposition of market value accounting, has actually pushed us into a position where we are having to be, as Harus was saying, de-risking and then de-risking again.

I would say that another opportunity that we have at the moment, given the much more favourable circumstances that we are in, would be to have another look at the accounting measures that we have to use. Even when they were introduced it was known that using market value accounting was going to create great volatility, and it did. Pension schemes have been in substantial deficit for many years, and now the volatility has gone the other way, and now we are all in in a surplus situation. When that happened on a previous occasion back in 1986 when there were substantial surpluses, a new regulation came in that effectively curtailed pension schemes' surpluses down to 105%. The problem with that was that when deficits started to appear, there was no cushion. This is a factor of the volatility that is being caused, at least in part, through market value accounting.

There is that, coupled with the requirement on the Pensions Regulator to avoid calls on the PPF, and all of these add up to a regulatory sphere where pension schemes have been pushed for many years into greater and greater de-risking. As Harus says, the upcoming new funding code carries on on that basis, and I think also it does not make a big enough distinction between open schemes and closed schemes.

Steve Hitchiner: To answer your question directly, no, I do not think, in general, pension schemes have been too cautious. I think there is an argument that the mark-to-market approach advocated by the regulator through the scheme funding regime has led to caution. I recognise that argument, but in my view, the different view of risk management by sponsors is also key.

I was thinking about this in the previous panel as well and it is a really important point to understand, which is that a DB scheme exposes the employer for that DB scheme to very, very significant financial risks. It is difficult to understate the level of risk that they are taking on when they sponsor these DB schemes.

The first two decades of this century very much saw those risks come to fruition. You had falling interest rates, which led to reduced return expectations, and increasing life expectancy. All of these things coupled



together caused enormous deficits and a massive increase in the cost of funding these promises that nobody had anticipated. Employers had a two-decade long battle against deficits. It has sent some companies under and other companies have really struggled to fund these promises that they have made. Against that background, if you were the entity responsible for funding those risks, you would understandably want to manage those risks in a cautious way.

In my view, none of that was caused by regulation. Regulation did not cause falling interest rates—perhaps indirectly but not directly—and it did not cause rising life expectancy either. I think trustees and sponsors, in general, noting we should be careful of generalisations, are rightly focused on securing the members' benefits and reducing the reliance on that sponsor covenant risk, because member security is paramount. These members have been promised their benefits and we need to deliver them. Trustees and sponsors are rightly focussed, in my view, on strategies that will achieve that without causing the kind of crises that we saw with people having massively underfunded pensions, that led to the conversations on the funding code in the first place.

Yes, we have moved on, financial positions have improved and that is a good thing, but we must not forget that it can reverse again, and we want to make sure these members are secured. In my view, trustees and sponsors are rightly focused on that and taking a cautious approach.

Q127 **Chair:** Thank you. Can I just put a point to you? One suggestion that has been made to us is that schemes might pay an additional levy to the Pension Protection Fund and, in return for that, get 100% benefit assurance from the Pension Protection Fund. Do you think trustees would be able to take more investment risks if that offer was on the table?

Steve Hitchiner: The answer to that question is yes, and that in turn leads to why I think it is probably not a great idea. You would need to speak to the PPF and I am sure they will give their own evidence to you on this, but my understanding is that it would be very difficult for the PPF to set a levy that properly accounted for that moral hazard risk. If you had somebody else that was promising that they would pay the benefits in full to your members if you failed, then what incentive is there for you to govern the scheme in an appropriate way, and for you to manage the investments and the strategy in a cautious way? There are none at all. That moral hazard would, in my view, be enormous and it would be very, very difficult for the PPF to quantify the extent of that moral hazard and then to properly account for that in a risk-based levy.

Q128 **Chair:** Any other thoughts on that?

Harus Rai: Just add to that, I have sympathy with what Steve has said but let me take one step back. Trustees have been told to ignore the existence of the PPF when having valuation negotiations and when looking at investment strategies. We are not allowed to take that into account. It is also worth noting that, in terms of entry into the PPF, it



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only applies if there is a qualifying insolvency event. There are some sponsors—I do not think it is the majority—where there might be a certain type of overseas parent where you are not eligible for entry into the PPF. I am not a PPF expert, but these are the quirks that were within those. In that scenario, would trustees suddenly take extra risk? Some may, some may not.

Also, entry into the PPF applies when that sponsor goes insolvent. No trustee wants to see a sponsor go insolvent because there are wider implications for the members who may also be employed by the sponsor. I think we need to be slightly careful around saying to trustees, “Well, as you can get 100% from the PPF, suddenly put a huge amount of investment risk in there”.

We also need to bear in mind that the investment risks that we take on and the strategies that we put in place, which are in negotiation with sponsors, are based on what the goal of that scheme is and what it is trying to achieve as its long-term goal. Some of that might be buy-out, some of it might be running it off until the last benefit is paid, some may now be to move it into a consolidator. We are taking the appropriate risk in line with the strategy of the scheme.

Q129 Steve McCabe: Morning. We have heard quite a bit about scheme surplus this morning and earlier in the inquiry. Can we be confident that the surpluses we are seeing at the moment are real and durable, or is this a temporary phenomenon? Janice, I will start with you because I think you alluded to this earlier.

