

Work and Pensions Committee

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

Wednesday 19 October 2016

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[Watch the meeting](#)

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

Questions 3257-3330

Witnesses

I: Baroness Altmann CBE, former Minister of State for Pensions, Tim Sharp, Policy Officer, TUC, Stephen Pugh, Finance Director, Adnams PLC, and Paul Duffy, Secretary, SME PPF Levy Consultation Group.

II: Chris Martin, Managing Director, Independent Trustee Services Limited, Andrew Bradshaw, Association of Professional Pension Trustees, and Janice Turner, Co-Chair, Association of Member Nominated Trustees.

Written evidence from witnesses:

- [Tim Sharp, TUC](#)
- [Stephen Pugh, Adnams PLC](#)
- [Paul Duffy, SME PPF Levy Consultation Group](#)
- [Chris Martin, Independent Trustee Services Limited](#)

Examination of witnesses

Witnesses: Baroness Altmann, Tim Sharp, Stephen Pugh and Paul Duffy.

Q3257 **Chair:** Welcome to you and thank you for coming this morning. Much of our session is specific questions to individuals. There are some general questions at the end to open up for your other views as well. For the sake of the record, Stephen, would you begin by identifying yourself, please?

Stephen Pugh: Yes. I am Stephen Pugh. I am the Finance Director of Adnams.

Chair: Ros?

Baroness Altmann: Ros Altmann, former Pensions Minister. I have worked on pension protection and pension funds for the best part of 40 years.

Chair: Ros, can you speak up when you come to it?

Baroness Altmann: Sorry.

Chair: We are anxious to hear your answers, as with others. Tim.

Tim Sharp: I am Tim Sharp. I am Policy Officer at the TUC, specialising in pensions issues.

Paul Duffy: Paul Duffy, long-term person in the pensions industry, advising a group of small self-administered companies on the reaction to the levy following the change of model.

Q3258 **Richard Graham:** Thank you very much. Stephen, good morning. I wanted to ask you about your written submission to this Committee, for which many thanks. In it, you highlight the difficulty of the Adnams scheme and in particular the provision it has in pension rights accrued before 1999, which increase at a minimum of 4% a year, which is clearly an incredible burden on the scheme sponsor. I think you raised the question of what can be done about this. From our point of view, can you explain why the sponsor and the trustees have not been able to reach an agreement on amending this themselves?

Stephen Pugh: It is difficult to amend that. The trustees would be saying to themselves, "Our pensioners are benefiting from this. Why would we want to remove that benefit?" If the company were threatened in insolvency terms by having to fulfil that promise, then clearly there might be leverage to say, "We will change it," but otherwise I cannot see they have any incentive to say yes.

Q3259 **Richard Graham:** I suppose the key question there is if the company is doing incredibly well and can afford it, then the company presumably isn't that fussed. On the other hand, if it is a serious impediment to financial success, growth and all the rest of it, then it might have an impact on the sponsor's ability to be able to keep honouring its pensions promise. What has been the dialogue between the sponsor and the trustees on this?

Stephen Pugh: There has been dialogue, but there has not been much movement. I think it is accepted by the trustees that it is generous, but it is also in their interest to say, "That is what you signed up to, so that is what we are getting," so that there is no reason for them to say otherwise.

You say that we are not that fussed. We are definitely fussed. It is material to us, but we are well-founded. It is not that we cannot afford it, but just doing some quick numbers, maybe 15% of our profit might be paid in in terms of making up that promise alone, which is not unaffordable but is perhaps not very reasonable.

I asked a slightly theoretical question in my submission around is there no point at which a promise could be revisited? You might say, "Okay, Adnams can afford 4%, so go away and get on with it." What if it had been 8% or 20% or what if it was less affordable?

Q3260 **Richard Graham:** Can you give us an idea of the impact of paying this 4%? Do you have any rough figures in mind as to what this costs the company and what that is as a percentage of turnover or profit, whether it is impeding something in particular or preventing new employment? Can you quantify that?

Stephen Pugh: I can give you some rough magnitude, yes. We have around £30 million or so of liabilities. If we moved from 4% to the current rate of RPI of 2%, we would save about £6.5 million of liabilities. If that were paid over 10 years—that is £600,000-ish a year—that is about 15% of our profit, so it is not taking the wheels off, but it is material just for that one promise and that has an impact on our financial planning.

Q3261 **Richard Graham:** What would you like to see done? What is your own belief as to the best way to solve this? You have probably taken legal advice and so on, have you?

Stephen Pugh: Yes, which is generally, "A promise is a promise. Go away." I do wonder what role absolute numbers have in pension promises, if somebody plucks 4% out of the air and says, "Pay that then." I can possibly understand if somebody says, "Index by inflation; index by wages," but, "Just give them a percentage," which might seem reasonable in 1987 when the promise was made, seems rather less reasonable in the circumstances of today. I do wonder whether absolute numbers should be revisited.

Q3262 **Craig Mackinlay:** Ros, nice to see you again. You have said you favour the change in the uprating of state pensions perhaps by revisiting the triple lock, and frankly I would not disagree with that at all. Obviously the Government have it in their hands to change this formula as they please, as the House decides. Do you think there should be something similar within the DB scheme to allow the sort of flexibility, whether it is just linked to the general increases in Adnams salaries? If we consider pensions to be a deferred salary, then it would not appear unreasonable that DB schemes could uprate by a similar method by which the general

salary bill is increasing for the existing company's current employees.

Baroness Altmann: There are two issues here and I certainly welcome the opportunity to clarify my view on the triple lock. As Minister, I had suggested that we keep the triple lock to 2020. I think that is a commitment that is important, but it was clear to me that after 2020 the only protection for the state pension in law is to uprate in line with earnings. My suggestion was that we should use a double lock, so that you have pensioners promised protection for the best of either earnings or price inflation going forward, because the very odd situation is that the OBR and the long-term fiscal forecast for the costs of the state pension bake in the triple lock, rather than the legally required earnings uprating.

Quite honestly, the 2.5% is a bit of a totemic political construct; it is not relevant to anything in particular. With a double lock, pensioners would have the guarantee that at least they would get the better of earnings or prices, but there is still nothing to stop any Government, any year after 2020, deciding to do more. You would not necessarily have to revisit that 75 pence state pension uplift that caused the whole furore in the first place, but you would leave Governments an opportunity to pay more.

Q3263 **Chair:** What you are advocating then is a double lock, which at a minimum would guarantee pensioner incomes don't fall in real terms but they might in some years rise in real terms as well.

Baroness Altmann: If the Government of the day deems that that is appropriate. The reason I suggested—

Q3264 **Chair:** No, with the double lock, if earnings were above inflation, then they would get a real increase whatever the Government thought.

Baroness Altmann: The idea would be that the state pension would not fall behind the average earnings increase or the average price increase, because pensioners will never have an opportunity to increase their incomes in future in the way that people who are working are. The reason I thought that made sense—and I still do—was that under the current legislation, the earnings protection may not be sufficient in years where inflation might be quite high and pensioners would then struggle, but also—

Q3265 **Chair:** You are saying then that you would increase it more than inflation in those years under your double-lock proposal?

Baroness Altmann: What it would do, importantly, is it would significantly reduce the long-term costs of the state pension in the fiscal forecasts, because the long-term fiscal forecast, for some strange reason, builds in the triple lock forever. Even though it is only committed to 2020, those forecasts assume that it will carry on. That 2.5% adds billions to the long-term costs of state pension and it doesn't relate to any realistic economic factors. Politicians of the day should be allowed to decide how much above either earnings or inflation, if anything, the country should award to pensioners, but at the moment that 2.5% sort of stymies any political discretion.

Moving on to the defined benefit scheme implications as a separate issue, the ability for companies to have a statutory override, so that if they need to they can change the way inflation is measured for the uprating from RPI to CPI does have some merit. If it means that the scheme is more sustainable and its sponsor is more sustainable in the long run, it will add to the security of members' benefits, which of course is really important.

If the sponsor is forced into failure or very close to failure, at that stage then the regulator steps in and benefits can be cut by far more than just RPI/CPI would imply. Of course public sector schemes and any private sector schemes whose trust deed happens to have wording that would allow it is able to do it anyway. You are not saying all employers must change from RPI to CPI, but you are allowing that if there is a requirement and if the employer would otherwise have a problem. We are trying perhaps to make the best the enemy of the good by saying, "Every last penny for every single scheme." In any case, we are not saying that, because if the scheme already has the opportunity to change it will have done or could have done.

