Response to consultation on DB sustainability Green Paper

from Baroness Ros Altmann

I am responding to this consultation in a personal capacity, as an independent pensions expert. I have spent many years working on UK pensions. Initially as an academic, then as an investment manager, running international equity departments and asset allocation teams investing on behalf of UK pension schemes. Then I was an adviser to the Government on investment allocation for pension schemes and the excessive reliance on large-cap equities (primarily in the UK). I also advised Number 10 on the problems in the annuity market. In 2000-2005, I worked with the Government on the failure of UK legislation to offer proper protection (despite having assured members they were fully safeguarded) and was involved in establishing the new regulatory regime, the PPF and the Financial Assistance Scheme. I have advised investment firms and pension funds on ways to modernise their investment approach, as well as continuing to address the asset allocation issues of pension schemes. I have been a trustee, Chaired investment committee and have worked with advisers and fund managers, to try to improve the ways in which pension schemes are managed. I have watched the development of the UK Defined Benefit pensions regime since the late 1970s and have responded to this Green Paper because I believe there are vital issues that must be addressed in order to optimise the pension outcomes for millions of members of such schemes.

Overarching response to Consultation Questions

EXECUTIVE SUMMARY

UK Defined Benefit (DB) pension schemes are the most expensive in the world. Over the past few decades, employers who started offering pensions to their staff on a 'best efforts' basis, have ended up being forced to take on more and more expensive liabilities. When schemes were just starting out, with contributions coming in and few benefits being paid out, the appearance of 'surpluses' was relied upon to continually offer better benefits to members. Once an improved benefit has been introduced, the law then tightened to require every last penny to be paid. Until 2004-5, unscrupulous employers were able to walk away from their schemes on the basis of flawed actuarial valuation measures, which did not reflect the costs of full benefit delivery. Many did so, leaving up to 150,000 members without their promised pensions. This scandal led to a dramatic tightening of the rules, that was designed to prevent employers from walking away without fairly paying for the pension promises made.

Unless the employer is facing imminent bankruptcy, the new rules mean benefits can never be reduced, even changing the benefits can be difficult. Inflation linking, spouse cover, full revaluation – especially the 8% or more revaluation of GMPs – have made these DB liabilities extraordinarily expensive for employers, way beyond anything they would have anticipated at outset. In the face of ultra-low interest rates that have followed the financial crisis, Quantitative Easing has dramatically worsened the pension problems of many UK employers.

The impact of low gilt yields has had a number of negative consequences. Firstly, the assessed value of liabilities has risen inordinately, secondly the costs of buying annuities has soared. The problems that led to the full buyout requirement in the early noughties have been mostly dealt with, and the new regulatory regime has worked reasonably well for the past 12 years. However, the DB landscape has changed significantly over time and I believe Government policy must now adapt to the new realities.

Most private sector schemes are now closed to new members. Those that have not already done so are also likely to close to new accruals too. A closed scheme is in run-off and if we wind forward 5 or 10 years, the employer currently responsible for the scheme funding will probably have no interest in continuing the stand behind ongoing payments. They will have no workers in the scheme, so why would they have an interest in having to deal with it? And, of course, some private companies will fail and the benefits will end up reduced in the PPF. Some will, indeed, be bankrupted by their pension obligations. The draconian annuity buyout requirements are placing much bigger burdens on employers than they are equipped to cope with, unless they are very large businesses. And even then, some will fail.

With Brexit on the horizon and such huge uncertainty about the future, planning for a new DB landscape now is the prudent approach. Just waiting complacently and assuming all is fine should not be an option. The economy, or corporate performance can change rapidly in pension timescales. Changing the law once a crisis hits would be sub-optimal. Preparing for a new situation is urgent.

There is no room for complacency, given the medium term outlook for private sector schemes: The Green Paper suggests many large employers could afford to fund their schemes more fully, but are choosing not to. It also concludes that employers are paying dividends which could cover the costs of their deficit repair relatively easily. I believe such complacency could be damaging for the medium term. We need to introduce measures today that will deal with pensions in five to ten years' time, because legislative change takes a couple of years to introduce and the Government should stay ahead of the curve, not behind it.

