

TPR Consultation on Draft defined benefit (DB) funding code of practice and regulatory approach

Submission Details

Name: [REDACTED]
Organisation: Hewlett Packard Pension Association (HPPA)
Responding on behalf of: Organisation and Self
Email address: [REDACTED]
Telephone: [REDACTED]
Date: 01 Feb 2023
Confidentiality: Organisation can be included on the list of respondents to this consultation
Name to be withheld

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Purpose

The purpose of this submission is to:

- Justify and propose enhancements to the code of practice focusing on a specific segment of pension schemes within the UK DB landscape
- Improve scheme governance and implementation of existing legislation
- Better enable Trustees to define and implement a funding and investment strategy that includes “other benefits”, specifically, discretionary increases for accruals before April 1997

Outcome

The expected outcome is that the TPR code of practice is enhanced to include basic ethical principles and guidelines that lead to better corporate citizenship and Trustee effectiveness within a particular segment of pension schemes within the DB landscape – those schemes that currently do not provide any form of inflation indexation to benefits accrued before 6 April 1997.

Benefits

An enhanced code of practice will:

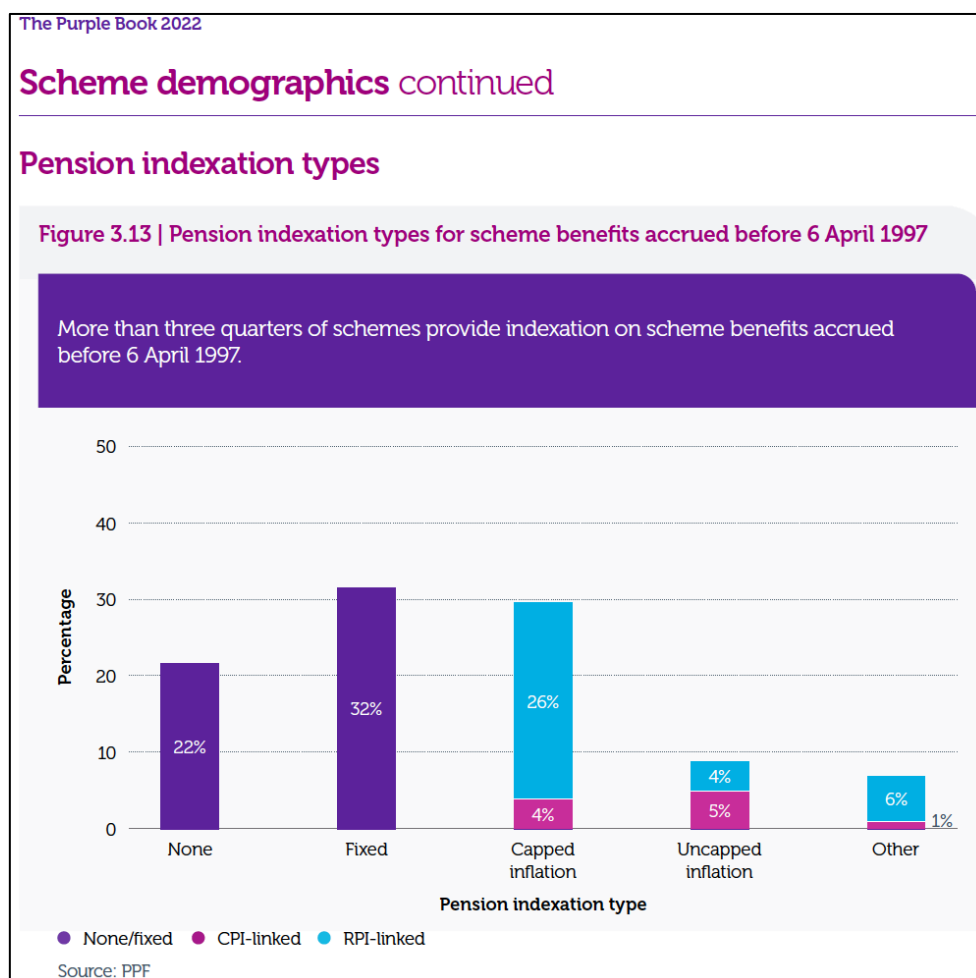
- ensure **greater collaboration** between sponsor company executives and Pension Scheme Trustees in determining a funding and investment strategy and policy for the treatment of their pensioners dependent on discretionary decisions for their pre-1997 service.
- **improve corporate citizenship and governance** across schemes where a company has sole power on granting discretionary benefits to pensions in payment for service prior to April 1997
- **Deliver more effective governance, better strategy and implementation of existing legislation** within these targeted schemes which is essential to delivering the outcomes expected within the Pension Schemes Act 2021 legislation which states:

“The trustees or managers must determine, and from time to time review and if necessary revise, a strategy for ensuring that pensions and other benefits under the scheme can be provided over the longer term.”

1 – Context

The Pension Protection Fund (PPF) Purple Book 2022 reports there are over 5,000 DB Schemes in the UK with 9.6 million members of whom approximately 4.1m (43%) are pensioners. It also reports that:

- more than 75% of all UK DB Schemes already provide various forms of inflation indexation to pensions in payment for service accrued before 6th April 1997
- 22% of all schemes provide no form of inflation protection within their scheme rules
- It is within these 22% of schemes that members rely on discretionary increases granted by the sponsor company or Trustees



This representation for an improved code of ethical practice applies only within the 22% of schemes where a company has sole power on granting annual discretionary increases.

