Magical Mystery Tour

The key areas of focus for the Government in 2019 will almost certainly be the same as they were last year – Brexit, Brexit and Brexit. But the Pensions Minister insists that the Government still has time for pensions, so what could be on the cards for defined benefit (DB) schemes in the coming year?

// Fixing A Hole

The regulation of DB schemes has been getting a lot of attention recently. Insolvencies of high profile companies with underfunded schemes have caused the pendulum of power to swing back in the direction of trustees, with pressure on the Pensions Regulator to reduce the risk of similar cases in the future.

The Regulator's response is well-documented. "Clearer, quicker, tougher" is close to earning a place in the Catchphrase Hall of Fame, and TPR has promised a further "radical shake-up" of its approach. All schemes can expect an increase in the volume and frequency of their interactions with the Regulator; having advised on over 30 proactive engagement cases in recent years, Aon has seen first-hand evidence of this change. The changes so far all sit within the existing legislative framework. However, the DWP has already issued a consultation on strengthening the Regulator's powers, so there is more to come.

// Dear Prudence

The March 2018 DWP White Paper set out several proposals on funding including:

- all schemes to set a long-term objective
- all schemes to publish a Chair's DB Statement every three years
- adoption of clear definitions for terms such as "prudent" and "appropriate"
- strengthening some elements of the Funding Code of Practice, with penalties for non-compliance

Aon's latest Global Pension Risk Survey showed that around 80% of UK DB schemes already had a long-term objective of either buyout or self-sufficiency. But it is rare for these to be directly reflected in the technical provisions and any requirement to do this could be detrimental.

The idea of defining prudence is particularly eye-catching. The concept has been around for a long time, but if it was an easy thing to define then surely industry would have already reached its own consensus.

The Government and the Regulator will need to walk a fine line here. A vague definition may be worse than no definition at all, but anything too precise could end up removing flexibility from a system that was designed at its core to be scheme-specific.

// Here, There and Everywhere

The 2016 Budget seems like a lifetime ago (politically speaking) but that was where the Government committed to creating a Pensions Dashboard by April 2019.

> **The Dashboard is intended to be an online portal that would allow individuals to view all their retirement savings in one place.**

A feasibility study originally due to be published in March 2018 has been substantially delayed, and there had been some speculation that the project was being abandoned altogether. However, the study was finally published on 3 December, alongside a consultation proposing a gradual rollout over a period of 3-4 years starting in 2019.

> **A lot of work has already been done but there are still some complex issues to overcome.**

To work properly, the Dashboard will need multiple pension providers, trustees and public bodies to share personal data relating to huge swathes of the UK population, so data security will be a significant concern. What happens if some providers or trustees decide the potential benefits of the Dashboard are not enough to justify the risks? Is compulsion really the right answer? And once the scope has been determined, how do you ensure people understand the limitations?

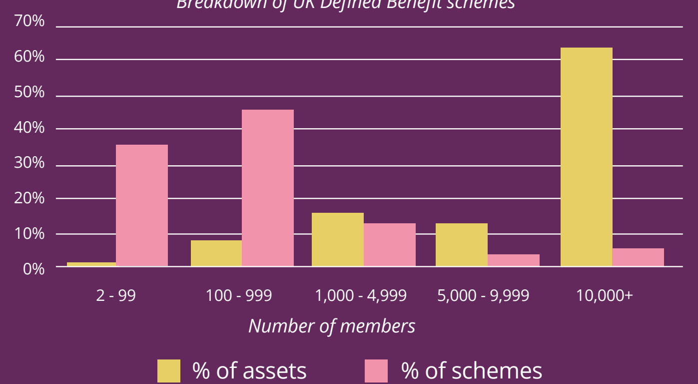
The sheer scale of this undertaking, and the number of hurdles to be cleared, give some clues as to why this is taking longer than expected.

// Come Together

Consolidation has been a theme in the Government's recent policy announcements, and can be viewed in shades of grey rather than black or white. Almost all schemes will be utilising consolidation to some degree, from delegating administration or investment functions to a full buyout with an insurance company. But the new consolidation goes further.

The DB pensions market in the UK is very fragmented. As shown by the chart below, most of the assets are concentrated in a few very large schemes, but the remainder is spread across many much smaller schemes.

Breakdown of UK Defined Benefit schemes



Source: PPF Purple Book 2018

These smaller schemes tend to suffer relative to large schemes – they have smaller budgets for governance, they experience higher per-member admin costs, and they have access to a narrower range of investment opportunities.

The continuing trend for DB schemes closing to future accrual also means there is a growing disconnect between these schemes and their sponsoring employers. Against this backdrop, it makes sense to explore the options for further consolidation.

// Revolution

The Government is soon to issue a consultation on the legislative framework and authorisation regime for commercial DB consolidation vehicles. The aim is for these to take over the responsibility for meeting the liabilities of other schemes, at a price which is more affordable than a traditional buyout. If the Government gets this right, it could have a big impact on the future of DB pensions in the UK.

One of the main challenges here will be deciding how restrictive the framework for consolidators should be. To quote the White Paper: "If the legislative framework is too restrictive, then the consolidator vehicles may not be commercially viable but if the vehicle is under-protective of members, then the risks to members' benefits will be unacceptable".

Creating a level playing field will also be difficult. Insurance companies clearly have the scale and expertise to provide consolidation vehicles. However, under the current set-up, they would need to comply with the Solvency II reserving requirements. This may prevent them from offering more attractive pricing, arguably handing an unfair advantage to consolidators operating outside the insurance framework. It would not be surprising if this all results in an untidy compromise that satisfies nobody in full.

// Here Comes The Sun

The Pensions Minister has recently stated his belief that a "substantial" Pensions Bill would be delivered in Summer 2019, leading to a new Pensions Act in 2020. This would cover some of the DB issues discussed here as well as wider issues such as Collective Defined Contribution schemes and DC consolidation.

The Minister also claimed that this Pensions Act would make pensions legislation "by and large, complete for some considerable period of time" and be followed by a "significant period of calm." Even in a more stable political climate, that would be a pretty ambitious goal.

By Ricky Marsh, Senior Consultant, Aon