A new direction

Summary
• The Pensions Regulator is adapting to a new world of defined benefit pension surpluses.
• Open schemes are pushing back against the regulatory focus on derisking strategies.
• The Work and Pensions Committee proposes shifting the regulator's objective from protecting the Pension Protection Fund to focusing on future members.

Gill Wadsworth explores whether the time is right for The Pensions Regulator to have new objectives

At the end of April, The Pensions Regulator (TPR) used its annual funding statement to call on DB scheme trustees and employers to reassess their long-term objectives in the new world of multi-billion-pound surpluses.

Figures from the Pension Protection Fund (PPF) reveal an aggregate surplus of £455.5 billion at the end of March 2024; an increase of on February's £442.3 billion.

These healthy figures are in stark contrast to the DB deficits that previously characterised this century, and are a long way from the funding levels recorded in 2005 when the regulator was founded.

Back in the dark days when DB deficits were so dire that they led to some high-profile company insolvencies, TPR's mission – as set out in the Pensions Act 2004 – was to ensure trustees prepare a recovery plan "setting out the steps that will be taken to meet the funding objective over what timeframe". At the same time the regulator's objective was to protect the PPF.

In today's landscape, where many schemes are back in the black, and the PPF is sitting on reserves of £12 billion, TPR's objectives are under scrutiny, with the regulator itself rethinking its approach.

Open and shut

TPR's latest position is to encourage schemes to think about derisking to reach a final goal of buyout.

TPR interim director of regulatory analysis and advice, Louise Davey, says: "Where funding levels have improved significantly, trustees should review objectives and strategies. Options range from moving to a long-term target with the potential to generate additional surplus, to entering a consolidator or insurance arrangement."

But there is consternation that the focus on derisking is to the detriment of open schemes, which, while accounting for only 4 per cent of the private pension sector representing a fall from 11 per cent in 2011, still amount to £165 billion in assets.

Among those is the £75.5 billion Universities Superannuation Scheme (USS) which has raised concerns that TPR is not giving open schemes sufficient freedom to take investment risk, particularly where they have an especially strong employer covenant.

The long-awaited DB Funding Code published this February indicates that for future valuations, TPR might consider a 20-year covenant horizon, a period that USS says limits open schemes.

Speaking at the Work and Pensions Committee (WPC) meeting this February, USS chief executive, Carol Young, said: "We believe that we have a covenant horizon of 30 years. That has been integral to our ability to think long term and to invest for the long term. Our great concern is that if anything in that guidance in any way shortens that covenant horizon, it will have very real-world consequences."

This view is shared by Unite national pension officer, John Neal, who says: "Rather than just intensifying pressure on schemes to derisk all the time, TPR should be making much greater efforts to promote responsible approaches to managing risk as will allow schemes to continue on a basis that benefits their members and does not put employers under too much pressure".

"Wouldn't that be great if TPR were helping to create an environment where there were better pension outcomes?"

He adds: "TPR is failing to strike the right balance between conducting enforcement where it is genuinely needed and not encouraging trustees and employers to be over prudent, derisk and ultimately close DB schemes where a DB scheme is sustainable."

In its third report on the DB scheme inquiry, published this March, WPC stated: "It is essential that DWP and TPR work with open schemes to address the remaining concerns – particularly around the employer covenant horizon – and report back to us on how they have done so before the new funding code is laid before parliament."

However, the revised funding code published this February has already introduced more flexibility – which WPC acknowledges – and some commentators argue there is ample freedom for open schemes to take investment risk.

Association of Professional Pension Trustees council member, Sarah Marshall, says: "Trustees of open schemes have sufficient powers to invest and fund the scheme as they see fit, subject to agreement/consultation with the sponsor who will usually wish to constrain costs."

Hymans Robertson partner and head of pension policy innovation, Calum Cooper, adds that while open schemes may be obliged to give TPR a strategy based on a 20-year covenant horizon, they do not necessarily have to follow it.

"What you are saying to open schemes is imagine you're only open for six years, something happens to your company and you have to close, what would you do? That would be what they submit to the regulator, but that's not actually the strategy. This is the plan B. The regulations then become a contingency plan rather than what schemes are trying to achieve, and I think they can thrive in that context."

Cultural shift

While the WPC would like TPR to afford DB schemes more freedom, it notes that the regulator remains hamstrung by an objective to protect the PPF.

The WPC says this objective is "no longer needed" and, to restore confidence with open and continuing schemes TPR should have a new focus "to protect future, as well as past, service benefits".

Since such a change would require new legislation and mean a "significant cultural shift and a need to invest in new capabilities and capacity", for TPR, the WPC calls on the regulator to "work with the pensions industry on what the change would mean in practice and what capabilities it will need to deliver on it effectively".

Cooper says: "Changing the objective is aligned with the Mansion House reforms and will allow open schemes to deploy more assets for productive finance. I think there's a good chance it will happen, but that means a fundamental shift in mindset. We need to take a step back and ask what that will that look like, including, for example, how to stimulate outcomes in trust-based DC schemes as well as DB."

He adds: "Wouldn't that be great if TPR were helping to create an environment where there were better pension outcomes?"

This view is shared by Neal, who says: "The real debate about use of PPF surplus should be about member benefit improvements. The PPF is financially strong. Its reserves are close to what are needed to meet its funding objectives. It has proposed reducing the levy charged to scheme sponsors by nearly 50 per cent, which is a reduction of £190 million. So, levy payers are benefiting from the PPF's strong financial position, but members are not. It's time for members to benefit also."

However, ACA chair-elect, Stewart Hastie, says the association does not advocate replacing the PPF protection objective for TPR, since the regulator "retains an important role in protecting the PPF from moral hazard risks".

He adds: "TPR already has a statutory objective in relation to sustainable growth of the employer, but TPR could be more supportive and clear on when enough is enough in relation to the protection of past service benefits and minimise scenarios of excessive prudence where this is at the expense of future service benefits and employer growth. We would like to see greater TPR focus and guidance for trustees and sponsors of well-funded schemes to help parties manage and distribute current and future surplus particularly where this could be used to meet future service costs."

Meanwhile, Marshall says: "Caution must be taken with any PPF surplus; we spent much of the last 15 years battling with deficits when the previous period had included contribution holidays and augmentations."

A PPF spokesperson tells *Pensions Age* that the lifeboat fund will "work together with policy makers to ensure any changes are beneficial to members, while enhancing the wider DB scheme landscape".

They continue: "Any changes to TPR's objectives will need to be considered carefully because, while our reserves and overall DB scheme funding levels have significantly improved in the past five years, changes in market conditions could impact the level of protection provided by our reserves."

A spokesperson for TPR says that "it is too early for a detailed discussion on the WPC's recommendations", noting it has until the end of May to respond to the report.

However, that does not give the regulator much time to reflect and ultimately adapt to the new DB world.

Written by Gill Wadsworth, a freelance journalist