Janice Turner: Yes, exactly. I do not think it is possible for people to say that the current economic circumstances or the current circumstances faced by the majority of schemes are going to continue indefinitely. Do we have a crystal ball? That is why we are saying that we should not be looking at, “Look at all these surpluses. Shall we dispose of them?” or “How shall we dispose of them?” We do have to exercise caution because we do not know what is around the corner.

Q130 Steve McCabe: Is that the view of everyone else?

Steve Hitchiner: I think it is important to distinguish between a surplus that might exist on an ongoing basis, which is predicted surplus, and the surplus that exists when you have secured all the guaranteed benefits with another party. In the latter case, there is very much a surplus, and that is when you get into discussions about if it should be used to improve benefits or if it should be returned to the employer.

In an ongoing situation, no, the surplus will go up and it will go down, and schemes could return to deficit again if financial conditions change. You try to make the strategy as resilient as you can against those risks, but apart from a situation where you have secured the liabilities, it is not really a surplus at all; it is an expected surplus. It only really materialises at the point at which you paid all the beneficiaries off, either when the last pensioner has died or when you have secured the benefits with an insurance company. Up until then, it is just a guess.



Harus Rai: I would absolutely agree with the comments from both Steve and Janice. Just to reiterate a point that was made previously, I think, Steve, you made the point that from the turn of the century we have had deficits. We had surpluses until the turn of the century and then we suddenly saw an eroding of surpluses. We saw changes in tax treatment and we saw changes in regulation, which created significant deficits. This Committee itself has spoken to various pension schemes in the past about the deficits that were created. You are right, we never know what is on the horizon and what might happen in five or 10 years.

As trustees, what we are trying to do—coming back to the point we have made a few times now—is to lock in the gains as and when that becomes possible.

Leonard Bowman: Just to again echo that, I do quite a lot of work with companies that are currently potentially in surplus, in a buy-out position, and are looking at whether they want to talk to the trustees about a run-off approach. In some of those cases trustees are quite keen to have the conversation because of the scope for win-win outcomes with some of the surplus being used for member improvements and some of it, in theory, going to the company, albeit in the regime that we are in at the moment. However, all the points that have been made are the issue that you hear. When is a surplus a surplus? At board level of a lot of these companies, the one thing we do not want to do is to go back to a situation where we have to pump money in because we overreact to a surplus, which is sitting on a piece of paper, but which we know from past experience can move around.

That is one of the challenges to this debate about, “We have these surpluses; how could they be used? How could we potentially support more use of these surpluses from an investment point of view?” While the focus is about securing the benefits that are on the table that have been promised to members, while that is the full story, I think you will rightly see quite a lot of caution by trustees and companies trying to deploy or do something with those surpluses until—exactly Steve’s point—a transaction happens with an insurer, it is a factual amount of money sitting there and you can say, “OK, that is real. What are we going to do with that?”

Q131 **Steve McCabe:** Thank you. Given what you have said, we seem to be hearing a lot at the moment about easier access to the surplus and how that could generate all sorts of things: schemes could do good, invest in the economy or pay extra money to DC members. How credible do you think that position is? Should there be easier access, and would it generate these incredible benefits?

Steve Hitchiner: Going back to my earlier point, recognising the difference between running on and buying out, in a lot of the context of this conversation you are talking about choosing to run the scheme on to generate surpluses, which you can then use for other generations, return to the employer, or improve benefits. I certainly would be in favour of the regulations being more flexible to allow that.



Would it make a difference? One important thing to understand here—again, it goes back to my point about diversity—is that 200 schemes, which only represent 4% of schemes by number, have over 60% of the assets. Of the £1.6 trillion of assets there are in schemes, over £1 trillion is in a very small number of very large schemes. If those schemes were to run on, it does not take very many schemes to run on for that to be a meaningful amount of asset in terms of the good that that could do, for want of a better description; obviously we can debate what “good” is.

Then on the other end of the spectrum, there are 4,000 schemes with less than 1,000 members, which represent a very small part of the assets. They are the vast majority of the schemes but a very, very small number of the assets. In those situations, those schemes are unlikely to have the governance structures to run on and I think it would be imposing quite a lot of risk on the sponsor in doing so.

Yes, regulation should be more flexible in allowing trustees and sponsors to run on, to try to do good with the surplus, improve benefits and so on and so forth, but we must not lose sight of the fact that for the vast majority of smaller schemes, it is quite right and proper for them to be targeting a transaction where they secure the liabilities for their members with an insurer. They are a smaller scheme and they do not have the governance budget.

I would not want the conversation about what these larger schemes might do, large open schemes running on, to distract from the fact that there are quite a lot of schemes that should be doing what they are currently doing, which is targeting that transaction. Recognising that mix and recognising that diversity within the landscape in these DB schemes is really important. But it would not take very many to run on for it to be an awful lot of the money. That is, I think, the point.

Q132 Steve McCabe: That is helpful. Thank you. Does anyone want to add anything?