Open schemes may need a different regime from those which are closed: If a scheme is still open to new members and new accruals, it is likely to be in a different position for the coming decades from one which has already closed. The cash flow needs and constraints will be different and the potential sources of funding will also be broader for open schemes. Increasing member contributions in a closed scheme is not an option, so the entire burden falls on employers, but as time goes on, the probability of the employer being both able and willing to support the scheme reduces.

The DB system is currently in an inter-regnum period, leaving the Government and the Regulator with a difficult balancing act to strike at this time. On the one hand, before private schemes close altogether, before they have no more workers in the scheme, before they need to restructure their business or suffer some kind of downturn, before they want to sever all ties, the trustees need to try to get as much money in as possible. But, on the other hand, if forcing employers to put more in today will just mean the business is weaker or more likely to fail, the members' interests will be jeopardised. This balancing act has been made much more difficult by Quantitative Easing and the distortion of interest rates. It is not clear that gilts are indeed 'risk-free' assets at the moment, nor is it clear that fixed income assets are the best way to 'de-risk' a scheme. Many employers and trustees are understandably concerned that interest rates are artificially depressed by official bond-buying. This has perhaps artificially inflated the present value measures of liabilities and the costs of annuity purchase. Overseas competitors do not have the draconian expenses of DB schemes that prevail in the UK. Using corporate assets to buy more gilts for pension schemes, potentially using money that will be needed as a buffer against economic downturns in future, could undermine the sponsor and ultimately the economy.

There are, of course, many sponsors who have already exceeded their capacity to support the scheme and pay full benefits on a buyout basis. This is not adequately recognised by the current regime. It is in this area that changes are important.

The Regulator needs more powers to assess sponsors, as well as corporate transactions, to be able to make the difficult judgment call as to whether the employer is putting in as much as can be reasonably afforded. To do this, the Regulator must be able to demand information that it needs, without having to launch a full investigation or use its powers for Contribution Notices and Financial Support Directions. It seems strange that tPR can ask for information, but cannot insist. Penalties for non-provision are important.

How can the DB regime adjust to cope with the run-off of most private sector schemes and deliver benefits more reliably?

Winding down regime, not just buying annuities on wind-up: The DB landscape is not sustainable as it currently operates. There needs to be more leeway for employers to manage their liabilities. This will have to include a new regime to handle 'winding down' rather than 'winding up' a scheme, which allows employers to sever ties with the scheme without having to buy annuities.

Sponsors are effectively prisoners of their pension scheme, harming competitiveness: Making employers prisoners of their pension scheme is not a viable long-term solution. The costs of UK liabilities are saddling companies with unusually high liabilities, which have little economic value and hamper competition. The current approach is trying to make the best, the enemy of the good.

Small schemes need to consolidate, may need to adjust benefits: The prevalence of small and medium sized sub-scale schemes is hampering good outcomes, making benefits more expensive to deliver and damages optimal investment. A new regime is needed that can facilitate scheme mergers. In ten years' time, any closed schemes whose employer is still in business is likely to be looking for a way out of ongoing responsibility. Mergers will enable economies of scale to deliver more benefits, more reliably.

Allow statutory over-ride if trustees decide it is in members' interests: Although it is not the ideal, I believe the pragmatic approach would be to allow a statutory over-ride to change the inflation measure used by a scheme for revaluation. This is the minimum adjustment that could help some employers manage their costs more reliably. The trustees should have the power to agree to a change from, say, rpi to cpi, if needed.

Allow benefit changes in order to facilitate mergers: Scheme mergers are going to be essential in the coming years. Currently, it is too difficult and costly to make this economic, but it would be in the interests of the majority of members, the PPF and remaining schemes to facilitate consolidation. This will not only cut costs, but will also allow better governance and access to a wider range of investment opportunities.

Approach to 'risk': Currently, there seems to be too much emphasis on 'de-risking' by means of switching to fixed income. In light of the ultra-low exceptional level of yields, in a market that has been artificially distorted by central banks, the traditional risk models may be misleading. It is not clear that Government bonds offer 'risk-free returns' and in some cases they may be offering 'return-free risks'. Indeed, experience over the last year or so suggests that schemes would have lost out significantly by chasing gilts, rather than relying on supposedly higher risk assets.

