

**PENSIONS AND  
LIFETIME SAVINGS  
ASSOCIATION**

**BSPS: CONSULTATION RESPONSE BY THE PENSIONS AND LIFETIME SAVINGS  
ASSOCIATION**

**“GOVERNMENT MUST  
COMMIT TO A BROADER  
REVIEW OF THE  
LEGISLATIVE CHALLENGES  
FACING DB SCHEMES.”**

23 June 2016

## **EXECUTIVE SUMMARY**

1. The Pensions and Lifetime Savings Association (PLSA) recognises the Government's priority is to find a solution that enables a satisfactory resolution to the pressures facing TATA UK and that produces the best possible outcome for British Steel Pension Scheme (BSPS) members.
2. We believe there is a strong regulatory system in place and Pension Protection Fund (PPF) protection offers good outcomes for pension scheme members when their scheme sponsor is unable to meet its obligations to the scheme in full.
3. Accepting that the Government's aim is to find a solution that minimises the risks to the UK steel industry and its workers, we believe that, should a legislative option ultimately be required then, on balance, the Government should proceed with a modified version of option 3. This would include prospective amendments to the scheme's benefits, via Section 67, as endorsed by the BSPS Trustees, so long as additional safeguards are put in place.
4. The additional safeguards that we would like to see put in place are that:
  - ▶ the Government ensures legislative changes are scheme specific to the BSPS;
  - ▶ the Government ensures that the PPF and the Pensions Regulator (TPR) agree whether the scheme is eligible for PPF protection and what legal entity will continue to support the scheme, ensuring that all necessary securities are put in place; and
  - ▶ the Government commits to a broader review of the legislative and wider challenges facing DB schemes.
5. This option should enable the scheme to continue to provide good benefits for its members on a self-sufficient basis.
6. If these additional safeguards cannot be put in place, then Government should proceed with option 1, utilising the existing regulatory framework which will still provide good member outcomes.
7. The BSPS is not the only scheme with significant pension assets and liabilities and a sponsoring employer facing an uncertain future. It is essential therefore that, the UK Government commits to working with the Association through our DB Taskforce, and the wider industry, to assess the challenges that DB schemes are facing and to develop and implement solutions for addressing them.

8. We have no objection, and consider that there is no legal obstacle to Tata UK using existing regulatory levers (option 1) and conducting a Regulatory Apportionment Arrangement should the trustees, parent and UK Company, PPF and TPR all agree.
9. We recognise that it may not be possible to undertake a buyout of the scheme benefits (option 2) given the stated unwillingness of the company parents and prospective buyers to inject more capital into the scheme; and the requirement for full member consent.
10. We believe that option 4 (a bulk transfer to a new scheme with reduced benefits) is unnecessarily complicated and could undermine the broader sustainability of DB provision.

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## INTRODUCTION

**The Pensions and Lifetime Savings Association is the national association with a ninety year history of helping pension professionals run better pension schemes. With the support of over 1,300 pension schemes and over 400 supporting businesses, we are the voice for pensions and lifetime savings in Westminster, Whitehall and Brussels. Our purpose is simple: to help everyone to achieve a better income in retirement.**

**Our pension fund members own nearly £1 trillion of assets and are responsible for the pensions of 16 million people. Our members include most open and closed funded DB schemes across the private and public sector. We therefore represent almost all those members saving in funded DB arrangements.**

The Pensions and Lifetime Savings Association (the PLSA) welcomes the opportunity to contribute to this consultation on the options for helping the British Steel Pension Scheme (BSPS) as a part of a wider package of Government support for UK Steel, steel workers and affected communities. We also welcome the Government's decision to consult widely with stakeholders on the proposed options to support the BSPS, and the recognition that they may have broader consequences across the pensions system.

We agree with the opening statement to this consultation that 'the challenges facing the British Steel Industry are not caused by the financial situation of the BSPS'. We acknowledge the Government's priority is to find a solution that enables a satisfactory resolution and maintains the ongoing production of steel in the UK.

In responding to this consultation we are seeking to ensure that:

- ▶ the Scheme (BSPS) secures a sustainable solution for its members which is supported by the Pension Scheme Trustees;
- ▶ any solution implemented is not detrimental to the sustainability of DB provision more broadly; and
- ▶ In recognising the challenges of operating in the current DB environment, the UK Government commits to working with us through our DB Taskforce, and the wider industry, to assess the challenges that DB schemes are facing and to develop and implement solutions for addressing them.

Accepting that the Government's aim is to find a solution that minimises the risks to the UK steel industry and its workers, we believe that should a legislative option ultimately be required then, on balance, the Government should proceed with the modified version of option 3 endorsed by the BSPS Trustees.