Q3266 **Chair:** Can I push you a little bit on that? Supposing one introduced the power so that the sponsor could say, "We are changing the indexation." If the company and the scheme are up against it, probably many trustees would agree to that. But there might be some employers who think, "God, this is another good way of pushing investments, which we might want to use for investment," and all the rest of it. Would you have any second stage where those trustees who think it is not warranted at that stage for an employer to exercise their right for lower indexation?

Baroness Altmann: I would suggest that there would be perhaps a need for regulatory approval. If the trustees agree—

Q3267 **Chair:** By whom, Ros?

Baroness Altmann: The trustees, if they are not comfortable with it, and believe that the employer is just trying to not pay what it can afford to pay.

Q3268 **Chair:** Who would be the regulatory authority they would go to?

Baroness Altmann: The Pensions Regulator I think is the appropriate authority for the trustees to turn to, or you could require regulatory approval anyway. There are a number of ways in which you can do that. We are at a very, very critical stage for defined benefit pension schemes in this country, with the majority closed. If you look forward 10 years, it is important to make sure that we can get money in today while employers still have some interest in funding them. The longer schemes are closed the fewer, if any, workers are there and the more companies will be sold on and employers will have less and less interest in supporting the scheme. It is a very critical phase now as we move forward.

Of course, as the economy is reasonably okay, you could argue that we do not want to make it too easy for employers, but what we also need to do at this juncture, I think, is have plans in place to secure the sustainability of these schemes for the longer term, rather than blindly forcing everybody to say, "Right, that is what you promised. You have to pay every last penny" and then looking back in five or 10 years' time, when a crisis might well be upon us, and saying, "If only we had a plan."

Q3269 Heidi Allen: A question for Paul: looking at smaller businesses now and the work that you do around the PPF levy, what is your view? Does it work? Does it penalise them unfairly? What would you like to change about it?

Paul Duffy: It does penalise smaller companies in particular, because smaller companies have a lot of fixed costs in running their plans, adviser costs as well as the contributions. Definitely there is a feeling somewhere that the levy is another tax. I think there is a recognition that it is here to stay at least in the short term, but we certainly have examples where the levy is twice the size of the money going into the scheme. You will be thinking there, "Wouldn't that money be better off going into the scheme and helping the funding?" because ultimately, if it goes into the PPF, that money will be in there anyway.

We got together initially because of the change in the model used by the PPF. They changed the model and changed the agency. That in itself brought a lot of anomalies and cliff edges in terms of the scorecards. For the group of companies that we represent, the levy rate—which does affect the levy payment—doubled, so following the change in 2015-16, the levies for the group of seven companies that I represent doubled. This was at a time when the levy payments to the PPF went down by 9%, so in the context of that somebody was winning and somebody was gaining. It seemed to us that the way that the model worked, it impinged on manufacturing and engineering companies.

In our submission, you will see that we made observations in relation to scorecards and what happens if you change banks and creditworthiness. We have consulted with the PPF on this and they are listening.

Q3270 Chair: Can I interrupt? When you say it doubled, might you give us some monetary figures to that, Paul, against the size of the companies you are talking about?

Paul Duffy: Say the levy was £100,000, then in those situations the levy would be £200,000.

Q3271 Chair: What sort of companies are you talking about? How big is their base, please?

Paul Duffy: We are talking about companies from a range of £6 million up to £50 million. It is the companies at the bottom end that are affected by this, because I cannot emphasise too much the impact on adviser costs, which are generally fixed to some extent, and the ability for these companies to survive. We are talking about survival here for lots of

companies that have these legacy DB schemes that started in the 1960s and 1970s. Invariably accrual ceased and they are trying to keep it going. Undoubtedly there are impacts on company behaviour, employment and the way in which they are developing. Some directors/owners of these plans are basically keeping it going just for the purpose of sustaining the product.

Q3272 Heidi Allen: Just for the record now, could you give us your top three things that you would like to see change?

Paul Duffy: I would like to see the suggestions that we have put forward to the PPF enacted in terms of looking again at the model, reducing the cliff edges. For example, I don't know if you have come across this idea of the bands that go from band 1 to band 10 in the levy. The band between 6 and 7, if you just drop into 7 that is another 55% levy, so that is one impact where we would certainly like the scorecards to be reviewed and we would certainly like to see creditworthiness being properly recognised.

There is another area where I have made a suggestion in the submission that we look at exits for the minority of companies that are at the other end and could consider buy-out. Buy-out for small companies is almost impossible in the annuity market because they are not available. I am suggesting that we look at introducing a section in the PPF where they could take on funds that are in a state that they could almost buy out. The advantage would not only be the availability of the ability to do it, but also hopefully significant reductions in cost.

It would be good if the Department for Work and Pensions could approve some review of this proposal so that we can follow it through and see whether we could extend the role of the PPF in this area to allow solvent companies to transfer their legacy DB plans.

In terms of costs, it is probably also worth mentioning the time that companies spend, trustee time and management time in managing it. In this situation, not only getting the plan off the balance sheet but getting it administered somewhere else would be a great help to these businesses.

Q3273 Heidi Allen: One final question. In a previous life I ran a small business. Would you say that the size of the business that should or should not be pulled into this should be looked at again?

Paul Duffy: Yes. In terms of my suggestion there, I was focusing on SMEs because we do not want to distort the market. I think we should start looking at SMEs to begin with and smaller entities, particularly those in the lower-risk bands. On the issue of survival of those in bands 9 and 10, it almost becomes a self-fulfilling prophecy if you get into those bands because you have been asked to pay a lot more money into the levy. At the same time the actuary is probably suggesting that because you are an insolvent employer the assumption should be more prudent and that you should be paying more in there as well. It is at that level that we need to focus on a set of proposals that help save employers at

that level. They employ a lot of people throughout the country and definitely it is affecting their ability to expand and employ and invest in the future.

Q3274 Richard Graham: Paul, thanks. I ought to probably declare an interest in this, because I think you represent at least one or two companies in my constituency.

Paul Duffy: Yes.

Richard Graham: Just to give us a bit of the flavour, the seven companies you represent, are they all manufacturers?

Paul Duffy: Six are.

Q3275 Richard Graham: Six of them are, and on average for how long have each of the businesses been going?

Paul Duffy: At least 30 to 40 years.

Richard Graham: Some for over 100?

Paul Duffy: Yes. In one example, yes.

Q3276 Richard Graham: When you talk about the cost going broadly from £100,000 to £200,000, the figure you gave of £6 million, that is a turnover figure, is it?

Paul Duffy: Yes.

Q3277 Richard Graham: So the actual profits of say a business with £6 million typically in the sector they are in, could you give us a rough idea?

Paul Duffy: Zero.

Q3278 Richard Graham: So what we are talking about, although £200,000 may not seem to some businesses a great deal of money, in the case of the SMEs you are representing it is a significant amount?

Paul Duffy: Very much so. When we are talking about SMEs, it is not just the levy. The levy could be seen as the straw that breaks the camel's back metaphorically, but we are talking about being able to afford the pension contributions in themselves.

Q3279 Richard Graham: Of course you have mentioned that quite apart from the levy payments and the scheme contributions, SMEs also have significant costs from external fees, legislative changes and so on. Have you had the chance to deliberate with the companies that you represent, with the sponsors that you represent—and with anyone else in the industry or the DWP—the possibility of arranging some form of scheme consolidation? Assets and liabilities of all seven could be pooled in some way, while recognising the individual accounts and so on, which could potentially heftily reduce the costs, possibly increase the quality of governance and all the rest of it. Is that something that the schemes and you have looked at?

Paul Duffy: Not in detail, I must say, because I think these group schemes that are being pooled together, there have been industry schemes that have worked like this. Ultimately you cannot pool deficits and you cannot pool covenant reviews. Where the savings are is if you are using uniform investment managers and uniform advisers, so there is some opportunity there and perhaps more could be reviewed.

Going back to the example I gave you on the £6 million company, then the costs for that company, legal costs and everything else, are up to £100,000.

Q3280 **Chair:** In addition to the levy?

Paul Duffy: In addition to the levy; in addition to the costs going to the scheme.

Q3281 **Chair:** With nil profits?

Paul Duffy: Well, because of that, perhaps no profits.

Chair: They may be pushed into nil profits.

Paul Duffy: Yes, definitely no profits.

Q3282 **Richard Graham:** Chairman, if I might, can I turn to Baroness Altmann on this? Ros, this issue has been around obviously for a while. Some would argue it has become a greater problem because of some of the issues Paul mentioned in his written submission and today, not least in terms of the new method of calculating the levy and so on. When you were at DWP was there any discussion about what could be done to help SMEs and whether there wasn't, in today's environment, an enhanced risk of some of these companies simply folding, not least because of the pressures?