Asset allocation now emphasises risk, rather than returns. This could be reckless conservatism and is unlikely to overcome deficits, as schemes need assets to outperform, not match liabilities: Pension scheme advisers have been encouraging trustees to move out of higher-return investments into low-return, supposedly lower-risk assets. This is particularly in schemes with larger measured deficits and weak sponsors. Such actions might reduce the likelihood of full funding if a weak sponsor cannot keep increasing contributions. Some schemes may be able to cope with this, but many will not.

Trustees need to manage investment risk, not just minimise it: It is right that trustees need to be mindful of investment risk, but it is much more important to 'manage' that risk, rather than just 'minimise' it, in many cases. It seems to me that this could be reducing scheme sustainability. Given the uncertainty surrounding investment risk measures and the need to outperform (not just match) liabilities, the investment switching to lower return holdings could increase the risk of failure. The problem for many trustees is that small and medium sized schemes do not have access to the widest range of investment opportunities, are paying excessive fees for asset management in pooled vehicles, are unable to protect the downside risk cost-effectively and have much higher per member management costs with lower governance budgets. Pooling or merging schemes, or at least merging their assets, such as is being done for local authority schemes, would allow better expected outcomes at lower costs.

Broader diversification and access to better investment approaches: Many smaller schemes do not have access to the most modern methods of money management and also fail to get the benefit of top advisers. Many do not have professional trustees or investment expertise on their board. As we look forward over the next period, with most schemes closed, the investment performance could be a key determinant of DB sustainability. The current sub-scale schemes are not likely to have the resources or expertise to make the most of the investment opportunities open to larger schemes.

Better Regulator powers needed: The Regulator already has significant flexibility to deal with employers and schemes. The system has worked well for the past 12 years or so, but is now in need of some updating in my view. It is essential that the Regulator has the power to demand information that it believes it needs to assess a scheme. In some cases, trustees can obtain vital data, but not always. There are no penalties for non-compliance with data requests and this must change urgently. The Regulator (and/or the PPF) may also need new powers to negotiate terms on which schemes can 'walk away' from their liabilities, without full annuitisation. There also needs to be new power to facilitate scheme mergers on a more cost-effective basis, allowing trustees to judge what is in the best interests of members and, if they have made every reasonable effort to contact members, to allow them to ultimately consolidate or change the scheme without every member's consent.

The Regulator should relax its attitude to DB to DC transfers: I believe that many members, especially with small deferred entitlements, could benefit from transferring out. This transfer value should, in my view, reflect any underfunding in the scheme and it should be offered as an option to members, but not mandatory. Administrative costs may fall if those with small deferred pensions transfer out, especially for those who have other pensions elsewhere. The assumption that it is almost never right for members to transfer is outdated, given the pension freedom changes.

System for self-sufficiency as has been allowed for BHS: Over the coming years, more and more scheme sponsors will need or want to be able to end their ongoing liability for their legacy pension scheme. They will have no business interest in the scheme. The employer can only reduce benefits when facing insolvency, but forcing sponsors to support unaffordable liabilities or go bust is a damaging binary choice. Using BHS as an example, it should be possible to devise a system whereby employers can pay a defined amount into their pension scheme, or commit to a programme of ongoing payments for, say, 5 years, that will end their responsibility. This could be on the basis of technical provisions, plus a reasonable margin to allow for uncertainty.

Regulator or PPF could introduce a range of consolidator funds to help manage long-term liabilities: Scheme mergers and consolidation are likely to be important for DB sustainability. For those employers who can afford to pay technical provisions plus a margin, but not full buyout, the Regulator could approve a consolidator fund to manage the ongoing investments and administration of payments. There will be others who cannot afford as much as this, but could afford more than PPF level benefits. A second consolidator could be introduced to enable members of such schemes to receive better than PPF level benefits, again measured on a technical provisions plus a margin basis. The Regulator or PPF could have the flexibility to decide which schemes would be candidates for this alternative consolidator.

Invest assets in housing and infrastructure, as well as start-up businesses: Many small pension schemes are investing only in equities and fixed income, or using pooled funds to have a little more diversification. This is not allowing them to benefit from broader asset diversification. It is also denying the UK economy the domestic source of funding that it could use for growth-enhancing investment such as in infrastructure, new business start-ups or housing. If scheme assets can be pooled, as is already planned for local authorities, there will be an improved source of funding for the UK economy.