This option involves dis-applying Section 67 for the BSPS so that they can amend their scheme rules to switch indexation and revaluation methodologies from RPI to CPI for future periods of payment and deferral.

This differs from the option proposed by the Government, whereby the indexation methodologies would be adapted for both past and future revaluation as well as future indexation of pensions in payment. Importantly, the Association believes that this option should only be carried out with appropriate safeguards put in place. Namely, that:

- ▶ the Government ensures legislative changes are scheme specific to the BSPS;
- ▶ the Government ensures that the PPF and the Pensions Regulator agree whether the scheme is eligible for PPF protection and what legal entity will continue to support the scheme, ensuring that all necessary securities are put in place; and
- ▶ the Government commits to a broader review of the legislative and wider challenges facing DB schemes.

This option should enable the scheme to continue to provide good benefits for its members on a self-sufficient basis. This option is the preferred option of the BSPS Trustees, if the scheme would otherwise fall into the PPF.

The current regulatory regime for defined benefit schemes hinges on the existence of a strong sponsoring employer and should continue to do so. Therefore, if it is absolutely essential to enable BSPS to continue without a tangible sponsoring employer then appropriate mechanisms need to be in place to protect the PPF.

In the longer term, in principle, it is sensible for other scheme trustees to be able to explore such options where they believe it is in the best interests of their members. However, much more thought needs to go into whether appropriate regulatory and governance mechanisms are in place to ensure that the pursuit of such an option is indeed in the best interest of scheme members, with a due regard to the sustainability of the sponsoring employer.

The Government must commit to a broader consultation on the challenges facing DB schemes, many of which are facing similar circumstances to the BSPS, and assess whether the disapplication of section 67 for the purposes of amending inflation protections and/ or broader legislative changes are required or appropriate to enable Trustees to address these challenges.

## **THE DB CHALLENGE**

Over the last 20 years successive government policies, reviews and legislative provisions have developed a strong regulatory framework for pensions.

It is our view that the Pensions Regulator (TPR) has wide-ranging powers to support and regulate schemes and the Pension Protection Fund (PPF) is well placed to absorb claims (even those as large as those of the BSPS) and pay compensation to thousands of pension scheme members. The protection that the PPF offers may be, in many cases, the best outcome for pension scheme members when their scheme sponsor is unable to meet its obligations to the scheme in full.

However, we recognise this framework is not without its issues or imperfections and it is right that there should be an examination of whether it is fit for purpose in the current environment.

The BSPS is one example of a scheme whose very public circumstances have brought to the surface the need to examine the challenges currently facing DB schemes. Schemes and their sponsors face a number of pressures in the current environment. Macro-economic conditions and the effect of quantitative easing, low interest rates and gilt yields have impacted scheme funding. As well as coping with these challenges, schemes are grappling with affordability issues associated with the significant improvements in longevity we have seen in the last 50 years.

Despite this, the BSPS appears well enough funded that, were the legislative framework to allow it to, it could in principle continue to pay pensions at above PPF levels of compensation into the future. This brings into sharp relief longstanding concerns over a lack of flexibility in the existing pension scheme legislation - the BSPS is not the first or only scheme that is well funded, but whose fate is intertwined with that of an ailing employer.

The legislation only provides for binary outcomes, which are:

- (a) the success of a going concern employer; or
- (b) insolvency of the sponsor, and PPF entry for underfunded schemes.

We recognise the original policy rationale for this inelasticity. However it is clear that it does prevent well-funded schemes from pursuing options that could provide their scheme members with reduced benefits, albeit above the PPF levels of compensation.

This consultation also highlights longstanding issues regarding the 'legislative hardwiring' of scheme rules. In the case of the BSPS this is regarding the hardwiring of indexation methodologies – many schemes are unable to update their future indexation methodologies because of the way in which their scheme rules were historically written – even though they believe this would provide a better outcome for their scheme members.

## **DB TASKFORCE**

In March 2016 the PLSA established the DB Taskforce in response to the increasing pressures facing defined benefit pension schemes.

The Taskforce has been set up to evidence and examine the size and shape of these challenges and understand their potential impact on members' benefits, the health of sponsoring employers and the wider economy. Working with a wide range of stakeholders the Taskforce plans to develop potential solutions to those challenges.