Baroness Altmann: One of the first big meetings I held when I was Minister was looking at the sustainability of defined benefit pension schemes. There has been a bit of an air of complacency.

Q3283 **Chair:** Where is the complacency, Ros?

Baroness Altmann: Probably both the DWP and the regulator. I think there is this general feeling that, "Most employers can afford it. They are just choosing not to," or, "It is not something that is a big issue. Let's focus on DC." But I think DB is really important, especially in the way we have just heard. The opportunities for cutting costs, while still being able to deliver benefits, are on offer but we have not used them in the way that I would have hoped we would.

Since last June things have become a lot more difficult, never mind less difficult. The situation is even more urgent, I feel. There are a number of small companies and charities who cannot cope with the costs of their defined benefit scheme, but also cannot get out of those without going bankrupt, or in some cases you have non-incorporated sponsors who are going to be personally bankrupted, lose their homes, lose everything, because of the costs, which in particular are the costs of annuities. If you

want to get away from this risk, the only way legally you can do it at the moment is buying annuities, whereas if you were to have some kind of pooled mechanism that used an approved measure of self-sufficiency that was agreed would be a reasonable measure to deliver the benefits over time—

Q3284 **Chair:** Agreed with whom, Ros?

Baroness Altmann: Again, I think you would need regulatory approval and you would need industry approval. This was intended to be a big piece of work across all the interested parties—PPF, regulator, DWP and the industry—whereby you could look at a regime for schemes to be able to wind down, but not have to wind up. The costs of annuities have become even higher. In effect, what we are doing at the moment is turning manufacturing companies, small businesses and charities into annuity providers.

I am looking at a scheme that is 98% funded on its technical provisions, which is what is meant to assume it can keep going for the long term, and it is 61% funded on a buy-out basis. The QE impact on annuities has been a little bit ignored, I think.

Q3285 **Richard Graham:** Ros, just to interrupt, where has this got to? Where was it by the time you left and who is going to lead on this? That is the crucial thing.

Baroness Altmann: I think DWP needs to lead on this. I hope they are continuing the work. It was put on hold for quite some months because of one of the big schemes that was taking up all the officials' time, which is a shame, because we lost a large amount of time when I think we could have been moving forward on some of these issues.

Richard Graham: So there are capacity issues, effectively.

Q3286 **Craig Mackinlay:** Ros, I am glad you have raised it. It is exactly what I was going to raise with Paul, but you probably will be able to answer it. How do we put together a rescue-type arrangement for these smaller almost zombie manufacturing companies? They used to have a huge number of employees and are now a lot slimmer. As you say, they have become really a company supporting an annuity pension scheme. We need to get our minds around how we can get these companies not out of them, but into something new, with completely eye-watering amounts, if you want to buy them out, of 30 times, 40 times. These are now eye-watering numbers. The other side of course is we are in a low interest rate environment. Government gilts are 1.1% or thereabouts. Is there an opportunity by which we could perhaps create the fund out of the low interest rate environment to then implement the buy-outs for these companies so that they can be released from what is perhaps holding them back for new profitability, new employment and all those good things? Do you think this is something—it would be quite revolutionary—whether we could think of that?

Baroness Altmann: Yes. We have to think about it, to be quite frank. What you are saying is what I was trying to say, but maybe did not

express it as well as I should have done, which is some kind of measure of self-sufficiency on an ongoing basis, without buying annuities, because the risk margins and the profit margins are enormous in annuities.

The local authority schemes have started to do something like this by pooling all their assets into this kind of sovereign wealth fund approach. The PPF has done brilliant work on managing its assets. If we were to have a division of the PPF that, let's say, took in assets from the existing schemes, the employers would be required to pay a premium, but not the extent of an annuity premium, in order to be able to say, "That is our limit of responsibility on a self-sufficiency basis". The PPF, or whatever this central discontinuance fund arrangement or this wind-down/pooled fund arrangement would be, would continue to manage the funds on an ongoing basis. If the funding environment becomes easier, great. If it does not, then the schemes would have been assessed as having enough to keep going without bankrupting the sponsoring employer.

As we move forward over time, as I have described, it will be more and more important to have a way to do this, because at the moment you have this sort of binary cliff edge: you either pay every last penny or if you are going bust, then you can make draconian reductions. I think we need somewhere in between that is approved. It is a big piece of work. I am not saying you can do it overnight, and it is one of the things I was hoping we would already be quite a bit down the road for, but I do think it is important.

Q3287 Craig Mackinlay: Paul, just very briefly, how often does the PPF then reassess these companies to say, "Now the risk surplus is X"? Is it every year, every three? Is it at the time the—

Paul Duffy: It is an ongoing basis. On a monthly basis the rating changes and that is why there is so much volatility in the calculation of the levy. It changes from year to year.

If you do not mind, can I just pick up what Ros has been saying on this issue? This is one that I have been looking at very closely as well. You used the term "zombie companies". That is exactly right, if there could be a situation where we could have a fund that companies could exit these plans and provide benefits for the members. The buy-out on an annuity basis was a reaction to Maxwell, if we recall, and it changed significantly the way things were done. It was too weak, the previous basis, but the pendulum went, "Dum", and I am afraid it is a backdrop to creating a lot of issues. I think Ros's suggestions here—together with mine, I hope—can be followed through.

Tim Sharp: It is important to be clear on the scale of the challenges that we are talking about. Clearly some companies have very severe problems, but if you look at the evidence submitted to this Committee from the Pensions Regulator, it is clear they think schemes accounting for about 10% of deficits have some sort of challenges in meeting deficit payments.

The other point that comes from the discussion we have just had is that we keep talking about funding schemes to a buy-out basis, but we have to remember these schemes are looking at liabilities arising over 20, 30 years upwards, sometimes 50, 60, 70 years. The problem we have at the moment, certainly the problem created, is that many schemes are continuing to have their deficits looked at on a gilts basis and it is no longer clear that that is the appropriate mechanism.

A lot of the agenda that Ros talks about we would be very interested in. Certainly in the UK, with 6,000 pension schemes, the ability to build scale somehow, whether that is pushing schemes together, whether that is common investment pools of the type that we have started to see with the local government pension scheme, there are important things that we can do there. But let's not overreact to a situation that in many ways is reflective of what has been happening with quantitative easing.

Q3288 Ms Karen Buck: How would you feel that we would best strengthen the position against companies that are solvent that seek to offload their responsibilities? What are the best measures to protect against that?

Tim Sharp: To protect against companies that are offloading? At the moment we have a position where clearly those companies that cannot continue the schemes go into the Pension Protection Fund. Looking at it from a member perspective, that is a very important protection. One of the challenges we have is sponsors and trustees feeling they have to fund schemes to almost buy-out levels, which is putting great pressures on those schemes and those sponsors behind them. I think we have a problem that we have too many sub-scale pension schemes that therefore have problems getting good value from their providers and challenges in governance as well. We haven't yet been able to tackle that.

Q3289 Ms Karen Buck: Just so that I am clear, in terms of the Pension Protection Fund specifically, the TUC are saying that there should be better compensation but without increasing levies. Just talk us through how you would envisage that working.

Tim Sharp: I don't think we are the only organisation looking at what the Pension Protection Fund does. Clearly, members whose schemes end up in the Pension Protection Fund today are in a far better position than those before the PPF was set up. The last Government recognised there were challenges, particularly in terms of how workers with long service were treated. We got legislation passed in the last Parliament and that is being consulted on now for implementation.

You have had evidence put before you—not from the TUC, but I think from other organisations—about the situation of those with a lot of benefits built up pre-1997 who do not get inflation uprating. They face severe constraints on their income, so we think that having the PPF look at ways of investing in a manner that means they are looking at whether they can increase benefits over time will be something sensible to do, rather than locking in at the moment a set of benefits that, depending on

who you are, can severely constrict the income going to those pensioners.

Q3290 Heidi Allen: A question for Ros, if I may. So far we have been focusing mostly on the smaller companies who are really feeling the squeeze, and the description “zombie” I think paints it perfectly. At the other end we have Stephen’s organisation, which is coping, it is a good business, it is profitable, it is managing, but wonders whether that is sustainable, but okay for now. If we turn our attention to the other end—and you probably know where I am going with this—what would you have done, what more could we have done with BHS, because that is the other end of the spectrum now?

Baroness Altmann: The thing that puzzles me and the thing that I—

Chair: Can you speak up, Ros?