Multi-employer schemes and charities need urgent relief: I urge the Government to address the problems faced by small employers in multi-employer schemes who are being forced into personal bankruptcy by their pension obligations. The law currently requires them to buy annuities not only for their own workers, but also for those of other employers' workers too. Those other employers have either become insolvent already, or have been able to negotiate an RAA and walk away without paying in sufficient money to cover their liabilities. Small employers and charities need relief from the draconian legal burdens that were originally designed in a different environment. To force plumbers to lose their homes and their entire life savings, just because they tried to provide pensions for a few of their staff, is disproportionately harsh. This needs an urgent response.

Regulator should differentiate between open and closed schemes: Currently, there is little differentiation between requirements placed on open and closed schemes. An open scheme has very different characteristics, with much longer time horizons and greater ability to increase member contributions to cover rising costs over time. It is closed schemes which need closest attention and consolidation.

SPECIFIC ANSWERS:

Question 1

Are the current valuation measures the right ones for the purposes for which they are used?

All pension valuation measures are necessarily estimates at a point in time. They should not be considered reliable and predictive, they are merely indicative.

a) Are the flexibilities in setting the Statutory Funding Objective discount rate being used appropriately?

Many schemes are using the flexibilities appropriately, but I am concerned about the excessive degree of conservatism shown by some smaller funds. There seems to be an over-reliance on using gilt or bond yield discount rates, even in the face of distortion of rates by monetary policy interventions.

b) Should we consider shorter valuation cycles for high risk schemes, and longer cycles for those that present a lower risk?

I would be in favour of longer valuation cycles than triennial, with the flexibility for the Regulator and trustees to demand more up-to-date valuations in times of perceived stress or ahead of corporate activity. Many schemes, especially if they are open to new members and new accruals, are spending too much time and money on these three-yearly valuations. By the time they have dealt with one tri-ennial, they are almost immediately into another one and it is not clear this adds significant value.

c) Should the time available to complete valuations be reduced from 15 months?

• What would be an appropriate length of time to allow?

I think 12 months would be more reasonable. By the time many triennial valuations are produced and acted upon, they are too out of date.

Greater use of approximated interim valuations would be more helpful, especially as we may move into a period of huge economic turbulence after Brexit.

Question 2

Do members need to understand the funding position of their scheme, and if so what information would be helpful?

Members may be misled by funding numbers, if they believe they are reliable assessments, rather than merely indicative estimates. Ascribing spurious levels of accuracy to the long-term funding numbers will not really help. However, a figure that will be relevant to members and could be of benefit would be to provide up-to-date transfer values. This transfer value would, in my view, need to reflect the current estimated under-funding of the scheme on a technical provisions basis. Another useful measure might be to explain the PPF level of benefits they would be entitled to.

a) Should schemes do more to keep their members informed about the funding position of their schemes?
Members can be confused with too much information and there is no standard funding measure that would help them. The most relevant to members is likely to be a transfer value, which is discounted by the estimated deficit and a measure of the PPF level of benefits they might receive.
b) Do we need Government communications to provide information to the wider public and media about the degree of certainty and risk in the regime? **Yes**

•What difference could this make?
Members might better appreciate the value of the benefits they have and how expensive pensions are to provide. Thus helping increase contributions into alternative arrangements for those whose scheme is now closed.

Question 3
Is there any evidence to support the view that current investment choices may be sub-optimal? If yes, what are the main drivers of these behaviours and how could they be changed?

Yes, investment choices are, in my view, often sub-optimal. The (perceived or real) regulatory drive towards so-called 'de-risking' for deficit schemes with weak sponsors is leading to more and more reckless conservatism. It is correct that schemes need to be mindful of investment risk, but they need to 'manage' the risk, not just 'minimise' it.

a) Do trustees/funds have adequate and sufficient investment options on offer in the market?

• Is there anything Government could do to address any issues?

Scheme consolidation would go some way towards improving the investment opportunities available to trustees.

b) Do members need to understand the investment decisions that are being made?

Those members who are interested should be able to see the investment decisions being made when reported by trustees, or examining the Statement of Investment Principles. It is trustees and employers who really need to understand these decisions. Members will, of course, have an interest in the ethical, socially responsible or governance aspects of investment.

c) Would it be appropriate for the Regulator to take a lead in influencing or determining an acceptable overall level of risk for a scheme in a more open and transparent way?

