HOUSE OF COMMONS

Work and Pensions Committee

Oral evidence: Pension Protection Fund and the Pensions Regulator, HC 55

Wednesday 12 October 2016

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Watch the meeting

Members present: Frank Field (Chair); Heidi Allen; Mhairi Black; Ms Karen Buck; Neil Coyle; Richard Graham; Steve McCabe; Craig Mackinlay; Jeremy Quin.

Questions 3142 - 3218

Witnesses

I: Steve Webb, former Minister of State for Pensions

II: Baroness Jeannie Drake CBE, pension scheme trustee; Professor David Blake, Director, Pensions Institute; Rosalind Connor, Association of Pensions Lawyers.

Written evidence from witnesses:

- Steve Webb, former Minister of State for Pensions
- David Blake, Pensions Institute
- Rosalind Connor, Association of Pensions Lawyers

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Examination of Witness

Witness: Steve Webb gave evidence.

Q3142 **Chair:** Steve, welcome. Might we begin by welcoming you back and asking you go through the same formal process of identifying yourself for the record?

Steve Webb: Thank you. Yes, I am Steve Webb. I am Director of Policy at Royal London and I am the last but one Pensions Minister.

Q3143 **Craig Mackinlay:** It is something of a leading question, Steve. Is there a crisis within defined benefit pension schemes, and, if so, what is the fundamental nature of that problem—if you believe there is one—and should it be considered just a temporary problem?

Steve Webb: Yes, there are schemes that are in crisis. Indeed, one would go further: they are the big data. They are the company schemes, and they are the ones that everybody knows will not pay. But throughout what I say today, I will emphasise the scheme-by-scheme nature of this.

If you look at the report that came out yesterday, the monthly figures from the PPF, the 7800 Index—first of all, they have about 6,000 schemes and 1,000 of them are in surplus. Occasionally one forgets that there are 1,000 schemes in there in surplus. The combined deficits of all these schemes improved by £40 billion a month ago. When I was the Minister, this was one of the most volatile numbers that ever came across my desk and the deficit number would bounce all over the place. I learned not to panic when the deficits increase by £40 billion and not to celebrate when they went down. It is a volatile number, so a bit of calmness in the face of these scary, volatile numbers is appropriate.

We have a scheme-by-scheme regulatory regime and I believe that is the right regulatory regime in broad outline, because the strength of the sponsoring employer's covenant varies, the nature of the liability varies. They are all different, so, while changes are probably needed to the regulatory regime, the basic regime is probably right and the large majority of schemes covering the large majority of members will, over time, sort things out. That would be the balance of my perception on all of this.

Q3144 **Craig Mackinlay:** Would it be fair to say that if you were looking at risky schemes—often through perhaps no fault of their own—it would be the type of company that was previously a big company, with loads of employees, and has now trimmed down to become a small company with a lot of potential and current pensioners?

Steve Webb: I am sure there are examples of that. I am just struck by the fact that it is very hard to pick. The PPF does its modelling on averages, in any given year it expects X number of insolvencies, but trying to pick which individual ones is going to be is pretty difficult. I remember schemes a few years ago that said, "You do not need to worry

about us. Why is our levy so big?" and you look at the state they are in now and you think, "It is a good job, they really were a risk". It is quite hard to pick that, because the industrial sector is as important as anything.

There are a whole set of sectors that have gone through great transformation and some of them will struggle to pay their liabilities, so it is more sectoral and to do with the long-term business prospects, because the key in all of this is: do not kill the goose that lays the golden egg. The best bet of these pensions being paid is to keep the firm viable and going. Anything that the Committee recommends needs to strike that balance, it needs to be clear what it is you are trying to achieve. Are you trying to protect members' pensions or avoid firms being over-pressed and pushed to the wall or both? Obviously they are in tension.

Q3145 **Craig Mackinlay:** If you were starting again, which is always with the great benefit of hindsight, how would you design the regulation of DB schemes today?

Steve Webb: The biggest thing I would do is build in flexibility from the start, so make the promises soft promises, like indexation. In the last Parliament we looked at conditional indexation: when the fund is doing well, you get their indexation; when it is not, you don't. If things improve later, maybe you pay back the indexation that you could not pay. I have absolutely no problem with that as a prospective strategy; a bit like the Dutch did, albeit the Dutch failed to communicate to the members that the promises were soft promises. There is nothing wrong with a pension that you go into that says, "Look, we will pay this definitely and we will pay this if things go well".

Q3146 **Craig Mackinlay:** I suppose the reality is there are no new DB schemes being created.

Steve Webb: No. In theory, you could change the rules for the future, certainly—and we still have 1.5 million accruing DB rights in Britain today—but the ship has largely sailed. We floated that in the last Parliament and we got a hammering in the media.

The media said, "Steve Webb wants to take my indexation away", and I said, "Well, the DB scheme is going to close. You are going to end up with a DC scheme with no indexation anyway. Conditional indexation is better than no indexation". The media could not cope with the counterfactual. They just said, "You are taking something away from us".

Q3147 **Chair:** We are going back on breaking past promises, aren't we, Steve, if we do that?

Steve Webb: I was talking about future service, so even for future service I could not get that through.

Q3148 **Chair:** The flexible indexation would only be on future promises, not on promises that have already been banked and paid for?

Steve Webb: Yes. That was what we proposed, and even that we got hammered for.

Q3149 **Jeremy Quin:** Steve, can I question you a little bit further on that, more on indexation? The whole debate about pension beneficiaries, CPI and RPI, you have already been hammered by the press on this argument and I am inviting you to do so again. What are your thoughts?

Steve Webb: The issue here is lots of schemes are using CPI now. Any pension scheme that says, "Uprate benefits in line with inflation or with the Government statutory measure" or whatever, they are all using CPI. We are only talking about schemes that have the words "retail price index" in the rules. We had to make a call in the last Parliament as to whether we would override the scheme rules and let the trustees say, "Even though members will get a smaller pension, you can just change the rules. You can impose a worse indexation".

We chose not to, on balance, because it is a pension promise that was made. You joined a scheme with those rules. Yes, it is a bit of a lottery, to be honest, which schemes have RPI in the rules, and I accept that, but if you joined a scheme with that in the rules, I think that has to be a last resort, to say, "We are a bit broke, guys. We are just going to break our promises", because once you do it for RPI, you do it for everything else. It is a thin end of the wedge kind of thing.

Q3150 **Jeremy Quin:** You have very wisely talked about the scheme-by-scheme approach. Could you have a situation where the TPR is given the ability to bless trustees shifting from RPI to CPI? Would there be a more flexible way around it for particular schemes?

Steve Webb: You are still breaking the promise and you are blaming somebody else for it, I suspect, because, once you say you can override RPI, why not override 60ths? You have a pension that promised you a 60th of your salary, "We cannot afford it, so you are only going to get X". RPI is totemic, but it is a specific example of a general issue. Once you say, "Pension schemes are under pressure. We will let them break their promises", I feel that has to be right at the end of the queue and there are other things that can be done in the interim.

Q3151 **Jeremy Quin:** Let's talk about those other things. The recommendations that we can make, how do you get the balance right between squeezing good, viable companies out of existence while still topping up DB schemes?

Steve Webb: Yes, dividends are a very important issue here. This Committee has done a superb job in BHS and in raising these general issues. One of the things you found is that BHS in two years paid more in dividends than it made in profits. That is an extreme case, but there are plenty of firms paying healthy dividends.

I asked somebody who works in this industry why firms did not just put more in the pension and less in the dividends, and he said, "It is the

directors' bonuses". If you are a director, your bonus is linked to your share price. Your share price is strong because you persistently pay good dividends. If you back off on dividends, your share price goes down, your bonus goes down. There are managers in British industry who do not want to let the dividends go down, because it will cut their bonuses, because there is a sort of macho thing about maintaining your bonus. In a sense, it is the dividend where there is money in a business that could go in the pension scheme.

With all these things you have to be incredibly careful about tweaking one little bit of the system because of the knock-on effects. If you really went for dividends big time, then will it be more expensive for businesses to raise capital? You have to think these things through, but I do think at the margins, regulators and trustees could be a bit tougher on the balance between money for the pension fund and money for the shareholders. I think that is somewhere there is give.

Q3152 **Jeremy Quin:** Generally on reporting, EVA is another, but EVA would not pick up the contributions to the pension scheme. That is a valuable point, Chairman, we should be picking up on. But are there any other general rules, other than having a look at dividends and perhaps rules as to how much you should be paying out compared to profits in those contexts, anything else that we should bear in mind?

Steve Webb: Yes. You do not want the regulator micro-managing British industry, but the regulator has looked at the cash balances of lots of firms and there are an awful lot of firms with cash in the bank and socking great pension deficits. That balance—and it always was a balancing act with these things—if you push firms so hard that then they are not there in 10 years' time, you have failed. It tends to be incremental change and incremental balance and dividends is probably the place I would focus on.

Q3153 **Craig Mackinlay:** It is scheme-by-scheme?

Steve Webb: Yes.

