



Work and Pensions Committee

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

Wednesday 2 November 2016

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Watch the meeting

Members present: Frank Field (Chair); Heidi Allen; Ms Karen Buck; James Cartlidge; Richard Graham; Luke Hall; Steve McCabe.

Questions 3331- 3424

Witnesses

I: Malcolm Booth, Chief Executive Officer, National Federation of Occupational Pensioners, Neil Carberry, Director for People and Skills, CBI, and Joanne Segars, Chief Executive, Pensions and Lifetime Savings Association.

II: Alan Rubenstein, Chief Executive, Pension Protection Fund.

Written evidence from witnesses:

- [National Federation of Occupational Pensioners](#)
- [CBI](#)
- [Pensions and Lifetime Savings Association](#)
- [The Pension Protection Fund](#)



Examination of witnesses

Malcolm Booth, Neil Carberry and Joanne Segars.

Q3331 **Chair:** Neil, welcome. Might you identify yourself for the sake of the record? We will go down the line, so your colleagues identify themselves, and then Richard will open up the questions.

Neil Carberry: Neil Carberry, CBI Director for People and Skills, which is responsible for the Pensions Policy.

Joanne Segars: I am Joanne Segars. I am the Chief Executive of the Pensions and Lifetime Savings Association.

Malcolm Booth: Malcolm Booth, Chief Executive Officer, National Federation of Occupational Pensioners.

Q3332 **Richard Graham:** We want to explore the balance of the responsibilities for employers to their pension promises while making sure they can sustain their business growth. You said recently in a policy paper that you wanted the Government to restate the Regulator's objective to sustain business growth. Why does it need to be restated when it is in the law?

Neil Carberry: I think the challenge in all of this is less about the legislation and the structure. In that paper we shared with you we were very clear that we think the basic framework of the 2004 Act is the right one, and the idea of scheme specificity is the right approach, with the Regulator intervening as necessary. Equally, businesses agree heartily with the point the PPF made in its submission that it is not in the interest of business as a whole to argue for ineffective regulation of these schemes, because, of course, the majority of the costs of failure in this system are picked up by businesses themselves through the levy.

Q3333 **Richard Graham:** What are you implying there? Are you implying that there is some ineffective regulation? What would your recommendations be to this Committee on how to improve it?

Neil Carberry: Our experience of the Regulator has largely been good for most companies most of the time. What we have noticed over the last perhaps 12 months is that while the Regulator has a set of legal objectives to balance, the question of how those balance is one that is open to interpretation by the Regulator and by individual caseworkers in interventions. We are very clear that what is important when we talk about defined benefit regulation funding and the effect on companies is that we are dealing with companies that are often in sectors at the heart of our industrial strategy. We need to set the regulation in context of the fact that 65% of respondents to our survey say that pension costs have an impact on business investment in their business, rising to 80% for



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medium-sized businesses who we know are at the heart of industrial strategy.

Q3334 **Richard Graham:** What are some regulations that you are saying should be scrapped in order to reduce the cost of regulation?

Neil Carberry: We think it is not a question of scrapping regulation; it is a question of striking the right balance in individual interactions between the Regulator and companies.

Q3335 **Richard Graham:** Okay. One thing you did say, I think, in your paper was that there should be no pre-set right approach on the funding-plan length. You are not recommending that the 23-year plan put forward by the BHS pension scheme is a model of how the Regulator should operate, are you?

Neil Carberry: We are not specifically picking a date, because the whole point of the system is to be scheme specific and the Regulator should be looking at each plan that is put to it; if there is a longer plan length than is normal, take into account what the reasons for that are. There may be, for instance, reasonable positions where a company says, "Over this three-year period I want to invest in this because it will deliver this return". Trustees ought to feel able, if that is a secure and effective proposal, to say, "We are supporting the company in doing this, because over the long haul it supports the covenant".

Q3336 **Richard Graham:** All right. Thank you. Malcolm, can I move to you now, because trustees, as Neil says, are crucial to all of this? What do you think are the barriers to trustees doing their job to safeguard member benefits, and what needs to change in order to help protect pensioners?

Malcolm Booth: I think the main concern is that if the ratio of trustees is very heavily in favour of the employees of the company whether they can adequately separate their duties to the company and their actions as trustees is a little bit of a concern. There needs to be a better balance within the trustee board to ensure that there is a degree of independence.

Q3337 **Richard Graham:** Yes. Who do you think should be responsible for that? Is that not up to the trustees? You are not looking for more regulation on this, are you?

Malcolm Booth: I think it is more a case of ensuring that there is an independent trustee, and ideally a representative of the pensioner, rather than just a member-nominated trustee who may well be an employee of the company and, therefore, would find it difficult to separate the needs of the company, perhaps, from those of the members who are in receipt of their pensions. Perhaps there is a need to look at how that regulation is there and whether it should be strengthened to ensure that that exists.

Q3338 **Richard Graham:** You would like to see a regulation that every board of trustees has an independent trustee who would be remunerated by the



pension scheme?

Malcolm Booth: Ideally.

Q3339 **Luke Hall:** Could I ask Joanne about consolidation? There is information that we have received back about how schemes can benefit from economies of scale by consolidating. I want to know if you can tell us what can be done to promote consolidation and whether you have any specific proposals that this Committee could recommend.

Joanne Segars: It is certainly the case that in the UK we have, in absolute terms, in relative terms, a very, very large number of schemes. We have 6,000 separate defined benefit pension schemes in the UK. By comparison, in the Netherlands, for example, with similar sorts of assets under management, they have just over 300, and that has come down from 800 over the last 10 years. Those smaller schemes, as you rightly say, are not really able to capture the economies of scale. Many of them have very, very good governance, but very often they do not have such strong governance as larger schemes. They are not able to access the advisers or pay for independent trustees, for example. What we have found in our work on our DB Taskforce is that there is a very strong case for consolidation, a strong case for merging schemes together; pulling schemes together. If schemes are able to do that they are able to access better governance, but also able to leverage economies of scale and derive some very significant cost savings—for example, a 1% uplift in governance, or 1% uplift in governance benefits—and very significant reductions in fee savings to asset managers—for example, the costs to asset managers.

Q3340 **Luke Hall:** How many have consolidated, Joanne?

Joanne Segars: In the UK? Schemes may have consolidated by buying out, but not in the way that schemes in Australia or the Netherlands are being directed.

Q3341 **Chair:** In particular, in answer to James, you were describing a move that you were trying to bring about, and I just wondered how successful it was.

Joanne Segars: At the moment we have identified the issue, and the need for consolidation, and that was one of the key findings from our DB Taskforce interim report. What we now want to do in the second phase of our interim report—as we work towards producing a final report with recommendations to the Government, and hopefully also to this Committee, which we will publish in the first quarter of next year—is to set out how we might go about that. I think it is clear that consolidation can take a number of forms. You could merge some of the back-office functions, the governor, the trustee and the administration. You could, as they have done in the local-government scheme, for example, merge the assets and pool the assets. That is working quite successfully, or starting to work quite successfully in the local-government sector. Or you could go the whole hog, as it were, and merge the assets and the liability.



There is a spectrum of options. What we want to do is to work out which is the best option: which will derive the best benefits to scheme members, to scheme sponsors, and also to the economy; to look at the pros and cons of each of those, how you might then go about it and what legislative changes might need to take place to enable that to happen; and also at what degree of carrots and sticks might be required. In the Netherlands and Australia there is quite a big regulatory intervention, quite a big push from the regulator and from Government to force schemes to merge, to require them to deliver better value for money and better outcomes for members. There are lots of different issues that I think we need to look at. In answer to your question, we are at the very start of looking at this, but it is work that we would be very keen to share with this Committee.

Q3342 Luke Hall: About the Netherlands and Australia, are there lessons that we can draw? What have been the main issues that have come up when consolidating so, seemingly, successfully in those two countries?

