PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

Seventh Delegated Legislation Committee

DRAFT OCCUPATIONAL PENSION SCHEMES (FUNDING AND INVESTMENT STRATEGY AND AMENDMENT) REGULATIONS 2024

Wednesday 13 March 2024

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not later than

Sunday 17 March 2024

The Committee consisted of the following Members:

Chair: Dame Maria Miller

Bradshaw, Mr Ben *(Exeter)* (Lab)
† Byrne, Ian *(Liverpool, West Derby)* (Lab)
Day, Martyn *(Linlithgow and East Falkirk)* (SNP)
† Duguid, David *(Banff and Buchan)* (Con)
† Furniss, Gill *(Sheffield, Brightside and Hillsborough)* (Lab)
† Grundy, James *(Leigh)* (Con)
Johnson, Kim *(Liverpool, Riverside)* (Lab)
† Jones, Andrew *(Harrogate and Knaresborough)* (Con)
† Knight, Sir Greg *(East Yorkshire)* (Con)
† Leadbeater, Kim *(Batley and Spen)* (Lab)
† Maynard, Paul *(Parliamentary Under-Secretary of State for Work and Pensions)*
† Morrissey, Joy *(Lord Commissioner of His Majesty's Treasury)*
Rees-Mogg, Sir Jacob *(North East Somerset)* (Con)
Rimmer, Ms Marie *(St Helens South and Whiston)* (Lab)
† Timpson, Edward *(Eddisbury)* (Con)
† Webb, Suzanne *(Stourbridge)* (Con)
† Wild, James *(North West Norfolk)* (Con)

Abi Samuels, *Committee Clerk*

† attended the Committee

The following also attended (Standing Order No. 118(2)):

Baron, Mr John *(Basildon and Billericay)* (Con)
Lavery, Ian *(Wansbeck)* (Lab)
Hollern, Kate *(Blackburn)* (Lab)

Seventh Delegated Legislation Committee

Wednesday 13 March 2024

[Dame Maria Miller *in the Chair*]

Draft Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2024

4.30 pm

The Parliamentary Under-Secretary of State for Work and Pensions (Paul Maynard): I beg to move,

That the Committee has considered the draft Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2024.

It is a pleasure to serve under your chairmanship, Dame Maria. The regulations introduce new measures that will support trustees and sponsoring employers of defined-benefit occupational pension schemes to plan and manage their scheme's funding over the longer term. The regulations will require trustees to send a statement of the scheme's funding and investment strategy to the Pensions Regulator, alongside the three-yearly actuarial valuations already required. This will articulate the trustees' approach to long-term planning and risk management.

The regulations will work with the regulator's revised funding code of practice, aiming to strike a fair and lasting balance between providing security for members of defined-benefit schemes and affordability for the sponsoring employer.

Sir Greg Knight (East Yorkshire) (Con): The explanatory memorandum states on page 7:

"There were concerns that the new regime would result in a disproportionate governance burden for small schemes".

Does the Minister intend to address that concern?

Paul Maynard: My right hon. Friend makes the very fair point, which I have always been conscious of in this brief, that small schemes may occasionally get out-shouted by some of the larger schemes. Alongside the Pensions Regulator, we have engaged extensively not just with industry but with the professional bodies that are often more involved in the running of smaller schemes. I am confident we have struck the right balance between providing the clarity and assistance that trustees of smaller schemes need, and the interests of members in ensuring that they get the benefits that are due to them. It has been quite a long process to come up with this particular set of schemes and, in my view, we have struck the right balance.

As many will know, DB schemes have around £1.4 trillion of assets under management. In a world where most DB schemes are closed and maturing, it is more important than ever that sponsors and trustees work together, are clear how their promises will be met, and agree how to manage the funding and investment decisions involved. These regulations will support them to do that.

DB funding levels have indeed improved in recent years. It is important that schemes take advantage of the opportunities that that brings, and crystal-clear funding standards enable that. This package of measures aligns with the Government's policy on investing in productive finance and the consultation on options for defined-benefit schemes.

Mr John Baron (Basildon and Billericay) (Con): As somebody who has run pension fund money, I have a few concerns. One is the administrative concern raised by my right hon. Friend the Member for East Yorkshire, but this could also smack of the approach, "I'm from central office—nothing to be concerned about"—*[Interruption.]*

The Chair: Order.

4.33 pm

Sitting suspended for Divisions in the House.

4.58 pm

On resuming—

The Chair: The Minister was making a speech, but Mr John Baron was intervening. If it is convenient for him to continue his intervention, that would be appropriate.

