Department for Work & Pensions

Laura Trott MBE MP
Minister for Pensions

Sir Stephen Timms
Chair
Work and Pensions Select Committee
House of Commons
SWIH 0AA

20 April 2023

Dear Sir Stephen,

Thank you for your letter dated 03 April. The Government welcomes the FPC's recent recommendations, and will carefully consider them alongside the upcoming WPSC report. To answer your specific questions:

Accept and legislate for FPC recommendations around the Pensions Regulator (TPR) having regard for financial stability

We are looking at the recommendations put forward by the FPC as I have set out above. As part of this we will look at whether financial stability should be something the TPR should have regard to. I can commit to report back to the committee when we have made a decision on this.

Powers of the Financial Policy Committee (FPC)

The FPC is responsible for identifying, assessing, and addressing systemic risks to the stability of the UK's financial system. It has broad powers of recommendation, as set out in the Bank of England Act 1998.

It can make recommendations to the PRA and FCA on a "comply or explain basis" and can also make recommendations to any "other persons" it deems necessary to fulfil its objectives, including TPR. The FPC is also able to make recommendations to the Treasury, including in relation to the regulatory perimeter.

As you correctly note, the FPC does also have powers of direction over the FCA and PRA, however we note that these are limited to the implementation of specific "macroprudential" measures specified in secondary legislation. This includes instruments that fall under the capital framework, such as the leverage ratio for the banking system and a power to set the countercyclical capital buffer (CCyB), and powers in relation to the mortgage market. We are not intending to expand this to include the TPR.

Notifiable events

We are working with TPR to ensure that it is better able to gather relevant information in a timely fashion in order to mitigate risks. In order to achieve that we need to consider the data that it needs and the best way to obtain this. The notifiable events regime is one way in which TPR can gather information in certain circumstances, and we are interested in pursuing this option but we want to evaluate all options before deciding on the best course of action including any potential future legislative change. We will work closely with TPR to assess the options.

Trigger points and feedback loops in LDI funds

In response to vulnerabilities seen in LDI funds last autumn, the FPC has published a framework for the steady-state level of resilience required in LDI funds. The framework expects that funds have sufficient resilience to respond to moves in the gilt market of 250 basis points at minimum, without the need to sell assets. Above this base resilience, funds are expected to maintain additional resilience to manage day-to-day volatility in yields and account for other risks they may face, such as operational risks.

The framework aims to create additional headroom for funds to continue to operate during large market moves and provide a longer timeline for them to recapitalise in an orderly manner. In this respect the FPC’s recommendations should reduce financial stability risks around recapitalisation.

Additionally, the Bank of England will be conducting an exploratory stress test around non-bank risks this year. The exercise aims to improve the understanding of how different participants in the non-bank sector would react to a variety of scenarios.

Yours sincerely,

Laura Trott MBE MP
Minister for Pensions

Andrew Griffith MP
Economic Secretary to the Treasury

Work and Pensions Committee

03 April 2023

Laura Trott MBE MP
Minister for Pensions, Department for Work and Pensions

Andrew Griffith MP
Economic Secretary to the Treasury
HM Treasury

(By e-mail only)

Dear Laura and Andrew

Defined benefit pension schemes with Liability Driven Investments

Thank you very much for your evidence to the Committee on 22 March about defined benefit pension schemes with liability driven investments. Given the overlap between your departments on some of the issues, we thought it would be helpful to write to you jointly to follow up on some of the issues raised in the session, particularly in light of the Financial Policy Committee's (FPC) statement on 29 March.

The Committee was interested to hear Minister Trott say that the Pensions Regulator's (TPR) powers and duties in relation to the impacts of pension funds on the wider financial system, should be looked at (Q277). On 29 March, the Financial Policy Committee (FPC) recommended that TPR should "have the remit to take into account financial stability considerations." **Do you accept this recommendation and, if so, do you plan to legislate for it?** The FPC also noted that "in order to achieve this, TPR would need "appropriate capacity and capability." **How will you work with TPR to assess the capacity and capability needed to achieve this? Will you commit to reporting back to the Committee on the results?**

We were interested in Minister Griffith's comment that the more the Pensions Regulator (TPR) could be part of the "very tight working relationship" between the Bank of England, the PRA and the FCA, the better (Q302). However, the FPC does not have powers of direction in relation to TPR, as it does for the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). **Do you think TPR should be included in section 9H of the Bank of England Act 1998 to give the FPC those powers of direction?**

The FPC also recommended that TPR should "take action as soon as possible to mitigate financial stability risks by specifying the minimum levels of resilience for the LDI funds and LDI mandates in which schemes invest." We understand TPR proposes to specify minimum levels of resilience in guidance. However, it told us in January that it does not have the information needed to assess whether such guidance is followed. It has suggested a 'notifiable events regime' but said legislation would be needed to make this mandatory. Minister Trott agreed that we need an "element of mandation" (Q301). **What assessment have you made of whether a notifiable events regime is the right approach? If so, when will you legislate for this? What alternatives are there?**

The FPC also said that LDI funds "should be able to: withstand severe but plausible stresses in the gilt market; meet margin and collateral calls without engaging in asset sales that could trigger feedback loops." We understand that some LDI funds operate trigger points, so that if collateral falls below a certain level, there can be a call for re-collateralisation before the buffer is exhausted (Q298). **What assessment has been made of whether collateral calls at these trigger points could create financial stability risks (for example, leading to the sort of forced selling we saw in September 2022)?**

We would be grateful if you could get back to us, as promised, on whether the Pension Protection Fund (PPF) and TPR have the information needed to provide detailed information on the extent to which individual schemes 'lost out' as a result of the events of September 2022 and whether they plan to do so (Q303).

It would be helpful to have a response by Thursday 20 April 2023.

Yours sincerely,

Stephen Timms

Rt Hon Sir Stephen Timms MP
Chair, Work and Pensions Committee

House of Commons
Palace of Westminster
London
SW1A 0AA

workpencom@parliament.uk
+44 (0)20 219 8976
Social: @@CommonsWorkPen
parliament.uk