**Response to Consultation - Pensions and Growth**

**Whether to introduce a new statutory objective for the Pensions Regulator**

**Response from Dr. Ros Altmann, independent pensions expert**

Questions:

**Q6. What would be the advantages of a new statutory objective for the Pensions Regulator to consider the long term affordability of deficit recovery plans to sponsoring employers?**

Summary of advantages:

- May send a stronger signal to trustees and markets that tPR can 'look through' short term factors that cause a disruption to deficits (artificial distortion of gilts by QE)
- May help more employers survive in the longer term
- May allow employers more time to make up their deficits
- May allow more employers to invest in their companies and create jobs
- May allow more members to achieve 100% PPF protection
- May boost the economy
- Can deliver some macro-economic benefits that offset the temporary disruption caused to pension deficits by QE

This consultation has arisen because of the exceptional difficulties that UK defined benefit pensions have had in very recent years. There is concern that the impact of monetary policy measures which have deliberately driven down long-term interest rates, have had a significantly detrimental effect on employers sponsoring such schemes. The concern is that, while monetary measures are aimed at providing an economic stimulus, the possibly unintended consequences of these measures for corporate UK is actually damaging growth in the short-term. Because pension schemes are relatively mature and because their liabilities are valued relative to long-term gilt or bond yields, the impact of much lower yields is to inflate the value of liabilities and has resulted in a sharp increase in scheme deficits. Even though the pensions are very long-term obligations, the employer sponsoring the scheme finds that they suddenly face a sharply increased deficit and trustees demanding much more money for deficit contributions. This will have an impact on the employer's ability to fund its business, invest or create jobs in the near-term and has also prevented some companies from accessing the capital or lending markets, as well as having led to stock market underperformance. All these short-term consequences of rising pension deficits will be damaging to the company and the economy, while the reason for the problems was a desire to stimulate growth. Thus, the impact on pension scheme sponsors may be undermining the effectiveness of the policy stance itself.

Because pensions are long-term liabilities, it seems unwise to force firms to adjust to short-term exceptional circumstances in the way that has been happening. Once the emergency policy measures are unwound, and real (and nominal) interest rates return to more normal levels, the long-term nature of the liabilities should allow deficits to be repaired over time. However, if the employer is over-burdened by having to meet short-term deficits that have opened up due to exceptional short-term factors, (and in this case short-term can be a matter of years for pensions) then policy will be sub-optimal.

Therefore, allowing more leeway to employers at the moment and ensuring that the Pensions Regulator can consider the long-term position of sponsoring firms, can send a strong signal that the current deficit position may not automatically mean a sudden surge in employer contributions that would be a risk to the survival of the company. So, a more relaxed attitude to the current exceptional circumstances could help companies raise money more easily, could allow them to invest and create jobs rather than shoring up their pension schemes for the moment and may ultimately lead to the survival of more firms. This will mean more people receive their full pensions in the long run and the PPF will have less schemes to support.
The Pensions Regulator (tPR) does already have to consider the position of the sponsoring employer when assessing the adequacy of contributions and deficit recovery plans, however this is in its Codes of Conduct, rather than being explicitly stated as a statutory objective.

The main advantage of making the consideration of long-term affordability of deficit recovery plans to sponsoring employers a new statutory objective for tPR is that it would send a strong signal to trustees, employers and markets that it is vital to consider employer affordability. Clearly, a statutory objective would appear to be stronger than a Code of Conduct requirement. Many trustees are unclear about how important consideration of employer affordability really is and sometimes seem to assume that they have to be tougher on employers, which can be more detrimental to the near term business performance than a more patient approach.

Since the current statutory objectives mention only the security of members and the PPF, there may be a perception that the relative importance of the employer's interests is lower. Having a statutory obligation to consider the employer's interest might allow the Regulator to take a more openly balanced view.

**Q7. What would be the disadvantages in creating this further statutory objective for the Pensions Regulator?**

Summary of Disadvantages:

- Some firms, that are going to fail anyway, continue in business longer, leading to more strain on the PPF as it takes in schemes with more members in 100% band
- Some employers and trustees may use more lenient approach to deficit recovery plans to avoid funding schemes well, again risking larger burdens on PPF
- Some employers and trustees may be encouraged to adopt more risky investment approaches to try to overcome deficits and if the risks are not rewarded the PPF burden will again be increased
- Some employers, who could actually afford to put more into their schemes, decide not to do so by pressuring trustees
- The Regulator's objectives will be even more conflicting than currently, as members and employers interests may conflict with the interest of the PPF
- The balance of power may shift more towards employers (having moved away since the pre-PPF days) and this could pose a risk to the PPF

The main disadvantage would be that some firms and trustees might use this as an opportunity to reduce pension contributions and leave their schemes much weaker than they would otherwise be. If the employer is ultimately going to fail anyway, then offering them more short-term protection would lead to a greater call on the PPF later, as more members will qualify in the 100% protection band having reached pension age. So, for those firms who are bound to become insolvent, adding this as a statutory objective could mean deficits keep worsening because there are lower contributions into the scheme and this is a bigger systemic risk, especially for the PPF. However, if a more relaxed short-term stance allows more firms to survive and prevents them from becoming bankrupt, then overall the pension system will benefit.