Baroness Altmann: The thing that really puzzles me and that I would have loved to ask is why the owner did not get clearance before selling the business. For me, that is key. If you want to sell a business with a pension scheme attached, and you do care about the promises you have made to your pensioners—you have owned that business for 15 years and those people have been loyally working for you for 15 years—and every month you have promised them that they will get this amount of pay now and an extra amount when they reach pension age, and all past pensioners also being promised that, why would you not use the established processes, which exist for very good reasons, to find out from the Pensions Regulator what it is you should fairly put into the pension scheme before you sell it to somebody else who will take over the responsibility that you have shouldered for 15 years? That is where I am really puzzled.

Equally, and allied to that, what I have not seen or understood is what plan there was for how the pension deficit was going to be met once the business had been sold, because it had a huge deficit, we all know that. Yet when some papers were submitted to you, some of what was indicated in those letters was that the business was being sold to RAL debt-free. How can a business with £0.5 billion worth of pension debt be considered to be debt-free? What was the plan for repaying that debt? If that means somebody thought, “This isn’t real debt. It is just pension debt,” which sometimes you do hear, then obviously that is not acceptable. If, however, clearance is not obtained before selling the business, then the regulator—absolutely rightly, under our system—has to go and investigate what happened in the past and get all the information from the seller, which would have been received in the clearance process anyway, and I believe it may have been asked for, but was not forthcoming. What was the urgency in selling that business?

Now I think we need to see what is done by Sir Philip to make sure the pensioners are looked after better than they would be if they went into the PPF. He has said he will do it. I hope he will do it. We are told that he is working on a plan. I think we need to get serious and real about when

an employer who wants to sell a business with a huge deficit attached is able to say, "That is it. That is the limit of what I need to do," and the regulator needs to then—if they have not achieved clearance beforehand—come back and say, "That was not anywhere near enough. What provision did you make?"

There are maybe three recommendations one could make: one which is quite draconian would be to tell the regulator that any scheme with a deficit must get clearance before the business is sold. I think a lot of employers would understandably argue that that could undermine the business and make it fail if there is a good deal on offer. Secondly, perhaps the regulator could say, "We have identified a certain number of businesses that if they are going to be sold, you will have to come to us for clearance and notify the owners of that." In that case the regulator could perhaps serve a notice on the employer saying, "You cannot sell the business," or you could leave it as it is now with clearance being required, or if you do not get clearance, a proper plan has to be written and identified and then be able to be demonstrated thereafter for how the pension deficit was going to be met, how the pension promises were going to be honoured.

Chair: Great, so a triple lock there. Paul, I think you want to come in, don't you?

Paul Duffy: Yes. Just a brief comment on my favourite subject, the levy. It is so important to get the levy calculation right for the larger companies because a company's situation can change. How much levy did BHS pay in over that period? I think it should be a focus of the next consultation period of the PPF to make sure that the levy for large companies is properly analysed.

Q3291 **Chair:** Tim and Stephen, what would you add to the triple lock, please, or fourfold lock?

Tim Sharp: We should be very wary about penalising good companies providing decent pensions for their workers. Anything that is too onerous just acts as yet another incentive to scale back pension provision. Also we have to consider to what extent situations like BHS are a pensions problem and to what extent they are a corporate governance problem. Let's not try to use pension legislation to deal with a problem of owners not taking sufficient account of other stakeholders' interests.

Stephen Pugh: I can only add that the triple lock, or however many locks you have now, includes absolute numbers and why would you want to do that?

Q3292 **Richard Graham:** Can I just come in? There is a linkage between the questions Heidi was asking about BHS and the former Pension Minister's reply, and in a sense, Paul, what you are looking for on the levy and what Stephen is interested in in terms of provisions and ability to change ancient trusts. The question for each of you is how can we balance trying to give smaller companies, who are not very profitable, the ability to reduce the costs of the structure of PPF on the one hand, and on the

other creating a situation where the PPF is accepting pension schemes from solvent businesses who might be paying out large sums of money in dividends? How can we balance the two so that effectively the shift of responsibility does not move from employers to taxpayers lightly—that is, we identify real cases that need help rather than just opening the door for everybody to offload their pension schemes into the PPF? I would be very grateful for your thoughts on that. Paul, should we start with you and then go down the line?

Paul Duffy: It is a very difficult question and I think it is a question of balance, as I see it. Ultimately we have to identify companies that would otherwise be profitable and succeeding if they did not have the legacy pension scheme. We should not try to hide behind the fact that we have a legacy pension scheme and underlying the company is not profitable. I think that has to be established, some way of identifying that and recognising that.

You suggested some way of pooling. I do like the idea from Ros that we look seriously at what we can do for companies that are solvent and could trade successfully, who have had a legacy scheme for 30 or 40 years and not provided any pensions for current employees. Remember, these companies are still in auto-enrolment as well. How can we get this balance so that small businesses that should be thriving continue to thrive?

Q3293 **Richard Graham:** But you recognise that there is in effect a relationship between concerns over PPF levies and other related costs and the dividends that the company's owners might be drawing?

Paul Duffy: Yes. The companies I am looking at, there are no dividends being paid, and there is a determination to meet these promises if they possibly can. It should not be forgotten that we are not talking in isolation of owners wanting to get out of their responsibilities. Remember, you would have heard this already, that these schemes were set up at a time when the situation was completely different. The promise given 40 years ago is entirely different to the promise now. We recognise that and anything that can be done to alleviate the situation would be greatly welcomed.

Richard Graham: Thank you. Tim.

Chair: Tim, briefly, because we have some big areas to go through still.

Tim Sharp: Yes. In the discussion I think we have kind of got away from—and it may be what you are coming to—the member position in all of this seems to be being overlooked. We have 11 million people still with DB benefits. We have not really worked out in this country how we are going to provide pensions adequacy more broadly. I think we should be very wary of anything that undermines the bit of good provision we still have before we have worked out how to provide pension adequacy more broadly.

Baroness Altmann: I think it is a difficult balancing act. One thing we could insist on in some cases is member consent. Many members would be realistic.

Q3294 **Chair:** You mean they should rebalance it?

Baroness Altmann: Yes. The other thing I would like to see is a relaxation of this aversion to DB to DC transfers. In the current environment and after pension freedoms, there are good, positive reasons why especially people with small, deferred entitlements should be encouraged or offered the chance to transfer out of the DB scheme. It will secure the remaining benefits of other members. Many of these would have been in the company for maybe one or two years and have a very small entitlement. The costs of administering those are huge. The value to the member, if they have other pensions elsewhere, is probably quite small, so in the current environment, particularly with very generous cash transfer values, even if you have some acknowledgement of the funding level of the scheme not forcing them to at all, but offering them the chance. At the moment I think there is this fear that it can never be right, but for many people this might be a very good way of enhancing their own financial situation as well as the situation of the scheme. So liability management I think is important.

I agree, I do not think employers in general are trying to avoid their responsibilities. I just think what has happened with QE has mushroomed the costs of the liabilities beyond anything anybody ever thought or imagined in their wildest dreams. The Bank of England's own pension scheme demonstrates that. In the current interest rate environment, with schemes that are now being encouraged to so-called de-risk if they have any question mark over the sponsor covenant, it requires a contribution of more than 50% of the worker's salary. Three or four years ago it was 25%. That is a black hole, almost.

Whatever happens, the employer has to keep putting that money in and yet there isn't any relief in any way for employers, whereas if you pooled schemes together, you could use the pension assets in those schemes to offset some of the problems that QE has caused. It could be used to promote infrastructure spending and social housing spending. These are huge sums of money, billions that we have in this country set aside for long-term payment. It seems to me there might be an opportunity, outside fiscal policy per se, to use pension assets in a different and more creative way.

Stephen Pugh: I think the question was around PPF funding and paying for that. I subscribe to the "this is a tax" point of view, because there is no reason why a company that happens to be running a DB scheme should be the insurer of other people who happen to be running a DB scheme that creates the problem for them. I realise that nobody, including the general taxpayer, wants to pay for that, but I do think that the mechanism that says, "It is the job of other DB schemes to pay for these DB schemes," is a non sequitur.

Q3295 **Richard Graham:** Thank you. That is all helpful to the conundrums that we are wrestling with.

Can I move on to another aspect of this, which is the regulator and the Pensions Regulator's powers? Does the regulator need more powers or just to use existing powers better, or some increase in some of the ability to fine, for example? Not new powers, but heavier ones? What can we do to try to make sure that the regulator doesn't leave pension schemes in the sort of troubles that some of the big recent headlines have illustrated? Ros, can we start with you on that?