Leonard Bowman: I would not disagree with that, I would add to that. When we are talking about use of assets, the role of it in the economy, we have to bring into the debate the role of future retirement provision. Fundamentally, if we can raise the standards of the capital that is being deployed to make sure that some of the younger generations are going to have a sensible amount of money to retire on, then we are talking about a larger investment pool there.

What is the relevance to this conversation? I absolutely agree that there is not ‘one size fits all’ and I totally support the point that there are a large number of schemes out there that should be focusing on securing their benefits in the insurance market and moving on, but there are other schemes and other situations where reinvigorating, new risk-sharing models could be used under the existing trusts, so that a new generation of employees are being better supported and more money is available for investment in those schemes.

As you have probably heard evidence on before, particularly, for



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example, in the local government space, there are funding models where you can have a very long time horizon and smooth out surpluses that appear, then go down and then go up. For some—not for all, probably not even the majority—combining that with this question of surpluses emerging, improving funding levels and getting more creative in the future retirement space is an important part of bringing all of this together.

What does that boil down to? We feel that, from a regulatory point of view, there needs to be a new focus on the quality of future retirement provision. There needs to be more of a balanced discussion. We are moving out of this phase of very large deficits. Yes, it could come back in some situations and maybe not all of these surpluses are always going to be there, but it is the right time to be saying that we need a more balanced policy position. That will mean that some companies just buy-out and use pure DC for their future employees; other companies will look at more creative solutions.

The regulatory support needs to be there to have confidence to do that, for trustees to be able to support a future trust, which has new money going into it, with new designs. It is an important piece that needs to be looked at in this window, while we are looking at this debate about how these assets are deployed.

Janice Turner: I would very much agree with that. One of the things that has been lost, as more DB schemes have closed and more people have moved into DC, has been what we are actually trying to achieve with pensions. We are not just trying to achieve a pension, we are trying to achieve a situation where working people can retire with an income that they can live on. That is not just a pension, it is a quality pension.

I remember the 2004 Pension Commission. They said that, and they quantified it by saying that for people on an average income, they thought that they should be aiming at a pension of about two-thirds of final salary. People who are on low incomes should be looking at a pension of about 80%, and that is because they are on such a low income they cannot afford to cut any more. For people who are at the higher-paid end, they should be looking at around 50%. That is a very helpful guide, I think, because with defined benefit pensions, that is exactly what they were aiming to do. People knew that they are going to retire with a pension of this much if they are in the scheme long enough.

DC schemes have broken that. When people moved into DC schemes—and I understand why—there was no understanding of, “Well, if you put this much money in and the employer puts that much money in, you are likely to end up with a pension of about that much”.

Now, given that employers do not have the pain of putting lots of money into paying off deficits, we are in a position where we can look very positively at what I am delighted the Government is doing, introducing



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collective DC. It is slow going and I know we all have to get it right, but AMNT has championed CDC as a positive solution for the future.

Collective DC and multi-employer CDC is the way we need to be going, but it would be important for us to come back to the 2004 Pension Commission definition and keep telling ourselves that we need to be getting pensions of this much. Rather than just any pension, we need to be focusing on how we can get a pension that people can live on. I would argue that currently CDC is the best new alternative.

Harus Rai: I do not disagree with any of that.

- Q133 **Steve McCabe:** I want to ask two quick final points. I do not know how familiar you are with the miners' pension scheme but I understand that is a 50:50 deal with the Treasury. At the moment the Treasury has benefited to the tune of about £6.5 billion. If we take your point about people having a decent pension, the average ex-miner gets just over £100 a week. Do you think that is a good example of how a surplus should be addressed? Are you familiar with the scheme?

Janice Turner: No.

Harus Rai: I am not familiar with that case.

- Q134 **Steve McCabe:** Maybe I should leave it then, I do not want to put words in your mouth. Tell me finally about the BP pensioners. They have said that the interests of members need better protection when a buy-out is being entered into. Do you agree, and what would the better protection look like?

Steve Hitchiner: I was listening with great interest to the points being made in the previous panel. This is a complex topic. I was making notes of points that I could add, and there is almost too much for me to get across. I will try to be brief and make what I think are some important points.

First, it is important to distinguish between discretionary benefits and guaranteed benefits. I felt there was some confusion about that point but it is a crucial difference. A lot of schemes are only recently now being asked if they will pay increases above the guaranteed increase because inflation has been so high. It is a current conversation, and lots of schemes are having it. I think it is really important to bear that in mind. There is a difference between discretionary and guaranteed benefits.

Where there is a history of providing discretionary benefits, a long history of providing discretionary benefits where you do not promise to do so, I do have a lot of sympathy in that situation. I get that. On the flip side, though, you also need to respect the financial risks that sponsors are exposed to, which I described earlier. In situations where you have a buy-out surplus, scheme specifics are so important. I do not know the details of the BP pension scheme and it would be difficult for me to comment. Obviously, the rules of the scheme will dictate how that



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surplus is used. In many cases I would expect there to be some kind of agreement where some of that surplus is used to provide those pension increases and some of it is then returned to the employer.

As I say, it is a complex topic. There is a lot that one could say on that. I do have a lot of sympathy with the points being made, but it is very scheme-specific and it is very difficult to comment on a specific situation because it will vary from scheme to scheme. The facts will be very different.