The Association intends that the work of the Taskforce, which issued a Call for Evidence on the challenges facing DB schemes and their sponsors on 9 June 2016, can help inform a broader review of the challenges that this consultation has identified. It is actively working with pension scheme trustees, sponsors, the social partners and advisers to evidence the challenges facing DB pensions, and to develop shared solutions. The Taskforce is keen to work with Government (including DWP, HMT and BIS and its arm's length bodies) to address these pressing issues.

## **THE BSPS SITUATION**

The BSPS is not alone in being a large scheme with significant pension assets and liabilities and a sponsoring employer facing an uncertain future. It is also not unique in the fact that it could, with changes to its benefit structure, be in a position to provide pension payments that are at or are greater than PPF levels of compensation over the long-term.

We recognise that the confluence of the scheme's history, the political imperative to support the steel industry and the pressing timeline for a resolution has required irregular intervention. Government must recognise however, that though there is a rationale for irregular intervention; this will have implications – short term and long term – for all DB schemes, trustees and scheme sponsors.

Firstly, it would be inconceivable for Government to consider such changes without also considering amendments for all schemes given that many face very similar challenges. While securing the best outcome for BSPS members is of paramount importance, this must be balanced with securing the best outcome for all DB pension scheme members.

Secondly, the nature of the proposed legislative amendments may have unintended consequences for the integrity of the current regulatory system. The extent to which the PPF's role is compromised by the persistence of a scheme without a tangible employer has not been assessed. In addition, the ability of the Pension's Regulator to pursue regulatory action in certain situations may be undermined.

Finally, bespoke adjustments to the legislative framework of members benefit protection, on a piecemeal or reactive basis, without a subsequent wholesale review

of the regulatory system may introduce significant risks to the UK's pension framework. These risks could include:

- ▶ encouraging employers to offload their pensions, where they or their parent company could have otherwise put sufficient capital into the scheme to protect benefits in full;
- ▶ encouraging 'PPF drift', whereby schemes that are very likely to end in the PPF are encouraged to carry on indefinitely, depleting the value of the assets that would eventually come to the PPF in the meantime;
- ▶ attrition of member protections over time; and
- ▶ encouraging schemes to continue to operate without a strong employer supporting them without sufficient securities in place.

A review of these risks is essential but cannot take place in a four week consultation. We recognise the Government's need to implement a legislative solution for the BSPS which ensures (a) members remain protected and (b) the scheme is sustainable on an ongoing basis. But we recommend that any short-term changes should be structured in a way that applies this solution solely to the BSPS in order to minimise the risk of contagion or undermining the remainder of pensions law. This solution must only be implemented alongside a Government commitment to a wholesale review, with appropriate timescales, of the current legislative system and corresponding regulation for DB schemes.

## **ASSESSMENT OF THE OPTIONS**

When setting out the options available the Government describes a number of criteria that it believes should bear significant weight. Namely:

- ▶ The necessity of an option that separates the pension scheme from the sponsor to enable the business to be sold to a new entity or, potentially, help the existing arrangement become more viable for the existing sponsor.
- ▶ The importance of the employer within its locality and the motivation to explore ways by which the scheme can be kept outside the PPF and therefore reduce the risk that pension scheme members, active (below Normal Pension Age - (NPA)) and deferred, receive a 10% reduction in their pension benefits – which it is stated will have a lasting detrimental effect on the locality.
- ▶ The consultation also states that the DWP believes all existing regulatory options have been explored and that therefore, a traditional regulatory apportionment arrangement is not possible.

For the purposes of this consultation, our response is based upon this position remaining the same. We do however recognise that this is a rapidly evolving scenario that has wider government involvement than the DWP and circumstances may change.

Given this, then option one (a traditional regulatory apportionment arrangement) and option two (a buyout of benefits above PPF levels) may not meet the Government's objectives as set out in the consultation document. The PPF typically seeks to take an ongoing stake in the 'new' business and it appears very unlikely that a 'white knight' investor will emerge and seek to take over the business and the pension scheme. The PPF will seek to protect the remainder of pension schemes it protects from undue claims, and we recognise that setting its approach aside for BPS may undermine its approach in other cases and heighten the moral hazard risk from employers wishing to 'offload' their schemes into the PPF.

The remaining two options entail some form of legislative change. The PLSA has long argued for greater flexibility in some elements of benefit provision, in particular around indexation. Careful consideration needs to be given to the broader implications of such changes, even when this legislation is only intended to apply to the BPS.

Below we set out our detailed consideration of each of the options in the consultation and an explanation for why we believe that a modified version of option 3 should be applied.

### **OPTION ONE**

*Use existing regulatory levers to separate scheme from employer under Regulatory Apportionment Arrangement (RAA) or Flexible Apportionment Arrangement (FAA).*

This is a well-established process and has proven to have sufficient flexibility to allow interested parties to come up with creative solutions and good member outcomes, based on previous examples such as Kodak and Uniq.