The DWP and TPR DO NOT KNOW the true scale of impact due to lack of discretionary increases

A Freedom of Information Request by the HPPA to the TPR in 2020 revealed that the TPR do not collect data on actual discretionary increases to pensions in payment for service prior to April 1997. The DWP and TPR therefore do not know the scale of the issue nor how companies perform against any objective standards of corporate citizenship.

While some global multi-nationals within the 22% espouse their corporate ethics credentials – their discretionary decision practices can fall well below acceptable standards of corporate citizenship.

HPPA Analysis based on TPR data provided following an FOI Request in 2020

Of the more than 75% of schemes that provides some form of indexation for pre-997 pensions in payment it is estimated that this covers approximately 7.9m members. The 22% of schemes with no form of indexation have approximately 1.7m members (18% of total members)

Of the 4.1m pensioners it is estimated that approximately 3.3m(82%) receive some form of indexation and approximately 730,000 (18%) are subject to discretionary practices within their scheme(refer to Appendix).

HPPA analysis suggests there could be as many as 500,000 UK pensioners who have not received discretionary increases over many years. This lack of discretionary increases has resulted in these pensioners suffering significant financial damage impacting the quality of their lives made worse by the current “cost of living crisis” eroding the value of their pensions and buying power even more rapidly. *No one, including government organisations, knows the true scale and impact – however – there is sufficient data and evidence to justify the need for a code of ethical practice to provide better outcomes for many members within the 22% of schemes. **It is likely that some have come to rely on taxpayer funded social security payments to make ends meet.***

Having this insight and understanding of the DB landscape is essential to having an effective code of practice. The code of practice risks being not fit for purpose for many thousands of pensioners and Trustees – if this aspect is not recognised and dealt with – as explained further below.

HPPA Estimation of Pre-1997 Indexation approaches across current pensioners

- More than 80% of all schemes with more than 1000 members provide some form of indexation
- Even amongst the smaller schemes with between 100 to 1000 members - 78% of schemes provide some form of indexation
- Over 3.3m (82%) of all current pensioners receive some form of indexation
- Approximately 734,000 (18%) of all current pensioners are reliant on discretionary strategy and practices agreed between company executives and trustees
- 80% of pensioners who are reliant on discretionary increases are within schemes with over 1000 members

Table 1 : Analysis of schemes by size and pensioners receiving indexation or subject to discretionary decisions (refer to appendix for source data analysis)

Scheme size based on membership	2 - 4	5 - 99	100 - 999	1,000 - 4,999	5,000 - 9,999	10,000+		
Number of schemes	239	2,024	2,421	755	179	212		
Total Pensioners	308	43,516	624,618	1,298,600	692,730	1,458,560	4,118,332	
% of schemes providing indexation	39%	72%	78%	81%	80%	86%		
% of Schemes not providing indexation	61%	28%	22%	19%	20%	14%		
Pensioners receiving indexation	121	31,132	488,652	1,054,360	557,280	1,252,160	3,383,705	82%
Pensioners subject to discretion	187	12,384	135,966	244,240	135,450	206,400	734,627	18%
% of all Pensioners receiving indexation	0.003%	1%	12%	26%	14%	30%		82%
% of all Pensioners subject to discretion	0.005%	0.3%	3%	6%	3%	5%		18%
Pensioners subject to discretion								
distribution across scheme sizes	0.03%	1.69%	18.51%	33.25%	18.44%	28.10%		
	20%			80%				
				47%				

Table 2 : Schemes by size of membership providing indexation for benefits accrued before 6th April 1997

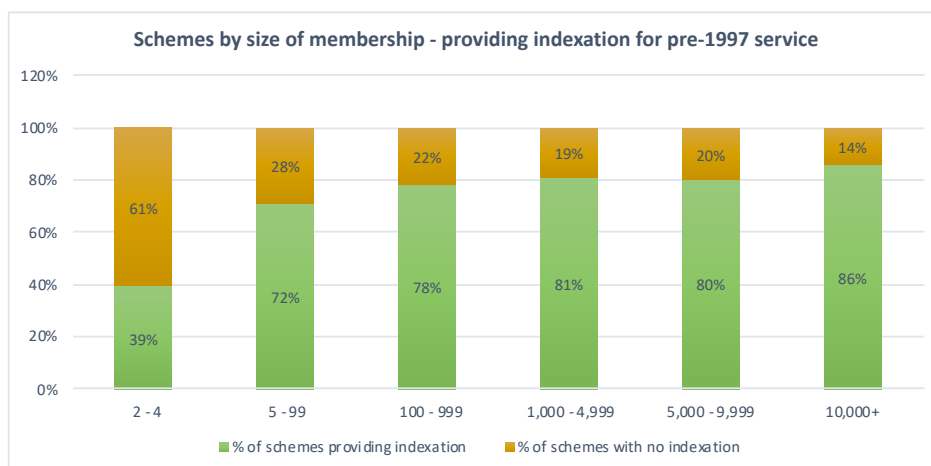
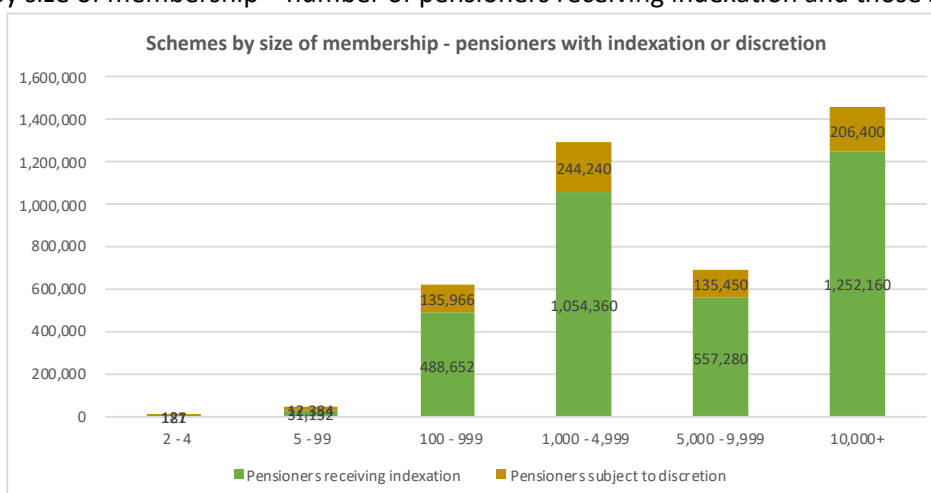