Q3154 **Craig Mackinlay:** Can I just pursue that a little bit, if I may, Steve? Restricting dividends for a better good would mean you would reduce the share price, so then across other pension schemes they would have a smaller triennial valuation and you are perpetuating the problem. Just a little bit on your potential to change or soften the rules, so an employee running through has been on a 40th or 60th promise. Are you suggesting perhaps it could be considered that, "Right, you are guaranteed all those years you have done are accruing at 60ths, but from here on in, they are going to be accruing at 70ths"? Just as a change of employment contract, it is just a—

Steve Webb: You can do what you like in the future, in a sense, because the employer could say, "Right, I am closing the DB scheme and there will be a new scheme tomorrow", not that any firm would open a new DB scheme probably, but in principle you say, "Right, this is the end.

Obviously everything you have earned has to be revalued and, from tomorrow, new accruals are on a new basis". You could do that.

Just on your point, because it is a fair point, if dividends are lower and share prices are lower, is that bad news for every company who has invested in equities? UK equities are a relatively small and declining proportion of what British pension funds are invested in, so, yes, it would have an impact but it would not be as big as you might imagine.

Q3155 **Richard Graham:** Steve, you have talked about not killing the goose that lays the golden eggs, really meaning the continuation of the businesses. Of course there is a bias in the system, which is that new companies, let's say tech companies, typically of course do not have these DB schemes, whereas little old industrial, often family-owned, firms up and down the country did have them, on the whole—still do have them, some of them—and of course pay the penalty for doing the right thing.

The first question I would love to ask is whether you think that the PPF system effectively builds into that a double bias, because the rules are the same for all companies contributing and, therefore, these little manufacturing companies, many of whom would like to use the money to expand the business and take on more apprentices and so on, are paying increased levies to the PPF, arguably to bail out some big business people who have done the wrong thing to their scheme. How do you think that conundrum could be resolved?

Steve Webb: As you know, in the last Parliament the remit of the regulator, the duties of the regulator, were changed. The thing we added was to have regard to the sustainable growth of the sponsoring employer. That is what the regulator is expected to do. If you have a situation where you have a firm of the sort you describe, which could make a go of the business if only they put the money into a new bit of kit, then in principle the regulator ought to say, "The sustainable growth of the sponsoring employer is best fostered by them doing that investment rather than shovelling money into the pension fund. That is okay". In principle, that is a flexibility that is there. Of course any business could make that claim and it needs to be credible, but there is that flex in the system already.

You have raised the interesting issue of small firms and small pension schemes, which is worth a conversation. Again, I have talked to some people in the industry and said, "What is the barrier to scale?" We all think that big schemes on the whole are going to be better run, more efficiently run and all the rest of it, so why don't all these small schemes just merge? The first problem is they have a different set of promises and a different set of funding level, so you put water and oil together and they do not mix. It is very hard to mix two different schemes and this firm does not want to be on the hook for this firm's promises and so on. How do we overcome this?

There is an idea out there that the PLSA, the NAPF as was, are looking at, and others, of some sort of template scheme that everybody could go into. You would take your very small engineering company that has this scheme. They might have to do something about the deficit, if they can, and then they potentially—initially on an opt-in basis—allow the members of their scheme to opt into this new thing, which perhaps the PPF run, which gets bigger and bigger and bigger and becomes a place where lots of these small schemes can get scale. There is a lot of detail you would have to think through, but it is an idea that is worth a good look at and might benefit small firms.

Q3156 **Richard Graham:** Thank you. Chairman, perhaps we can take that up, certainly.

If I can ask one slightly different question then, of course the other aspect of deficits is that they swing up and down, largely as a result of the way in which they are calculated. It is all driven off bond yields, which have arguably been depressed by a long phase of quantitative easing. Do you think the time has come for a look at the accounting rules and the way in which pension fund surpluses and deficits are calculated?

Steve Webb: Again, this is an issue we wrestled with in the last Parliament. Accounting standards, as such, are very hard for politicians to change. In fact, they cannot—they are international, so there will always be an accounting standard figure, which probably looks big and scary. But that does not have to be the basis of policy, something else can be the basis of policy. I do not believe that that significant rise in bond yields will ride to the rescue, because you have to remember DB schemes are mature and getting more mature, so many of these schemes are closed to new members, closed to new accruals. They are all getting older, so the assets you need in the scheme to back these promises are getting less and less risky, that is you need more and more bonds and gilts.

There are all these schemes with ageing populations who, over the coming decades, are going to want more and more and more gilts, which is going to keep the price and the yield down. Yes, yields might be artificially low at the moment, but I do not think the cavalry is coming any time soon. Even without QE, we would still have low long-term interest rates and that therefore is a real thing, not just an accounting fiction. Yes, the month to month wobbling is noise, but there is something real going on here. We could measure it in a different way, but it would not change what was there. What matters is how we respond to what is really there.

Q3157 **Richard Graham:** It might inhibit them from investing in bonds with high yields—for example, infrastructure projects, which do not necessarily have the credit rating of which the deficit is calculating.

Steve Webb: Yes, at the margins. Again, it is not so much the way the numbers are measured. It is the way you behave in response to the number, as long as you understand what the number is. I think there is a

danger. Again, we were sort of pressed in the last Parliament to fiddle with the deficit numbers basically to say, "Look, we all know low interest rates are temporary, let's just do gilts plus something or other arbitrary". It would not have solved anything.

There are other countries that do something a bit like that and it has not helped them with their fundamental problem. I agree, there may be answers in investment strategy that are better than just buying gilts, but changing the measures I am not convinced gets you very far.

Q3158 **Mhairi Black:** I want to come to the Pensions Regulator. It is fair to say that we have seen very public and appalling cases where pension schemes have gone wrong, like BHS. I want to know in your opinion whether you think the Pensions Regulator has the power now that it needs to be able to deal with it effectively.

Steve Webb: Again, at the margins there are new powers that would be welcome. Just in passing, I recall the process of bidding for a Pensions Bill and obviously DWP have a Pensions Bill going through now, but my sense is Parliament is going to have other things on its mind over the coming years, so the capacity to do another Pensions Bill in this Parliament might be quite limited.

My advice to DWP and the Committee is: if you think the legislation needs changing, this Pensions Bill might be the only game in town and you, the Department and whoever, will need to move darn quick to catch this train, because there might not be another one. You would need to move quickly if you want to legislate.

What would be my priority? I do think a power over mergers and acquisitions is the obvious one, the fact that they were not even obliged to be notified about BHS. Clearly you do not want Brighton vetting every corporate transaction in Britain, but you could have a threshold, a certain size of debt to a certain size of company. That would be a good thing.

Q3159 **Mhairi Black:** Is that like a formal approval from the regulator?

Steve Webb: If necessary, yes. I don't see why not. As I say, it would have to be pretty limited, because you would need some pretty high-powered lawyers to do this kind of stuff. That would be a focus. Beyond that, it would be marginal changes, to be honest. They have a lot of powers. There have probably been cases where things have been allowed to drift too long, where you are nearly on the next triennial valuation before the last one has been sorted out and I feel that needs to be curtailed.

Q3160 **Mhairi Black:** Yesterday I met with the National Federation of Occupational Pensioners. The two things that they mentioned that I was interested in was, first, the approval of the regulator, and, secondly, they talked about the board of trustees, making sure that companies were able to strike the right balance to make sure that pensioners' interests were adequately reflected. Is that something that you think should be

implemented?

Steve Webb: I guess this partly comes back to the scale issue. If you have a big well-run pension scheme with independent trustees, member-nominated trustees who can give proper time to the job, then in principle all the trustees are supposed to act on behalf of all the members of the scheme. On balance, you could argue at the margins the balance is not quite right, but overall that is not too bad. Probably the issue is small schemes, where being a trustee is quite a demanding thing. It is quite a skilled thing and there are not enough good trustees to go around, which would be another reason why, if you get consolidation and scale, then you would have better governance.

Q3161 **Jeremy Quin:** If I may, Chairman, this is following up Mhairi's point on M&As and those circumstances, Steve. Clearly putting that into the loop, particularly for listed companies, it would have to be either very confidential and kept very confidential or very quick—in fact, it probably needs to be both—so you need a pretty rapid response. I am very sympathetic to the concept. The difficulty is what powers you are giving and what they are going to be blocking. Would they have a power to say, "I am terribly sorry, you are not a fit and proper person to take over a company with this scale of a deficit"? In recent circumstances, that would be an interesting thing to explore, but hard to give that power to somebody.

There are also circumstances in which companies are going to go bust unless a takeover happens and happens very quickly. In those circumstances, I presume the regulator would have to have the power to say, "We are going to look at this after the takeover has gone through". But those are often the exact circumstances in which we are most worried about the pensions, so it is a very open-ended question, but there are difficulties and nuances below the basic idea of giving a brake to M&A activity.

Steve Webb: Indeed, so I don't think the regulator are the right people to do the fit and proper person test, for example. That feels like somebody else's job, in principle, at least. In terms of what they could stop, you have a recovery plan in place before the transaction takes place, and I guess one question would be: is that recovery plan affected by the takeover, the new structure, the debt levels of the new employer, all of that kind of stuff? Perhaps the test is: is the recovery plan credible anymore? If it is credible, you do not have a problem. If it is not credible, then a condition of the takeover ought to be a credible recovery plan. That feels like the focal point for me.

Clearly there is confidential stuff, but the regulator in Brighton is sitting on bucket-loads of confidential stuff every day of its life, that is what it does. I seem to recall I visited Brighton once and I was not allowed to go in a certain room because there was confidential stuff I should not see in it, so they take it seriously. Speed: yes, speed is clearly important, but they would need to be resourced to do it, but they could do it.