Baroness Altmann: If we want the regulator to up the amount of regulation it does and increase the scrutiny of DB schemes, given where we are in the cycle, it is probably going to require extra resources. Of course all regulators want to be as efficient and need to be as efficient as they can, but certainly my impression had been that an awful lot of resource was going into the DC auto-enrolment programme, which was absolutely vital, of course, for the future of the economy. But I do not think we can do this kind of regulation on the cheap, and if we want the regulator to look more closely and be more involved in—as I described before—this critical phase of defined benefit pension provision, it may well be that more resource is required.

Q3296 **Chair:** Who would pay, Ros?

Baroness Altmann: It does seem to me that pension schemes themselves do perhaps need to be required to pay more. I am not sure I completely agree with Stephen on the PPF levy, because it is an insurance arrangement, and any insurance arrangement does require those who do not suffer the damage that the insurance is covering you against to put money in that they will never see back in order to have a fund available for people who do suffer the damage.

Q3297 **Chair:** You are putting another cost on the employer pension scheme, aren't you?

Baroness Altmann: But it should be spread across the industry and if there is another mechanism for raising the money from other levies on, for example, asset managers that manage pension funding, I think there are ways in which we could look at how to fund it. But in the grand scheme of overall pension funding and the actual levels of costs to actuarial consultants, legal firms, accountancy firms that each pension scheme is currently paying associated with its scheme, the cost of an extra few people at the Pensions Regulator is probably not that material. For pension schemes that are doing all that they are required to do and operating well, it should ensure that fewer schemes then call on, or fail into, the PPF.

Chair: Stephen, do you agree with that?

Stephen Pugh: Failure is often about wider insolvency issues that don't just affect DB scheme employers, so I do not really agree. I see the insurance argument, but it is focusing the pool of contributors too

narrowly and what we do with our DB scheme is unrelated to what other people are doing.

Tim Sharp: If there is anything that we have picked up from the BHS situation—and I think we should be a bit wary of using quite extreme cases for setting policy—one of the things might be how can we ensure that the regulator intervenes earlier in these situations and is able to be a bit more proactive? There are certainly questions around the regulator's ability to demand information. That seems to be quite lacking at the moment. But I would agree with Ros's point that we have to be very wary about loading the regulator with new responsibilities if we are not going to either give resources or refocus it perhaps away from schemes in general and maybe perhaps more on to those schemes that look in the riskiest position.

Paul Duffy: On the insurance aspect of the PPF levy, I don't think I have ever seen any insurance where the delivery of a premium can bring about the event you are trying to cover. This is not an apocryphal story. I have heard of an example where delivery of a very large PPF invoice actually triggered the directors to say, "Well, that is it." There definitely is a feeling that this is an additional cost to running a pension scheme, and to add to that the cost of increasing the regulator I think would not go down very well. There should be perhaps a refocus at the regulator. I agree that there should be a compulsory clearance in the situations that we have heard about in BHS, and if there is some more money to be paid, then I would suggest that it is paid elsewhere.

Q3298 **Richard Graham:** Ros, very briefly, it has been suggested to us that if, for example, the Pensions Regulator had the ability to give very large fines to companies who did not respond to requests to provide more information, that would enable the regulator to take a view, for example, on pre-clearance and that would focus the mind rather. At the moment I think the maximum they can levy is £50,000, which for a large company might be a pretty small fine compared to the cost of sorting out the pensions deficit. I think with auto-enrolment there is an ability there for the DWP to fine quite significantly, thousands of pounds a day, if it wishes to. Would that be one way of increasing their ability to exercise their powers, while also raising some funds that could then be used to help beef up resources?

Baroness Altmann: Yes, I completely agree. I think that the regulator does need more powers of enforcement. At the moment, I hope that the Pensions Bill may—I have not seen the details—increase the regulator's powers, but one of the things that did concern me was that the regulator can ask for information, but there is no requirement for the trustees or the scheme to provide the information. That is the same with all pension schemes, auto-enrolment, any of the other mechanisms. For example, the regulator is not able to track the costs that pension schemes pay. They can ask, but if schemes choose not to respond there is nothing they can do. I think increasing the powers to collect information, and associated with that, fines for firms who choose not to co-operate would change the balance within the industry in a way that is potentially helpful

for members, which of course ultimately is what this is about—delivering good pensions to members.

Q3299 Heidi Allen: A bit of a cat among the pigeons, a bit of an off the wall question, if I may, building on what Ros was just saying about perhaps more regulation powers to collect information and fining. Stephen, a final question for you. I do have some sympathy with your insurance argument, because if I am a good car driver I get a choice of different insurers that I might go to. A good employer doesn't. The Pension Protection Fund is what it is. Also building on Tim's point about corporate governance, not to confuse that with pensions issues, if there was a different system of regulation, rules, fining, and I don't know what that might look like, is it time to look at the PPF totally again? It strikes me there is an awful lot of cost—money, admin, processing, penalising for good companies—wrapped up in it.

Stephen Pugh: At the end of the day, people's pensions will be secured by the state in some fashion or other. I think it will happen with DC pensioners in future, because DC provision is inadequate in most cases. Is there a way in which you can say, "This is just another example of that and can be dealt with in a different way"? You would have to look at a concrete way of resolving that. I have not thought about it, so in the abstract I cannot really say, "Yes, there is a better idea here." Quite possibly. I think we all do dread the PPF invoices, although perhaps because we are well-founded we suffer less than many. I would like to think it were true, but I do not have a solution for you now.

Chair: Thank you all very much. We have run over time. We are grateful to you. Thank you very much for coming.

Examination of witnesses

Witnesses: Chris Martin, Andrew Bradshaw and Janice Turner.

Q3300 Chair: Janice, might you begin by introducing yourself for the sake of the record?

Janice Turner: Yes. My name is Janice Turner. I am the founding Co-Chair of the Association of Member Nominated Trustees.

Chris Martin: Hi, I am Chris Martin. I have been a professional trustee for 25 years. I am Managing Director of Independent Trustee Services, which is trustee to just over 100 pension schemes that are in different states and different conditions. I personally have experience in some of the more challenged schemes.

Andrew Bradshaw: Andrew Bradshaw. I am a professional independent trustee and I am a council member of the Association of Professional Pension Trustees.

Q3301 Craig Mackinlay: Obviously of late there have been some very high-profile DB pension scheme cases and others that are deemed to be in some distress. Are these exceptional cases or do you think it represents a wider malaise across the DB environment?

Janice Turner: We would feel that the ones that we are alluding to, such as with BHS, do tend to be exceptional. Most of our members when they are talking about schemes, are looking at schemes that are very well-run, and some of them have surpluses. Most of them have deficits, but they are not in the exceptional category. But you could look at it in a wider sense, in that there is a wider malaise that is the decline of defined benefit pension schemes overall. They are supposed to be very long-running pension schemes. When we are doing our valuations we have to look at them over an extremely long time, yet at the same time we have the volatility in the market. We have had previous situations decades ago, where employers were taking pension contribution holidays and now we are in the situation we have been hearing about.

The big concern that we do have is what we might feel is a kind of a falling commitment—a declining commitment—to the continuation of DB. What our members do feel is that as defined benefit schemes close, what they are being replaced with, DC schemes, if enough money was put into them then that might be okay, but the average contribution into DC schemes is currently running at something like 6%. So the decline of DB schemes is of great concern to our members because what we are looking at in the long run is the impoverishment of millions of people if there isn't something that is brought in to either stabilise DC schemes or provide a collective model as an alternative, which of course would be CDC.

Chair: Great, thank you. Please don't feel you all have to answer every question, but you may want to answer this one. Chris.

Chris Martin: Yes, I would, please, Frank. The high-profile cases to which you are referring—I am familiar with a couple of those—I don't think are a reflection of DB schemes generally. The vast majority of DB schemes have responsible employers, diligent trustees who are looking to face the challenges that are in front of them. It is a challenging time with gilt yields where they have been for so long. It is without doubt difficult.

I guess what concerns me though—we touched on this when we met before—is the schemes that are in that space where they are becoming stressed, where the viability of both the scheme and the sponsoring employer are starting to come into question. You get into the cause and effect where the DB deficit is out of scale with the ability of the employer to support it. As an industry, I don't think we have any reliable information on how many schemes are in that space, how they are moving and how they are being managed. If we want to do something to try to improve member outcomes for members in those schemes, we ought to have a far sharper focus on where they are at and what tools are available to us as trustees and to sponsors to try to improve the outcomes. At the moment, too many of those schemes are just drifting

from a stressed state to distress and then into the PPF. We are not intervening at the right time.

