"NOT MUCH OF A REGULATOR" - THE PENSIONS REGULATOR AND THE BHS PENSION SCHEME

"YOU'RE NOT MUCH OF A REGULATOR, ARE YOU?"

It is clearly the task of MPs sitting on these committees to ask challenging questions, although this rhetorical question was perhaps intended more as a challenge than as a question.

The issue that drew the comment was a 23-year recovery plan in respect of a £200m deficit, agreed between BHS and the trustees of the BHS Pension scheme, filed two months late in 2013. This prompted the Pensions Regulator to open a recovery plan case – essentially a process of discussion and inquiry to establish whether the recovery plan was appropriate in context, whether it could be improved by agreement or whether an exercise of formal powers might be required. The committee's concern seems to be that the Pensions Regulator is too slow, too flexible and too sparing in its use of formal powers.

This is however to misunderstand both the nature of those powers and the Pensions Regulator's strategy.

In relation to closed defined benefit pension schemes, the Pensions Regulator is not regulating new business. It is not in this regard any kind of licensing authority that can set limits for a certain activity and enforce those limits when they are not complied with.

The setting of stricter funding standards for liabilities incurred by employers over past decades is controversial as it is arguably retrospective law: if the laws had been as they are now, the employers would probably not have incurred the liabilities. Employers generally set up these schemes on the basis that the rules gave them the ability to control the associated costs or cap benefits if costs became unacceptable.

On a more practical level, imposing strict funding standards at a level that would be sufficient to ensure schemes would not fail in the future, would result in the immediate failure of many of those schemes and their sponsors. This is why the DWP and the pensions industry have campaigned hard against the European Commission in recent years, to maintain flexibility and to avoid fixed funding rules being imposed through a new EU directive; those funding rules might have cost UK employers £300bn according to industry bodies.

Flexibility is essential. It is essential in order to enable corporate groups of varying sizes and facing different challenges and opportunities in their own businesses and industries to absorb the increased costs associated with historic pension liabilities. These costs, or rather the present value of those costs, have been driven up in recent years by matters quite unrelated to those employers such as quantitative easing, low growth, low inflation, low gilt yields and vast improvements in life expectancy. It is not just fair to give employers time to absorb the consequences of global economic change and a tidal-wave of statins; it is also sensible.

If the Pensions Regulator were to set a bar, it would be either too high or too low. Instead, it seeks to educate and persuade and to apply pressure when it is required or likely to be beneficial, so as to ensure that, without unnecessary detriment to growth, employers secure their pension liabilities as soon as possible.

This is also what the legislation requires. Pace of funding is generally a matter for agreement between the trustees and the employers under legislation and the Pensions Regulator can only formally step in if there is no agreement or the agreement reached is not appropriate. These are anti-abuse powers. The formal processes are also outside the control of the Pensions Regulator's staff, expensive and subject to a full rehearing in the courts on appeal. No quick triggers.

Faced with the task of dragging ever more funds out of corporates with draconian but unwieldy powers, the Pensions Regulator's strategy, as often piously stated, is to be proportionate, risk-based and cost-effective. It is also to exploit the leverage it gains from not exercising its powers too often: any case carries unwanted notoriety, which most wish to avoid. A sparing use of formal powers also enables the Pensions Regulator to set the rules through guidance, rather than leaving it to the courts to define them haphazardly through appeals. It avoids being called out over differences between cases, which can be attributed to negotiation rather than principle.

The Pensions Regulator understands its powers and has been using them to great effect by not using them too much.

MORAL HAZARD INVESTIGATION

What could not be discussed at the committee hearing was the ongoing investigation relating to the possible use of the Pensions Regulator's "moral hazard" powers, i.e. its ability to seek funding from related parties particularly where there have been transactions that damage the ability of an employer to fund its pension scheme.

As a reminder:

- Only contribution notices can be issued against individuals and only in respect of actions taken after the Pensions Regulator's powers came into force, i.e. no earlier than 6 April 2006.

The Pensions Regulator therefore cannot, and never could, impose a contribution notice on Philip Green or his wife on the basis of the dividends of £422m apparently paid to them between 2002 and 2004, although those dividend payments might be relevant to the reasonableness of a contribution notice based on later transactions.

- Financial support directions, which can be issued against associated parties other than individuals, can be issued if it is reasonable provided certain financial threshold tests are met. Historic transactions prior to 6 April 2006 may be relevant to what is reasonable.

The Pensions Regulator started its anti-avoidance or "moral hazard" investigation in March 2015 and expects "significant progress" by the end of 2016.

ANNUAL FUNDING STATEMENT FROM THE PENSIONS REGULATOR

The Pensions Regulator has just issued its "Annual funding statement" and accompanying "Annual funding statement analysis". The latter includes detail on market indicators, including bond yields, forward gilt curves and asset returns, funding levels, the ratio of dividends to deficit reduction contributions for the FTSE 350 and others, and shows how the Pensions Regulator assesses a range of funding risks.

This follows the guidance issues in December 2015 on "Integrated risk management" which provides a principles-based framework to support its regulation of scheme funding.

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