Please reply to:

José Leo
Chairman, The Hundred Group Pensions Committee
c/o Heathrow Airport Ltd,
The Compass Centre, Nelson Road
Hounslow, Middlesex, TW6 2GW

Tel No: 0208 745 9927
E-mail: jose_leo@heathrow.com

7 February 2014

DBConsultation@thepensionsregulator.gsi.gov.uk

Ms Mouna Turnbull
Defined Benefit Regulation
The Pensions Regulator
Napier House
Trafalgar Place
Brighton
BN1 4DW

Dear Ms Turnbull,

Consultation: Regulating Defined Benefit Pension Schemes

I am writing on behalf of the Pensions Committee of the Hundred Group of Finance Directors with regard to the above-named consultation.

The Hundred Group represents the views of the finance directors of FTSE 100 and several large UK private companies. Our member companies represent almost 90% of the market capitalisation of the FTSE 100, collectively employing over 7% of the UK workforce and in 2011 paid, or generated, taxes equivalent to 13% of total UK Government receipts. Our overall aim is to promote the competitiveness of the UK for UK businesses, particularly in the areas of tax, reporting, pensions, regulation, capital markets and corporate governance.

We have not answered your questions individually, but have set out our thoughts below under a number of headings.

Sustainable growth objective

We welcome the introduction of a new objective for the Pensions Regulator to minimise the impact of its funding policies on the sustainable growth of employers. We believe that both the objective itself and the associated text in the Code of Practice are important steps towards a more balanced regulatory policy to the funding of defined benefit pension schemes.

However, whilst we hope that the new objective will lead to a real change in regulatory direction, we cannot be certain that change will be achieved until we see the outcome of funding negotiations undertaken once the Code has come into force. We hope that the Pensions Regulator will take all steps to ensure that its caseworkers receive the necessary training both to understand the new regulatory approach and to apply it in practice.

We also encourage the Pensions Regulator to monitor its regulatory approach to ensure that the new objective is reflected properly in its funding policy and applied consistently.

Transition

We understand that the intention is that the Code will apply to all valuations in progress when it comes into force (expected to be in July 2014). However, we also note that trustees and employers are enjoined to 'bear in mind' the messages in the revised Code.

This could create a period of undesirable uncertainty. Where valuations have already been signed off or are close to being signed off, it is unlikely to be helpful to either trustees or employers to have to revisit those decisions in the light of the revised Code. We would value a clearer statement that complete (and near complete) valuations will not be judged in the light of the new regulatory approach.

Equally, however, the wording of the consultation document may not be sufficiently strong to reassure trustees that they can take the employer's arguments about sustainable growth into account <u>before</u> the Code has come into force. A clearer statement that trustees can <u>apply</u> the principles of the revised Code (rather than simply 'bearing it in mind') before it comes into force would be desirable.

Regulation of larger schemes

The revised regulatory approach is clear in setting out its focus on larger schemes. Whilst we accept that larger schemes present a potentially greater risk to the Pensions Regulator (and the PPF), we do not believe that schemes should be investigated simply because they are large or ignored simply because they are small.

We have particular concerns that large schemes may find themselves being used to test out the new regulatory approach, with those schemes unfortunate enough to fall within the first tranche of the new regime being subject to considerable extra scrutiny (and the associated costs that this will involve).

Integrated approach to risk management

We agree with the proposed approach of schemes (and employers) looking at risks in an integrated manner. We would, however, caution that this needs to be done in a cost-effective manner. The Code could be clearer on how an integrated risk management approach should be documented and what sort of documentation the Pensions Regulator might ask for as evidence that the trustees have followed such a process.

As written, the Code could lead to unnecessary additional work for trustees in producing documentation in some sort of required form proving that they have an integrated approach to risk, funding and covenant. In many cases, trustees believe that they already follow the principles of the Code, but do not have one definitive document explaining in full that they have done so. There is therefore a risk of creating a requirement for a new compliance document that will lead to additional cost, but no additional benefit to the scheme.

A key part of the Pensions Regulator's risk management approach is contingency planning. We think that the emphasis on such detailed contingency planning may be overstated. It is unlikely to be a useful exercise to make detailed contingency plans for all risks; the emphasis should rather be on having a response strategy, i.e. a means for the trustees to be able to react quickly in certain circumstances rather than guessing in advance what the reaction needs to be (e.g. having certain delegated authorities in place with investment managers or service providers or an emergency contact list or even at a minimum ensuring that the trustee will receive timely information to enable them to make decisions).

Investment policy

We understand the logic that weak covenant should imply a lower risk investment policy; however, this ignores the funding dimension: for an underfunded scheme with a very weak sponsor, there is no way to improve the funding level other than taking some (limited) investment risk. It is right that the Pensions Regulator should warn that taking investment risk implies a greater reliance on the employer covenant; however, the Code should recognise that there are circumstances in which it may be appropriate for schemes with a weak sponsor to accept some measure of investment risk.

In general, we note that there appears to be a rather one-sided emphasis in the consultation on downside risk. Given that 'balance' is the key note in the new Code, it would seem appropriate to indicate that trustees should take an appropriate level of risk, focusing on downside risk where appropriate, but also taking into account the potential upside benefits of taking on certain risks.

BFO indicator

Whilst we agree with much in the Pensions Regulator's revised Code, we have some concerns that it may lead to increased advisory costs. One area where this may well be particularly true is the 'balanced funding outcome' (BFO) indicator, where we expect that trustees and employers may wish to conduct analysis to understand where they are likely to fall relative to this indicator (with associated advice costs).

It appears that details of the BFO indicator for a particular tranche may only be disclosed by the Pensions Regulator when many of the funding decisions are already well advanced. We would urge the Pensions Regulator to be as transparent as possible about how the BFO indicator will be applied in order to provide maximum visibility to trustees and employers.

Format of the documents

We appreciate that changing the focus of defined benefit regulation to achieve a more balanced outcome between trustees and employers is a significant undertaking and therefore that it is necessary to set out the new policy in some detail. However, we think that the suite of documents taken as a whole is far too long and at times repetitive – a 15 page document that both trustees and employers could refer to directly and as needed during their funding negotiations would be much more useful than the current 70-page Code which neither side will have the time to read more than once and which will generally be replaced by an adviser's summary. We would therefore urge the Pensions Regulator to make its final Code of Practice (and the associated policy documents) much more focused and concise.

Conclusion

Overall, whilst the package of documents appears to demonstrate a movement towards a more balanced regulatory approach, we are concerned that it may lead to an increase in the governance and administrative requirements associated with funding. This could give rise to additional costs for large schemes in particular, without necessarily providing any greater confidence that trustees and the Pensions Regulator will apply a more flexible and business-oriented approach to the calculation of technical provisions and recovery plans.

There is therefore a real risk that the new regulatory approach could lead to more of the same but at a greater cost. The onus will be on the Pensions Regulator to ensure that this does not happen.

I trust that these comments are useful. Please let me know if you would like to discuss them in more detail.

Yours sincerely,

José Leo
Chairman
The Hundred Group – Pensions Committee