Chair: We may come back to that. Andrew.

Andrew Bradshaw: Yes, I would support that. The majority of schemes we are pretty confident will be there for the longer term. They are being run well and the employer covenant is strong. But there is a growing number—it is a minority—of schemes that we are getting worried about. Again, it is difficult to know the exact numbers, but we do need to focus our attention on those schemes.

Q3302 **Steve McCabe:** I want to think about the powers that trustees have. What I am particularly interested to know is should there be some kind of legal obligation on the sponsoring employer to provide complete information to the trustees and to consult if they are going to contemplate any change that might impact on the pension scheme?

Janice Turner: We do feel that a requirement would be helpful. We feel that employers do tend to share information. Many of them do consult and they will supply the information that we are requesting.

Q3303 **Chair:** But they do not have to, do they? Should they?

Janice Turner: We think so, yes. That is why we are saying a requirement would be helpful. If it was a requirement, as you say, it would make it harder for companies to hide the information that they would rather trustees did not have.

Chair: Brilliant. Chris, what do you think?

Chris Martin: There is a general requirement to share information. What it lacks at the moment is any obligation to share it in a timely way, so if you are coming up to a corporate transaction that involves a covenant of a scheme, receiving the information a day in advance is—

Q3304 **Steve McCabe:** Should there be a requirement with some kind of acceptable time limit?

Chris Martin: Absolutely, so that trustees get the information and can do something about it and in turn can then share it with the regulator, who can do something about it.

Chair: Andrew, what do you think, please?

Andrew Bradshaw: I would agree. The wider point about trustee powers, if I may, not just the information sharing part, is because it is actually a lottery in terms of what powers you have as a trustee. The first thing Chris and I will do when we pick up a scheme is—

Q3305 **Chair:** What do you mean by a “lottery”, Andrew, please?

Andrew Bradshaw: They were set up 70, 80 years ago, some of these schemes, and the first thing that I would do—and I am sure Chris does—when we are appointed is we look at the trust deed and we want to know what our powers are. For example, in some schemes trustees do have

the power to set the contribution rate and they don't require the employer's agreement to that. A number of schemes, we do have the power to wind the scheme up. I mention that because although it is a minority, a number of schemes do have those very powers and trustees are aware of those powers.

Whether that should be introduced to other schemes is worth considering, particularly those in stress situations, because while with an ongoing scheme the fact that you have the power to set the contribution rate may be helpful, you do not need it because you are balancing the need to get contributions into the scheme against the affordability. As a good trustee, you would not want to push the company too far in terms of what it can and cannot afford. But in the distressed situation it can be very good to have those powers to force employers to perhaps put more into the scheme than they—

Q3306 Steve McCabe: Are you advocating that at least minimum powers should be defined in law?

Andrew Bradshaw: I am suggesting that for the distressed schemes that are in trouble, it would help for other trustees to have additional powers or the regulator. It does not have to be both. It goes back to the actions around that.

Q3307 Steve McCabe: Is it your request that they are quite clearly defined? You said it is a lottery, so it depends on the scheme we are talking about. Do you want some clear definition of at least minimum powers for trustees?

Andrew Bradshaw: Yes. If we are not going to give the regulator more powers, or if the regulator is not going to use its powers more proactively, then for those schemes that are in a distressed situation—and I would limit it to that group—it would be useful for trustees in those situations to have wider powers.

Q3308 Chair: Of those schemes you know have been distressed, Andrew, how many have used their powers, if they have them, to increase contributions?

Andrew Bradshaw: It is very rare. In my experience, the fact that you have that power can in itself be very valuable, so you never get to the point of using it. But as a trustee, in those difficult situations it does help to remind the company that the trustee has that power and that if certain things do not happen over a particular period of time, the trustees might be minded to use that power. That is normally enough to get things moving on the employer's side.

Chair: Might you tease that out a little more than you have done in your evidence for us, because that is an important point?

Andrew Bradshaw: Certainly.

Q3309 Richard Graham: I think all three of you heard the earlier evidence on the issue of powers or exercising powers more effectively. Chris, in an

earlier hearing you shared your thoughts in terms of the information exchanges and so on. In all of your experiences, is this about the Pensions Regulator exercising their powers more effectively or being given more clout in terms of size of fines in order to be able to get the information that both trustees and the regulator need to assess the situation in the pension scheme? Shall we start with Chris?

Chris Martin: I am not sure that the size of fines, unless the fines were draconian, is really going to change behaviours.

We are halfway through a piece around information-sharing just now and hearing from the vendor of the business is one thing. What is missing at the moment is the prospective purchaser having to put some credible submission in front of the trustees. By credible submission, I mean something that is a viable plan for supporting the scheme in the long term.

Q3310 **Richard Graham:** Does that argue for pre-clearance?

Chris Martin: I don't know whether you want to wrap it into clearance, because I understand that could be very restrictive, but I think the purchaser should have an obligation to say, "This is how I intend to support the scheme going forward." The trustees could then form a view on, "If you are going to support it in that way, we think it is going to cost you X," or the regulator could even make a statement as to how it might view that going forward as well. It puts that purchaser on notice that it has an issue that it needs to address.

Q3311 **Richard Graham:** If, for example, the regulator worked out which are the businesses with schemes that look most fragile and then had a system in which it had the power either to insist on a pre-agreement between vendor and buyer about how the pension deficit was going to be resolved, or for the buyer to come up with a solution with the trustees within X number of weeks of buying a company, would that meet what you are looking for without impeding M&A transactions?

Chris Martin: That would be incredibly helpful. If you could achieve that within prescribed timescales that everybody understands—28 days or whatever—before completion can happen, that then sets the agenda; everybody knows what they are dealing with. Things will go off plan in future, they always do, but at least you start with an expectation of how the scheme is going to be managed, whereas in some of the situations we see, it really is just on a wing and a prayer and no information for the trustees.

Janice Turner: One issue with additional powers, as was alluded to in the previous session, are the resources required to carry them out. That is quite an issue. For example, the issue of the clearance system: if there was going to be a clearance system prior to every transaction, then that would place a very heavy burden on the regulator. That would have to be thought very seriously about. If the regulator is going to get further involved, then they need to be able to operate at the same speed that is required to carry on these transactions, because if they did not do that,

then it may place in doubt some of these transactions, which are otherwise extremely sensible transactions for the future benefit of the enterprise.

Q3312 **Chair:** What sort of timescale are you thinking of here, Janice?

Janice Turner: In what sense?

Chair: There is an application. How quickly should they clear it?

Janice Turner: I am not an expert in this.

Q3313 **Richard Graham:** Andrew, in terms of your answer to this question, could you also give an idea of whether it is possible to speed up the valuations of pension schemes? At the moment, the system allows for 15 months, which does seem an incredibly long period of time. If the regulator could get the information faster, maybe that would help speed up some of their thinking on which of these business schemes are on the edge.

Andrew Bradshaw: I have seen what the regulator said about the enhanced payers and I would support that. I think that is all very sensible. But I think this goes to resource and a bit of focus. It is very easy to say, "Okay, throw resource at it," but of course that has to be funded from somewhere. The regulator is being asked to do a lot of different things; it is being asked to look at auto-enrolment, DC; it is being asked to keep schemes out of the PPF; it is being asked to give general guidance on governance and to get involved with all the schemes. My sense is that perhaps if we asked the regulator to refocus on the problematic schemes, that could help speed up the process in terms of clearance because they could use the manpower they have and redeploy it and that could happen quite quickly.

To go to your point about valuations, I agree with that. The industry has moved on. It is 10 or 12 years since the Pensions Act. The information that is available to us as trustees now in terms of the software means that on a daily basis we can look at deficits and in theory we could agree a valuation within a matter of days. We could sit with a company and do it a lot more quickly than we have in the past. I would certainly encourage that. I would also certainly encourage flexibility around whether it is appropriate for all schemes to have a valuation every three years. I do support that. Some of the larger, well-established schemes could have a longer period between valuations and others could come earlier.

Richard Graham: Chairman, I think what Andrew is saying there effectively is not dissimilar to the Ofsted way of rating schools: those that are in good shape, you have a lighter touch; you don't pay so much attention to them. Those that are in special measures, that is where the focus is.

Q3314 **Ms Karen Buck:** Do you think if the Pensions Regulator were to take a more interventionist approach it would prevent schemes getting into trouble?