Joanne Segars: What we have seen in Australia is the Government there set a value-for-money test. Of course, we are talking in Australia about defined contribution schemes; here we are talking about defined benefit schemes. We would need to be quite careful about just cutting and pasting one regime to another. That has been successful in driving down the number of schemes there are in Australia and delivering better value for money for scheme members. There are lessons we can learn there. We would certainly be very keen to talk to our colleagues and counterparts in the Netherlands to see what they have done and how they have gone about consolidation. Their system is, first, looking at defined benefit, secondly, perhaps a little bit closer to ours. There is lots of experience that we can gather. Of course, Ireland is also looking at how they might reduce their very large number of schemes into a smaller number of schemes.

Neil Carberry: Can I just build on that? I think the challenge with looking at international examples is that every country starts from very different starting points.

As Joanne says, the system in Australia is DC, which is fundamentally easier to align. In the Netherlands there is a lot to learn, but also they have had some significant troubles with core-benefit cuts over the last few years within their system.

For businesses, the big blocker to consolidation, if you look at our paper, are things like access to illiquid assets. Consolidation enables that because you have more skills. The big blocker is how you handle the risk. For companies and CBI memberships the cost of the scheme is always what gets reported. It is the future risk to the company of funding the scheme that worries people rather more. It is not what we are paying today; it is what we might pay tomorrow.



If we are going to move to consolidation, the big question companies will want to answer is, "If you are beginning to impact that risk to my company, how do I know that you are doing the right thing, and what is the comeback on me and the expectation on me?" It is quite a difficult path to chart. It is linked to the points Malcolm made about stewardship of schemes, because we are in a different environment now than we were a decade ago, because most members of schemes do not work for the companies that are sponsoring them, first, because of these schemes being relatively mature and, secondly, because so many of them, because of the risks they pose to companies, have been closed to new members initially, and now accrual.

Q3343 Richard Graham: Can I just challenge that gently, Neil and Joanne? First, this is not a new problem. It has been around for a long time. For some of us the work that has been done to try to find a solution seems to move at a glacial pace. Neil, we have some of your members, small employers with 100-year-old family businesses, who are very frustrated by the fact that their PPF levies are rising. They cannot use that money to expand the business, and grow it, and export, and all the rest of it that they would like to. They are really interested in the idea of seeing whether schemes could consolidate.

Joanne, have you, PLSA, had the chance to involve Rosalind from the Pension Lawyers to do a summary paper about what are going to be the most difficult legal challenges on the one hand, and on the other hand survey the 1,000 smallest DB schemes to find out which of the employers and which of the trustees are most enthusiastic about taking this forward, so that you can build a coalition of the willing and really find out what the biggest, thorniest issues are likely to be fairly swiftly?

Joanne Segars: Yes, I think there will, fairly swiftly, emerge quite a lot of thorny issues, so you are perfectly right about that. We have not commissioned Rosalind to do that piece of work, but we do have a lawyer on our DB Taskforce who is charged with helping us answer those very questions, as you say. From a small employer perspective, for a small employer they might be advised to buy out their scheme. For lots of small employers that is simply—

Richard Graham: But the cost is horrendous.

Joanne Segars: Horrendous, but also one of the problems for very many small employers is buy-out companies simply do not want to take small employers, so they do not have an out. For many small employers that may be attractive.

Q3344 Richard Graham: As the options have shrunk, the need for your paper and a solution have increased. But, Chairman, what I am worried about is that by the time a few equivalents of Green Papers have been issued, all important, worthy stuff, we crawl towards something, and legislation would be hard to get through before the end of this Parliament. Meanwhile, these businesses want solutions.



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Joanne Segars: That is why we are very keen to push ahead with this. This is the key focus for the next phase of our work on the DB Taskforce.

Q3345 **Chair:** What is the timetable, Joanne?

Joanne Segars: We will produce a report and recommendations in March next year, which is, in terms of speediness, 19 weeks away. It is not very far at all. In terms of building a coalition, one of the things that I have detected over the last few months is a growing recognition for a resolution to this issue. The Pensions Minister very kindly addressed our conference last week and was very keen that he sees this as being a particular issue; he also came to the all-party group too last week and raised that as an issue. The TUC has also raised this as a potential issue, so I think there is a growing coalition. There are a lot of issues to go across, one of them, as Neil has addressed, is the issue of employer risk, and that may depend on where we come out on that spectrum of consolidation options that I talked about. From an employer perspective, they may want to divorce themselves from—

Q3346 **Chair:** Joanne, we are looking for recommendations. That is our problem.

Joanne Segars: We will deliver them by March.

Q3347 **James Cartlidge:** Obviously a critical issue is pension deficits and how we measure them. I was interested to hear your views on whether you think pension deficits are measured in the right way and what is the effect of the current methodology, particularly, Neil, in terms of investment from companies and, therefore, the wider economy.

Neil Carberry: For us this is a classic example of how one figure drives the whole system. What we actually know about defined benefit schemes is that the world is massively uncertain. I do not know if you are a Douglas Adams fan, it reminds me of the concept of “bistromathics” in the “The Hitchhikers Guide to the Galaxy”. It is a number that defines itself by being any number other than the one that it says it is. The challenge is that the way we measure deficits at the moment is a perfectly valid way of measuring deficits, but it is on the deeply conservative end. If you look at the First Actuarial index that they launched the other week, that takes a more fair-value approach, you get a surplus figure for DB in aggregate. That is not to say that there are not schemes that are significantly challenged.

The most important thing is that we have in mind when we look at those headline-deficit figures that they are a product of a certain time and a certain set of circumstances for schemes that last decades, and decades, and decades. For us, I think the critical bit of that is—the gilt rate is where the gilt rate is—that it is the wedge above the gilt rate that schemes use to calculate their liabilities that is the challenge. Often what we are seeing now among CBI members is a situation where the investment strategy for the scheme is looking for gilts plus 3, gilts plus 3.5, but the liability is being discounted at gilts plus 2, which is embedding a deficit because of the way the liabilities are priced. It comes



back to Richard's original point, if you go back to the regulations that method of calculating liabilities is just one option that is laid out, but because of the highly intermediated nature of the defined-benefit regulation system, because of the arrays of advice that both companies and trustees have, there is a deeply, deeply risk-averse approach to thinking about this. In some ways that is a good thing, but it does mean that we default to a very, very high number when it comes to deficits.

Q3348 James Cartlidge: The impact on companies' investment plans must be significant, presumably.

Neil Carberry: They are. Essentially, the larger the deficit at the time of calculation, the more cash is liable to come out of the business as part of the discussion that you have with trustees and, therefore, the less is available to other sources. There is only so much you can do with cash in the business. You can invest it, in people, capital, or growth; you can pay it to the pension scheme; or you can take it in profits. It is the balance between those three that we have to get right.

Can I just come back to Joanne's answer, because I think it comes to the point, Richard, that we were making earlier, which is that Green Paper legislative change takes time? The one thing Government can do now to unlock some of this for those small businesses is to get that debate about investing in growth for the company for the long term, which strengthens the covenant—the best security any pension-scheme member has is a successful employer for the scheme. That is the one thing that can be done right now. It can be done by the Chancellor this month.

Malcolm Booth: There are a number of concerns, I think, as far as the members, in terms of what has been said. One of my concerns would be that the current TPR requirement to consider the economic situation could be used as a get out of jail free card for the companies, and rather than addressing the issues of the deficit they say, quite justifiably, that they need to survive economically. I think that balance must be carefully addressed. I think the key issue is, whatever decisions are made and however they are treated, the members' interests have to be protected. On consolidation I would not have a problem, providing the benefits to the members are protected and they are not changed automatically.