Table 3: Schemes by size of membership – number of pensioners receiving indexation and those subject to discretion



There is evidence that also indicates:

- Where companies and/or Trustees do not have a strategy for discretionary increases – then discretionary increases are unlikely to be granted
- Some pensioners have not received discretionary increases for over 10 consecutive years
- Over the past 20 years – some pensioners will have received as little as 5% increase to their pensions while inflation has risen by well over 60% - resulting in massive financial damage
- It is likely that when a company has sole power over pension discretionary decisions, it is the larger American global multi-nationals who are more prevalent in using the Pensions Act 1995 in a way that enables them to put their own financial interest first, to the detriment of ethical treatment of their pensioners, even when they have the resources to provide discretionary benefits

If the DWP and TPR analysed actual data on discretionary increases granted for pre-1997 service over the past twenty years – it would reveal the clear need for an appropriate code of ethical practice and regulatory oversight into the way in which companies and Trustees deal with discretionary benefits.

There is evidence to suggest that within certain companies – the historical practice of persistently not granting discretionary increases is due to executive culture, decision practices based on low ethical standards, lack of collaboration with Trustees on developing strategy and most importantly – the simple reason that UK legislation allows companies to put self-interest first and Trustees are disempowered. Reasons for this are explained further in Section 2 below.

2 – Why is a code of ethical practice needed?

It is important to emphasise first that the proposed code of ethical practice is:

- **NOT** asking for change to the law to require schemes to now pay indexation on pre-1997 accruals
- **NOT** asking for retrospective change
- **NOT** asking for or suggesting that full indexation be given every year
- **NOT** asking for change to existing legislation or a “one size fits all” solution
- **NOT** asking for intervention or comment by a Minister in any one single scheme

Such a code of practice is designed to work within the framework – and improve the implementation – of existing legislation. The reasoning behind this is explained further below.

The true purpose of a DB pension scheme is to provide members with assured pensions and “other benefits” over the longer term. “Other benefits” includes discretionary increases to pensions in payment for service before April 1997.

The Pensions Schemes Act 2021 Schedule 10 introduced amendments to Part 3 of the Pensions Act 2004 relating to a scheme’s Funding and Investment Strategy which places a fundamental and critical requirement on Trustees:

“The trustees or managers must determine, and from time to time review and if necessary revise, a strategy for ensuring that pensions and other benefits under the scheme can be provided over the longer term.”

However – there is a conflict of interest between the Pensions Act 1995 and the above requirement on Trustees within the Pension Schemes Act 2021 – which can only be resolved through guiding principles, code of practice and oversight by The Pensions Regulator.

The current TPR Code of Practice does not recognise and does not provide any guidelines or practice in dealing with this conflict.

The rationale for this assertion is outlined below.

The way in which the Pensions Act 1995 is used and implemented

The Pensions Act 1995 introduced legislation creating the situation where pre and post 1997 pensions in payment can be treated very differently.

The critical difference is that pensions in payment for service before April 1997 do not automatically benefit from any form of inflation indexation and in many schemes such increases are at the discretion of company leadership – unless of course the Scheme rules state otherwise as reflected in the PPF Purple Book data cited above.

When a company has sole discretionary power, self-interest is allowed to take priority over the interests of other stakeholders – and how companies apply the Pensions Act 1995 legislation is a key factor.

Culture and leadership ethics within companies and Trustee Boards are a critical factor in behaviour and decision practices – for example:

- Some companies treat pre-97 pensioners in the same way as post-97
- Some companies have implicit policy of meeting minimum statutory obligations only, consistently giving priority to financial self-interest while pensioners are denied discretionary increases
- Some companies have a primary focus on minimising contributions and exploiting any opportunity to extract economic value from fund surpluses – to the detriment of their pensioners
- When Trustees allow a company to extract economic value from fund surpluses – this is counter to their fiduciary duty to their members dependent on discretionary increases and a governance issue
- It is factors such as these that lead to significant disparity in how people are treated – for example:
 - Digital pensioners within the Hewlett Packard Plan have received discretionary increases totalling only 5% over the last 20 years – while retail price inflation has grown by well over 60%
 - In stark contrast – the company IBM has been providing discretionary increases (50% of RPI) to pre'97 pensions in payment since 2012 through collaborative policy developed between company leadership and pension Trustees, even although it is the company that had sole discretionary power

Current legislation enables companies that have sole discretionary power to always look after their own and shareholder financial interests (such as dividends) first – even if they have the financial resources and potential to provide discretionary increases but choose not to – and Trustees become powerless to intervene or persuade executives on viable alternative outcomes.