I believe the Regulator needs to signal a more flexible attitude to investment risk and the process of managing risk, rather than 'de-risking'. Helping trustees understand the need to take carefully judged investment risks, rather than just trying to switch out of higher return assets to protect against downside risks is important, in light of what seems to be excessive allocation to fixed income. I believe removing the annuity purchase requirement for employer disengagement from a scheme would also assist in this regard. If the ultimate de-risking requires annuitisation, then more trustees will be driven to try to buy more gilts and bonds, which reduces expected returns and increases costs of DB scheme support.

d) Would asset pooling or scheme consolidation help schemes to access better investment opportunities?

Yes, definitely. this is really important and DB scheme consolidation could benefit returns, reduce risks and reduce costs for the DB pension system as a whole.

e) Is regulation (including liability measurement requirements) incentivising overly risk-averse behaviours/decisions that result in sub-optimal investment strategies?

There is little doubt that perceptions of regulatory requirements are driving overly risk-averse behaviours. The annuity buy-out requirements are partially driving this, but actuarial convention and herding of advisers' recommendations also drives this risk-aversion.

f) Are you aware of evidence of herding or poor advice from the intermediaries and advisors? **YES. A study of advice received by trustees would show significant uniformity in recommendations.**

g) Are measures needed to improve trustee decision making: skills such as enhanced training, more Regulator guidance, or the professionalisation of trustees?

Trustees of small schemes would particularly benefit from a more professional approach, but without larger scale, they would be unable to take advantage of the best investment opportunities and the widest range of investment options.

Question 4

Is there a case for making special arrangements for schemes and sponsors in certain circumstances such as a different regime for employers who can afford to pay more, and/or new or enhanced flexibilities for stressed sponsors and schemes?

I believe it will become increasingly important to recognise the need to help some employers, who really cannot afford their full liabilities, to support their schemes on a more realistically affordable basis. This could be on a new measure of self-sufficiency, which is not full annuitisation, but would be better than PPF level benefits. This needs to be planned for now, as the outlook for such schemes is already clear.
The least the Government could do is to allow schemes a statutory over-ride, if the trustees believe it is necessary to change the inflation measure from rpi to cpi. This change would not be mandatory, but could be permitted in order to improve scheme sustainability over time. There are schemes which could benefit from this over-ride which are currently locked into rpi, while others have been able to make the necessary change just because of slightly differently worded trust deeds.

a) Do you have any evidence that Deficit Repair Contributions are currently unaffordable?

Some charities and some employers in multi-employer schemes have liabilities that are unaffordable for the long-term and some cannot meet their current obligations.

b) Should we consider measures to encourage employers who have significant resources as well as significant DB deficits to repair those deficits more quickly?

There is a delicate balance to be struck between forcing an employer to put much more into their scheme now, or allowing them to use those resources to support their business. In light of Brexit, with economic uncertainty even higher than usual, employers might need extra resources to cope with market turbulence in the next couple of years. However, if firms do have money to put in now, it would be a shame to miss the chance to obtain better support. Many of these will be delicate judgments but the Regulator should ensure trustees make agreements with employers that have been carefully analysed and assessed.

•c)Are there any circumstances where stressed employers should be able to separate from their schemes without having to demonstrate that they are likely to become insolvent in the near future?

Yes, multi-employer schemes and unincorporated employers should be treated more leniently and if the employer is seriously stressed then allowing them to reduce

benefits very slightly, rather than risking major reductions in the PPF could be to members advantage.

Should the Government consider a statutory over-ride to allow schemes to move to a different index, provided that protection against inflation is maintained? **YES**

• Should this also be for revaluation as well as indexation? **YES**

Should Government consider allowing or requiring longer, deferred or back loaded recovery plans? **Yes, this would have been appropriate in the case of Tata Steel, where the employer wanted the Government to change the law, but a much longer recovery plan could have allowed more time for the business to recover – as it eventually has done so far.**

Should it be easier to take small pots as a lump sum through trivial commutation? **Ensuing that people who want to can take small pots out of DB and transfer to DC can benefit scheme funding, due to reduced administration costs and lower liabilities. The Regulatory attitude could be relaxed now that pension freedoms make DC more attractive.**