Q3162 **Chair:** When you say "sit on" do you not think there might be more expeditious—

Steve Webb: Is it the most active verb I could have used?

Q3163 **Heidi Allen:** If the regulators are not the people to identify if a person is fit and proper, what about when things look like they are going to go spectacularly wrong a la BHS and there is a sense that directors might be deliberately not looking after the pension fund, knowing the Protection Fund will pick up the pieces? The moral hazards powers, are they wide-ranging enough? Do they get used enough? Would you change them?

Steve Webb: I hesitate to say in this room that hard cases make bad laws. Although BHS is a fascinating precedent, I just have to be slightly careful. There is a slight uniqueness about that, but there are general issues that you raise that are quite right. The moral hazard powers, it seems to me, are an incredibly fine balance.

You have looked at Bernard Matthews and all that kind of stuff and pre-pack administration. It is always this balance. It is: if you had a simple choice between, "You can lose your pensions and lose your jobs or just lose your pensions", that is, go into the PPF, it is blindingly obvious which you would do, isn't it? You try to keep the jobs if you can. The worry is, once you say that, can 100 people who should not be there try to get through that loophole? That is where the moral hazard powers come in.

I am not a trade union or the Pensions Regulator here, but it is a resource-intensive job to do this kind of thing properly. It would be hard to say that the regulator needs to get behind or under the skin of what the motivations were, who said what to who, what the transactions were and all of that without probably significant extra resources. I am not sure. It can do a certain amount, and some of what it does is after the event, as you indicated, but we would all rather these things were done before the event rather than after the event.

Q3164 **Chair:** When you say it is the choice, and maybe BHS is exceptional, we do not know yet whether the Bernard Matthews workers' jobs are secure; we do know probably where the pensions will end up.

Steve Webb: Yes.

Chair: In a sense, we are beginning to see a pattern, aren't we?

Steve Webb: I don't know about a pattern. There have been pre-administrations before where exactly the same thing has happened. The fact that—

Q3165 **Chair:** But I meant your business, you lose your job and the scheme is orphaned.

Steve Webb: Yes, there is no guarantee in these deals that the subsequent business does not crash and burn in a year's time.

Q3166 **Heidi Allen:** I am not one for waste either, so you don't over-resource if

you don't need it, but are you suggesting that they could exercise their powers more fully if they had more resource, or is it because, in your view, BHS, Bernard Matthews and so on are perhaps hopefully unusual and, therefore, it is not a regular thing that they should need to do? Where does the balance lie? Are they doing enough? Are you exercising them enough?

Steve Webb: My feel is, if you look at the world of pensions, it feels like it is moving from DB to DC, so you have auto-enrolment mostly into DC. You would assume a regulator would gradually shift their attention to the world we are moving to, but of course they cannot really do that because there is the entire legacy to deal with.

We want the regulator to have a good look at DC and be looking at dodgy master trusts and all that kind of stuff. Yet we also want them to be going for some of these questionable transactions and really getting under the skin. The other side has fantastic lawyers, the people that TPR are dealing with are incredibly well-resourced and all the rest of it. Can we expect a regulator to deal with these people and keep control of them without investing in quite senior people?

Q3167 **Heidi Allen:** Would you invest more?

Steve Webb: Yes, I would. Of course one can always say they could do more with what they have, but I do think if we are asking them to vet major mergers and acquisitions, and to look at what was going on behind the scenes when the pre-pack was done and so on, that is pretty resource-intensive and you don't want it to last five years, do you? You want it done pretty quickly.

Q3168 **Ms Karen Buck:** Is there a case for allowing the possibility of a fine being applied in cases like BHS, either as a means of recovering funds or just as a deterrent activity, rather than requiring an intervention to try to recover the money that these schemes should have paid in the first place?

Steve Webb: There are different things you could fine people for. For example, you could say the recovery plan process in BHS, for example, dragged on for a ridiculous length of time, things did not happen promptly, so you could fine people for that kind of thing. I am not sure, given the amount of money and the wealth of the people involved and the scale; I don't know what the right fine would be.

Would a £50,000 fine mean anything to some of the people we are talking about? It has to be something that has a deterrent effect. If someone is doing something corrupt, lock them up or whatever. I am not sure where fines fit in. Fines for not doing the stuff quickly enough, which would make things happen more quickly is probably a good thing, but probably more serious penalties for some of the things that are alleged.

Q3169 **Ms Karen Buck:** Do any of these people have a sufficient fear of reputational damage for that in itself to be significant?

Steve Webb: Funnily enough, if you think of a wealthy entrepreneur, they are probably far more worried about their reputation than they are a token fine.

Q3170 **Richard Graham:** On that, Steve, are you almost suggesting that there are slightly different skillsets involved in dealing with these very complicated, arguably well-resourced legacy schemes, where entrepreneurs have a lot at stake, where it is reputation and cash, and the day-to-day world of the TPR going forward, which is looking more at the shape of the future, the master trusts and so on?

Steve Webb: Absolutely, yes.

Q3171 **Richard Graham:** To explore that, if that is the case, what sort of body do you think would be best to look at the legacy cases? For example, would retired QCs or maybe some distinguished Members of the House of Lords with pensions experience, perhaps on a voluntary basis, be better equipped to immediately tackle these specific things on an ad hoc basis when they come up, and give the TPR that extra resource needed to forensically dive in and give them good advice on their chances of success if they were to go to court?

Steve Webb: Yes, or former Pensions Ministers perhaps. I don't, no, if I am honest, Richard. This is serious work; it needs to be done rigorously by experts. It is not the great and good giving an opinion. This is: look who you are ranged against. You are ranged against big businesses who can buy the best and there is always this problem with Government regulation.

If you want a good job, a good career and a good wage, are you going to work for the regulator who will pay you this, or the company who will pay you three times as much? We have this problem all the time. Governments come in saying, "We are not going to pay people in quangos lots of money". Some of these are very specialist and marketable skills, and, frankly, if we don't, they will not work for us.

Q3172 **Neil Coyle:** You have mentioned BHS a couple of times. Obviously we probably only tend to hear about problems when they emerge in a case of insolvency or issues like that, when problems might have existed for much longer. You have talked about zombie schemes before, and others who have contributed evidence have suggested the need to act with more flexibility beforehand. What is your view? Should insolvency be the only trigger for pension commitments to be changed?

Steve Webb: No, not necessarily. Pension commitments to be changed: let's backtrack. Let's say you have a scheme that everybody knows the day is going to come when it cannot meet its liabilities. Do you just let it run on, potentially letting the deficit get worse, so that the hit on the PPF is worse? Who pays for that, every other sponsoring employer paying the PPF levy, or do you end the pain now, force a wind-up of the scheme and say, "Look, we all know this is never going to get any better. We will put them in the PPF now before it gets any worse"?

Of course the trouble is trying to identify those schemes and politically, if I were Richard Harrington, I am not sure I would want to be the one who said to an employee, "We have just wound up your pension scheme and put it in the PPF", because the employee will say, "Where was the burning platform? If you had let it run on for a few years, I would have been a pensioner member and I would have received 100%. I am now only getting 90%". So forcing the pace is difficult on these things, but it is probably in the public interest because otherwise you just take a bigger hit on the PPF. Waiting for an insolvency is not necessarily the best thing to do, but the process would be pretty tough, I think.

Q3173 **Neil Coyle:** Who should have the ability to identify potential schemes that are at risk?

Steve Webb: Certainly the PPF is doing a risk-based levy every year, so they are already assessing these firms. TPR is signing off recovery plans every three years, so there are a lot. To be honest, those two between them could give you a list, frankly, starting with the ones that are most obviously the clearest-cut cases. It is not a problem of identifying them, but it is a tough message to say to the workers, "We are going to force the pace on this", because they will say, "Interest rates might pick up, the stock market might boom and the company might start to do well".

Q3174 **Ms Karen Buck:** What about post-insolvency in terms of where pensioners rank as creditors? Is there scope for changing that in some of these particularly egregious cases?

Steve Webb: That is an interesting question. The priority order of creditors, it is a classic one. You look at it and you think, "This cannot be fair. The pensioners are at the bottom; the banks or whoever are further up. It is not fair". Instinctively that is what you feel but let's say, for the sake of argument, that we put the banks further down the list, then the bank is going to say, "Right, I am less confident I am going to get my money back, so I am either not going to lend at all or I am going to charge higher interest rates".

That might be the right answer, but it has knock-on effects. It is one of these things where you cannot tweak a little bit of the system without having big knock-on effects. You can argue that the priority order needs looking at, but there are no silver bullets on this.

Q3175 **Jeremy Quin:** Just going back, if I may, to the point Heidi was making earlier on the moral hazard elements. We have touched on the debate again here, so you have a board of trustees, they know they have a problem. I am not saying they are all putting on a 25 to one outsider at Cheltenham, but how do we police the gamble approach? I know the TPR is there to do it, but is there any means that can be used to check on moral hazard in this context?

Steve Webb: In the specific example of a scheme that is under-funded and goes for higher-risk investments because the downside is, "Well, I am covered by the PPF anyway" you want good-quality trustees. There is

a debate to be had about whether there should be an independent trustee, for example. That is an interesting question, but if the recovery plan is based on not credible returns then it should not be signed off. But of course how far can you micro-manage this? How far can TPR take 6,000 DB schemes, look at each one's investments? There is just a limit.