There is clear evidence that when company executives do not collaborate effectively with Trustees on developing strategy for discretionary benefits:

- **Trustees are hindered in meeting their obligations within the Pension Schemes Act 2021**
- **It results in a “weakened” Board of Trustees**
- **There is no pathway for Trustees to break this “deadlock”**
- **Trustees become “powerless” with limited influence in changing company decision practices**
- **Trustees become less effective in meeting their fiduciary duty to members**
- **Pensioners are not treated in an ethical way**
- Refer to Appendix for illustrative examples of this negative impact

This is the key reason why a code of ethical practice is necessary.

We believe many Trustee Boards would agree with, support and advocate the need for such a code of practice.

3 – Summarising Statements

The **primary purpose** of a Code of Ethical Practice is to ensure **greater collaboration** between sponsor company executives and Pension Scheme Trustees in determining a funding and investment strategy and policy for the treatment of their pensioners dependent on discretionary decisions for their pre-1997 service.

A **secondary purpose** is to resolve an **inherent conflict** between the Pensions Act 1995 and the Pensions Schemes Act 2021. This conflict arises when sponsor company executives choose not to collaborate with Pension Trustees on developing strategy and policy for discretionary increases for pre-1997 service. In this situation – which happens at present within certain schemes – Trustees are put in a “deadlock” situation with no pathway to resolve it. A well-designed code of practice will prevent this from happening. Further details on this are explained in our various papers submitted to the DWP and TPR, and the attachment below.

This representation for a code of ethical practice is based on achieving more effective implementation of existing legislation – THEREFORE – the TPR and DWP have the powers and opportunity to act now – without the need for further legislative change.

Enhancing the code of practice for the reasons given above will improve the lives of many pensioners dependent on discretionary increases within the targeted schemes without significant impact on the company or government finances.

Members of schemes negatively impacted over many years by poor collaboration and lack of strategy for dealing with discretionary benefits deserve change that delivers better outcomes over their pension lifetimes.

Risks to achieving the expected outcome

Any code of practice dealing with this issue has to set clear expectations of what is considered best practice and provide clear guiding principles, behaviours and criteria that outline how UK pensioners with pre-1997 service are expected to be treated.

This issue has remained unresolved for many years – with no government organisation or MP or pension Trustee representative organisation seen to be persistently taking the lead to find a better outcome.

Where a code of practice is shown to be ineffective – then legislative change is the only option remaining to ensure fair and ethical treatment of all UK pensioners dependent on discretionary increases.

It should not be forgotten that the UK is the only country in Europe that has no legislation for the treatment of pensions in payment for pre-1997 service. It should not be forgotten that UK pensioners who have experienced chronic erosion of the value of their pensions over their retirement lifetimes feel a sense of betrayal. Pensions legislation should not allow the purchasing power of a person's income to erode over their lifetime to the extent that it has occurred in the past.

There is clear and compelling evidence that the time has now come for this situation to be reviewed and dealt with properly – and a code of practice is a good starting point.

4 – Outline of enhancements required to the Code of Practice

Legislation states that: *“The trustees or managers must determine, and from time to time review and if necessary revise, a strategy for ensuring that pensions and other benefits under the scheme can be provided over the longer term.”*

Developing a Funding and Investment Strategy for *other benefits* requires a set of guiding principles, criteria and indicators representing DWP and TPR views on what is considered best practice on how companies and Trustees “must” and “should” deal with *discretionary increases* for accruals before 6th April 1997. This requires the code to be enhanced in multiple ways.

The HPPA submit initial proposed enhancements as follows:

Responsibilities and Roles

Employers and Trustees must collaborate on developing ethical principles, goals, objectives and associated policy for discretionary increases which will influence the way in which the funding and investment strategy is developed.

Agreeing a funding solution

Employers and Trustees must reach agreement on a Funding and Investment solution that reflects the agreed ethical policy and which strikes the right balance between the needs of scheme members dependent on discretionary decisions and those of the employer.

Managing Conflicts

Trustees have the option to request TPR intervention and mediation if they are unable to establish open and transparent working relationships and/or policy and funding solution that reflects their fiduciary duty to members after all relevant factors have been considered.

Key Documents – Statement of Strategy

The Chair of Trustees must publish the agreed ethical policy and how it is being implemented as part of the Statement of Strategy.

Long-term planning and journey plan to the ‘end game’

The journey plan towards a low dependency funding status must start with the premise of “discretionary benefits are anticipated over the long term aligned to an agreed statement of ethical principles and policy”.

The Long-Term Objective (LTO)

Trustees cannot implement a buy-out solution that does not deal effectively with discretionary benefits over the longer term as such a strategy is not aligned with Trustees fiduciary responsibility to represent the best interest of all classes of members ([refer to Pensions Management Institute article in appendix](#))

5 – Summary Appendix

The Summary Appendix below provides a few extracts of the information contained within an earlier representation submitted to the DWP consultation.