Q3349 Richard Graham: Malcolm, can I just explore that very quickly? There is a balance in this, clearly, but we have seen instances in the past where a reluctance to see any change at all to anything has led to pension schemes ending up in the PPF and possibly taking a bigger hit than might have been the case had there been more flexibility in the relationship between the scheme and the business. What are your constructive thoughts on how that balance can be struck? Are there any particular changes that you would like to see?

Malcolm Booth: I think there is a need for something between where we are now with a DB deficit and PPF. If a pension scheme is forced into Pension Protection Fund, that is it. There is no way back, and the benefits



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are then what are set for the Pension Protection Fund. That can very adversely affect the poorest members of the scheme.

Q3350 **Chair:** Malcolm, do you think if that industry revived they should be able to rescue their scheme?

Malcolm Booth: I think there should be some methodology, which is why I am suggesting that a halfway-house arrangement, however that was structured, that would enable that to happen. I think one of the biggest concerns with regards to the benefits that the Pension Protection Fund pays is pre-1997 accruals are not counted and get no further increase. The potential there is that the poorest of the pensioners will then receive no further increase, because that is when their accrual occurred. You have the potential to force a number of people into poverty, which is something that we should avoid at all costs, and the cost would eventually come back to Government if that happens. I think the other side of that is everybody wants the companies to succeed, but we have a vulnerable group of people who rely on those pensions to be paid at those levels and the obligations that were set and given to them to be met. I know it is very fine balance to achieve, but often the key people in this, the poorer pensioners, are potentially overlooked and not fully considered in the impact.

Q3351 **Chair:** Everybody loses by going to PPF though, don't they, Malcolm?

Malcolm Booth: That is the difficult balance.

Q3352 **Richard Graham:** What is your view, Malcolm, on indexation, for example? Should the law allow for all pension schemes to change their rate of indexation to CPI?

Malcolm Booth: As an organisation we campaigned heavily against the change from RPI to CPI. My own view has been it is not necessarily the best thing to do. I think the concern I would have, again, is if it is blanket legislation companies who can afford to continue to pay the levels at RPI should do so, but will chose to move to CPI to reduce the deficit, which I think is morally wrong. However, in a situation where, "Move to CPI or go to PPF" is a straight choice, I do not think that is a choice. That is a case of go to CPI, and how that is managed is the key factor. Perhaps it should be the option that the Pension Regulator and the Pension Protection Fund would be enabled to facilitate that change within a scheme, rather than have a blanket change.

Q3353 **Ms Buck:** It is slightly outside your area, but are there aspects of corporate governance that could be addressed that would help build the trust that would allow flexibility to occur when it does need to occur? It does seem to me that the trust is fundamental to this. There will be occasions when it would be beneficial to avoid going into the PPF.

Malcolm Booth: Absolutely.

Q3354 **Ms Buck:** With experiences, including BHS, now very popularised and



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understood, the trust that is necessary for that to happen has to be less than it was. Do you think there are ways in which it is possible to rebuild confidence, and when it is necessary it can be done?

Malcolm Booth: I think there are ways, and I think perhaps there needs to be a change in attitude and a greater desire of companies who may be in difficulty to perhaps communicate with the Pension Regulator earlier, so that decisions are not made in a hurry and you have a longer timescale to address those issues. I think involvement of the members, and possibly going out to the members and saying, "This is the situation, this is what we should do", and getting their agreement would be beneficial.

Q3355 **Chair:** Shouldn't that come first, Malcolm?

Malcolm Booth: Yes, I think there should be a system where that can happen. I think we may need to address the fact that it cannot be 100%. It would have to be a case of a significant proportion of the membership—whether it is 75%, we could argue the number—agree and therefore that is an acceptable step to take. I think the risk with all of these decisions and the risks, in terms of significant changes to benefits and significant changes to people's hopes and aspirations as a result, is that the already damaged reputation of the financial service industry, and pensions in general within the general public, will suffer more, and all the hard work that has been done to create the right environment to encourage savings now for future pensions will be lost. The risk then is that people will become disinterested in pensions now, not adequately provide, and we are buying a difficult situation in 20 or 30 years' time when those people retire. We must do things that will support and increase the confidence in the pension system, not damage it further.

Q3356 **Ms Buck:** What would those measures be? It is fine saying, "We need an attitudinal change", and I think that is right, but frankly I think the attitudinal change will flow from concrete steps that will rebuild confidence in the wake of examples where a lack of transparency and worse has really damaged that confidence.

Joanne Segars: Yes. Quite clearly, we do need to build confidence in pensions broadly, and it is an issue that this Committee has looked at and come up with some very, very good recommendations on in the past. If we are talking specifically about younger generations, we can see that younger people, as millennials, are joining pension schemes in droves. I think they are the least likely to—

Q3357 **Ms Buck:** I am trying to be a little bit more specific, particularly following on from where Richard was asking questions about where it might be possible to win an argument that it is better to change the benefit arrangements before going into the PPF.

Joanne Segars: Certainly, again, one of the findings that comes out of our taskforce report is that we have a very binary system, you either go into the PPF, or you limp on, and you might ultimately end up doing



damage to the company, or ultimately to the pension scheme, and then end up in the PPF. We do need to find some mid path. Again, it is not something that I have solutions on today. It is one of the findings of our interim report, and something that we will work on as part of thinking about how consolidation in fact could help that.

I think it is worth remembering that the introduction of statutory revaluation and indexation has added about 20% to 30% in terms of DB liabilities. It is quite a significant issue. It is, as Malcolm said, a very clear balance between the ability of the sponsor to pay and the duties of the trustee to take account of all the members and the beneficiaries—not just the pensioners, but all the members and beneficiaries—but also, the intergenerational issues between those who are in the DB scheme today and those who are not in the DB scheme today, or those who have retired from the DB scheme, those who are still saving, and those who are still coming through. There are a lot of balancing issues here, but it is certainly the case that we would want to see a midway path, a third way, if I am allowed to use that phrase these days, to think about how we might avoid those binary outcomes.

Q3358 James Cartlidge: I want to get back to the central point about economic impact, because this is critical. We are an underinvested country historically, and we need that to change. If you take the analogy with the banks, you have this argument about how much capital they should hold. After the credit crunch, obviously the pressure is to be much more conservative, and potentially you simply make any potential recession worse. We had that sort of debate. This is very similar, it seems to me, the balance between how conservative and prudent we are and how much we are investing. It does not seem to me that necessarily there is a feel for how you could resolve that, and I think what we would need is a firm idea of how you can get that balance that is not just aspirational, it is the formula, as it were, especially in the context of low interest rates and all these other pressures.

Neil Carberry: There are two challenges here. I think one, going back, if you stand back from defined benefit there are some significant issues. There are challenges. There is also a massive amount of money paying a lot of good pensions to a lot of people, and we should never forget that. It is also, and a former governor of the Bank of England said this, in its point DB was a fantastic way of investing in the British economy.

Joanne Segars: And it still is.

Neil Carberry: And it still is.

Joanne Segars: Let us not forget.

Neil Carberry: Although more of that money is now flowing into gilts and, Lord help us, synthetic gilts, than into things that get to work more quickly in the economy. There is something there about how we do that. How we give capacity to smaller schemes to invest in things like



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infrastructure and consolidation is part of that. Coming back to the point about corporate governance, within schemes the reason this is difficult is that the core relationship is the relationship between the trustees—and not the trustees going to member vote on everything, the trustees demonstrating leadership on members' behalf—and the company—and one might link in various examples of this—giving the board of trustees enough information to make reasoned decisions. Then the Regulator's role becomes much more like the one that was initially set out by the initial Chair of the Regulator, Dave Norgrove, which is we step in when that relationship is not working effectively.

Q3359 Chair: Neil, if I can take you back to earlier questions that Malcolm was raising, Malcolm is presenting, as you would know, if you change the basis on which inflation is calculated it is a once and for all concession. I may be the last person in Christendom, but I think good times will come again and, therefore, what we ought to be about is how many schemes can we get to survive in the meantime, for which we need greater flexibility. Therefore, it seems to me that we want to approach this with trustees saying, "Yes, we will look at different ways of calculating the rate of interest, but when good times come we want to reconsider the concession that we have made". Has that come up in conversations at all?