Q3176 **Jeremy Quin:** What is an incredible return? The incredible return may be the Google of tomorrow, yes.

Steve Webb: Yes, exactly. Yes, that is right. If you have a fantasy recovery plan, you can do something about it, but there is an awful lot of grey area short of that.

Q3177 **Craig Mackinlay:** The problems facing DBs are very different from DCs. I am starting to think the Pensions Regulator should almost be split in two, one to deal with DBs and one to deal with ongoing DCs. I am worried that they are trying to do two things, where they are two completely different animals, and I am starting to wonder whether that specialism would be an improvement of the situation.

Steve Webb: Possibly. There are certain common threads, for example, governance; you want good governance, whether it is DB or DC. Many firms have both, so they have a DB pension with a DC section or they are running two, so one regulator dealing with the firm on both at the same time. I am not sure you would gain a lot, but they are clearly distinct sets of issues, yes.

Could I raise one issue, if I may, because it is something that was not on the question list, but I thought was worth thinking about briefly?

Chair: Please do, yes. We would love to be questioned by you.

Steve Webb: It was not a question, but it is DB to DC transfers. What is happening at the moment is if I want to take my DB pension rights and put them in a pot of money pension, the amount of cash I am being offered is becoming eye-watering.

Q3178 **Craig Mackinlay:** Thirty times is quite regular now.

Steve Webb: Yes, at least. I met a financial adviser the other day who said his client had had a transfer valued last year, a transfer valued this year and the increase is worth a house, the average house in Britain. That was the increase in the transfer value. It might be worth the Committee having a little think about that process, because the golden scenario is a win, win, win here. The company is happy, because they de-risk, they get the person out of the scheme. The punter is happy, because they are getting offered an incredible amount of money, which might be good value in certain circumstances. The Treasury might even be happy, because they will probably get some tax a bit sooner than they would have done.

But there is not an advice framework to help individuals make those decisions wisely, so to say "No" when it is not in their interest, because

the advice framework on these transfers was written years ago, when everybody bought an annuity. Anybody transferring £500,000 into a DC pot is not going to buy an annuity with it probably, so DB to DC transfers could be part of the mix for this problem, that helps reduce scheme liabilities, reduce scheme volatility in a sort of consumer-friendly way. But advisers are terrified to advise because if they block a transfer, the punters are not happy. If they allow a transfer and a few years later it looks wrong, they get done for allowing that, so the FCA needs to be asked to update the regulatory framework. There are no silver bullets in all of this, but that could be a small part of the mix.

Q3179 **Craig Mackinlay:** Could I just add a little bit to that? I went to a seminar on pensions in my normal life and it was 30 times, even up 40 times being offered. Do you think there is going to be some temptation by the Chancellor to say, "When we are working out your lifetime allowance, it is not going to be 20 times for DBs, we might want to up that" which will push a lot of people into a lifetime allowance charge?

Steve Webb: Yes.

Craig Mackinlay: I hope not, because this is possibly temperate.

Steve Webb: It would look retrospective if he did. If you are an ex-MP with accrued pension rights, for example, and the Chancellor just multiplied by a larger number, you might feel quite miffed by that, really.

Q3180 **Craig Mackinlay:** But that temptation must be there, now that these big multiples are out there.

Steve Webb: Yes. To be honest, the Chancellor would like more of this, because, instead of me earning my pension over 30 years and getting a bit of tax every year, I suddenly have this big lump sum, which if I take something beyond the tax-free lump sum is then taxable straight away, so the Chancellor would probably quite like this.

Q3181 **Richard Graham:** That is also another reason why, although it may look eye-wateringly good, it may not be quite as good as it looks at first sight.

Steve Webb: Yes. That is why we need a proper advice framework, which we do not have, I do not think.

Q3182 **Chair:** Steve, as your ideas develop on this, might you give us notes?

Steve Webb: By all means.

Chair: Thank you very much and thanks for your session today.

Steve Webb: A pleasure. Thank you very much.

House of Commons

Examination of Witnesses

Witnesses: Baroness Jeannie Drake CBE, Professor David Blake and Rosalind Connor gave evidence.

Q3183 **Chair:** Welcome to all of you. Rosalind, will you begin by identifying yourself for the sake of the record?

Rosalind Connor: Of course. My name is Rosalind Connor. I am a pensions solicitor. I have been doing that for about 20 years. I am also presently the Chair of the Association of Pensions Lawyers, which is a non-lobbying organisation of pretty much all the people practising as solicitors or barristers in the pensions field in the countries of the UK. We act for pretty much all the employers, trustees and members who take advice legally on their pensions issues.

Baroness Drake: Jeannie Drake. I am currently a pension scheme trustee. I have a kind of amateur background in pensions, but lots of experience, I suppose. I was the TUC spokesperson on pensions for many years, I have dealt with pension issues for many years as a trade union official and I was involved in the formation of the PPF, so I have a sort of general background knowledge, but I am not an economist or an actuary or a lawyer.

Professor Blake: I am David Blake, Director of the Pensions Institute at Cass Business School and I am a pensions economist.

Q3184 **Heidi Allen:** We have the academic and the practical and we have a combination of both between you. People talk about this crisis in our pension schemes, in our defined benefit pension schemes, linked possibly to where interest rates have been and the gap seems to be getting bigger and bigger. We are looking at about £500 billion is the estimated deficit now. In your view—perhaps to David first of all—is this something we need to be worried about? Is it temporary? Will it bounce back? Is it natural volatility? How much should we be worried about it and who really knows how big the problem is?

Professor Blake: It is a very serious problem. In the report that we did called "The Greatest Good", we estimated that 1,000 schemes out of the 6,000 were going to be in very serious trouble and unlikely to pay benefits in full. We need to concentrate on 1,000 schemes. I personally think that there is a new normal here, which this is going to be a permanent problem. As Steve said, we now seem to be in a regime of low interest rates, which seem to be permanent, possibly the result of quantitative easing, but that is going to go on for many more years. That raises the price of bonds and makes it more expensive to fund the pensions. I would say that the year 2000 marked the end of a very benign period in global financial history, when we had very stable real returns on equity-type investments between about 1950 and 2000. When there was a crash, there was a bounce-back quite quickly.

We have now entered a new world of what I think are very volatile and possible low average returns on the kind of growth assets that you would otherwise want to invest in. We have the problem of increasing longevity. We also have the issue that the retirement age has not increased with longevity, so 70 is the new 50 and our retirement ages are not increasing.

My view is that DB is dying in the private sector and that could change attitudes towards public sector schemes, in which 20% of the workforce have 60% of the pension benefits. That might lead to some concept of unfairness in a few years' time, but this is a permanent problem. It is concentrated at the moment in a number of schemes that the regulator ought to be, through its covenant grouping, able to identify.

Q3185 **Heidi Allen:** Perhaps before I ask the two ladies their view on that, just specifically in your written evidence that you provided to us, you talked about a lack of transparency. Do you want to just give us a little bit more information on that?

Professor Blake: Yes. The real problem is that there is inadequate sharing of information between the company, the trustees and the regulator. In the cases of these weak schemes, the company might not be sharing information with the trustees and the trustees, therefore, do not have the information to pass on to the regulator.

The regulator relies on publicly available information in company accounts, which are backward-looking. In our "Greater Good" report we recommended that there should be some form of early warning system, as it happens in the US Pension Benefit Guarantee Corporation. They have an early warning programme in which the trustees are required to pass on negative information to the regulator.

The company has to be frank with the trustees and they then have to inform the regulator. Obviously you need to make sure that the company is not crying wolf and not trying to use this as a way of avoiding its obligations, so we need something forward-looking. We need something much closer so that, if the company is in trouble, the company must be frank with the trustees and the trustees then must be required to inform the regulator.

Q3186 **Heidi Allen:** Mandatory—so that would be a complete change then, wouldn't it?

Professor Blake: Yes.

Chair: Do not feel you necessarily have to all come in on every question. I don't want the Chair being totally deskilled. I am watching to see whether you want to come in, but Jenny or Rosalind, do you want to come in on this question?

Rosalind Connor: On the point about there being a crisis, I would say in the last 20 years everyone has always talked about a crisis in defined

benefit pension schemes, so the industry got rather inured to it, because people keep telling us it is all about to die terribly and yet it still moves. But I would say I do think the crisis is there—and it was alluded to by Professor Blake and it was referenced by Mr Graham earlier—the fact that DB pension schemes are not available now for many people.

Everyone in my business, all the young people coming through, are now experts in advising employers and trustees when they want to wind up or close down or close to accrual pension schemes, which they are doing all the time. No one younger than me knows how to set one up and that is a really bad thing, because defined benefit pension schemes I think we would accept are good. They involve the employer taking the risk on things like investments, which it is very tough to get an individual to take, particularly an individual who has no other assets when they retire, yet we have all sort of said, "Oh, well, they are dead and there is not really much we can do about it".

The legislation over the last 20 years has been there very much to protect and gold-plate the benefits that are there and I absolutely understand why, but the result, which I do not think anyone was going for, is there is this great competitive disadvantage if you are an employer with a defined benefit pension scheme, you are competing against people—this was the point Mr Graham made earlier and it is exactly that point—who do not have it, so everyone is just closing them down and 1.6 million people are in a defined pension scheme in the private sector. That includes the university scheme, which is 700,000 people, which most people would think of as public sector, so that is not a great story and that to me is the big crisis.