It includes a few infographics directly related to the Hewlett Packard Scheme – for the only reason that this information is considered representative in indicating the size and scale of the issue that likely exists for many pensioners dependent on discretionary decisions.

Graphic 1 : The Purple Book 2022 – The UK DB Pensions Universe (published by the Pension Protection Fund)

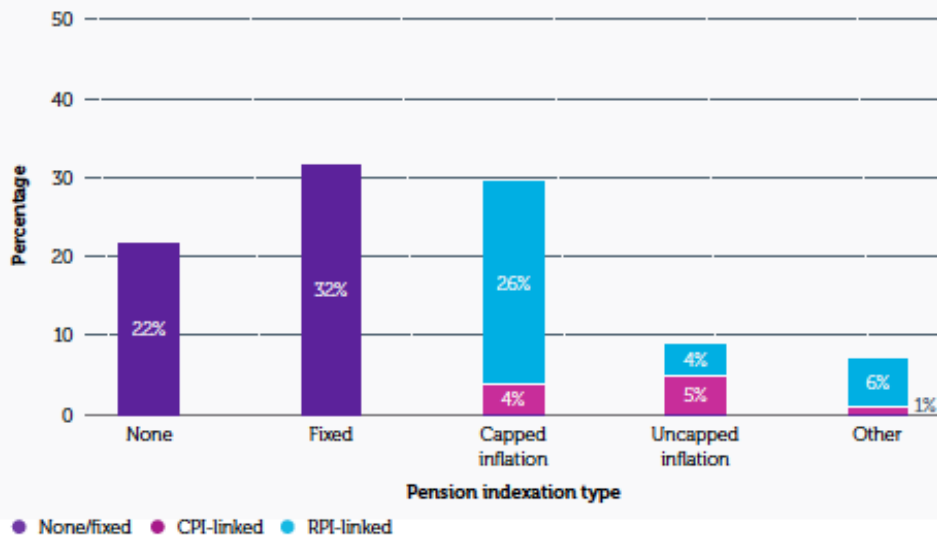
The Purple Book 2022

Scheme demographics continued

Pension indexation types

Figure 3.13 | Pension indexation types for scheme benefits accrued before 6 April 1997

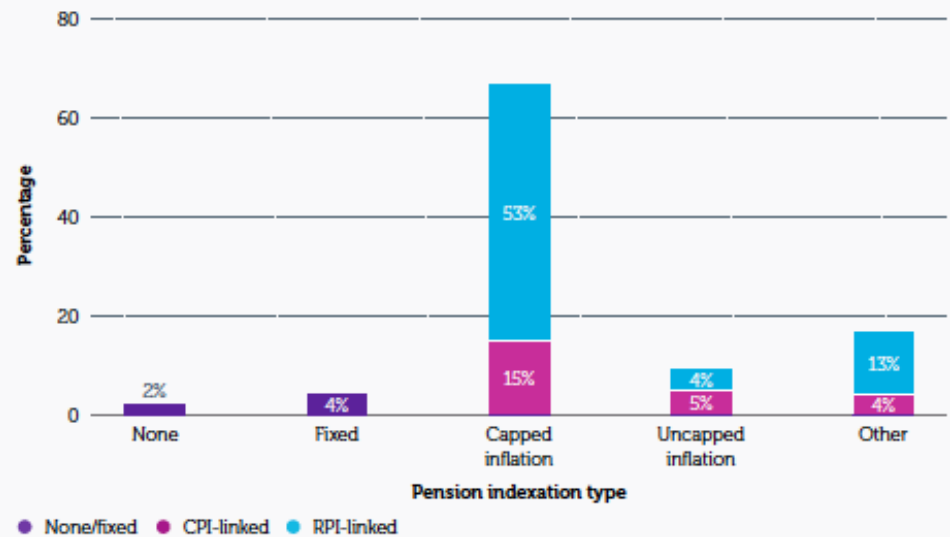
More than three quarters of schemes provide indexation on scheme benefits accrued before 6 April 1997.



Source: PPF

Figure 3.14 | Pension indexation types for scheme benefits accrued after 5 April 1997

Around two thirds of schemes provide indexation of capped inflation on scheme benefits accrued after 5 April 1997. For the vast majority of these schemes, the inflation cap is five per cent a year.