Neil Carberry: There are conversations. I am a trustee of a scheme where we stuck with RPI. We have the capacity to go to CPI, but we have stuck with RPI because we feel it is the right thing to do.

Q3360 Chair: You have actually reserved the right to go back to the old way of calculating?

Neil Carberry: No, we have stuck with the old way of calculating. That is because we have a good relationship with the sponsor.

Q3361 Chair: No, I am speaking of those like Malcolm has described, really up against the margin, which could go under the PPF unless they made some concessions. One of the problems about making concessions is it seems that once you have made them you have made them forever. That is a shift in the balance between capital and labour, isn't it? One way of getting greater flexibility would be to say, "This genuinely is flexible. You may wish to review this back at another occasion when it looks as though your firm, please God, is prospering".

Joanne Segars: That is very much the Dutch model of condition indexation. "When we can pay, we will pay. If we cannot, we cannot", with an aspiration, perhaps, to make good any loss. Again, in the mix of all the things that we are looking at, this is an option.

Q3362 Chair: When you are thinking about this, Joanne, of your 6,000 defined-benefit schemes how many have shut up shop? We have considered this morning a report on intergenerational redistribution, and clearly if you are in a firm where you cannot join the scheme, money is going into the



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scheme, and you are paying towards a previous generation's goodies. What is the picture, please?

Joanne Segars: About 13% of schemes in the private sector are still open to new members.

Q3363 **Chair:** In fact, this redistribution is going on?

Joanne Segars: Redistribution? An intergenerational redistribution, yes.

Q3364 **Chair:** From the workforce now to pay for past promises.

Joanne Segars: Yes.

James Cartlidge: Which they will not themselves receive a portion of.

Chair: No, which they will never have the chance of having.

Q3365 **Richard Graham:** The 87%, if you do not mind, Chairman, how many of those are pensioners and how many are deferred pensioners?

Joanne Segars: Sorry, the number is buried in this report somewhere. Typically a scheme will have about 25% of its membership as active scheme members, and about 75% are either deferred or pensioners.

Richard Graham: The demographic is aging all the time on that and, therefore, the intergenerational question becomes more urgent.

Q3366 **Heidi Allen:** We have described two rather depressing worlds of limping along or ending up in the protection fund, and it strikes me that nothing much has changed, really, over the years. My husband used to work for Polaroid. He has been there, seen it, and he eagerly gets his annual statement and hopes there might be a few pennies in there now. Let's talk about the Pension Regulator. Are they intervening at the right time, when the schemes look like they might be in trouble? Should they come in earlier? If you do believe they should come in earlier, or more strongly, perhaps, do they have the powers and the resources to be able to do that? Perhaps I will take the answer from everybody. Maybe I will start with Neil.

Neil Carberry: Broadly, in the normal course of business the Regulator's intervention strikes about the right balance. We have about the same number of members who phone us up saying, "Yes, that was fair and equitable" as members who say, "They were really tough on us on this, but we got out of the far side of it". I think the Regulator's challenge comes in the more complex deals, perhaps where the relationship between the trustees and the company lacks some of the clarity we would all like to see. I think there is more they could do, and we are very clear in the paper we shared with you that we are always willing to discuss targeted changes to regulation to make it easier for the Regulator to intervene.

Two observations on that: the first thing is when the Regulator was set up they had more commercially-minded people inside the Regulator, so the skill set to get involved in these really complex deals is a big issue.



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The second point is we were very vocal about the fact that we were worried, back in 2006, by giving automatic enrolment enforcement to the Regulator. It is a huge task that they are doing very well, but it is a very different task, and we do worry about whether the DB stuff does not get as much profile or focus because of that. A real injection of skills into Brighton would be helpful to help them decide when to intervene. There may be a case for some specific changes to their powers, which is a discussion we are ready to have with Government.

Joanne Segars: Similarly, I think we would agree, overall the Regulator is doing a good job and doing that job very, very well. As Neil has suggested, in some of those more complex cases we would certainly support the Regulator having more powers. Again, we are very keen to talk to the Regulator and talk to Government about what those powers might be to enable it to intervene more and earlier in some of the complex M&A activity that we have all been concerned about. That does need to be proportionate, however. We would not want to see the entirety of the UK global world grinding to a halt, or this just being an enormous payday for lawyers. We do need to make sure that we can get back to a system that is proportionate and that does not clog up corporate activity, because ultimately that is not good for the economy, and it is not ultimately good for pensions or for pensioners either. We are keen to work with the Regulator to develop what those issues might be.

I think there is a broader question though, and again it is this issue of consolidation, about whether we are regulating from the right end of the telescope. Because we have so many schemes the Regulator is very often down in the weeds of regulation, down in almost micro regulations. The same might be true of DWP. If we had fewer, larger schemes, then it would be much easier for the Regulator to have a very different and more supervisory relationship with those larger schemes and, therefore, be able to intervene more easily with the sponsors and with the schemes. I think we need to see some of these issues as being very much linked. To your fundamental question, the Regulator is doing a good job, we would say, but there is more that they could potentially do in terms of M&A activity.

Q3367 **Chair:** Malcolm, do you think the Pension Regulator is doing a good job?

Malcolm Booth: I think they are with the resources they have. There is a question as to whether they need more resource to be able to deal with all of the things that they should.

Q3368 **Chair:** Before you go on to that, Neil made a really valid—sorry, I must not expose my bias, but he talked about the culture of the Pension Regulator changing over time, which we very much noticed. Before we go to extra powers, do you not think we should pick up on Neil's point about having a body that is much more commercially oriented and has a bigger sense of how the market is playing out?



Malcolm Booth: I think the Regulator needs those skills and needs that approach, but again, the risk is if the Pension Regulator is there to protect the member and the member's interest, if they become too commercial will they lose that focus? I think one of the concerns that came out, perhaps from BHS, and perhaps also from the situation that still goes on with British Steel, is: are they able to act against those parties or ensure that those parties that are involved make the correct moral positions? Should there be a better pre-clearance system where mergers are taking place so that we do not have a situation where a company can be sold with a pension deficit and effectively then shunted into liquidation so it ends up in a PPF? That type of regulatory activity needs to be sharp and focused to prevent that happening and continuing to happen. I believe that the regulations are already in place, but there may be an issue as to whether there is enough resource to fully implement them. Again, if the Regulator feels that there is a need for an extension of those powers or a change in those powers, I think it is a matter of discussing it with the interested parties.

Q3369 **Heidi Allen:** Would it be fair to say that overall the bread and butter of what the Pension Regulator does day-in day-out is fine, but when it comes to the more complex, potentially risky areas, the skill and the resource just is not there? Would that be fair?

Chair: Or put it another way: when we need them most they are least able to respond. Would that be fair?

Joanne Segars: It might be a little harsh, if I may say. I think what Neil and I have been talking about is some additional powers the Regulator might have, for which it would need to staff up and acquire the right skills.

Q3370 **Chair:** What are they, Joanne, please?

Joanne Segars: I think it is partly about making sure, as, in fact, the Regulator has set out in her letter to you, that the Regulator has the powers to get to the information from sponsors and from schemes in a timely manner. Then it is about that ability to intervene and to ask the sorts of questions about what the future of the pension scheme in any merger and acquisition activity.

Q3371 **Chair:** I think she has those powers already, doesn't she?