Harus Rai: Again, I cannot comment on the BP pension scheme because I am not involved in that scheme and do not know the particular circumstances.

In terms of buy-outs, and I have done many buy-outs, let us start by saying that insurers do not like discretions. Therefore, part of a buy-out is to solidify, within the deal, how the trustees would have exercised a particular discretion. What you then do is say, "Well, what are the benefits, under the trustee rules, that we are required to pay to members?" The first part of that deal is to say, "What is, effectively, the cost to pass that scheme over with regard to that?"

Steve quite rightly talked about, as did Leonard, where there is a true surplus, once you have secured that benefit and you know what surplus is then left. Throughout that process, if there was a history of discretionary increases, you are also having conversations with the sponsor around whether we augment members' benefits within that deal. Some schemes will, some schemes will not, but it is an active, robust conversation that is happening between trustees and sponsors in terms of making sure that members get the right benefit.

Where you can augment members' benefits—first you have to look at the trustee rules and say, "Who has the power to augment?"—you are then having those conversations to say, "Is it possible to?" It is not a situation where those conversations are not happening.

Q135 **Steve McCabe:** Thank you. Janice?

Janice Turner: Agreed.

Q136 **Steve McCabe:** You would agree.

Leonard Bowman: The first thing I would like to say is that I am deeply proud of our industry when you have bodies like that coming forward with such challenging and well-structured points to make about the situation. It is one of the great strengths of our set-up in the UK, when you have that level of member engagement, understanding and challenge that can come here. I cannot talk about those specific situations because there will be a lot of nuances, but they do raise some really important challenges.

One point worth remembering for a lot of the scheme rules that were written to have discretionary increases built in is that they were open



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schemes. I think the point was made by one of the groups. There was a societal contract between the workforce and the company that this open scheme would have surpluses and it would have deficits. When it had a surplus, there might be a refund or a smoothing of company costs and some form of discretionary award to members, and when there was deficit, you are all in it together. No increases are being awarded and the company is having to pump money in. You lose that once you have closed the scheme. Then it is all about securing the benefits. It is all about that route to that.

I personally—and I do not expect everyone to agree with this—totally understand a general company—not BP, not Hewlett Packard; I am not close to it—that for 20 years has been told, “You now have to pay this and the deficit is now this”, “You now have to pay...” Bear in mind, with all due respect, that once those schemes are closed the members are not paying any more money at that point. They paid a lot of money for their benefits and they have every right to expect them.

We are just talking about a company pumping money in for 20 years. You finally get to the point that a notional surplus emerges and, unfortunately, that is combining with this horrendous inflation period that we are in and the impact it is having on individuals. I get why that is a difficult discussion for a company to have, when all they have been doing is funding a deficit.

As I say, the issues that were put forward in the first panel are really important. They are not straightforward and, like everything in this space, there are two sides to it.

Q137 David Linden: I would like to talk about trustee knowledge and understanding, because if we learned something from the LDI episode it was that a lot of trustees are in quite a difficult position. I think it was the TPR that did a survey that showed that nearly one-fifth of DB trustees had never even used or were not aware of the TPR’s codes of practices. Of course, we have had the DWP putting forward a number of proposals for consultation about whether there should be a register of trustees or a requirement for a certain number of trustees in a board to be accredited, and indeed a requirement for professional trustees to be accredited. I will focus my questions specifically to Mr Rai and Ms Turner, if possible.

Mr Rai, you said that many trustee boards are technically competent, certainly in larger schemes, and able to challenge advisers effectively, but you go on to say that smaller schemes tend to have a relatively smaller pool of individuals from which to populate a trustee board and tend to rely very heavily on their advisers. Ms Turner, you say that too many lay trustees are not given enough time away from their jobs to fulfil trustee duties. My question to both of you would be: what intervention do you think is required in terms of supporting trustees to make sure that they are making decisions that are informed and incredibly complex?



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Janice Turner: We have obviously put a lot of thought into this, and we believe that the fundamental issue is the scheme sponsor's attitude. Companies' attitudes to their own pension scheme are the major factor influencing trustee performance, particularly with the smaller schemes. Where companies understand the importance of the scheme and its governance, trustees tend to be able to perform well, but when companies do not recognise this, it often works against the trustees' ability to operate effectively. This is in two ways.

One is that the trustees are not given sufficient time away from their day jobs to fulfil their trustee duties, and not just fulfil it as in attending the meeting. A meeting can have 200 pages of paperwork to read beforehand. Trustees need the time to focus on reading all that, thinking about it, and probably making notes about questions they want to ask in relation to it. That takes time. They also need to have time to train. They need to have encouragement to train. Importantly, the employer needs to be prepared to pay for the training as well.

AMNT strongly believes in trustees being able to have sufficient knowledge and understanding. We believe that there should be at least one trustee on every board that is accredited by the PMI, and they are lay or professional trustees. In order to do that, we have to enable trustees to be able to have that paid for, because the cost of becoming accredited is about £1,000. You have to sit two exams and then there is the accreditation process. It costs about £1,000. We have member-nominated trustees who have gone to their employers and said, "We would like to be accredited", and the employer has said, "Well, I am not paying for it".