Question 5

Do members need further protection, and should this be delivered by a stronger and more proactive Regulator, and/or trustees with enhanced powers?

a) Is it possible to design a system of compulsory proactive clearance by the Regulator of certain corporate transactions, without significant detriment to legitimate business activity? **If the BHS case were to arise again, it would be helpful to get the Regulator to intervene before the sale. It was clear the scheme was underfunded and the trustees did not have sufficient power to intervene.**

b) Should the Regulator have new information gathering powers? **YES**

c) Should civil penalties be available for non-compliance? **YES**

Question 6

Should Government act to encourage, incentivise, or in some circumstances mandate the consolidation of smaller schemes into vehicles with greater scale and better governance in order to reduce the risk to members in future from the running down of closed, especially smaller, DB schemes?

It is very important that the Government acts to facilitate more mergers of DB schemes. Looking forward over the next ten years or so, the employers cannot be relied on to keep supporting the liabilities and the complexity and cost of DB schemes is beyond the capabilities of many boards. Indeed, achieving economies of scale is essential in order to control costs, improve governance, professionalise the investment approaches and to ensure access to as diversified a range of asset classes as possible.

a) Is there anything in the existing legislative or regulatory system preventing schemes from consolidating?

The requirements for full buyout, the requirements for member consent to changing benefits and the multi-employer rules make it difficult and of course the pensions industry (all parts of the pensions advisory process) have a vested interest in keeping as many schemes separate as possible, because they would lose advisory business. When 100 schemes merge, 99 advisory firms (investment advisers, actuarial advisers, audit firms and professional trustees) may lose business. The biggest firms may not be against consolidation but the majority may well be.

The current legislation does not facilitate mergers at reasonable cost – the costs of changing to a new scheme or benefit structure could be prohibitive. Introducing a streamlined process for scheme mergers, that could also put responsibility on trustees or the Regulator to assess whether this is in the long-run interests of members, would make the consolidation more practical and affordable. Members may not be traceable, allowance must be made for schemes where every effort has been made to trace them and merger would be in the best interests of the sustainability of the benefits promise, without every member having to agree.

• How might such barriers be overcome?

b) What other barriers are there which are preventing schemes from consolidating?

See above

• How might they be overcome?

c) Should Government define a simplified benefit model to encourage consolidation?

Such a simplified benefit model would definitely help and ultimately could deliver better benefits to more members than the current system over the long-term. This consultation is a chance to think about the longer-term, not just the next few years and to prepare for a time when the majority of schemes that are now closed do not have willing sponsors. Once a scheme is closed, it is in run-off and is a pool of assets waiting to be distributed to members over many decades. This will need management time, investment and administration resources and is likely to be most efficiently and effectively delivered by merging small schemes together.

d) Should rules be changed to allow the reshaping of benefits without member consent?

• In what circumstances?

See above. If merger or consolidation is judged (by trustees or tPR) to be in members' best interest, then I believe it is important that the law introduces a new flexibility for this situation over the next decade or so. Trying to deliver every last penny to every member could mean overall benefits will be reduced.

e) Are costs and charges too high in DB schemes?

YES. Costs and charges for small schemes are generally much higher than for larger schemes and the opportunity to benefit from economies of scale are significant but are not currently being utilised.

f) Should schemes be required to be more transparent about their costs or justify why they do not consolidate?

YES. The current situation is unsustainable in the long-term. Transparency on costs is not sufficient and allows schemes and members to be paying too much for services that

could be delivered much more cheaply. This clearly places extra burdens on employers. The Regulator and industry bodies have published significant evidence of the higher cost base for smaller/medium sized schemes.

- In what circumstances? **In all circumstances**.

g) Is there a case for mandatory consolidation? **YES**
•In what circumstances? **With small and medium sized schemes which do not have access to sufficient expertise, which are closed and have few or no active members the case is clear. If the scheme is in deficit, the case is even stronger.**

g) Should the Government encourage the use of consolidation vehicles, including DB master trusts?

I believe the Local Government pooling is a good test-bed for how best to consolidate investment approaches. MasterTrusts would need streamlining of benefits to work most effectively and employers should not be held responsible for pensions of other employers unrelated to them. MasterTrusts are one way of describing a pooled model, but there could be other ways too.

h) Are further changes needed to the employer debt regime in multi-employer schemes to encourage further consolidation?