Chris Martin: Yes, I agree. There is a big issue for the regulator around resource. It is undoubtedly a challenge for them. They face some very challenging times. Particularly with that population of schemes I described at the beginning, which perhaps are drifting in a stressed situation with nobody guiding them as to how to address the challenge, if the regulator focuses attention there, starts to intervene directly and proactively, and critically—perhaps this does not happen now—to follow up as well. It is one thing to intervene and to make a presence known. You then have to follow through with that intervention and work with trustees, focused on member outcomes.

I don't know whether we are going to talk about the regulator's statutory objectives, but sometimes it feels as though their statutory objectives are competing, because they have to look after the interests of the PPF and they have to look after the interests of members. Sometimes how you square those as a regulator can be quite challenging to trustees because we are here just to look after the members. If you have a body that has competing objectives coming in and intervening, it sometimes makes for a discussion that is more difficult than it should be. Giving clarity to the regulator that it is there to deliver best outcomes for members, would focus its attention as well.

Q3315 **Ms Karen Buck:** How is it possible to then determine what level of resource the regulator would need to do this, given that for this sort of preventive intervention it is quite hard to illustrate in advance what the capacity would need to be?

Janice Turner: You would be looking at the triennial valuation probably as a starting point. It would probably be a wiser use of resources to be targeting certain schemes rather than having some kind of across the board increase in intervention. We did that a few years ago. There used to be a policy in place known as the 10-year trigger. That was basically that any pension scheme that had a deficit—and that allowed the sponsor more than 10 years to repair that deficit—had an automatic call-in from the regulator. It did not matter how perfect the agreement was that had been made between the sponsors and the trustees. It could be an absolutely wonderful result, yet because it came to more than 10 years, it had an automatic investigation from the regulator. Clearly that was not a good use of resources.

Q3316 **Ms Karen Buck:** So you need judgment more than triggers?

Janice Turner: Yes, we do. We need judgment and targeting, I would have thought.

Andrew Bradshaw: I would agree with that: refocus on those schemes in the distressed space that do need looking at. Resource is always limited; we have to accept that. That would be a much better use of their resources at the moment.

Q3317 **Chair:** Can I ask a general question to all of you? In this session we have talked about the resources for the regulator. To what extent do you think the culture within the regulatory system needs to change and will not

necessarily be solved by more resources? Chris, do you want to kick off?

Chris Martin: That is a great point. Clarifying their statutory objectives would be very helpful in setting the culture, because if there is a lack of clarity or potentially conflicting objectives, that clearly cannot assist them.

Others who have made submissions have said they think that the regulator already has a full suite of powers. I would support that. I do think they have all the powers. It is interesting that at least two of the powers—

Q3318 **Chair:** When you say, Chris, that they have all the powers, do you think by having all the powers they have the resources to quickly use the powers if they wanted to?

Chris Martin: Part of it can be down to resources. The other is down to culture though. I would be interested in Janice and Andrew's views on this too. I have a definite sense that there is sometimes a reluctance to use the powers because it might provoke challenge. To my mind, a regulator should be challenged. It develops its powers, it develops its use of its powers by being challenged. Its power to impose a schedule of contributions is one that you would have thought in a decade it would have used, but as far as I am aware, that has not been used. So there may be a cultural thing there that perhaps says you develop better regulation by being challenged and by seeing the way you shape regulations for the future.

Andrew Bradshaw: It goes back to focus again, where they have been focused. For example, on DC and auto-enrolment, they have been very effective and I think that is because they had a very clear mandate. It was very clear what they were expected to do. They were expected to improve governance in DC schemes; they were expecting trustees to look at charging rates. That has been very effective.

It is less effective where the regulator is taking a general view on governance and perhaps just getting a general involvement in actuarial valuations. It is often quite difficult to see where they are adding value there, so I think refocus their efforts. It is always good to have more senior people the more complicated the issues get, so I would certainly support perhaps more senior help for some of the case teams that they have at the regulator. That will help the case teams that have to be more proactive and firmer with the use of some of those powers.

Chair: Janice, your insights, please.

Janice Turner: Some of our trustees have felt that it has been quite clunky, in that there could be long periods of silence followed by an immediate request for some information by a week on Tuesday. Maybe there could be a resource problem behind that kind of thing.

If you had asked that question a few years ago, I would have thought that the culture in the past has been rather more confrontational. I have discussed the 10-year trigger issue. Now there has been a move much

more towards working with pension schemes and trying to find a solution, although I do agree that a better focus, a much stronger focus on member outcomes would probably be a good way of getting around the competing objectives that they do have.

Q3319 **Ms Karen Buck:** Is there a case for reforms to the clearance system for major corporate transactions, such as the failure of a scheme's sponsor?

Chris Martin: The process itself could certainly be streamlined. It is too clunky, to use Janice's term. It tends to be a bit too last-minute as well. Clearance is generally developed to the point where it is near-perfect before it is considered. I think it should be more of an iterative process, with the regulator being part of that discussion and developing the plan. Again, this goes to being more forward-looking than just clearing a particular transaction. Somebody needs to sit back and think about what we are trying to get out of clearance. Is it just for that moment in time or is it where the scheme is going to go in the longer term? At the moment it is just that moment in time focus.

Janice Turner: There probably is a case for looking at it, but again, the regulator does need to have the resources to act at a comparable pace to others. It would be tempting to say the regulator should have greater powers, but if it took too long to come to a view, then we have an issue.

Andrew Bradshaw: I would support that. I would say to the regulator as well, "Look to the trustees and work with the trustees," because we are aware of what is going on. We have a sense of it and we use our judgment at times. Perhaps a less formal process at times would enable trustees to pick up the phone and chat through where there might be concerns without fearing they had to go through a very formal process. That might help.

Q3320 **Heidi Allen:** My question has probably pretty much been answered. In all these sessions we keep hearing about resource, resource, what can the regulator do and where should we focus them. You have talked about some of that. Is there anything else you have not mentioned so far about the way the regulator operates that you think could be changed to help you do your jobs?

Janice Turner: One issue that we think trustees would very much benefit from would be more clarity in relation to time off for trustees to carry out their duties, particularly in relation to training. At the moment lay trustees—I should add that in our recent survey of our members, two-thirds of our trustees are not paid a penny for these great responsibilities they take on—

Q3321 **Chair:** Should they all be paid?

Janice Turner: That has been a discussion among our trustees that has taken up quite a lot of time. There might be a view that the greater the qualifications the trustees obtain, then perhaps there is an argument for greater payment. I know of pension schemes where when their trustees attain the Pensions Management Institute's level 3 qualification in

trusteeship, that attracts greater payment and reward for getting greater knowledge and understanding is always a good thing, I imagine.

The way the situation is at the moment is that trustees are entitled to appropriate time off. For the bigger schemes, they tend to have quite sophisticated arrangements for the training of trustees, quite formal. With the smaller schemes, it does tend to be left to the trustees themselves. We cannot praise highly enough the regulator's online trustee toolkit, which is absolutely fantastic as a resource. But when it comes to trustees having the time to complete that and to do their training, if there is a much more informal approach to training and time from within the employer and within the scheme, trustees who are not in self-scheduling roles, such as airline pilots—we have airline pilots who are trustees; we have librarians, who are in a customer-facing role—they find it quite difficult to try to get the time off.

Some trustees have said that they feel they have to argue for every day that they need to do their training. You cannot be expected to do, for example, the online toolkit without being able to sit there and focus for blocks of time. The one thing that I think trustees would value would be the regulator saying that there should be a minimum, at least this amount of time off, particularly when a trustee has just taken on their role. It may well be that the trustee has no prior experience at this level of pension schemes. They do need to have the support to get up to the level of training that they have.

To give you an example, the AMNT very strongly, as you can see, supports trustee knowledge and understanding. Most trustees would believe that you can never know enough; you can never have enough training. We have put on special sittings of the PMI exam to encourage our members to obtain this qualification, yet we never thought that as an association we would have to take the decision, which we did recently, which is that when trustees cannot get their employer to pay for the exam that we would pay for it ourselves.

Andrew Bradshaw: In terms of the regulator, I would ask for greater flexibility to work with trustees. Going back to the point about trustees, we are there to act in the best financial interests of the members. The regulator is there to protect the members' interests. Where we are in the distressed space, I would not be over-prescriptive. I would allow trustees, employers and members, with the regulator's support, to look at what can be done to keep these schemes viable and ongoing. I would not want to prejudge what that might be because things change very quickly. There are a lot of ideas around and a lot of goodwill within the industry to work together, to help with these schemes, so I would ask for a cultural shift, that they would work with trustees on that.