It has put member-nominated trustees in a position where they agree that trustee boards should be properly qualified and have sufficient knowledge and understanding, they want to do that, they want to be the best trustee that they can be, but they have had to choose between not being accredited or being accredited and having to pay £1,000 themselves, because obviously most lay trustees are not paid anything extra for their trustee duties.

We are arguing that there should be proper time off for trustee duties. At the moment it just says "appropriate time off". Who is going to decide what appropriate is? We know that there are member-nominated trustees who have to argue for every single day that they take away from their day job. There was an industrial tribunal not so long ago, which I refer to in our papers, where a member-nominated trustee had been allowed to attend meetings of the pension scheme in office hours, but her workload had not been reduced to take account for it. Basically, the member had been put in a position where they either have to do their work outside office hours, or they have to make up for it somehow.

In the end, she took the employer to Industrial Tribunal, and then the Industrial Tribunal threw it out because she had no contractual or



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statutory right to time off for her trustee duties. We have been arguing this for 10 years, and we think this is a really important point.

We also think that employers and pension schemes should be required to encourage and pay for appropriate training. A very easy win that we could have relates to the trustee toolkit. Every trustee is required to complete the trustee toolkit within six months of becoming a trustee. We are not aware of that ever having been enforced. That means that although I would like to think that there are many, many MNTs—

Q138 David Linden: Just to confirm, who is supposed to enforce that? Is it the TPR?

Janice Turner: Yes.

Q139 David Linden: Is the TPR, in your view, toothless?

Janice Turner: Not toothless, they have just chosen not to enforce it. They could enforce it.

What we are saying is that a very simple thing to do to ensure that every trustee has done their toolkit, would be simply for every pension scheme to send the regulator the certificate that you can download when you finish your toolkit, to prove that every trustee has done it. No trustee that has finished their toolkit would mind at all doing that. It would not cost anything. It is just a small addition to the scheme return. However, at a stroke, in our view, it would ensure that every trustee that has not done it, will have done it. We think that is a really simple thing that we could do.

The second thing, as I said earlier, is that we do believe that there is a very strong case for at least one trustee on every board to be accredited. Again, that has to go hand-in-hand with what I have said earlier. Also, trustee boards should be encouraged not just to have one, but they should be encouraging all trustees to become accredited.

Q140 David Linden: Should there be a register?

Janice Turner: Yes, we think so, because at the moment you have a situation where The Pensions Regulator does not really know who all the trustees are, and if you are a charity trustee that is not the case. We cannot see anything wrong with that. We think it would improve communication because the regulator could write directly to the trustees and say, "This is something important that you have to read", rather than hoping that they see it somewhere else. There are many things that could be done, but we think that the key points that we have made really need to be done.

Harus Rai: Just to add to that point, we are not against the idea of there being a trustee register at all. The DWP's estimation is that there are tens of thousands of trustees, both lay and professional. I do not know the



exact number because—this is the point—there is no register. We are absolutely not against the idea.

I am conscious of time, Chair, so let me just take one step back. There is a requirement under the Pensions Act 2004 for all trustees, regardless of classification, be it lay or professional, to have trustee knowledge and understanding. It is a legal requirement for you to have that. The regulator then, to give them credit, created the toolkit. It was a very good basic understanding of pensions for lay trustees and for the new trustees.

Q141 **David Linden:** Was it a box-ticking exercise, though?

Janice Turner: I would not say it was.

Harus Rai: There are a lot of modules in there, going into depth about different types of pensions and different areas that the trustee might deal with. There was then a test at the end of it to test their knowledge. My understanding is that the regulator, in line with the new general code that we are waiting to be established, will be revamping the toolkit over a period of time. I do not know anything more, apart from that they are going to do that.

Janice quite rightly talked about lay trustees, and I will touch very briefly on that before I talk about professional trustees. If you look at the regulator's response in the call for evidence of the DWP, they put non-accredited lay trustees into three camps. The first is those who fully understand what is expected of them and have the time, which is the point that Janice quite rightly said. The second is those who understand what is required of them but do not have the time, again the point. Then you have a third category, which is those that do not understand what is required of them and do not have the time.

According to the regulator, the bulk of all trustees fall into camp three. That is generally at the smaller end of schemes. The larger the schemes, the more you might see accredited, the more the advisers, and the larger the pool of trustees that they can go to.

Whilst I have sympathy for Janice's comment about the accredited lay trustees, let us not forget that it is unbelievably difficult to find individuals who want to put themselves forward as a member-nominated trustee, especially at the smaller end, because of the smaller pool of members that they can go to. The point Janet raised, quite rightly, is that lay trustees are generally not paid. This is entirely voluntary but they are doing this role. I wish my packs were 200 pages but it could be significantly more. They are having to do that and then take all the pressure of those pension schemes. That is something that people are not then putting themselves forward for.

With regard to professional trustees, we have an accreditation regime that was introduced back in 2019, which was introduced by a large



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professional standards working group of various bodies. In 2019 that came into effect, and since then we have been talking constantly to both DWP and the regulator to say that must be mandatory. It is entirely voluntary. At the moment you can either be accredited via the Association of Professional Pension Trustees or by the Pension Management Institute, and over 500 professional trustees have voluntarily chosen to do that. We believe it should be mandatory to go down that route and we are pushing for that, and I understand that Nausicaa Delfas is going to be giving you evidence next week on that point.