Neil Carberry: I think you summed up the challenge well. Things are working where most sponsors want to interact with the Regulator. What they really want is a letter from the Regulator saying, "Yes, this is fine, there is not a problem". It is a minority of cases, but it is where people are not engaging with the Regulator that, I think reasonably, they feel that they might need some clarity about what they can ask for that is less contestable. I think it also comes back to the role of trustees. I am picking up something that Malcolm said, that the role of the Regulator is to protect members, but indirectly the role of the trustee is to protect members. It is really the operation of the trust board independently of



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the company that is the primary guarantor of this, and the primary red button for the Regulator to push. Making sure that the Regulator can see those two things and that they are operating independently but in partnership is really, really important.

Chair: The last question for Richard.

Q3372 **Richard Graham:** Chairman, if I might, just before the last question can I ask a very simple factual question?

Chair: A last question.

Richard Graham: How long do you think schemes should take to produce their triennial valuations? Neil, you are a trustee, you have lots of members with schemes; what is the maximum length of time it should really take?

Neil Carberry: I think it can take up to 18 months from the day of the valuation to the final agreement.

Q3373 **Richard Graham:** That seems to be an extraordinarily long time. Joanne?

Joanne Segars: I think the days when doing triennial valuations was a simple exercise are long, long gone, and they can be very, very complex exercises involving some quite tricky negotiations.

Q3374 **Chair:** You seem to be defending high fees, Joanne.

Joanne Segars: Certainly not.

Q3375 **Richard Graham:** Just long processes?

Joanne Segars: It is a long process.

Malcolm Booth: It just seems to be a very long process.

Q3376 **Richard Graham:** Yes. I would have thought that would be something that would help TPR.

Can I come back, Chairman, to the whole business of this balance of responsibility between employers and schemes? Neil, if you found that you had a member of the CBI who was clearly obfuscating from providing information, either to trustees or the Regulator, proposing funding plans that stretched out for at least a generation, making verbal commitments to resolving the pension scheme but not doing anything about it, what would you say publicly about such a member's behaviour?

Neil Carberry: Observationally, it is highly unlikely they would also tell us that that was the position.

Q3377 **Richard Graham:** Let's assume you are reading it in the newspapers.

Neil Carberry: I think we would hold to the line of the starting point that I set out here, which is that the most important thing is that companies—and uniformly the CBI-membership companies feel they have a



responsibility to support these schemes. We have put in our paper about allowing schemes to use the official measure of inflation because legislation requires a limited-price indexation. Many companies will do more, as I have set out. Beyond that, there is no proposal for benefit cuts from us, because the core of our membership takes the view that these promises were made, and we work extremely hard in the context of a very difficult trading environment for investment to service them as best we can. That is where we would come from in any comment.

Q3378 Richard Graham: Would you accept that if there were plans, for example, to allow the trustees the flexibility to change the rate of indexation if there were serious moves to push forward on the consolidation of the smaller schemes, at the same time it would be perfectly reasonable to make sure that the funding plans do not stretch out as long a whole generation?

Neil Carberry: That is a very complicated question, to which the answer is: that is a conversation we will certainly be ready to have in the context of your report and whatever action the Government takes afterwards.

Q3379 Chair: If it was 23 years you would jump, would you? If the repayment period was 23 years?

Neil Carberry: It depends on the context of the sponsoring employer. I am not particularly keen to make a comment of one particular non-CBI member.

Chair: We are keen you do.

Neil Carberry: The Regulator established when it was set up a kind of 10-year trigger. If it is above 10 years we will have a look at it. That still seems not an unreasonable view, and the higher above 10 years you go the more you have to have, if you will forgive the language, a damn good reason to be proposing what you are proposing. If you get very, very, very long recovery plans proposed with trustee support, the first question is: have the trustees got strong logic for why this is the case?

Q3380 Chair: Are they all from the company?

Neil Carberry: Or insufficiently independent, I think was the way I put it.

Chair: Another way of putting it. Yes. Joanne?

Joanne Segars: I would agree with that. Clearly, recovery plans are scheme specific, and that is the fundamental basis of legislation. I think if they are very long, and much longer over 10 years, it is right that they are looked at, particularly in the context of a particular company, and perhaps its particular ownership structure, again, avoiding talking about a very specific non-PLSA member case. I think it is right that the Regulator can look at those. We want to see schemes well funded. We want to see sponsors backing those schemes.



I very much agree with Neil, those employers who are sponsoring defined benefit pension schemes are committed to those schemes. We want to see trustees making sure that they are doing a full job in making sure that they are looking after the future of the scheme, and the members, and the beneficiaries; all the members and the beneficiaries. There is quite a complex set of relationships, and it is one that has become much more complex, but we think where the Regulator needs to intervene, that they should intervene.

Malcolm Booth: I think there needs to be a balance, and I think one of the questions that perhaps the individual members may ask is: is the balance correct between how much is being funded into the defined benefit scheme and how much is being paid in dividends by the company? That ratio may be something that should also trigger questions in terms of very high dividend increases versus no change in contribution towards deficits in the pension scheme.

Q3381 **Chair:** Trigger questions for whom, Malcolm?

Malcolm Booth: For the Regulator. If the Regulator becomes aware of the fact that perhaps the dividend has gone up by 20% but the funding of the DB scheme deficit has remained the same, perhaps there should be a question as to why—

Q3382 **Chair:** Don't you think it is the duty of trustees to tell the Regulator that? Because otherwise, God, it is a hell of a job if the Regulator is looking for this information.

Malcolm Booth: I would accept that, but perhaps there is also a need for the trustees to be able to say to the Regulator independently of the company, "We are a little concerned about this, and it does not appear we are being listened to".

Q3383 **Chair:** Hence the importance of independence in the trustees, isn't it, Malcolm?

Malcolm Booth: Yes.

Q3384 **Chair:** Brilliant. Thank you very much for your evidence today. We are grateful to you. We are now going on to PPF.

Examination of witness

Alan Rubinstein.



Q3385 **Chair:** Alan, you know the rules. Might you identify yourself, and Karen will then open?

Q3386 **Alan Rubenstein:** Certainly, Chairman. My name is Alan Rubenstein and I am the Chief Executive of the Pension Protection Fund.

Q3387 **Ms Buck:** Good morning. Do you think the moral hazard framework is robust enough to protect the PPF? If not, what changes might be envisaged?

Alan Rubenstein: I think the framework that we have is generally robust and works pretty well. We have 10 years of experience—just over that now—of the regime that was introduced by the 2004 Act and I think we have learned some things along the way. In our written evidence to you we have suggested a number of small changes to that, which we think would improve that framework, such as, for example, a more interventionist approach from the Regulator on schemes that are in difficulty; such as new powers, potentially the power to fine firms if they are found to be trying to evade their responsibilities. With changes like that, I think the regime remains fit for purpose, yes.

Q3388 **Ms Buck:** Do you think that would also be the case were we to see a deterioration in the overall economic situation or are there contextual risks that have not yet been factored in?

Alan Rubenstein: When we look at our modelling of the economy and we look at a number of scenarios, we run stochastic models that look at a million possible outcomes. When we do that, we find that there are very, very few of those scenarios that would threaten the PPF materially. We are confident that the PPF will be able to stay there and do its job and protect the 11 million people who have defined benefit entitlements.

Q3389 **Ms Buck:** Overall relatively minor changes, but otherwise things are fine?

Alan Rubenstein: Yes, I would describe them as tweaks, but important tweaks, because one of the things we have seen, for example, in the clearance procedures is in the early years of the regime there were a lot of applications for clearance relative to where we are today. That may be because M&A activity now is less than it was then, but I think at least part of it is down to the fact that in the early years, companies and their advisers were not sure where the Regulator would draw the line, so they erred on the side of caution and they went for a clearance—which of course is not obligatory—whenever they were concerned. As time has gone on, advisers have a sense of where the line might be and so we have seen far fewer applications.

One of the things we are suggesting is just to nudge people by the idea of if you do try to avoid your liabilities, instead of just being able to issue you with a contribution notice or a financial support directive, which essentially replaces the money that is missing, there should also be an element of a fine alongside that. That will encourage people, if they are in any doubt, to go for a clearance or not. We think that is a better approach than one that would require pretty much every single



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transaction to have to go to the Regulator. My personal view is that would not necessarily be good for the conduct of business.