Q3187 **Jeremy Quin:** I entirely understand where Rosalind is coming from on that and I was going to ask a question of Professor Blake. Our focus, understandably, in the current interest rate environment and given the cost of acquiring annuities, is on the DB schemes. Can I ask what is going on with the DC schemes? Because presumably exactly the same issues are hitting DC schemes, with people coming up to retirement who are DC beneficiaries, yet we do not hear about it because it is not big companies having to make a big decision.

Professor Blake: That is because the company understands fully what is going on and the individuals do not necessarily understand what is going on. They prefer the lump sum and hope that they can make that last for the whole of the rest of their lives, so the increase in drawdown is at the expense of annuities and we had a big collapse in the annuities market for various reasons.

But the problem is on the individual, and what you are going to find in future is, if those individuals do spend their benefits too quickly, there is going to be an increase in poverty in old age and the crisis will be an individual crisis. It depends on how many people do that in 10 or 15 years' time and then it becomes a collective crisis, but what do you do then? Because you know what the terms of your pension were. With a

DB, there is a requirement for the employer to carry on paying a pension, an index-linked pension, until you die. The issues are very different in DC schemes. There is going to be a bigger crisis coming along, but it will be a very personal crisis in a few years' time.

Q3188 **Jeremy Quin:** I was going to ask Professor Blake what he was going to do about it, but, to be perfectly fair, he is sending the question back in this direction. Professor Blake is the first person I have come across—Steve Webb was, previously—who is saying this is going to be a long-term issue rather than a short-term hiatus. In that scenario of people drawing down their DC schemes as a lump sum in the expectation that in one, two, five years' time they will then be able to invest in an annuity when rates have normalised, you are positing the theory that that may not be the case, in which case, is there academic work as to what the scale of the problem could be in 10 or 15 years' time if these lump sums get eroded before the interest rate cycle turns and we are then able to see them investing safely in annuities?

Professor Blake: We did look at that in the independent review "Retirement Income" report that I published earlier this year, but in terms of quantum, something like the Pensions Policy Institute might have done some figures on the relative sizes of the problem. At the moment with auto-enrolment there is not a big pot there yet, so allowing those people to spend the lump sum of money is neither here nor there, they are going to rely mostly on the state pension. It is when you start getting in 10 or 15 years' time or 20 years' time or 30 years' time rather large pots accruing and you then have an absence of a habit of buying an annuity.

The real problem is no one knows how long they are going to live. No one can really estimate how long they are going to live and there is a real danger that people are going to spend their pots too quickly. Most people are likely to do that. There will be a small number of people who do not spend enough and could have enjoyed their early retirement much more because they are hoarding their assets. This will benefit a few people, in my view, but many people will find in a few years' time that this has not worked for them.

Baroness Drake: I was going to say we are going on to the DC market, but yes, of course they will be hit by what is happening to yields, of course it is affecting annuity rates, of course that will influence behaviour, because people will see what they get for annuity against a big pot and they make behavioural responses.

Lots of freedom has been given, but you have two problems, how people behave based on their knowledge and understanding and their own emotional position, and secondly, what the market provides the consumer who has a pot of money and both of those need to be dealt with. You deal with the behaviour issue and people engaging with the market with guidance, advice, whatever the public policy is. It is up for

review and has in fact gone back for review; it has been drawn out of the Bill.

The other area of course is: what are the products there? At the moment, it is a very narrow range of products provided in a certain market way. Huge amounts of the auto-enrolment have gone into master trusts. Could you get a regulatory base for a master trust that they can produce collective solutions on retirement products? Certainly that is something I know that the TPR and I think the DWP are interested and are looking at.

Your core question, are the gilt yields affecting annuities—yes, of course they are. Does that impact on people's choices when they come to retirement with a DC pot? They can be very big. As someone who signs off some of these transfers in DB, they can be big pots, but it is first how you make people make decisions, and secondly, what options they have in the market or through their master trust. There is a lot of work going on and hopefully the Committee will look at that.

Chair: What we also have been seeing and what we are hoping is to tease out of you what you think you might be recommending as well.

Q3189 **Steve McCabe:** I want to go back to something we put to the former Minister earlier. Given everything that you now know about defined benefit schemes, if you were starting again, how would you regulate it differently?

Professor Blake: I would start by recognising that DB started as a promise that was going to be delivered on a best-efforts basis. It has been turned into a guarantee by various UK and European Union regulations. As a result of this, it has been effectively over-regulated out of existence. We would need to go back to the original model and ensure that regulation supported the delivery of pensions on a best-efforts basis. You simply cannot have companies delivering guarantees over 30 or 40 years. They are simply not able to do that, the instruments are not out there to enable them to do that.

The second thing is that politicians need to recognise that a pension scheme lasts for 70 years. It is a longer process than commissioning and decommissioning a nuclear power station and they should stop making piecemeal changes to the regulations that by themselves appear innocuous, but add up over time to destroying the goose that lays the golden eggs, the preservation of benefit—

Q3190 **Chair:** So you are against us making any recommendations that will require changes?

Professor Blake: I would say that you make recommendations that recognise that this has to work for 70 years, try to have that in place to design the whole thing and make sure that the recommendations are consistent with a design that will last for 70 years and then not tinker with it.

Baroness Drake: I would start from the basis of reminding ourselves what the positives are in the regulation and then I have, in my view, three suggested areas where it could be improved. You have to remember, in the year 2000 you have the BHS problem then, with large numbers of schemes with employers simply walking away, companies becoming insolvent. We have to remember that the regulation put in place in 2004 was addressing a problem. That dealt with it quite well. It does not mean it has dealt with everything and we cannot review it.

The PPF has been a great creation; 225,000 people would be out on a limb if there was not a PPF. Insolvent employers now cannot walk away from their schemes, which they could before. They could just wind them up, carry on trading and it was not their problem. You have gone through the principle of giving the TPR moral hazard powers. The issue is whether they are strong enough, or they are deployed correctly and the funding regime has been strengthened. I would not revisit all of that. They were very fit for purpose and had a material effect at that time. You then row forward, because regulation does not remove all risk and things evolve.

My three areas are the information-gathering powers, which first I would probably in certain areas say to the TPR may be more proactive and more focused—that triggers a resource issue—but also give them more power. Reading the BHS evidence that came forward, you had the chair of the trustees saying two days before the sale, "I am still waiting for key information to do a moral hazard assessment" so there should be an ability to compel information to be provided from corporates earlier.

I would not give the TPR that kind of formal clearance power, because I think—as Steve Webb suggested—you have to be careful that it is balanced between getting investment in companies and whatever. I would consider giving them in extremis powers, maybe an in extremis wind-up power, so in a very, very bad situation—I will not give it as an example—where, if you can see that an employer is determined to move and there is absolutely no clarity on moral hazard or securing that scheme, you could give the regulator, for example, a wind-up power, so they issue that before the corporate deal goes ahead and it stays in place until there is evidence how the scheme is going to be secured.

I would probably look at the stressed schemes regime: there is RAA, but whether it is worth looking at something else around the stressed schemes regime, because it would be interesting to know from the regulator what percentage of schemes are stressed and what percentage of liabilities they cover. Then you get some metrics around where is the big stress in the system? Because there are lots of schemes where the employer is behaving very responsibly that are not stressed.

The second one is we have scheme-specific funding, which is right in principle, because you then set your funding to the specific requirements, but I wonder whether on stressed schemes there should be more action upstream and also maybe a tougher regime on recovery plans. Maybe it

has become too easy to extend the recovery plans rather than addressing upstream more quickly the problems.

The third one I would put—I have had this view for a while, and reading the BHS letters confirmed it for me—is strengthening the duty and the requirements on the sponsoring employer to consult and inform the trustees, because the regulator wants trustees to engage but the law does not necessarily give them the armoury and they can have very weak powers under their own trust deed. The law does not give them enough if you have an employer who does not want to meaningfully inform or consult. I would certainly strengthen that and put a duty on the employer to inform and consult so you are not left struggling with the behaviour or response of the employer.

When I read the letter from the TPR where they were giving the kind of timeline, and two days before the sale the chair was saying, "I am still waiting for critical information to do the moral hazard assessment that you have asked me to do" and two days later it is sold, then that tells you that it is crying out for a duty. All the way through it struck me when I read those timelines, time after time after time, there is a point from the regulator saying, "Trustee awaiting critical information", whether it was doing the RAA assessment in the first place or the moral hazard. So those would be my three areas.

Chair: Really helpful, Jeannie; thanks. Rosalind.

Rosalind Connor: I am going to be slightly boring and legal here. If I was starting again, there is a really fundamental problem with the regulation and how it fits together. What we have is an awful lot of statutes; we have 16 Acts of Parliament with the word "pensions" in the title that presently operate, including seven Pensions Acts and two Pension Schemes Acts. There is one Companies Act and they repealed the old one when they brought it in.

There is the Pensions Regulator, who has powers, and then a lot of guidance about when it might or might not use it. There is the Pensions Ombudsman with the concept of maladministration, which is completely outside everything else. Then you have to worry about the revenue, because of course there are revenue rules on keeping your scheme within the tax-efficient environment you want it to be in. Underlying all that, their trustees have duties in relation to trust law.