We do think that that is the case. We are reviewing the accreditation to make sure it remains fit for purpose in terms of the way the pensions market is moving. It is a requirement under the APPT accreditation regime to complete the toolkit, as well as any other module that we believe has been introduced that trustees should do. For example, with the recent scams module, we would not renew professional trustees if they had not completed it. It is an absolute requirement for them to do that to get accreditation with us. That is just to pick up on those points.

Q142 Debbie Abrahams: Thank you very much. Good morning, everyone. I trust that you heard the evidence that the previous panel gave. My questions predominantly relate to the sole trustee status. First of all, what are your views on that? Do you think it was acceptable that the Royal Ordnance Pensioners' Association were informed by the employer that they would be removing them or replacing them with a sole trustee? That is the first of my questions.

Harus Rai: Did you want me to pick that up?

Debbie Abrahams: Yes. Quick responses, if that is OK.

Harus Rai: Sure. As a professional trustee firm—I am talking more here as the Managing Director of Capital Cranfield—we provide services to schemes as a professional corporate sole trustee. There are a number of reasons why a board might move from a traditional trustee board, which includes lay trustees, to a professional corporate sole trustee. The biggest rise in that, as we have seen over the last number of years, and where there is the biggest bulk of sole trusteeship, is schemes at the smaller end.

If I refer to a report done by Hymans Robertson just recently, 41% of all the sole trustee schemes out there have assets below £10 million. Another 39% have assets between £10 million to £50 million, and then 11% above that have assets between £50 million to £100 million. Therefore, 91% of all sole trustee cases are schemes at the smaller end. That is where we have seen a significant difficulty in trying to find member-nominated trustees. It is right to say—

Q143 Debbie Abrahams: I am ever so sorry for interrupting, I am just conscious of time. In the case, as I understand it—and you may have



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more information about the Royal Ordinance pension—they were performing well. I think what you are getting at is that with smaller schemes there is greater risk, there are issues around performance and so on. That was not the case there.

I am getting at the issue now, which I think Mr Bowman mentioned earlier, that there was a social contract that was agreed with the 2004 Pension Act, entered into by employees and employers, that there would be this contract. Do you think the balance of power is too much in favour of the employees making unilateral decisions that will affect the scheme members?

Harus Rai: The trustee rules define who has the power to appoint and remove trustees. We have to remember that where there are member-nominated trustees, member-nominated trustee regulations are also coming into effect. If member-nominated trustees are in term and they are going to be removed, then all the other trustees have to agree to that. I cannot talk about Royal Ordinance scheme; it is not one that I have been involved in and I do not know the particulars of that.

As I say, it is not just in respect of how a trustee board is performing. There could be situations where trustees themselves might want to step away. It is important to also remember that in the majority of cases that I have been involved in, both the trustees and the sponsor have been involved in that conversation, to the point where the trustees also interview the potential—

Q144 **Debbie Abrahams:** That was not the case, and I appreciate that it is not one that you were involved in; it is certainly not to impugn your reputation and your work. What I am really getting at is my previous point. You are saying that this was already in the schemes, so there is little that you should do about it. I am talking about: what should we be doing where there is a clear balance of power that is potentially being misused and not in the interests of scheme members?

Harus Rai: Any trustee has to be acting in the best interests of members and the governance models in place. As I say, there are various reasons why. I know you want to talk about what should happen. At the moment in time, the trustees can only act in accordance with the trustee rules. If the power is with the sponsor, they have the power to appoint and remove. You cannot just remove member-nominated trustees who are in term, you have to comply with the regulations.

Janice Turner: Up to a point. May I?

Q145 **Debbie Abrahams:** Yes.

Janice Turner: There is what should happen and what does happen. You are absolutely right, everything is down to what is in the trust deed and rules. We were contacted by a member who said that the trust deed and rules said that the trustees board and each trustee had to agree if the employer was going to move to sole trusteeship. They had to agree to



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resign, basically. The member-nominated trustees did not want to, they did not think it was a good idea at all that the scheme moved to sole trusteeship, but the employer exerted the pressure that an employer can. We said to them, "You should complain to the regulator", which they did, and the regulator did not think it was important enough to intervene. It was a very small pension scheme. No doubt that had a bearing on it.

We do strongly believe that if a pension scheme is going to go to sole trusteeship then it should be with the board's agreement, and that if anything is happening that the board is not happy with, then the pension regulator ought to be intervening.

Q146 **Debbie Abrahams:** Thank you. Mr Bowman, do you want to add anything?

Leonard Bowman: There are situations where I have worked with sole trustees and it has been absolutely fantastic. To give you an example, an employer is going through a rapid change, perhaps buying or selling a business, there is a lot of security moving around in that structure that stands behind the scheme, and that sole trustee has the experience and has come across this in enough situations to move quickly and put the company's toes to the fire in terms of making sure that there is more cash made available, or security. There are positives.

Q147 **Debbie Abrahams:** Unless they are appointed by the employer.