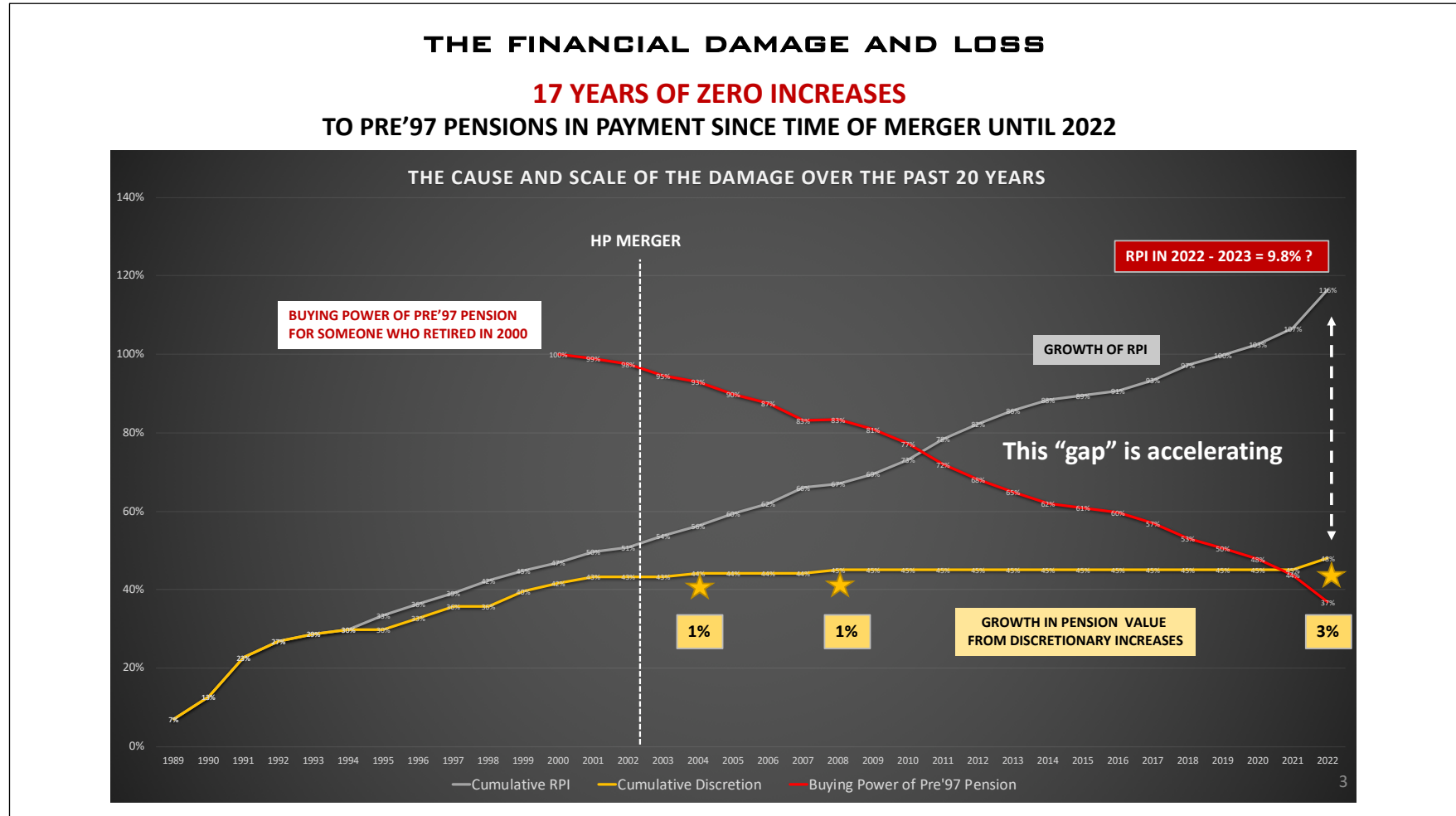
Source: PPF

Note: this is based on scheme return data provided by schemes, where the scheme return specifies that in cases where there is more than one rate of indexation, the rate applying to the largest proportion of protected liabilities should be submitted.

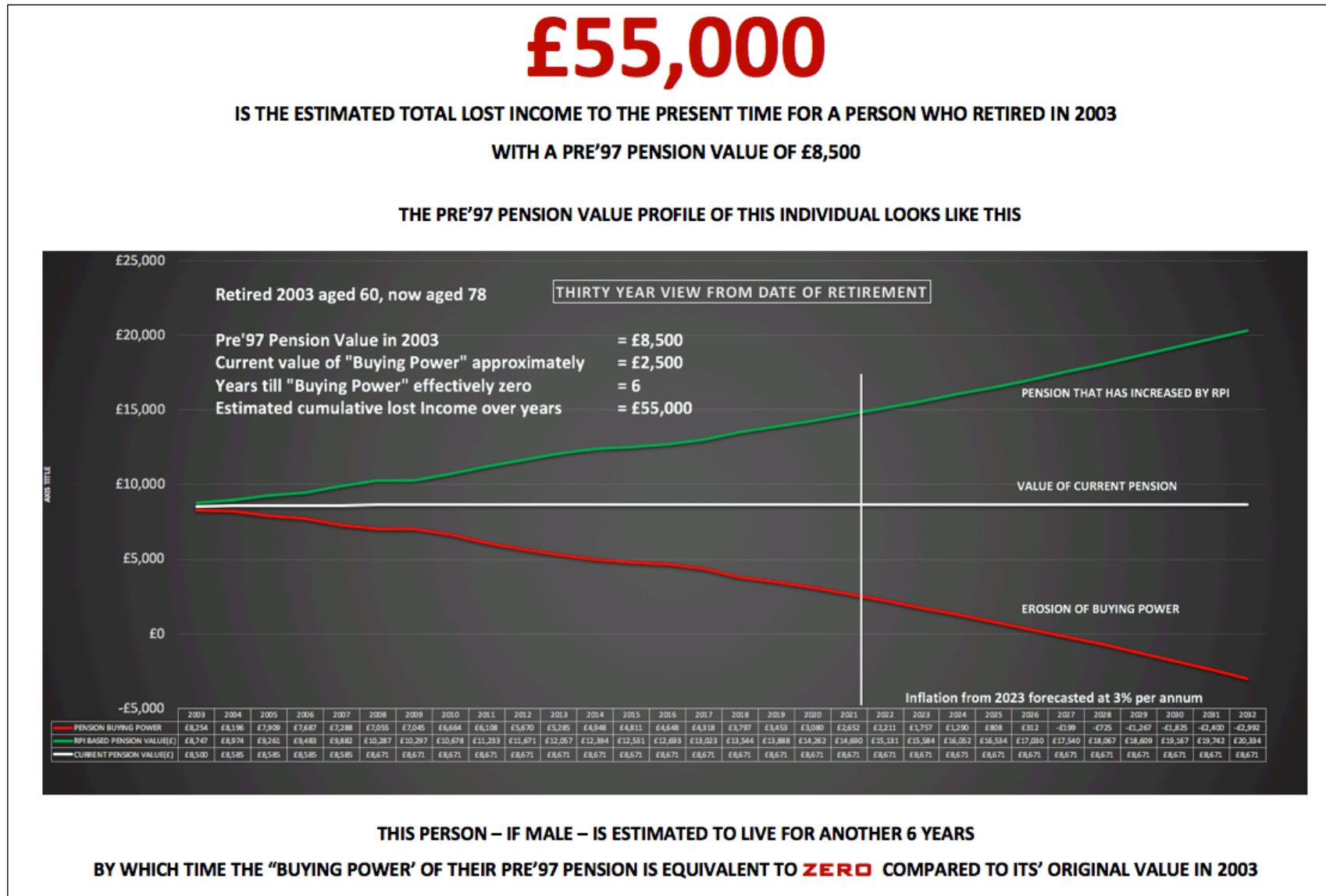
Note: most of the schemes with no pension indexation don't have any scheme benefits that were accrued after 5 April 1997 or are cash balance schemes.