Mr Baron: Thank you, Dame Maria. I fully understand where the Government are coming from on these measures, but what assurance can the Minister give that the Pensions Regulator, if and when it intervenes, is suitably sighted of investment risk, so that it understands the pension scheme and its funding liabilities, and whether or not it has low funding capability, so that it will be a help rather than a hindrance?

Paul Maynard: I am grateful for that intervention. The Pensions Regulator is expert in regulating, but more than that, it recruits investment consultants, experts in covenants, and experts in risk management. It reaches out to the wider community—to not just those who run pension schemes, but those who manage the process from beginning to end. Having met with the regulator on many occasions, I am confident that it has the necessary skillset to implement its own funding guidance and ensure that it is adhered to by scheme trustees.

As I was saying as my hon. Friend intervened, DB funding levels have improved in recent years. It is important that schemes take advantage of the opportunities that brings, and crystal-clear funding standards enable that. This package of measures aligns with the Government's policy on investing in productive finance, and the consultation on options for DB schemes. We want to encourage schemes to get the most from their assets through more productive investments, while at the same time ensuring that scheme members can be confident that they will receive the benefits that they have been promised. We know that most DB schemes are well-managed and properly funded, and that the vast majority of members will receive the promised pension.

Good practice is not universal. Some schemes still take inappropriate levels of risk. There remain around 27% of schemes, on a technical-provisions basis, that have a deficit that will need to be repaired. The regulations embrace good practice and build on the existing funding regime for DB schemes by providing clearer funding standards, which will ensure, as far as possible, that schemes are properly funded over the long term.

The regulations set out the details for the scheme funding provisions in the Pension Schemes Act 2021, the details for the funding and investment strategy, and how important metrics, such as maturity, covenant strength and low dependency, must be determined. Schemes will be required to have a funding and investment strategy that sets out the way pension benefits will be paid over the long term. That could be through buying out with an insurer, entering a super-fund, or running on with employer support.

As they were originally drafted, the regulations would have meant that one component of the reforms—recovery plans—would come into effect from April and not September. Having identified that, and to avoid potential confusion and additional administrative requirements for the small number of schemes affected, we withdrew the regulations and re-laid this revised version.

I am pleased by the positive response to the regulations from our stakeholders, and I am confident that the regulations will support schemes and sponsoring employers to make long-term plans so that their members get the retirement income that they have contributed towards and rightly expect.

5.1 pm

Gill Furniss (Sheffield, Brightside and Hillsborough) (Lab): It is a pleasure to serve under your chairpersonship, Dame Maria.

The regulations will place additional duties on the trustees of defined-benefit pension schemes to help ensure good practice. As the Minister pointed out, the vast majority of those schemes are already well run by dedicated trustees who want to do right by their members, but we know that that is not universal and we support measures to ensure that people's money is well looked after.

The defined-benefit pensions sector is an evolving industry. As has been highlighted, the last significant legislation relating to it dates back to 2004-05, a time when many defined-benefit schemes were open. The landscape has changed significantly, and it is vital that regulation keeps up. For instance, research shows that many large schemes are yet to set long-term objectives. The requirements in the regulations should, I hope, help to fix that.

Turning to the consultation, I am aware that, while many stakeholders were supportive of the objectives of the regulations, concerns have been raised about the extra administrative burden that they may incur. I am also concerned that underfunding could be a risk to scheme members and pension protection funds, and I would welcome the Minister's reassurance on that point. Will he outline what discussions he has had with the Pensions Regulator on its implementation of the flexibility that it may well be awarded? Could we please have more guidance on what exactly will be required from each DB scheme?

We will not oppose the regulations and we hope that they are successful in promoting good practice across the sector. I thank the Minister for his explanation of the changes, and I look forward to his answers about extra guidance for affected schemes and to the questions that I have just raised.

5.4 pm

Mr Baron: I will keep my comments very brief, for the benefit of the Committee. I seek clarification. It is not just the admin cost of these measures that concerns some of us. I am pleased that the Minister responded about the investment expertise that he believes the Pension Regulator will ensure is present whenever it intervenes, but there is a clause in the explanatory memorandum that concerns me slightly. Paragraph 7.1 states:

> "Rather than eliminate risk from the system, the changes aim to support trustees in planning for the long-term and managing risk effectively—balancing the protection of member benefits with the sustainability of the employer."

That makes sense, except that the sustainability of the employer can fluctuate depending on the economic cycle and individual circumstances. If we take that at face value, we could have a situation where the company's fortunes are fluctuating and therefore to maintain the balance, as mentioned in the explanatory memorandum, the investment strategy has to fluctuate as well. That is not the best basis on which to take forward a long-term investment strategy. Will the Minister put my mind at rest that that will not be a problem for companies or, more importantly, those who hope to benefit from the pension over time?