There are also concerns that there will be some employers and trustees who decide to use the opportunity of an increased emphasis on long-term employer affordability to justify taking a more aggressive investment stance that entails higher risks. I do not believe this is as much of a problem as has been suggested. Indeed, I believe that the current significant increase in pension fund purchases of gilts and other fixed income may itself be adding significantly to the longer term risks. Gilts and bonds do not really 'match' pension liabilities and, if a scheme is in deficit, it must find upside to generate the increased returns it needs above gilt yields to repair its deficit.

There is a risk that, if employer interests are perceived to rank more highly than before, employers may use the opportunity to press their own interests and, with a far more powerful voice than members or trustees, they may override the interests of members. There is a careful balance that needs to be struck. The balance of power for employers has been reduced in recent years and there is a risk that changing the statutory objectives could raise the employer's power to levels that could harm the PPF.

There is currently a perceived (but not necessarily real) imbalance in the importance of the relative interests of each of the parties involved in pension funding. The Regulator's statutory objectives are already to some extent in conflict with each other. Protecting members' interests may require the scheme to carry on as long as possible, to ensure more members receive higher PPF 100% protection, but the interests of the PPF mean schemes that are going to fail anyway should be transferred over as soon as possible, so that fewer members receive the 100% protection and better control over the assets can be achieved. Adding a requirement to protect the long-term position of employers could arguably add another level of conflict to the Regulator's objectives, but, as the employer interest is already a factor being considered anyway, I suspect the Regulator could handle this conflict.

**Q8. Is the consideration of the long term affordability of deficit recovery plans to sponsoring employers already implicit in the existing objectives and requirements for the Pensions Regulator? If so, is this sufficient?**

Yes, the consideration of long term affordability of deficit recovery plans is already a factor that is in the existing Codes of Conduct for the Regulator, but it does not have the same prominence as the statutory objectives. Having the employer interests as an implicit objective is not as effective as an explicit statutory objective. This may not be sufficient for many trustee boards, especially smaller schemes, who tend to take an ultra-cautious approach and may feel obliged to protect their own position by forcing the employer to fail, rather than taking more of a risk and allowing the company to carry on without more short-term deficit contributions into the scheme. Of course employer affordability must be a key consideration in deciding on contribution levels and an increased emphasis on taking account of longer term affordability, rather than the short-term position, may help trustee boards and members secure better outcomes for members in some cases. But it will still require each situation to be looked at on its own merits.

The Regulator needs to help steer trustees away from dangerous 'groupthink'. If all pension schemes are buying the same assets at the same time, or changing asset allocation in the same way, there is a danger that if their views are wrong, there will be a systemic failure.

**Q9. Are there other options (including legislation) which would ensure that the Pensions Regulator carries out its functions in a way which appropriately balances protection of members, the Pension Protection Fund and sponsoring employers?**

The challenges of appropriately balancing protection for members with the security of the PPF cannot be underestimated. Adding to this the careful consideration of the survival of sponsoring employers adds significantly to the challenges faced by the Regulator. Nobody has a crystal ball, so we can't be sure what the future holds for any particular scheme or employer. However, it is clear that the best interests of the members are served by an ongoing successful sponsor who can afford to pay the promised pensions. Forcing employers to fail, just because they have been hit by distortions in the gilt market and cannot currently afford to put large sums into their scheme until an economic recovery is underway) would be counterproductive.

The Regulator does, however, already have significant flexibility.

Perhaps one option would be to require the Pensions Regulator to take the general economic environment and stance of policy into account when assessing deficit recovery plans.

Perhaps the Regulator could be required to consider ongoing profitability of the company and ensure that a percentage of any earnings growth must be directed to the pension fund in future years.

Perhaps the Regulator should be obliged to consider the position of open schemes differently from the position of more mature closed schemes. Taking account of scheme maturity would allow a greater ability to relax deficit recovery periods for some schemes, that would help the firm thrive and better protect members' long run interests.