GRAPHIC 2: The scale of impact from lack of discretionary increases

Digital pensioners within the Hewlett Packard Plan have received discretionary increases totalling only 5% over the last 20 years – while retail price inflation has grown by over 56%

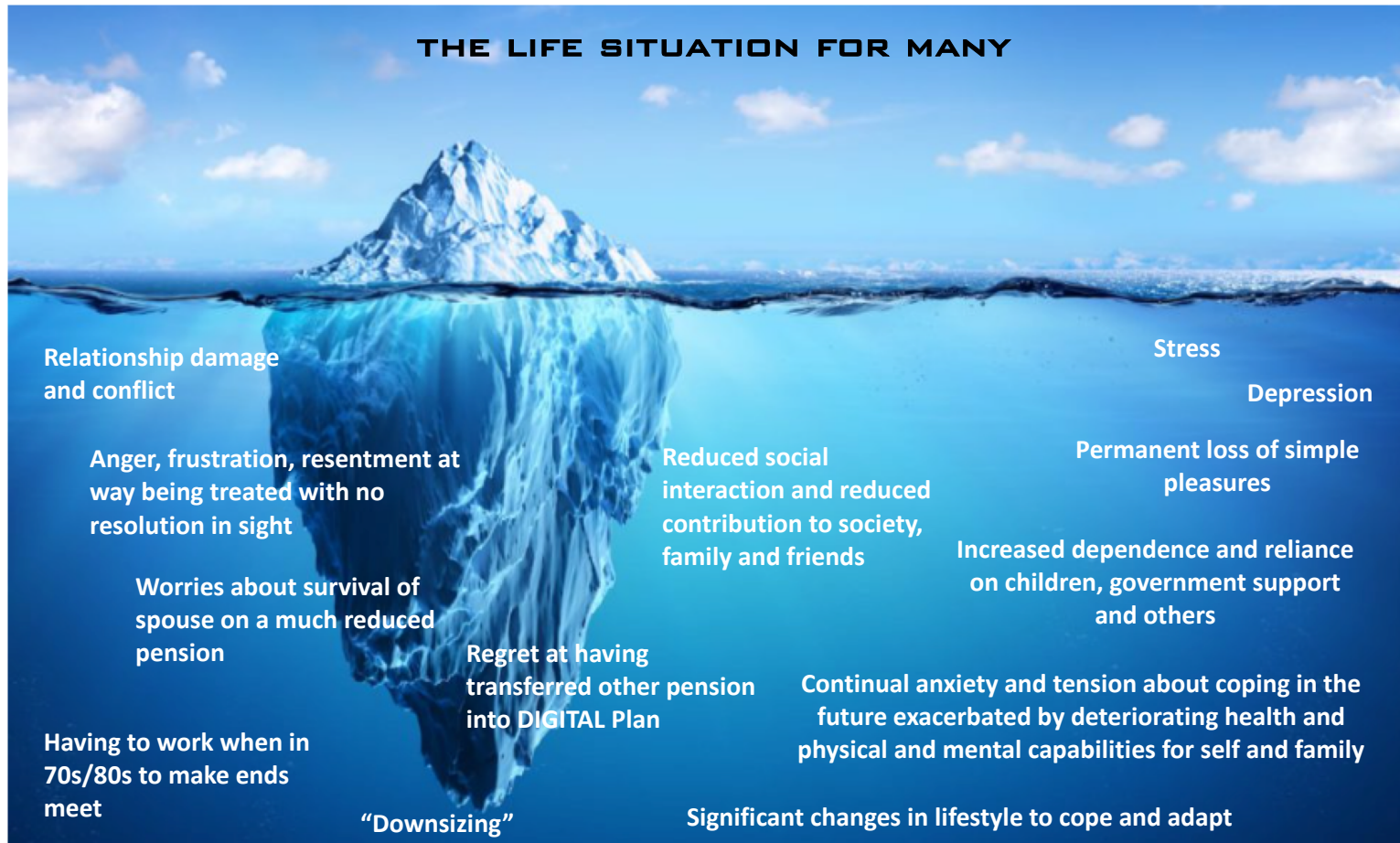


GRAPHIC 3: The scale of impact from lack of discretionary increases



GRAPHIC 3: The scale of impact from lack of discretionary increases

THE DAMAGE IS MORE THAN JUST FINANCIAL



Extract from Pensions Management Institute Article October 14 2022 – MERCER VIEWPOINT

Buyouts are particular problematic for DB scheme members, since while securing their benefits, these transactions crystallise rights and preclude discretionary benefits.