The problems facing plumbers in their multi-employer scheme are in urgent need of addressing. Requiring full annuity buyout and saddling ordinary individuals with debts 0n a massive scale is not equitable. Multi-employer schemes need to be streamlined, but also the joint and several liability should be achieved through the PPF levy, rather than by the individual scheme. Employer debt should not be only assessed on a buy-out basis. The rules should be relaxed to allow employers to pay technical provisions plus a margin - as has been allowed to Sir Philip Green in BHS. This would be more affordable and more reasonable than forcing the employer to pay the next several decades' worth of pensions all in one go. We are trying to make the best the enemy of the good.

i) Is there a case for consolidation as a cheaper, but more efficient form of buy-out, with the employer and trustees discharged?

YES, this could be one option offered to employers or trustees. A range of ways in which schemes can be 'wound down' rather than 'wound up' is needed, to try to deliver the best possible pensions at affordable cost, without the excessive charges of annuities and in some cases with some adjustment to benefits.

• If so, (a) what should be the requirements for a scheme to enter such a consolidator, especially the level of funding; and

If the scheme can pay technical provisions, plus a margin (perhaps 15%) then entry could be automatic. There could be different consolidators for different circumstances – perhaps schemes that can pay only technical provisions and then commit to paying in more over time, another consolidator for schemes where the employer has paid in and now no longer has connection with the scheme etc.

•(b), should the residual risk be borne by the member, or by the PPF?

The PPF currently bears risks of these small unconsolidated schemes and ultimately the members therefore bear the risk of reduced benefits. That is likely to remain the case. But if consolidators can aim to deliver full benefits or much better than PPF, then members will benefit in the long-run from those who do succeed. Relying on employers to keep supporting the schemes for the entire duration of all future liabilities, especially once the schemes are closed, but even for open private sector employers, is unsafe.

d) Should Government encourage creation of consolidation vehicles for stressed schemes?

YES. Stressed schemes require even more attention to cost cutting, efficiency and professionalised management. With a stressed employer's scheme, the extra costs of running separately are likely to eat into members' benefit security.

e) Should employer debt legislation for multi-employer schemes require full buy-out and for the actuary to assess liabilities for an employer debt by estimating the cost of purchasing annuities?

NO. The requirement for annuity purchase on buy-out was prudent when introduced in 2005, but is now draconian. The plumbers' scheme is a classic example of the unaffordable burdens falling on employers. Currently, the employers are, in many cases, prisoners of their scheme. They cannot afford to buyout benefits (and they are being expected to pay for legacy employers' workers as well as their own). It does not help the long-run security of the scheme to force individual employers into bankruptcy, and is not a fair sharing of responsibility. If these were big companies, or even medium sized entities, they could probably negotiate and RAA and their liabilities would be reduced to an affordable level. But this is not being offered and the flexibilities in the current system are not being utilised for such employers, which is leaving them exposed to personal bankruptcy.

f) How else could historic orphan liabilities be met if they were not shared between employers?

These multi-employer schemes are carrying liabilities of employers who have either become insolvent, or negotiated an RAA and walked away. The remaining employers should not be forced to pick up this bill and, if they had their own scheme, would not be in this position. Those members whose employers have become insolvent would be in the PPF in any other circumstance. The Regulator needs to actively negotiate with plumbers or employers in any other schemes similarly affected, to determine how much is realistically affordable.

g) Are new measures needed to help those trustees of an association or employers who could be held individually liable for an employer debt?

The Regulator needs powers to negotiate fairer exit terms with unincorporated or small employers. The individual liability is causing huge injustice and an RAA-type settlement needs to be offered. This is urgent as the plumbers are in distress, both financial and emotionally, through no fault of their own. These are not employers who have tried to avoid their responsibilities to their workers. They have paid their

contributions as requested and have tried to provide good pensions for their workers over many years.
I think there may also need to be an inquiry into how the trustees have managed the situation, why employers were not properly informed about the changes in legislation that affected their scheme, nor given proper opportunities to act in their own interest. Surely, these small employers cannot be expected to be legal experts and indeed the very reason they joined this multi-employer arrangement would be so that the trustees and other experts could manage the situation on their behalf.

Baroness Ros Altmann

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