Chris Martin: I would make two points briefly and echo Andrew's point. Particularly in that distressed space, when you are trying to optimise the outcome for members, the process is too clunky and it destroys value at the moment. It is not because the regulator chooses it to be that way; it is the way statute makes it. There is a lot that could be done there to

both relieve the regulator from his burden and deliver better outcomes, which is win-win.

Secondly, something that has always surprised me is that as the CEO of a professional trustee company I have never been called into a room with the regulator and six other CEOs and had a conversation with them. I have always thought that if you wanted to touch the biggest number of schemes at the same time, you would pick the half dozen big corporate trustees, who probably represent 70% to 80% of DB liabilities, and have that direct regulator to trustee conversation. That seems like an easy way to leverage your influence.

Q3322 Mhairi Black: On that, the system as it is currently set up appears almost binary between getting, typically, the full promised benefits or the PPF level. I know this is something that, Chris, you have negotiated a middle ground on a couple of times. But how practically could we change things so that there is a greater flexibility between those two options?

Chris Martin: This comes back to the point I was making with the first of my last two points. The process at the moment destroys value rather than creates it. The tools that are available for trustees working with sponsors and with the regulator are very blunt. You are in a position where you have a stressed scheme and you are heading towards that distressed space where it is going to be a bad outcome, potentially ending in PPF for members. There are steps that you have to go through. One of the tests is that insolvency has to be inevitable in the next 12 months. By the time you have got to within 12 months of insolvency, it is self-fulfilling, so that test itself should be removed.

Trustees should be able to form a view on viability. We work in with the sponsor with our advisers. If we don't think the scheme and its sponsor are viable over the next three years, why wait until 12 months? Why not say now that we need to do something about the liabilities? I think trustees should be empowered to make changes to member liabilities. Some of these pensions were promised 40, 50, 60 years ago in a different time, but if the trustee forms the view that it is in the best interests of the generality of the members to change some of those benefits, then we ought to be able to do it and we should be empowered to do it in a way that is going to improve the outcome rather than just destroy value.

At the moment, the process is just set up to take too long. It is too clunky; it has too many interventions. That is why unfortunately so many schemes fail and end up in the PPF.

Janice Turner: Our members are divided on this issue. As you heard in the earlier session, on the one hand we can see that there are a lot of companies that are distressed in relation to the pension scheme and these historical liabilities are a major factor. But the problem is we are talking about deferred pay, we are talking about promises that have been made to people, quite often many years ago, that they have based the rest of their working lives on. So to say—

Q3323 **Chair:** Their non-working lives rather, isn't it?

Janice Turner: Working lives and non-working lives, yes. They have planned the rest of their life on the basis of the promise that they were given at the beginning. If you are now going to say, "This is the situation and we are going to reduce those benefits," a lot of people would be very concerned at how widely and how often this mechanism is going to be used. We know that there are pension schemes where companies are doing incredibly well and yet companies still want to close the pension schemes. If there was a power to reduce these liabilities, these promises, then to what degree are companies going to take advantage of that? That is a real worry.

Andrew Bradshaw: Janice makes a very important point. We have to do the right thing for members. That is our job as trustees. When you are looking at changing members' benefits, essentially you are breaking promises that have been made over a number of years and I think you have to get that on the table. Let's not pretend that they are not promises—they are promises and people have expectations in relation to them.

Q3324 **Chair:** They are property promises, aren't they, really?

Andrew Bradshaw: Yes, they are promises and breaking those promises should never be taken lightly. I refer back to the general duty that trustees have to act in the best financial interests of the members. It does mean that should not open the floodgates because it should be in very specific situations where we have taken proper financial advice and thought through all the other alternatives and it should be a last resort. But I do agree with Chris that the legislation could be made more flexible to at least allow trustees and companies and the regulator—possibly in consultation with members, and we should consult members where we can—to look at whether that is a possibility.

Chris Martin: Could I add one further point, very quickly?

Chair: Very quickly, yes.

Chris Martin: One of the other restrictions at the moment is around employer-related investments. To Janice's point: if members are having to give up some of their benefits, the scheme and the trustees and the members should get something in return, particularly to stop an employer then flourishing and paying out dividends to shareholders. We ought to be able to have some of the shares. That creates a natural check and balance. But employer-related investment restrictions would prevent us from having those shares.

Q3325 **Chair:** But also, Chris, should there not be flexibility that if you surrender some of your property rights now, in better times, which will come, you have a right to invoke those and go back to the old regime?

Chris Martin: If we had, for example, 20% of the equity in the company and the company pays a dividend in the future to all its shareholders, we

get our share of that and the ability there to pay back some of those pension increases.

Q3326 Mhairi Black: A last question: the Pensions Regulator has a very mixed and fairly limited record of using its moral hazard powers. Do you think these powers are an effective deterrent to the neglect or dumping scenarios?

Janice Turner: We defer to others with greater authority and expertise in this area. We would tend to concur with the Association of Pension Lawyers, who stated in their submission—we have also heard it anecdotally—that the very existence of these powers is enough to deter people from having various punishments imposed. For example, the directors do not want their houses going into the pension scheme. The Association of Pension Lawyers were looking at the BHS scenario and saying that it seemed to them that many of the events that caused concern took place before the Pensions Act 2004 came into force. So the BHS case, they argued, should not be used to suggest that the current law is fundamentally flawed. We would tend to share the view that they do tend to act as a deterrent, but when you have individual cases where companies or individuals are going to be acting in an irresponsible manner, then one wonders to what degree any powers are going to avoid that happening in the first place in all instances.

Chris Martin: They have been effective in avoiding dumping. The incidents of dumping are relatively limited.

Neglect is more difficult. Neglect is those schemes where perhaps they are sub-scale as far as the regulator's ability to influence them or simply you come back to resource again. You cannot, perhaps at the smaller end of DB, spend sufficient time to stop them being neglected. That is probably a different issue to powers.

There may be a way of looking at that around whether we should be aggregating up these small DB schemes. In the population of 6,000, how many are there that are sub-£20 million in assets? Is there a better way of focusing the regulator's attention, which is to start putting those schemes together and managing them as one? There are all sorts of legal challenges, as I am sure Andrew would elaborate on, but it is a thought that is worth running with.

Chair: Yes, worth looking at. Andrew.

Andrew Bradshaw: Scheme dumping, yes, certainly it has helped with that. It has been very effective and the PPF—Pension Protection Fund—has been a very worthwhile initiative. It has been very successful and it has made a huge difference to a number of pensioners' lives and outcomes. It goes back to a point we have talked about: it is the area not necessarily around scheme dumping, but around those schemes in difficulty, often through no fault of the employer, that needs to be looked at now. In a way, that is a different set of powers and a different set of issues, but I think it has stopped scheme dumping.

Q3327 **Chair:** Chris, might I ask you a last question? Tomorrow we have a debate on BHS. Is there any news you can give us from your angle about where we are?

Chris Martin: The discussions are continuing. From the trustees' perspective we are, as you would expect, singularly focused on the member outcomes. We have an ambition to see members get benefits better than PPF levels. It would be wrong for me to say much more than that at the moment, but there is plenty of dialogue.

Q3328 **Chair:** Is there a concrete proposal on the table?

Chris Martin: There is not a single concrete proposal in front of the trustee at the moment.

Q3329 **Chair:** When you are saying, quite properly, "looking after the members' interests" are you hoping to negotiate one where members do not lose out, rather than just get something between what they would have received and the PPF?

Chris Martin: Our reference point there must also include the ability to deliver something more than PPF, which of course comes back to the influence the regulator can bring into that process. To my mind, it is not a simple case of saying, "We will only settle for full benefits." The trustees have to be realistic about this on behalf of the members and settling for somewhere between PPF and full benefits might be the best outcome that can be delivered, taking all the factors into account.

Q3330 **Chair:** At one time the discussion was about allowing those with small entitlements to settle them and go away, but with the gain that others would get their full entitlement with the bonuses. Is that still being discussed, Chris?

Chris Martin: The idea of paying what are called wind-up lump sums is still being discussed. It is important to us as trustees that members with those small pots get fair value for them, so it is not a case of escaping liability with those wind-up lump sums. That is an important line in the sand. It is an interesting point. That is only for members up to £18,000 in value. I think if I spoke to some of the members who are £20,000 to £25,000, they would feel they were the disadvantaged people because they would like to take the wind-up lump sum. We should not necessarily categorise it as being something that is bad for members; it is consistent with freedom of choice, in some ways.

Chair: Thank you all very much. Fascinating. We are grateful to you.