When I look at this, a lot of the legislation has been passed without really understanding how you can make that play for you. As a result, it gets sort of pushed down and trustees stop paying attention sometimes to the trust law duties. Trust law is a really old concept of law. It is much older than contract law, but it has been brought up-to-date by lots of constant case law around it and basically means that if I have an asset and I want it to be looked after by someone, I might give it to the Baroness here and she would hold it for me and she would have duties; rather like the duties of looking after something for a small child, that you really have to take a

lot of care over it. Increasingly, when you look at a lot of recent legislation, there has been a kind of assumption that the trustees are almost like a commercial entity, which they are not. If trustees are properly trained, good at their job and empowered, you can get a lot out of them.

What I would ask is as legislation is passed, it makes use of the other legal restrains that are there and it all fits together a bit better. The reason why there are over 1,000 of us is that people cannot do anything without asking a lawyer because they cannot look it up themselves, because you have to look in 100 different places.

Q3191 **Richard Graham:** I am very interested in your different responses. Professor, just to sort of stretch you a little bit, what you were implying earlier was almost a sort of caricature of the laissez-faire, "Do not ever interfere" approach to Government, which has led many ships to crash on the rocks. You are saying that pension schemes have, on average, a sort of 70-year life, they are best efforts, not guarantees, the Government should not tinker and, therefore, those employers who do not want to face up to their responsibilities on the pension schemes should basically—logically, from what you were saying—be allowed to just run away from them and then use the PPF.

Presumably you regard the PPF as an example and Government and Parliament tinkering, to sort of pick up the corpses of these schemes and look after them, in which case, why have DB schemes at all? Why not just plop all 6,000 into the PPF and then wait for the asset not to be able to meet the liabilities? I am sort of astonished by what you were suggesting. Can you try to give any justification for Government simply watching responsibilities to very large numbers of elderly people just being ignored and you are assuming we should shrug our shoulders? Is that really what you mean?

Professor Blake: Company pension schemes are voluntary agreements between the employer and the employee and they are still voluntary agreements. The issue was that over time, as a result of regulation and laws, the voluntary arrangements and offering pensions on a best-efforts basis have been turned into guarantees.

Q3192 **Richard Graham:** That all happened quite a long time ago. We are dealing with today and tomorrow. Are you suggesting—

Professor Blake: Yes, but it is the consequence of those—

Richard Graham: —that Government should try to pass a Bill saying, "No, no, forget all these guarantees. They are just simply best efforts" and that is the end of it?

Professor Blake: We are only really talking about the funds in trouble, so about the 5,000 or 6,000 schemes will be able to deliver on their promises. Over time there will not be any new DB schemes and they are

switching to DC, and over time this problem will go away. The issue is with the 1,000 schemes—

Q3193 **Richard Graham:** Yes, but we have to deal with it meanwhile, so that is why we are trying to look for suggestions as to how we can best deal with situations where companies that might have been able to afford those guarantees to their pensioners and deferred members suddenly find they either cannot because the business model is in trouble, or because there has been irresponsible management or a whole number of different things might happen.

That is why we are looking for your best ideas about how—maybe at the margin—we can tweak things so that people like the regulator have more powers to deter people who are wilfully ignoring responsibilities, or to try to anticipate problems that might be ahead, interest rates and so on, so that as many of these 6,000 schemes have the best chances possible of delivering. Surely the PPI can come up with some good ideas to help us on that.

Professor Blake: We are really talking about the 1,000 schemes in trouble. Our estimate is that 600 of those will never pay benefits in full, about 400 companies could be helped to survive if they can offload their benefits, so the issue is: is there something between the full benefit and something above the PPF benefits that we can, with the agreement of the workers and the regulator and the company, deliver?

Q3194 **Richard Graham:** What do you propose?

Professor Blake: One of the first examples of this was unique, which—

Richard Graham: But what do you propose, David?

Professor Blake: What I am proposing is that we allow schemes to renegotiate their deals to stop the company becoming insolvent for the small group of companies in that position, that you allow renegotiation of existing—

Q3195 **Richard Graham:** How do you do that without inevitably invoking squeals of, "This is grossly unfair" from businesses that are doing the right thing, which are working hard to try to ensure—

Professor Blake: It is most likely to be—

Q3196 **Chair:** What is the formula that would allow a company to begin that process?

Professor Blake: The company goes to the trustee and says, "We are in serious trouble. We cannot continue along this basis" and the trustee goes to the regulator and says, "If it is a trade-off between jobs and pensions, we are willing to renegotiate our agreement". In some cases, that might not happen and you wait until the company goes bust.

Q3197 **Chair:** But surely given what we know about trustees, good people but the level of their qualifications, they do not need to go just to the

Pensions Regulator, they need to go to somebody and say, "Is the employer telling us the truth?"

Professor Blake: That is correct. One of the recommendations we made in "The Greatest Good" report was that the regulator should provide a list of specialists in corporate finance. The trustees are not experts in corporate finance, so they cannot possibly judge the trade-off between—

Q3198 **Chair:** Where do they go for this advice?

Professor Blake: The regulator has a set or puts together a list of experts in the field that the trustees, with the agreement of the sponsor and the agreement of the regulator, could go to for the specialist advice that they currently do not have to assess whether this is a genuine case.

Q3199 **Chair:** Why can't they go independently? Why do they need the sponsor's agreement?

Professor Blake: You want to have the agreement of the sponsor and the trustees and the workers to do this. In some cases there will not be—

Q3200 **Chair:** If I, as sponsor, had given misinformation, I would not be too keen on people having the right to go and find out.

Professor Blake: That is a different type of problem. If there is misinformation, then that might be a question—

Q3201 **Chair:** No, what I am saying is surely, given that there might be, the trustees should have the absolute right to go to the Pension Regulator, ie alerting them, but then saying, "Who do I get advice from that the wool is not being pulled over my eyes?"

Professor Blake: That is right, and the regulator would have a list of specialists in corporate finance and corporate recovery that the trustees could use, because they are not experts in this. They are not experts in corporate finance.

Q3202 **Richard Graham:** So your main suggestion is an enormous beefing-up of the cost of TPR, to have a whole range of specialists?

Professor Blake: They would have a directory of specialists. They would not have the specialists in house; they would have a directory of specialists.

Q3203 **Chair:** Would they be paid or they would volunteer to do it on a voluntary basis?

Professor Blake: Who, the regulator?

Chair: No, the expert, the panel of experts.

Professor Blake: No, they would have to be paid; obviously they would have to be paid. The issue is you have this distance between the full benefits and something above PPF.

Q3204 **Chair:** The payment could come, couldn't it, from the pension scheme itself or the sponsor?

Professor Blake: Yes, it could, or the sponsor.

Q3205 **Steve McCabe:** Can I just go back to Rosalind for a second? I want to make sure I have understood the point you were making there about 17 statutes and seven Acts. Were you essentially arguing for some kind of consolidation Act with an emphasis on the role of trustees?

Rosalind Connor: The Companies Act is a great case in point because it is one really long Act of Parliament, but what they did is they in fact included loads of stuff from the previous Act, but they just put it all in one document. There are lots of spaces in there that acknowledge directors' fiduciary duties and the other bits of law that come into play.

Yes, a consolidation would be great. I appreciate Parliament is busy and there is lots of other stuff going on. If consolidation is a bit too far, I suppose my plea is that as things develop, in the light of everything that this Committee is looking at, we do not want another layering on top, so you think, "Hang on, we have this thing here. Why don't we just tinker with that, rather than just shove something new in?" There are lots of great institutions now around pensions that the industry understands and it is quite valuable that it understands, because it means that the people advising trustees know about them. Let's not throw everything away, let's develop what is there a bit more. That would be nice.

Q3206 **Chair:** That would be a good approach for all legislation, wouldn't it?

Rosalind Connor: It would.

Chair: When you come forward to the Cabinet Office, you say, "This is what I am taking off the statute book, because this is going to cover it and it is more important".

Steve McCabe: That used to be a Government rule, didn't it?

Chair: Jeannie, do you want to come in, please?

Baroness Drake: One can frequently say, "I would not start from here" but that does not mean one starts again; they are not synonymous. The thought of a kind of radical reappraisal of statutes and combining them is a huge job.

I am definitely in Steve Webb's camp: that you need a proportionate response to this and you need it quickly. There is an opportunity coming down the line, if it is possible in a Pensions Bill, because we have two issues here. Is what is in the armoury for the TPR sufficient to deal with bad corporate behaviour? That is one issue and it is quite clear where the consensus seems to be building, there are some early gains in strengthening the powers.

The other one is the overall sustainability of the system and therefore do you need overriding statutory measures to deal with this? My argument

would be the overall sustainability of the system is still sustainable. The case is not made that it is not sustainable. You have stressed schemes that are becoming more stressed in a situation that we are facing. It may be that the RAA or the options around that need to be revisited and allow maybe a more upstream response to those stressed schemes, because the PPF and TPR will know them. The PPF knows every scheme, its insolvency risk; it will have priced risk in that scheme when it sets the levy. You have to be careful you do not allow gaming on the PPF, because the PPF is a very treasured body, not to be lightly disregarded in terms of its sustainability.

It is one lifeboat we have, so you have to avoid gaming, but we had a view or a view was taken of moral hazard in 2004 and now it is time to revisit it a little and maybe looking again at the stressed schemes, get the metric around it, get what would help to deal with those. Now, we know RAAs allow benefits to be changed, the Halcrow example showed that, but they were in their context, and in their context you can do things if they are part of a clear stressed regime as opposed to—

Q3207 **Chair:** Jeannie, if you think any further on this, might you come back to us with a separate note? It is really important, as you say.