5.5 pm

Paul Maynard: I thank the shadow Minister—the hon. Member for Sheffield, Brightside and Hillsborough—and my hon. Friend the Member for Basildon and Billericay for their contributions.

I will do my best to reassure my hon. Friend. I fear he has greater expertise than me in this matter, so I may not succeed, but I am sure he will let me know. To his specific point, the funding risks taken by schemes need to be supportable by the employer. They are required to address any deficit that emerges if risks materialise. When we say "employer covenant", we are really referring to the strength of that covenant—the financial ability to plug a gap should it occur.

The key objective of the reforms is to provide clearer and more enforceable funding standards. The regulations will define the strength of the employer covenant and set out the principles for how that is to be assessed. They will then set out a further principle for how to determine scheme liabilities. The level of risk that can be taken depends on the strength of the employer covenant and the maturity of the scheme. The regulations will require schemes, as a minimum, to have sufficient funds to have a low dependency on their sponsoring employer by the time they are significantly mature to meet the scheme's future pension promises. That means that, under reasonably foreseeable circumstances, further employer contributions will not be expected.

Mr Baron: This will be my last intervention. I take on board what the Minister has said, but he still has not directly answered the bit of my question about the fluctuating fortunes of a company. I appreciate that pension schemes going forward will be funded on a low-dependency funding basis and should be fully funded

[Mr Baron]

from the registered date. But what assurance can he give that, if the fortunes of the company fluctuate markedly, and if the trustees are going to meet the obligations according to the explanatory memorandum, they will not find themselves in a situation where they have to continually adjust the investment risk profile of the portfolio they are overseeing to ensure that they maintain that balance during what could be difficult economic times?

Paul Maynard: I am sure my hon. Friend will be aware that we have seen volatility in pension schemes over recent years. Many DB schemes are now funded to surplus, to a much greater extent than has hitherto been the case, but I recognise that that will not always be in the case. Let me try to go down one level further in terms of what the regulations will prescribe in the hope of reassuring him. If I do not reassure him, I will happily invite him to the Department for a thorough going-over with officials, but let me do my best first.

The regulations are subject to the principle that the funding and investment risks taken by a scheme before the relevant date must be supportable by the employer. The relevant date is the date on which the scheme is expected to reach significant maturity. Less mature schemes, such as open schemes, can support more risk because there is more time to adjust any funding shortfalls that may emerge if the risks are realised.

The regulations amend the Occupational Pension Schemes (Scheme Funding) Regulations 2005. They require trustees and managers to follow the principle that when determining recovery plans, the period for the recovery must be set with reference to what the employer can reasonably afford. The regulations will also make it clear that when determining an appropriate recovery plan, the trustees and managers must take into account any impact on the sustainable growth of the employer.

What I draw from that, and what I hope my hon. Friend will draw from it, is that should a DB scheme find itself facing a deficit that was not anticipated, both the trustees and the managers of the scheme will have the flexibility to determine the appropriate recovery plan, and that any variation within a short period of time can be accommodated by the fund. Over a longer period, the reference date that they start their planning from should enable longer-term volatility—the ups and downs that we naturally see across time—to be smoothed out. If that does not answer my hon. Friend's question, he can grab me at the end and he will get a speedy invite.

On the point the shadow Minister made on some of the issues around guidance more generally, we have tried to ensure that the regulations are flexible and will work well for all schemes. It is important to make the point that even mature schemes can invest in a wide range of assets as long as they reach low dependency at significant maturity. We also want the regulations to allow open schemes to take account of new entrants and future accrual when determining when the scheme will reach significant maturity. To make long-term planning and implementation easier and to avoid unnecessary administrative burden, we have given the Pensions Regulator the flexibility to ask for less detailed information depending on the circumstances of a particular scheme.

We can expect the revised DB funding code of practice to be laid before Parliament this summer, in time to come into effect from September 2024 in line with the regulations. Around the same time as the Pensions Regulator publishes its code, the regulator will also publish the fast-track parameters and the updated impact assessments. Later in the summer, the Pensions Regulator will consult on the covenant guidance. There is a whole suite of things coming up over the course of the summer, all intended to be in force ready for 22 September, when the regulations will become effective.

We are making sure, in collaboration with the regulator and the industry, that any burden is proportionate to the outcomes and reflects the particular circumstances of any individual scheme. Fundamentally, as the shadow Minister agreed, the regulations will guarantee that member benefits are protected, but that we enable defined-benefit schemes to grow as best they can to meet any funding shortfall that may occur. On that basis, I hope that I have answered everyone's questions, and I commend the regulations to the Committee.

Question put and agreed to.

5.12 pm

Committee rose.