Leonard Bowman: They were here. They were appointed. Sorry, I will just finish this piece. It is an example of exactly this point, "You are a trustee, you are a trustee, you are a trustee". Let us bear in mind that as human beings, whoever you work for, people fundamentally do not want to be on the wrong side of the law or in trouble. There is a commercial element to life but there is also a human element. If somebody says, "This will put you on the wrong side of the law, you are a trustee and if you do this you are on the wrong side of the law", that is a guardrail.

However, I would say it is growing rapidly, talking specifically about the sole trustee. Is it wrong to take a step back and say, "Are the right guardrails there, given the pace of growth? Are we completely comfortable from a regulatory point of view?" The regulator has made comments in the past that it is an area that needs to be looked at. I do not think that that is wrong, but I do not think we should be throwing the baby out with the bathwater and saying—

Debbie Abrahams: "This should never happen."

Leonard Bowman: —"This has never happened. This is just not right." However, it should require that step back. Given the pace of it, are we all comfortable that the right structure is in place around it?

Harus Rai: Just one final comment. It is worth noting that while sole trusteeship is right for some schemes, it is not right for every single scheme. The trustees and the company should look at the circumstances



to say: is it appropriate? The APPT has created a code of practice which states that any firm that is providing professional corporate sole trustee services has to comply with our code of practice. That creates more transparency. It covers issues around independence. It covers issues around conflicts or what to do in certain scenarios to relay concerns, for example, that the regulator has raised. We do believe that firms who are providing that should comply with that code.

Q148 Nigel Mills: We have had a good canter around most of this. What are your views on consolidators then? The view has been expressed that we have too many small schemes that are not sophisticated or skilled enough to deliver for their members, and if we consolidate them we can get better returns and the world will be a much happier place or something. Is that a fair assessment? Do you think consolidators have a role to play? Now we can all afford buy-out, are they going to be a thing that came and went?

Steve Hitchiner: I will try to be brief, but it is quite a lot to unpack. First of all, there are two types of consolidation and they often get lumped together but they are very, very different. It is important to distinguish between them. There is a type of consolidation where you are simply trying to make the scheme run more efficiently by collecting things together, and then there is a second type of consolidation, which is where the sponsor hands over the financial risk for paying the benefits to another party. They are two very different things. They often get lumped together but it is important to separate them because they are different.

Consolidators that purely seek to achieve efficiencies have been around for some time, they serve schemes of all sizes and they have not been particularly successful. I could not say for sure why, but I suspect it is because the cost savings for the sponsor are not that great in the first place. For what they get in terms of loss of control of those financial risks, it probably does not stack up. For whatever reason they have not been that successful, but they exist and they are out there.

It is important to remember that the most successful consolidation vehicle currently operating is insurance company buy-out. That is a consolidation vehicle, it is a really good one, it has been running for quite some time, it is generally quite successful and the path is well trodden. As far as I am concerned, that remains the gold standard consolidation vehicle that most small schemes, in my view, should be targeting. It is as close to a guarantee as we can get. Yes, there are still risks within the insurance sector, I am not saying there are not, but in comparison to a lot of the other options it is the closest thing to a guarantee that is available and that is what most schemes should be targeting. In my experience, most schemes are.

Obviously we have the new idea of a commercial super fund consolidator, which will take away the sponsor's risk to fund the benefits but at a lower cost than an insurer. That definitely presents us with a valuable additional option and there may be some circumstances in which that is useful, but



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an insurer, a bulk annuity, is the consolidation vehicle that most will target. I am sure that will remain the most predominant consolidation vehicle used by small schemes within the UK DB market.

Harus Rai: I would agree with Steve. We have seen in the DC world huge amounts of consolidation, small trust-based arrangements moving into a DC master trust. We have also seen consolidation in the number of DC master trusts, going from well over 100 to in the 20s at the moment, I think. There has been huge traction in consolidation in that world.

In the DB world, as Steve quite rightly says, it is very much at its infancy. There is a very large cost involved for schemes moving from a standalone arrangement to a potential consolidator. For some schemes that cost is not insignificant and one that makes it not achievable. There are also gateway tests that have to be achieved. Just to pick on two of those, either the sponsor could never buy-out because it financially could not afford it, or secondly, it could not buy-out for the foreseeable future. A three to five-year requirement is currently being mooted. For some schemes it is not even an option for them.

As trustees, our role and our fiduciary duty is to act in the best interests of members and scheme beneficiaries. If moving that scheme to a consolidator is in their best interests, like the view that we take with buy-outs, if we feel that is in their best interest, then absolutely, we would engage with it.

Q149 **Nigel Mills:** That would be where you might have a weak sponsor and a consolidator would give you a better chance of delivering the benefits?

Harus Rai: It will vary depending on the individual circumstances of each of those.

Janice Turner: I would agree that it very much depends on the circumstances of each scheme. What concerns us is: what are the arrangements for these consolidators? If you have private sector consolidators, are they going to be paying levies to the PPF? If they are doing that, then surely they should not be paying any levies that have any impact on the existing DB schemes and the levies that they are paying to the PPF. What we are saying is that any governance of such super funds needs to be completely separate from the rest of the DB schemes.