Baroness Drake: Yes.

Q3208 **Craig Mackinlay:** I want to keep concentrating on the current powers of the Pensions Regulator. I know, Jeannie, you have said about extra things it perhaps should have to be able to act a bit more effectively, but, just looking at the powers that it currently has, you did note that during the BHS episode there were loads of letters saying, "We are waiting for information" and it didn't seem too much of a stick to make the carrot sort of break. Do you think they should be more interventionist within the powers that they currently have? We will deal with that one first. Professor Blake, we have heard your views on that, so Rosalind and perhaps Jeannie.

Baroness Drake: I would take it from two directions. The trustee is the front line and the trustee powers will vary according to their scheme. Employer powers were very important to the scheme, but I don't think in law, unless you are lucky enough to have a trustee rule that says you can wind up the scheme and that allows you to call in your section 75 debt, the power of the trustees to get the information that they need and the consultation that they need in difficult situations is weak. You are very dependent on the disposition of the employer.

I want to make it clear there are lots of good employers who behave very well and there is very constructive engagement. If you have to rely on your employer behaviour, and it is not good behaviour, you don't have a great deal of powers to say, "Give me the information. Give it to me in a timely way and have proper consultation with me. I have to understand this covenant and what you are doing to the covenant". I would definitely put a duty on the employer to consult and give information. It is not a

threat to the good employers. They are doing it. I have articulated that before and when I read the BHS stuff, I mean, I thought this is crying out for it.

Just one other point is that the trustees—how can I put it?—because they don't have those powers to stop a corporate event or demand information, they will look to the regulator and sometimes—to put it carefully—it is, "Well, I can see a problem emerging" or, "I am not quite sure but if I go to the regulator they look at in extremis things. They will just tell me to go back and chat".

It is about just boosting the confidence of trustees that if they go they will get a bit more backing a bit earlier. I don't want to be too critical but people get a cultural and mood music feel and a sense of: if they did go maybe they would get a sharper response. So I, as a trustee, who can see an emerging issue could get more of a focus on it earlier.

Q3209 **Craig Mackinlay:** Do you think trustees feel that if they go to the TPR it is just a bit of a waste of time?

Baroness Drake: No. I don't want to go that far because that would be unfair, but if you can see or if you are little anxious about a problem emerging or if you are having difficulties on the recovery plan—I think you make the same point in your evidence, if I may, Rosalind—there is that sort of, "Well, where is the focus of the TPR and will they give the oomph that I need? Probably they won't". So maybe that could be sharpened—the sense that the TPR would come in earlier saying, "Give me the information, I am not just going to say go and chat about it, let's get some information around this".

On the other side, I share the view that others have been expressing that there clearly needs to be a greater onus on employers to notify where there is a corporate event of some type that is going to be significant: greater information-seeking powers so the TPR doesn't have to keep pushing the trustees in the BHS case to get the information. It is, "I must have the information". I do think they need some in extremis powers where it is so clear that they can somehow put a halt until how you protect or deal with that scheme is done with.

It was quite interesting, I did look up the number of pre-clearance cases and they were down to nine last year. They had been 260-odd at the beginning. I don't know the reason for that but it is a good question to ask the regulator, "Why do you think the numbers going through clearance was 263 in 2006 and fell to nine in 2016? Is that telling us something?" I could speculate as to what it is telling us but it is a legitimate question to ask. Is it because people are much clearer and do not need to come, or is it because there is a perception that you wait until the problem manifests itself downstream? I don't know but it is a valid question to ask.

Q3210 **Chair:** Rosalind, would you develop our ideas on that, please?

Rosalind Connor: Yes, one of the problems is that the regulator has quite a lot of powers. Our general view as an association is we probably don't need to fiddle with them much. They have the power to wind up the pension scheme if it is necessary for the protection of members. They do not use it very much. They have had that since the 1995 Act because what they also have is the power to appoint trustees, and that is often where they are worried about trustees maybe not having the backbone or not having the right skills, or being too cosy with the employer—which sometimes, though rarely, happens—then that is a great way in.

They have the power to demand. Their information-seeking powers are very wide. There is a notifiable events regime; there are things that companies and trustees are required to notify to the regulator. They were reduced after it first came in. They were reduced in the economic downturn because everyone was notifying all time. One of them was a change in your credit rating, for instance. Everyone's credit rating fell—not everyone's but a lot of people's—so people were just going all the time. I am not sure in retrospect—at the time, we all thought that was sensible. I am not sure in retrospect it is great because you are losing some of your early warning.

When you look at a number of the cases—and I was not involved in BHS and do not know what happened—you do think particularly things like the trustees saying, "We are waiting for information", in a way the way that the rating was set up with the regulator was, yes, exactly as Jeannie is saying, the trustees cannot get hold of the power but they can phone the regulator and the regulator has powers that it can use which are enforceable powers. It has powers to demand information; it also has powers to make people do things. There is a great thing called a third party order, where they can basically say, "In order for us to do our job you, and not the people that are an employer or trustee, need to do this thing". That is great when people are saying, "Well, I would give you the information but I am waiting on the asset manager who holds the information". They can issue that order.

The regulator doesn't use them much. My assumption is that that is a resourcing issue. I go to Brighton quite often, as a lot of people in my industry do. It is not a glamorous location teeming with people with vast amounts of equipment. As Steve Webb alluded to earlier, we are asking them to do a lot and an increasing number of things. That is a bit of a problem. No, I don't think the regulator uses its powers enough, I don't think it is interventionist enough, but I do appreciate that what I am asking involves a lot of funding at a time when there is a lot of pressure.

Q3211 **Richard Graham:** It is very interesting, Chairman. Effectively, we have three rather different views. We have the Professor saying do nothing at all. I think we have Baroness Drake saying, yes, there are some incremental things that should be done, and I think Rosalind Connor is saying the powers are there, it is just a case of using them, which might be a resource issue. That gives the Committee some interesting

conundrums to wrestle with. It probably enables you to ask Rosalind whether Jeannie's suggestions do need a bit more in law and, if so, what? Perhaps also to give us an idea of what could happen to a business that is saying to trustees, "We are not going to give you the information". The TPR can say to it, "I want you to give that information" but what is the penalty attached to it?

Rosalind Connor: There is a problem with the penalty attached, which is that at the moment all of it runs into a bit of the Pensions Act 1995 that says you can fine someone up to £5,000 for an individual, £50,000 for a business. I don't want a £5,000 fine. The business I work for doesn't particularly want a £50,000 fine but it can wear it a lot better. A £50,000 fine on the type of business that is putting £1 million into its pension scheme every year is neither here nor there.

So there is a problem. The regulator has much stronger fining powers in relation to auto-enrolment, which are quite meaty, that can round to thousands per day of failure to comply. That can get people really panicky and running around saying, "That's an awful lot of money very quickly". It is interesting when the auto-enrolment came in, and it was coming to the regulator but someone said, "Oh, look at those fine provisions, they are not fit for purpose" and I certainly think having more significant penalties on failure to comply with regulator demands would be great.

One of the things I would say the regulator does very well with its limited resources is it tends to pick a few cases, go all the way with them and make a lot of noise about it so that it encourages other people. They certainly have shaped behaviour by that. There is less bad behaviour because of that. Of course the fines, when they say, "We were very cross with these people and we issued a fine and they had to pay £40,000", then people go, "Oh". It doesn't have the same impact as maybe the moral hazard powers or the auto-enrolment fining.

Q3212 **Steve McCabe:** As you were saying that, I was struck by Steve Webb's comment earlier—that the impact of the dividends and the bonus were such that it was much a greater incentive to pay out a strong bonus than to look after for the pension fund. Is that something that could be regularly and easily changed, by putting a duty on those in receipt of the bonus to show that they had done everything reasonable with the pension fund?

Rosalind Connor: In a way there is something there, because of the moral hazard powers, which are quite brutal really, and the contribution notice powers, that allows a contribution notice to be issued against an individual director. That particular bit of the law is one of the most effective bits of pensions legislation. I am not necessarily advocating one broadens it out, but my experience since that came in is that does really panic businesses. Even if the person making the decision is not themselves at risk, it is a very different thing taking a commercial view, which businesses will.

Businesses run in environments where they know they may get a big hit somewhere down the line. The idea that an individual is going to have a demand for £6 million on them—there are not many people who can view that comfortably. I have found that when you advise employers about their pension scheme environment, the moment you mention that you get a very, very different reaction because that really matters to people.

The payment of dividends falls within that. If you pay significant dividends while you have a pension scheme deficit, you may find yourself falling within the contribution notice situation. My understanding of the stuff about the BHS scheme—again from what I have read—is that in fact those dividends pre-dated this legislation. If that was happening now I am not sure that those dividends would be paid, and certainly no one who advised would pay them because no one wants the risk of a personal demand for that kind of money.

My own experience is not that people are encouraged to go the dividend route. Finance directors are under a lot of pressure from a lot of different directions, and their fear is being fired rather than not getting their bonus because the dividends are not being paid after all. The scheme looks like it is not performing well.

Baroness Drake: Contribution notices are quite heavy. In a sense, as a trustee, when one is looking at the funding of the scheme and discussing it with the employer, you are told by the regulator to take into account what the dividend policy is. You say to the employer, "You are paying too much dividend; please can we have some more money in the scheme?" So it is out there as something that should be in the mix.