Q3390 **Chair:** Before we go on, Alan—we have it in your evidence, but people watching will not know—what size fines are you talking about and who should pay the fine?

Alan Rubenstein: The actual size of the fine is clearly something that Parliament would need to decide upon. The suggestion that we made was that it should either be up to the same amount as the contribution notice or warning notice, effectively doubling it, or possibly up to twice the amount, but that would be a matter for discussion. The intention would be that one would not really need it, that good companies, as ever, would do the right thing. It is just to encourage those who are getting close to the line or are perhaps inclined to try to transgress upon it, to nudge them in the direction of seeking clearance before they go ahead.

Q3391 **Richard Graham:** Alan, thank you and welcome back to the Committee. Powers for the Regulator have been discussed. We have evidence from various people and views range broadly from, “Any changes to the powers risk unintended consequences and should be avoided like the plague” to, “We should be giving the Regulator powers to fine anyone and everyone almost unlimited amounts to make sure that it gets what it needs” to a view that, “It has most of the powers, but maybe should be exercising them more frequently”. Where do you stand on this sort of spectrum of heavy intervention and no intervention?

Alan Rubenstein: As we set out in the evidence, I think there are four things, broadly speaking, one could think about. One is the fines that we have just discussed for people who try to avoid their liabilities. One is a more interventionist approach in terms of scheme funding and that is really in the case of those funds that are in difficulties, but not hopeless cases; I think earlier intervention by the Regulator there would be helpful. That may or may not need more resource and that is a question for them to answer.

We also see—again in the sense of giving a nudge—the power of trustees, or in extremis, the PPF, to approach the Regulator and say, for example, “Look, we have been locked in negotiations with this employer for ages. They will not budge. We need your help, and in extremis, we need you to order the winding up of this pension scheme because we can’t see how, under these conditions, it can ever deliver the pensions it is promising to people”. Of course the Regulator would then have to decide whether or not to exercise that power. These are fairly small tweaks to the existing framework, so I suppose in that I am saying the existing framework works pretty well, but I still think that there are opportunities to improve it.

Q3392 **Richard Graham:** What about corporate transactions? Again, there is a range of options mooted there, so if, for example, a business wishes to be bought out or partly bought out, should the Regulator have the power



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in certain cases—certain schemes that have been identified as being in heavy deficit—to have to give a clean bill of health before that happens or to call for the purchaser to come up with a plan within a short space of time or no change at all?

Alan Rubenstein: As I have said, I think that the clearance provisions that we have at the moment broadly work well. What we are seeing at the moment, or what we have seen over the last few years, is a decreasing use of those powers. I think if we could—

Q3393 **Richard Graham:** Why is that, do you think?

Alan Rubenstein: Because I think that companies and their advisers have a sense of where the Regulator is likely to come out and how far they can potentially push.

Q3394 **Richard Graham:** It is not because the whole process takes so long that the corporate transaction would not happen?

Alan Rubenstein: There is a risk of that. I know that some of the submissions you have seen, for example, have suggested that either all transactions or all transactions over a certain size or all transactions with a deficit of whatever percentage should be obliged to go the Regulator for clearance. I think that could possibly work.

Q3395 **Richard Graham:** Would that reduce the potential for the number of schemes simply being offloaded into the PPF?

Alan Rubenstein: I do not think it necessarily affects that, because that is something different.

Just to finish on that last point, if I may: while a regime of sending every scheme to the Regulator for a clearance could work, I personally think—and it is the PPF's view—that there is a better way, which is rather than go through clearance for everybody, keep the same clearance framework, but make it clear to companies that if you transgress, then you are going to not only have to pay the contributions that were due, but also a penalty on top of that.

In terms of transactions that involve an insolvency, that is slightly different. There is a very clear mechanism, the Regulated Apportionment Arrangement—or RAA—that people talk about, which we, in partnership with the Regulator, use. There it is clear that our first test is that before we look at one of those, the employer has to effectively be insolvent.

Q3396 **Richard Graham:** The other aspect of course of this session is about changes to the PPF and what could or might be possible there to improve the situation for both employers and pension schemes. You know, and we have had some correspondence on it, about the issues of some of the small and medium-sized employers, who find the PPF levy volatile, expensive and so on. In your written evidence, you have said that you are considering the potential for simplifying requirements for smaller schemes and then this is something that could be considered alongside



the scheme consolidation. You were here for the earlier evidence on the pace at which some proposals are going to be coming forward. What is your overall view? If there was a serious scheme to consolidate small pension schemes, would that help them financially enough to offset the cost of the PPF levy, which you think would solve the problem, or do you need to do a bit more too?

Alan Rubenstein: I think the challenge in consolidation as regards PPF levies at least is one of how that might be achieved, because different schemes have different levels of funding. If there was some mechanism that brought schemes together on a common level of funding, then I think that might potentially be helpful. If one is talking purely about pooling of investments or pooling of administration, but leaving the fundamental schemes separate, I do not think one gets any benefit from that. But I should say that we do recognise the issue of small and medium-sized employers and we have a specific dialogue group with a number of SMEs, including one or two from your own constituency, I think. I hope they will tell you that we are alive to their problems and we are looking at solutions. When we go out to consult on our next levy triennium, which will be relatively soon, then we will look to address these issues.

Q3397 **Richard Graham:** Thank you for that. If I can just ask one last question on that point, I think the short answer is they will believe it when they see it.

In terms of the PPF's role, in the 10 years that you have been running it, since inception, there is no doubt that the reputation of the PPF as an asset manager is very high—at the moment, because these things can always change. Does that encourage you to want to play a more active role in taking in schemes that would then be managed by the PPF or a subsidiary of the PPF itself or is that stretching the remit beyond what was originally conceived and produces other risks?

Alan Rubenstein: It would certainly stretch the remit as it is written at present. Our remit from Parliament is very clear, which is to—

Q3398 **Chair:** But would you favour it, Alan?

Alan Rubenstein: I think in the right circumstances, if Parliament wanted us to do something like that, then obviously we would do as Parliament told us.

Q3399 **Chair:** You heard in the first session, "Here is this idea" but nobody wants to own it.

Alan Rubenstein: I think Steve Webb also in his evidence talked about some sort of pre-PPF. If we were asked to do it, then obviously we would take it up, but I think there are difficulties in that consolidation that we should not minimise.

Q3400 **Heidi Allen:** In the first session we talked a lot about the role of the Pensions Regulator and how it almost had three jobs to do now, I guess:



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routinely bread and butter day-to-day stuff, looking at how schemes are performing; it now has the auto-enrolment chunk of work to do as well; and also getting involved in the detailed stuff when things really start to go wrong or there is M&A activity. In your view, how do they cover those remits? Do they have the skills, the resource? People have spoken about how there seems to have been a culture shift in the way that they operate. Do you think they are able to do all of those jobs, or if not, what needs to change?

Alan Rubenstein: If we start with the resource, that is really a question that they need to answer. I think in their evidence to you, they suggested they probably needed more resource.

In terms of skill sets, they have people with the skill sets on board and I think that since Lesley Titcomb became their chief executive we have seen a cultural shift to be, if anything, more commercial rather than less commercial, which is an interesting contrast with your previous organisation.

Q3401 **Heidi Allen:** Give some examples of that.

Alan Rubenstein: Just in the way they conduct themselves with us, in the way that they partner with us in looking at potential RAA cases, in terms of sharing information about risks.

Q3402 **Heidi Allen:** Is that organised or is that more commercially astute?

Alan Rubenstein: I think it is both, because it shows that they are now willing to focus on where the big risks lie.