Leonard Bowman: All that I would add—and you have heard this before—is the distinction. Master trusts can consolidate to provide standard governance models and more investment opportunities, which could be an important part of the small scheme space. There are all the challenges you have heard today and would have heard before, getting the right trustees in, and the different model of a Clara or whoever, that super fund model.



For the super fund piece, we will all benefit from getting to the point of clear legislation and regulation. When does it work, when does it not work, and can advisers build a framework? You would have heard this before but I think it is virtually impossible for trustees at the moment with these proposals, unless you have a very extreme situation, to be confident in saying, "Yes, this is right for us". Getting to a point where it is more of a well-trodden path with some transactions done and a very clear regulatory framework, I think, is essential. Buy-out is the gold standard, no question of that, but it has a role. We need to define what that role is.

Q150 Nigel Mills: Does the PPF have a role here, for the long tail of small schemes that probably are not ever going to get to buy-out and will just run, being maybe run well and maybe not. Is there a role, while we have this optimal period, to try to proactively sweep those up and get them into a better place, or do we just have to let nature take its course or time tick on?

Steve Hitchiner: I am slightly cautious about the idea of the role of a public consolidator. Obviously the PPF might be the body. First of all, if the PPF were to run that public consolidator it would be quite important to make that separate from the existing compensation scheme, because that compensation scheme exists for a particular purpose and it has been funded by levies on other schemes for a particular risk. It would be important to keep that separate.

The main point I would make is that transferring DB liabilities, as I said at the start, and as has been alluded to quite a few times, is a very, very complicated and complex business. It needs to be done correctly and well, otherwise members will not get the right benefits. The current market for bulk annuities, as I say, is functioning very well. It is very well developed. We also would hopefully see the establishment of super funds as a viable additional option, where that improves security. I would be slightly cautious about a public consolidator disrupting either the existing bulk annuity market or the establishment of a viable market for commercial consolidators.

The only possible justification for a public consolidator, in my view, would be market dysfunction. It would be because the market for either bulk annuities or commercial consolidators is not serving the general marketplace. For me, that case is not sufficiently made at this point in time. You often hear it referred to that small schemes cannot access the bulk annuity market. That is not the experience of our members. In our view, small schemes can access the bulk annuity market as long as they are well prepared. By well prepared, I mean as long as they got their data in good order and their documentation in good order. Then they can, in our experience, access that market.

Equally, there is no reason why commercial super funds cannot offer things to small schemes when they are fully established, and I think that would be their view too. I think the main type of scheme that would not



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be able to access either a super fund or a bulk annuity would be those that are either poorly funded or that have poor governance, in other words, poor data documentation, and that are making no efforts to sort that out.

Yes, you could have a public consolidator that would offer something to those schemes, but if you did, where would be the incentive for schemes to improve their funding or to improve their governance? You create a moral hazard if you have a consolidator over here that you do not have to pay for, versus a consolidator over here that you do have to pay for through good governance and a good funding level. Who is going to pay for that top-up funding? Who is going to pay for all that work to sort out the data and documentation? If someone else is going to pay for it, then why are trustees and sponsors going to sort their own schemes out?

As I say, for me, the case is not sufficiently made. It is possible that you could point to market dysfunction, but I think you have to be careful of moral hazard as well.

Nigel Mills: I think time has ticked.

Q151 **Chair:** Thank you. Sorry, Janice.

Janice Turner: I was just going to add that actually AMNT is much more favourably disposed towards not-for-profit consolidators. In fact, we have argued that that is quite a sensible idea in the past. However, if it is going to be the PPF, then I absolutely agree that it has to be completely separate from the existing PPF. There can be no cross anything, really.

Harus Rai: A very final point on that. In terms of the PPF, we would need to see what benefits would be provided under that. I agree that it should be separate. The current model has its own benefit basis and uses its own factors. As a trustee, if we are going to sign something like that off, we would need to know what they are going to be providing.

Q152 **Chair:** A final point to you. We heard earlier from David Carson, on behalf of Hewlett Packard pensioners, about the difficulties they feel because there is no obligation on the scheme to upgrade pre-1997 pensions. Do any of you think something should be done about that or do you think that is just history?

Steve Hitchiner: The requirements to provide increases to pensions came in in April 1997, as I am sure many of you are aware. That applied to all service that was earned on and from that date, and since that date there has been a requirement to provide those increases. If you were to suddenly say that pre-1997 you had to provide those increases, that would be a huge retrospective cost on employers. I think that needs to be understood.

Just one other point. It is very dangerous to single out a particular aspect of the benefit structure in terms of quality. You may have a scheme that does not provide pre-1997 increases, but it may have an earlier



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retirement age and it may have a higher rate of accrual of pension. You need to be a little bit cautious in just singling out a single aspect of the benefit structure as being “ungenerous”. You need to look at the benefits as a whole.

Chair: Any other thoughts?

Harus Rai: Whilst I would agree with what Steve has said, most of the schemes that I have been involved in do provide pre-1997 increases. It does vary from one scheme to another.

Chair: Thank you all very much indeed. It has been a very helpful session. Again, if there are any thoughts that occur to you afterwards, please do email them and we will be interested to see them. We are very grateful to you all.