I was reading the PPF evidence, and I am with them on this because I looked at the figures and the FTSE100 paid five times in dividends than contribution to their DB plans. In 29 cases the 2015 dividend was more than double the deficit. Employers make choices here between transferring value to scheme members and shareholders. Sometimes there is good reason for that, sometimes there isn't.

I don't think it is a question of new powers, and I did read the PPF evidence on this. I think there was a case for a more interventionist approach on scheme funding. It didn't require new powers; it required a sense of prioritising. They did call out the amount of cash held by some employers and the dividend payments that are being made. You are definitely supposed to take that into account. Two hundred and twelve schemes with over 10,000 members, which would push you towards the bigger employers, account for 62% of the liabilities in this universe, so it is something worth thinking about.

I don't think you need new powers. I would hope you wouldn't have to go as far as a CN. As I keep saying, there are a lot of good employers out there but there is a need to say, "Hang on, there is a funding challenge here. These are tough times", and is the dividend policy getting enough

attention even though it is quite clearly said by the TPR we should take it into account?

Q3213 **Craig Mackinlay:** There seems quite a lot of flexibility in terms of when schemes have problems and tackling those scheme deficits. I do not want to be too cynical, but it seems that the bigger the name among the magic circle and the top four, the better the chance of having a long length of time to tackle those scheme deficits. The TPR: is there a codified method by which they say, "Yes, these are the means by which we will allow you 20 years", other ones will be 10? Do you think strong employers that are very healthy should be trying to close these sooner? In cases you may have seen, do you think these 20 year or 25-year tackling deficit arrangements are practical or sensible?

Baroness Drake: Personally—it has to be a personal view—I think strong employers, well placed employers in a strong position, if they are not already doing so should pay down their deficits more quickly because as a trustee it is harder to get the money. You are dependent on the employer being good for the money over 30, 40 years, and chasing the money when they are in a difficult trading situation is a lot harder than saying, "These are the good times, guys. Can we have a fair share of the action too?" That is a perfectly legitimate point to take. So, yes, I would expect in the good times that you would push for stronger funding in that situation.

When you become a stressed scheme, jumping up and down demanding strong funding, it may make you feel good but if something is not sustainable, it is not sustainable, and if you do not address it something corrects and then people get hurt. I do not want to see lack of sustainability because it is usually the people I care about that get hurt. I do not know the definitive detailed answer but I would say maybe you go back to saying RAA; maybe there is something before that that is particularly focusing on stressed schemes—whether you can do something earlier, whether you can have more scope to do something earlier.

Q3214 **Chair:** Jeannie, you are suggesting that we are simply looking at recommendations—a set of recommendations about how we encourage companies doing well to make sure that they are adding equally to their pension schemes. We need different sets of recommendations about those who are about to enter crisis point, which just don't add to the crisis.

Baroness Drake: Yes.

Rosalind Connor: One thing I would like to correct is any impression the Committee has that trustees—who are the people basically acting for the members here—don't have a quality of arms with the employer. Historically they tend to be the only people who had advisers. Now the employer has them as well because they have to negotiate with each

other. Obviously I wouldn't say that the magic circle firms are the only ones—

Q3215 **Craig Mackinlay:** I just think we had a rough experience with BHS.

Rosalind Connor: The point is that the funding for trustee advice comes from the pension scheme. Now, one may want to look at that and the issues that may raise but pension schemes, they all have lawyers, they have actuaries, they all have somebody who is assessing the viability of the employer, so that when the employer says, "I can't possibly put any money in. I will go bust" they are doing due diligence on that anyway.

I would say the way the regulator has promoted how funding should happen, and the way people have worked with that over recent years, has got really quite good. It is very scheme specific. It looks at things, like risks to the scheme and risk to the business and how those might interact. There are places where a 25-year recovery plan makes sense.

Years ago I saw one in relation to an entity that was a not-for-profit organisation that had some very, very significant assets. It was in the world of museums, shall we say—not quite a museum, but that kind of world. So it had the assets. It was the equivalent of the British Museum saying, "I have the Elgin Marbles". There are an awful lot of people out there making sure I do not become insolvent. You can be confident, as confident as with anyone, that I will be around 25 years' time, what I don't have is a lot of cash because what I have is the Elgin Marbles and I cannot sell them". Just to clarify, it was not the British Museum but it was someone in that kind of world. That makes sense.

The present scheme funding environment allows you to do that. It also requires, as a matter of law, that people who have the money put it in. You are required under the European Directive, where it all filters down from, to get the scheme fully funded and keep it fully funded as soon as you can. The law is there, but again I come back to—a bit like a broken record—the point about enforcing it. The regulator has the power to impose a valuation if one is not agreed on time or is not agreed sufficiently prudently.

The time period for agreement is too long. It made sense in 2004; technology has moved on, does not take 15 months to a valuation any more. That aside, the point is when you get 15 months the regulator can impose and they don't. They don't because that does require a lot of resources, which they don't have in house. I assume it costs a lot of money from them to contract them in, which they would have to do. That is one place where people know that the regulator will not impose.

Obviously, they do not know because the regulator may impose, but the industry is pretty aware that the regulator really never comes back on that. I am with Jeannie on this whole point that most schemes are great and most employers are great, but, if employers want to be unscrupulous and you are acting for the trustees and you turn around and say, "You

know what, if you don’t do that we can get the regulator to impose a valuation on you”, they will say, “No, you are not, the regulator won’t do that”.

Q3216 **Heidi Allen:** Very quick, because we have touched on it already: the moral hazards. So I have heard from you, Rosalind, to say the powers are there, I have heard Jeannie say it is about time we looked at them again, so I am interested in your views as to whether the powers are punitive enough or are they just not being used, and what, if anything, you would do to change them?

Baroness Drake: Can I just say, Rosalind is the lawyer, so I may be arguing for more powers when she is saying, “Your point is valid but the powers are there. It is about using the powers”. So I am not going to sit here and say there is an absolute hard line. Our sentiment is in the same direction; I wouldn’t necessarily have her knowledge of whether it is a new power or utilising an existing power. I just make that point. That is in mitigation of my lack of legal knowledge. It doesn’t mean necessarily we are on the wrong page; it is where the emphasis is: is it deployment or is it new powers?

Q3217 **Heidi Allen:** I suppose the fact from an operational day-to-day point of view that you feel that it needs changing suggests that something needs to be done.

Baroness Drake: The trustee powers. The duty on the employer to inform and consult, I am clear that is legislative change.

Rosalind Connor: Yes, it is. What I would say on the moral hazard, and I have said it already, is that I think they are punitive enough. I don’t think they get used enough, and this is the point Jeannie made earlier about not many people going for clearance. Clearance is clearance so the regulator will not use those powers. In the early days we were all very much encouraged to do so and over time, I would argue, less so. The clearance process is not an easy process to use—

Q3218 **Heidi Allen:** That was going to be my next question. Would you change anything there?

Rosalind Connor: That is partly because it is quite cumbersome and there are a couple of rather odd things there, such as the regulator takes the view that, if there isn’t something they see that is wrong they will not give you clearance. That is really irritating because, if I was buying a business where I knew the regulator was looking at the old owners and was angry with them about things they had done, I would not buy that business unless I got clearance. I have not done anything that might require me to get clearance, but you will not find a purchaser who will take it unless they can be guaranteed a clear hand, so that means the businesses where there was trouble and mismanagement in the past cannot be saved. That is not good.

From that point of view, there is a problem. When it runs, the clearance process runs quite efficiently and quickly. It is that there are lots of odd ways in which it is quite difficult to run. If the regulator was encouraging us or there was some other way of encouraging people to go for clearance more, and perhaps the regulator published its clearance results on an anonymised basis, you would get a lot more understanding of what it was that the regulator might do. One of the problems with the moral hazard powers is that people don't know when they might be used, which means that some people are overly scared and a lot of people are not scared enough.

Baroness Drake: I don't disagree. I am conscious of the Committee's time. I have articulated the areas where I would focus. But I do not think I disagree with that sentiment.

Professor Blake**:** In relation to the previous question as well, I would disagree with my colleagues on this issue of the tackling of the deficits. I don't think you need to worry about the stronger employers; you have to worry about the weaker ones. The reason is that the Pension Protection Fund cannot charge the full risk adjusted premium that it would do if it was an ordinary private sector insurance company.

The stronger employers face a double jeopardy of, first, paying off their deficit sooner, which might affect their investment programme, and, secondly, they will end up paying higher premiums overall if you get more and more companies going into the Pension Protection Fund. They will then decide, "We will buy out. We will leave this and we will not be involved" and the Pension Protection Fund will be in serious trouble, which then leads to the moral hazard issue. So I am concerned about long-term viability of the PPF.

Richard Graham: That has been incredibly helpful. I get a strong sense that we need to talk to the TPR about their powers and there may be something that needs to be done on penalties. I get a sense that we need to perhaps look at what in extremis powers they might have for a scheme that is clearly doing the wrong thing and simply not co-operating with either trustees or the TPR. That is the sense I get. I am seeing a little bit of nodding, which is encouraging. Issues like pre-clearance and valuation speeds and details, we might dig into them as well. So that has been very helpful.

Chair: We are very grateful and I am sure the regulator will be looking at your evidence when they come before us. Thank you very much.