Q3403 **Heidi Allen:** Is there nothing in what you have seen, either in the previous management or the current, that you think could be improved—earlier intervention, greater powers—or do you think broadly they do their job well enough?

Alan Rubenstein: As we have said, and I am recorded in the past as having said, we want to see the Regulator be more interventionist and tougher on funding. I have also said, and you would expect me to say that, I have one mission, which is to make sure that 11 million people are protected. They have a wider range of responsibilities. When we look at the Regulator, of course they have changed over the years and we would like to see constant improvement in the way that we ourselves try to improve constantly.

Q3404 **Heidi Allen:** But you think that is an iterative thing rather than a fundamental lack in the provision that they are giving at the moment?

Alan Rubenstein: Yes, because coming back to where we started, I think that the framework of having a Regulator who oversees and supervises and regulates pension schemes and their employers and also a safety net, the PPF, that compensates those whose employers become insolvent, and through no fault of their own see their pensions at risk of being sharply reduced is a positive system. There are about 230,000



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people now receiving compensation from the PPF, who by definition are receiving more than they would have done had their employers gone bust and there had been no PPF. There are another 130,000 in assessment who are equally protected, so I think as a system we have been quite successful.

Q3405 Heidi Allen: Although I suppose—being devil’s advocate—that is great, but is it good enough to say, “They got more than they probably thought they would do”? Is there a role for the Regulator to have stepped in earlier and stopped it in its tracks?

Alan Rubenstein: The challenge you face there I think is the one that you were discussing in the last session, about what is the right level of funding for a pension scheme and what should a funding plan look like. Clearly there are lots of views on that. In our evidence, one of the things we said is that there should not be an indefinite term that you can stretch out funding payments. We would argue that companies with very, very long-term funding plans, when you look closely, they probably have other issues that need to be addressed and it is those other issues perhaps rather than the pension scheme that is arguably the real problem.

We would argue that there should be a limit on plans. If you look at the Regulator’s own statistics, roughly 50% of plans have a recovery period that is eight and a half years or less; roughly three-quarters of pension schemes have a recovery period that is 10 years or less. One of the questions that the Committee might like to ask is whether that 10 years should be a natural stop and the Regulator should have to have very good reasons to allow people to have a recovery period longer than that.

Chair: Great question.

Heidi Allen: Thank you.

Q3406 Steve McCabe: It has been suggested that there should be new duties placed on the sponsors to co-operate more and share information in a more timely fashion with trustees and the Pensions Regulator. Is that your view?

Alan Rubenstein: I would certainly support the idea that trustees and employers are open. It is only if you have that open dialogue that trustees can understand the problems that the employer might be facing and hence make a sensible decision. There was talk earlier on, for example, about is there is a middle way between a pension fund as it sits today and the PPF. I think we have to recognise that what is being talked about in that middle way is a transfer of value, essentially, from the members to the shareholders of the company, because members are going to have to be asked to give up something. It is much easier for trustees to have that discussion if they have proper information about what they are talking about.

Luke Hall: It usually helps.

Q3407 Steve McCabe: What I am trying to clarify with you is should that be a



requirement? It is not a case of just saying it would be helpful. If you are saying it is going to work if you have that information, should there be a requirement, a legal requirement, to get that information provided?

Alan Rubenstein: What I am saying is that that should always be the case, so I would hope that you would not need a legal requirement to make it happen, but if you do, then I wouldn't object to that, no.

Q3408 **Luke Hall:** In answer to Richard's question earlier, you talked about consolidation and the fact that back-room administration consolidation brings no benefits. I wondered if you had any recommendations about what can be done to promote full scheme consolidation.

Alan Rubenstein: Sorry, just to be clear, it does not bring any benefits necessarily in terms of the PPF levy. It obviously brings benefits in terms of economies of scale, so it should be possible to reduce the cost of running the schemes; it should be possible to buy investment services more cheaply, so there are benefits there. But when you are talking about bringing schemes together, the benefits you get from that are limited if the funding levels are different, so you cannot put schemes together. You have groups of trustees who say, "Yes, I quite like the idea, so long as I get to stay a trustee" and so you saw an overgrowth almost of governance and no actual progress. I think that would be a bad thing. That is something one has to watch out for.

But as I say, in principle, I would agree with Joanne that there are a lot of small schemes out there. I think about a third of our schemes between them pay perhaps 3% of our levy, so you can see the scope is out there if one could figure out a solution.

Q3409 **Luke Hall:** Do you have any recommendations about what can actively be done to promote that?

Alan Rubenstein: I wish I did. I genuinely think it is a very difficult area because of the difficulty in terms of different funding levels. When we look at it from the PPF, the things we look at for our risk-based levy are essentially, "What is the risk that the sponsor of the scheme will fail and what is the deficit that the PPF will have to make up if it does?" If we can bring schemes to a common level of funding by some means, whether it is by employer contributions or whatever, then that might be one sense in which you can bring a group of schemes together and look at this pre-PPF idea that Steve Webb talked about. I think it is quite tricky just in terms of the mechanics of it, but it is something certainly worth studying.

Chair: We are finding it tricky as well.

Alan Rubenstein: I am glad it is not just me.

Q3410 **James Cartlidge:** I want to ask you about the impact of the levy on small businesses and particularly where it varies remarkably. We have touched on this earlier, but certainty is very important in business. Are you looking at ways to smooth out the liability and give more certainty to



businesses over their liability?

Alan Rubenstein: We try to do some of that already. If you look back to the history of the levy, when it originally started in year 1, the Government just imposed a flat rate and told the PPF to go away and think about how they would do a risk-based levy. That was introduced in about 2006-07 and was very volatile, because each year a levy amount was set, each company was rated independently, and because the PPF was trying to collect a total levy, that could lead to companies thinking they had done the right thing but still seeing levy increases.

When we did our first major revision, which came into force in 2012, we worked with our stakeholder group, including the PLSA, the CBI and others to say, "What is it that matters to business?" As you say, what came through to us was stability and predictability, so we set a levy framework that tried to do that, but in the sense that if the risk changes and the Act requires you, as it does, to charge a predominantly risk-based levy, then you can set the framework to be stable. But clearly changes in the funding, changes in the insolvency risk of an employer ought to be reflected, so that is what we do.

Q3411 **James Cartlidge:** It can be changes in rules. I have a case: the East of England Co-op is a mutual with their head office in my constituency. They have written to me and they had a £74,000 levy in 2015; it is now £160,000. According to them—and this something affecting mutuals generally—it is because of changes in the rules, that they obviously are registered with the FCA Mutuals Register rather than Companies House. Are you aware of this specific point?

Alan Rubenstein: Yes, I am aware of the issue. I was not aware of their individual levy.

If I could take you forward, the first revision was all about stability and predictability, so companies could work out what they would be on the hook for. It was what they did that mattered, rather than what everybody else did. In 2015, which is the switch year that you are talking about there, we moved from a levy based on Dun & Bradstreet general scores to an Experian levy, but the Experian levy is based specifically on the experience of the PPF.

Now the PPF universe is generally companies that are better risks than the population at large, because they tend to be larger, they tend to have been around longer, so our average company has been in existence for more than 10 years and has more than 100 members. On the standard sort of D&B ratings, you find that typically companies have probably been around for less than five years and have less than 10 employees. Moving to a bespoke approach is an improvement in the risk measurement and so its rate—

Q3412 **James Cartlidge:** They then had a quite significant increase.



Alan Rubenstein: I will absolutely come to that, because what I wanted to make sure the Committee understood is that we are constantly trying to make it better. The first stage was predictability and stability. The next stage in 2015 was something that was more related to our world and also transparent, so companies can see exactly how the levy is calculated for them, what the component parts that go towards risk are and you can use a “what if” tool to predict what will happen to them.

