



Law Society
of Scotland

Consultation Response

Security and Sustainability in Defined Benefit Pension Schemes

May 2017



Introduction

The Law Society of Scotland is the professional body for over 11,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland's solicitor profession.

We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom Governments, Parliaments, wider stakeholders and our membership.

The Society's Pensions Law Sub-committee welcomes the opportunity to consider and respond to the Department for Work and Pensions' consultation: *Security and Sustainability in Defined Benefit Pension Schemes*. The Sub-committee did not have a view on all of the questions but would like to put forward the following comments for consideration.

Response to questions

Question 1 – Are the current valuation measures the right ones for the purposes for which they are used?

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

If not, why, and in which way are they not being used appropriately?

What evidence is there to support this view?

How could sponsors and trustees be better encouraged to use them?

We have no reason to believe that the flexibilities in setting the Statutory Funding Objective discount rate are being misused. We note, however, that the discount rate is not the only assumption used in the valuation so believe it is important to look at the valuation basis as a whole.

We understand that a variety of approaches are used by schemes to set the valuation discount rate, taking advantage of the flexibilities in the current regime. Whilst consistency between valuations appears to be a common feature, a number of schemes choose to vary the approach to setting the discount rate for each valuation. Until recently the Pensions Regulator had given a very strong steer to trustees to fund on a gilts

plus basis and this approach has been retained by many schemes to ensure consistency between valuations.

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

What should constitute a high or low risk?

Or should a risk based reporting and monitoring regime be considered?

We do not believe that this change is necessary or helpful. Reducing the period between valuations could result in trustees and employers losing long-term focus for the scheme as they move very quickly from valuation to valuation.

Many actuarial consultancies have developed systems to monitor a scheme's funding position on a more regular, often daily, basis. If trustees become concerned by the funding position, current legislation already gives them the ability to undertake an earlier, out-of-cycle valuation.

It is unclear what might constitute a high or low risk scheme. Scheme and employer circumstances change frequently so they may move between being classed as high or low risk in a short space of time, which can create unnecessary confusion as to when/if they are required to undertake a valuation.

c) Should the time available to complete valuations be reduced from 15 months? What would be an appropriate length of time to allow?

We believe the 15 month period remains appropriate for the completion of valuations. In a number of cases, valuations can be completed well in advance of the 15 month deadline. In other cases, particularly where there is a significant deficit, the negotiations between company and employer can take time.

Whilst acknowledging that a proportion of the work involved in a valuation can be completed prior to the valuation date, there are a number of parties from whom information is required as part of the valuation process. For example, the audited accounts are required, which can take a period of seven months after the valuation date to complete. Detailed covenant advice may be necessary to advise on affordability of contributions – again, this can take a significant amount of time. Membership data is required from the scheme administrators, which for large or complex schemes can be time consuming to prepare, allowing for changes in membership over the intervalation period. Reducing the 15 month period could therefore result in an increase in trustees requesting an extension to the valuation period.

d) Should other measures or valuation approaches, for example stochastic modelling, be mandated or encouraged?

If so, which ones and for what purpose?

How would the information provided to the Regulator to explain the agreed recovery plan differ from that at present?

What would the costs be, and would they outweigh the benefits?

Current legislation does not prescribe a method to be used for valuation calculations other than requiring technical provision to be based on discounted scheme cashflows. This therefore already allows a variety of valuation approaches to be used by schemes and in particular allows a proportionate approach to be adopted to take account of a scheme's particular circumstances.

Complex methods such as stochastic modelling would be more difficult for trustees to understand and involve significant additional training and time to set up. This would also be a more expensive approach for pension schemes to adopt and in the vast majority of cases we do not believe a stochastic approach would add any material value to the funding discussions. These approaches may be appropriate for larger schemes, however, where their governance budget allows.

Question 2 - Do members need to understand the funding position of their scheme, and if so what information would be helpful?

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?

What difference could this make?

We think that the current level of information and communication at present is probably appropriate in most cases. If individuals feel they would benefit from further information, it is possible for them to seek that information and they will be able to access it.

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?

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?

The Government should issue CPI-linked gilts. Given that a significant number of schemes are seeking to match CPI-linked liabilities, there is a disconnect in that gilts are still RPI-based, even though this index has been criticised and CPI is generally seen as preferable.

Some consideration could also be given to whether it would be possible to create an investment scheme around infrastructure that would only be available to registered pension schemes.

b) Do members need to understand the investment decisions that are being made? If yes, are there any specific decisions that need articulating?

Members are relying on the trustees to make investment decisions (with appropriate advice) and do not need to understand the investment decisions being made. Information is, however, available to any members who are interested in the decisions being made.

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?

We do not think it would be appropriate for the Regulator to take action in this area.

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

Schemes already invest in pooled funds so it is not necessary to have an additional layer of pooling. We also note that the advent of fiduciary management is a result of herding of some sort but this is not necessarily negative.

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

In principle we support enhanced training, however, it is difficult to see how this might be put into practice.

There is a danger that too onerous a training obligation could act as a disincentive to act as a trustee and in professionalising trustees the connection between trustees and the scheme might be lost.

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?

It is difficult to define “employers who can afford to pay more”. Similarly, if a company is never going to be able to meet its pensions deficit, it would seem to be more sensible to reach a settlement that gives PPF or better than PPF benefits. We think that this flexibility already exists under the current law and we do not, therefore, think that legislative change is required.

c) If measures are needed for stressed sponsors and schemes, how could “stressed” be defined?

Should a general metric be used, or should this be decided on a case by case basis?

This should be decided on a case-by-case basis and will need some analysis to assess whether a company is stressed.

d) 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. One situation which arises from time to time where a company is not insolvent but the pension scheme is a significant burden. This can result in a situation where the business is deteriorating and the question then arises as to whether it can “shed” the pension liabilities, which would allow it to continue trading, or whether it needs to go through the “death process” before this is possible.

Insisting that such a sponsoring company must have reached the point of imminent insolvency before it can be separated from the pension liabilities can be argued simply to harm the company without achieving a better outcome for the scheme, its members, or the PPF. It might therefore be helpful to find a way of identifying cases where insolvency is not imminent but the pension scheme can be credibly demonstrated to be dragging the company towards that outcome.

Whatever is decided, there should be a consistent approach for all businesses.

i) Should the Government consider allowing schemes to suspend indexation in some circumstances?

If so, in what circumstances?

We do not think that the Government should allow schemes to suspend indexation.

k) Should Government consider allowing or requiring longer, deferred or back loaded recovery plans?

If so, in what circumstances?

Should other changes be considered, such as the valuation method of Technical Provisions?

It is also already possible to do this provided that the rationale can be explained.

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?

We note that the Pensions Regulator already has powers which it does not use as much as it might.

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?

There is an unavoidable correlation between the extent of any consolidation and the savings that can be achieved. Anything involving the consolidation of liabilities – which would be required in order to achieve significant economies - almost inevitably brings up numerous problems. Although in principle it does not make sense to have so many small schemes with the same or a similar set of objectives, only true consolidation into a single fund would be likely to generate significant savings and the cost of achieving that would be disproportionately expensive.

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