“The only benefits that a member will be entitled to are those covered in the benefit specification at inception of the policy,” notes Mercer chief actuary Charles Cowling.

He adds: “This may or may not include inflationary adjustments, capped or otherwise. On the plus side, these should always meet regulatory minimum requirements, eg, some form of inflation linkage for post-1997 accrual.”

As a result, he notes that trustees “need to consider very carefully whether buying out and giving up any rights or expectations that members have in relation to discretion increases is genuinely in members’ best interests”.

Unlike a pension scheme, insurers do not have trustees to exercise discretions.

Cowling adds: “As commercial organisations, there would be no incentive to do anything other than provide the cheapest alternative.

“Therefore, as part of bulk annuity purchase, trustees (with input from sponsors) need to codify exactly which benefits they want insurers to cover rather than leaving open-ended discretions.

“Theoretically, if the bulk annuity is held as a buy-in, trustees can offer discretionary increases on top of the benefits provided by the insurance, although this leaves the question of how these will be paid for.”

Cowling warns, however, that “following buyout and wind-up, there is no longer any scope for further discretionary uplifts as the scheme and trustees will no longer exist”.

“In these cases, the insurer will just pay members whatever is agreed in the benefit specification and paid for in the premium at the time of buyout,” he adds.

HPPA ESTIMATIONS based on data provided by TPR – data provided after FOI Request by HPPA in 2020

ANALYSIS OF INDEXATION APPROACHES FOR SCHEME BENEFITS ACCRUED BEFORE 6 APRIL 1997								
ANALYSIS OF TPR FOI DATA - based on scheme data provided September 2020 with some adjustments to reflect 2022 Purple Book								
UK DB LANDSCAPE BY SIZE OF SCHEME	Number of Pension Schemes - By number of members and pre'97 indexation approach							
	Number of members within scheme	2 - 4	5 - 99	100 - 999	1,000 - 4,999	5,000 - 9,999	10,000+	
	Total number of Schemes	239	2,024	2,421	755	179	212	5,830
	Assumed average membership/scheme	3	50	600	4,000	9,000	16,000	HPPA estimate
	Estimated membership of all schemes	717	101,200	1,452,600	3,020,000	1,611,000	3,392,000	9,577,517
	No. of schemes as % of total Schemes	4.1%	34.7%	41.5%	13.0%	3.1%	3.6%	
	No. of members as % of total	0.01%	1.06%	15.17%	31.53%	16.82%	35.42%	
Schemes with an Indexation Approach applied within Scheme Rules		2 - 4	5 - 99	100 - 999	1,000 - 4,999	5,000 - 9,999	10,000+	
Automatic increase granted each year based on indexation approach specified within scheme rules	Fixed Interest Value	11	757	828	154	24	13	
	Full Indexing in Line-CPI	23	93	81	45	15	14	
	Full Indexing in Line-RPI	11	92	66	24	7	12	
	Max & min-CPI	3	5	12	3	3	3	
	Max & min-RPI	2	44	124	48	8	13	
	Percentage Increase-CPI	3	3	3	3	3	3	
	Percentage Increase-RPI	3	3	8	5	3	3	
	Up to max-CPI	3	58	101	46	8	12	
Up to max-RPI	35	393	671	285	73	109		
Sub-Total - number of schemes		94	1,448	1,894	613	144	182	4,375 75%
Estimated number of members		282	72,400	1,136,400	2,452,000	1,296,000	2,912,000	7,869,082 82%
% of members within scheme segment		39%	72%	78%	81%	80%	86%	
% of total members		0.00%	0.76%	11.87%	25.60%	13.53%	30.40%	
Schemes where increases to pre'97 pensions in payment are subject to discretion		2 - 4	5 - 99	100 - 999	1,000 - 4,999	5,000 - 9,999	10,000+	
Number of schemes subject to discretionary decisions	Not Applicable-CPI	3	6	3	3	3	3	
	Not Applicable-RPI	3	3	3	3	3	3	
	Not Applicable-N/A	32	537	495	126	26	21	
	Not Applicable-Unknown	107	30	26	10	3	3	
Sub-Total - number of schemes		145	576	527	142	35	30	1,455 25%
Estimated number of members		435	28,800	316,200	568,000	315,000	480,000	1,708,435 18%
% of members within scheme segment		61%	28%	22%	19%	20%	14%	
% of total members		0%	0%	3%	6%	3%	5%	
% of members who are pensioners	Estimate of current pensioners across all schemes							
43%	Scheme size based on membership							
ESTIMATION OF CURRENT PENSIONERS AND TREATMENTS OF PRE-97 service	Pensioners	308	43,516	624,618	1,298,600	692,730	1,458,560	4,118,332
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