The case of mutuals is one where we have been in discussion with representatives of the mutuals association and we understand entirely their concern. We have looked at this very carefully; we have taken legal advice on the matter because we were so concerned. The difficulty is that when you are talking about mortgages and charges, corporates, if they want to enforce that, have to register at Companies House. A mortgage registered at Companies House is pretty clear proof that that mortgage exists. Then you can use mortgage age as a factor, because Experian’s analysis shows statistically that companies with new mortgages are a greater risk than companies with old mortgages and companies with no mortgages are the best risk of all.

When it comes to the mutuals, many of them do register on the FCA Mutuals Register, but crucially, there is no requirement for them to do so, so it is not clear, if somebody has no charges on that register, whether they do have mortgages that they have not chosen to register because they think it is immaterial or whether they truly do not have any mortgages or charges.

Q3413 **James Cartlidge:** I understood there was a requirement that they had to.

Alan Rubenstein: No, there is not.

Q3414 **Chair:** No. If there was a requirement they had to, would it mean that their levy would fall?

Alan Rubenstein: If there had been a requirement on the FCA register, then in fact some would probably see a higher levy and some would see a lower levy, because what we do is we say because we cannot tell, we give everybody in that case a neutral score, so we effectively take mortgages out of the equation. That would mean that companies that truly did not have mortgages would have had a higher score and would have had a lower levy; companies that had recent charges potentially would have gone the other way.

Again, I talked about the fact that we are about to consult on our next triennium and, as I say, this is one of the issues we have recognised. When we consult on that, one of the things we will be doing is trying to solve this problem for mutuals.

Q3415 **James Cartlidge:** If it is okay, I will write to you on this specific case.

Alan Rubenstein: Yes, please do.



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James Cartlidge: Obviously there is a broader economic point there. It is nothing to do with you that the National Living Wage is coming in, but we also have high pension contributions. A lot of the firms I speak to, they see what is happening with the pension levy. Obviously this is, as I say, not your direct responsibility, but in the context of facing a lot of overall business costs, it is this point about general economic risk from higher levies, which could be self-defeating.

Alan Rubenstein: All I would say to that is that when I first joined the PPF as chief executive in 2009, the first levy that was set was £720 million as an aggregate number. We have brought that down in most years. It currently sits at £615 million and for next year we have also set the target as £615 million. When you look at the constituents, something like 60% of companies will see their levy remain in the same band. Of the 40% that see the levy change bands, slightly more of them, 20%, will see their levy go down because their insolvency score will improve; slightly under 20% will see it deteriorate. The actual numbers on it, I think there is a pretty clear distribution. Of course the reason for the changes is simply because of new accounts coming in affecting people's insolvency scores.

Q3416 **Richard Graham:** Nonetheless, James's point is a valid one, in the sense that when you look at those statistics you have just given, the burdens of the increase tend to fall, anecdotally, on smaller companies, companies for whom in some cases a doubling of the PPF levy is really quite a high percentage of profits, if they are making profits at all. Therefore for them it is no consolation that the total take, if you like, has reduced, indeed—arguably—it is rather irritating, if they see bigger and more profitable companies paying less while they are paying more because of the changes in calculation through the Experian model, which largely concerned property valuations and so on. I think we welcome the idea that you are going to look at this and that the dialogue is happening, but as I said earlier, I think changes would be very much appreciated by those companies involved.

Alan Rubenstein: Just to respond to that, as I said before, we do appreciate how it feels for small businesses. They can rest assured that although they may not see it, the same effect applies to large companies as well, in the sense that we have a model that is only a model, so it can never be perfect, but it is—

Q3417 **Richard Graham:** Can I just interrupt there? What happened, for example, to the PPF levies on BHS? Did they increase significantly? Has their deficit ballooned?

Alan Rubenstein: From memory, yes. They would have done, because as insolvency risk rose and as funding deficit increased, those are the two primary components of the levy. I can write to you with the numbers if you would like.

Q3418 **Richard Graham:** Is that information that you can share with us by



writing to the Chairman?

Alan Rubenstein: I say yes, but I think I will need to speak to our lawyers, because I suspect that that information cannot be publicly released. I think we can probably provide it to the Committee in confidence.

Q3419 **Chair:** It did not work, very sadly, did it?

Alan Rubenstein: This is essentially a mutual insurance by companies, so you always have to expect that there are some companies that are going to claim. The fundamental principle that we have adopted, which Parliament has asked us to do, is to make the levy as risk-based as possible. That is what we seek to do. Every time we have revised it I think we are better, but we are clear that we are not perfect and we will never will be, so the next revision we will try to get better again and address some of the issues that have been raised here.

Q3420 **Chair:** James's point was slightly different, wasn't it? That was if you are a small company, your base to bear this cost makes you more vulnerable than if you are a big company.

Richard Graham: Yes, the levy is a percentage of turnover.

Alan Rubenstein: It honestly depends on the health of the company. Each company is scored on a scorecard that has a number of variables. One of the steps forward when we revised in 2015 was a lot of people complained to us that, for example, the old Dun & Bradstreet scores were known to be influenced by how many directors you had, what age they were, where the brass plate of your company was and so on. Stakeholders were very clear to us at the time that they didn't think that was relevant. It might be relevant to small companies starting up, but to our universe it wasn't, so we moved to a basis that is entirely based on demonstrable, factual, numerical evidence. We look at various factors: typically there are seven factors in each scorecard, which are as independent as we can make them and which add up to a prediction of the insolvency risk. Again, we have to start from—

Q3421 **James Cartlidge:** Forgive my ignorance here, but to what extent can they appeal?

Alan Rubenstein: There is an appeal procedure, but interestingly, because this system is so transparent and you can see what you are being measured on and we have set out the formula—

Q3422 **James Cartlidge:** Can they appeal on that specific point, if you have a small business for whom it will be very difficult? It may be fair on your scientifically assessed risk base, but it will be difficult for them to afford it and it could tip them further towards insolvency, in fact.

Alan Rubenstein: Two thoughts on that, if I may. Firstly, the levy itself is payable by the scheme, not by the employer, though I know that many employers have agreed to take it on, but it would be possible for them to



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agree with the trustees that in a particular year, the scheme paid it out of its resources rather than passing the bill through to the employer.

Secondly, we have always said that we are open to anybody who has trouble paying the levy coming and talking to us and talking about payment in instalments or some such arrangement.

Q3423 Heidi Allen: I was just curious. When you touched on the example of BHS just then and Richard or Frank—I cannot remember which—asked the question about when they started to come into real trouble, insolvency, and you said, “Yes, automatically the levy would have gone up for them”, what happens when things like that start to occur? Are there automatic triggers or warning bells? Does something flash on a dashboard for you and you get involved, you start to talk? What happens to the Regulator at that point? Are you suddenly on super-alert and you are talking to each other? What are the processes that happen?

Alan Rubenstein: The typical process will be that we monitor the top 500 deficits that we look at on a regular basis and we also monitor companies on a risk basis. We do not disclose the factors that go into assessing who falls into that or who is on that list, for obvious reasons. We share that on a regular basis with the Regulator, who have their own measures of risk, I think largely based on looking at the valuations that come in to them and they have specific triggers. There is that arrangement there, so the minute any scheme figures on that list it will go on to a quarterly discussion with the Regulator, so they will be alerted.

Q3424 Heidi Allen: Two questions: is quarterly often enough, and have you ever had any examples where what is flashing up on their warning list is not the same as yours? Is there a gap there?

Alan Rubenstein: There is deliberately a gap. We look at slightly different aspects to them and we find that helpful, because clearly when people are appearing on both lists, then I think we can all agree that there is likely to be an issue and they should be getting more involved in speaking to the scheme.

In terms of looking at it, we look at it ourselves monthly; we just have a quarterly proper formal meeting with the Regulator. But clearly if anything comes up that worries us, we would pick up the phone to them and they, in their way, would pick up the phone to us.

Chair: Alan, thank you very much, as always. Very good evidence and we are grateful to you.