Traditionally a RAA is used to separate the scheme from the employer and enable the scheme to fall into the PPF without its sponsoring employer declaring bankruptcy. In most RAAs the scheme will enter the PPF and, in return, the PPF will negotiate a stake in the ongoing employer, because the PPF believes that, on balance, it will secure more from the employer as an ongoing entity than it would as an unsecured creditor in insolvency.

### **The PLSA view**

This vehicle is already available, requires member consent and has a good level of regulatory oversight. We have no objection, and consider that there is no legal obstacle to a similar arrangement for Tata UK should the trustees, parent and UK

Company, PPF and TPR all agree. In principle, we would expect an RAA based on existing legislative terms could be completed relatively quickly.

We recognise that, though desirable for many involved, this option may not be possible. We appreciate that the sale of Tata UK as a going concern may potentially be hindered if the existing RAA process is followed as Government has indicated prospective buyers may only take on the business if all remaining pension issues are resolved. Obviating this process via a ‘work around’ would certainly increase the moral hazard risk surrounding future RAAs and is therefore undesirable. Equally, this option would not achieve the stated intention of preventing some members from reductions of benefits to PPF levels. It is worthwhile mentioning, however, that 70,000 scheme members would see very little difference in benefits under PPF compensation than under the benefits they would be provided with under option 3.

## **OPTION TWO**

*Undertake a buyout at reduced benefit levels that are above PPF compensation levels.*

This approach would require either the employer to become insolvent, the scheme to be in PPF assessment or members to consent to such an approach. The consultation states that the full buyout deficit is estimated at £7.5bn. The buyout on a PPF (S179) basis is £1.5bn.

### **The PLSA view**

It would appear that the current employer does not consider it affordable to pay the sums required to obtain a full-buy-out (meet the employer debt). It is also evident that a buy-out on a PPF basis would also require considerable additional sums to be paid to the scheme – which, based on the available evidence, appears challenging. The current legislation would also mean that if the scheme was to enter a PPF assessment period it could only exit to buy-out or run as a closed scheme if it was overfunded on a PPF basis – which it is not.

To achieve a buy-out at reduced benefit levels the members of the scheme would be required to consent. Based on the size of the scheme, and even if the trustees considered it to be in the members’ best interests, this would undoubtedly be difficult. In our view it would be unlikely to be completed in the period that fits with the publicly stated timetable to find a resolution of the issues surrounding the future of the UK’s steel industry.

## **OPTION THREE**

*Reduce scheme liabilities through legislation by dis-applying Section 67 of the 1995 Pensions Act and allowing BSPS trustees to use scheme rules to reduce the levels of indexation and revaluation. This change would apply to the BSPS only.*

This would reduce the level of reserves required for inflation protection so that the scheme would no longer be in deficit on an ongoing basis and would be able to continue to run on with a sponsoring employer outside the PPF.

We understand that the trustees of the pension scheme support a modified version of this proposal as set out in their publicly available consultation response. This modified version would, by their calculations, enable the BPS scheme to continue to operate on a self-sufficiency basis either as a standalone scheme or with a new sponsoring employer. This proposal is different from that put forward by Government in that it only proposes to amend indexation and revaluation for future periods. In particular it recommends:

- ▶ “Future increases to pensions when in payment are limited to those required by legislation.
- ▶ Increases to deferred benefits for future periods of deferment are calculated using CPI instead of RPI (but are otherwise unchanged – contrary to what is stated in the Consultation Document, see section 4.5(ii)(c) below).
- ▶ The trustee has a power to reinstate pension increases if and when it is financially safe to do so.”

### **The PLSA view**

Changes to Section 67 are not to be undertaken lightly. This section of the 1995 Pensions Act provides important protection for DB members that their benefits will not arbitrarily be amended.

It is worthwhile noting that the requirements to increase pension scheme benefits in line with inflation came into effect in 1985 (where salary related schemes were required to increase deferred pensions by the Limited Price Index) and in 1997 where pensions in payment were required to be uprated by “the appropriate percentage” (both are subject to a 5% cap).

This had a number of consequences which are relevant here. Firstly, many schemes originally set out to provide inflation protection only if they could afford to do so. Secondly, that many schemes drafted reference to RPI for indexation of pensions in payment in their scheme rules at a time where RPI was the de-facto inflation index – essentially ‘hardwiring’ RPI into their scheme rules – this is what is commonly referred to as a ‘drafting lottery’ since some legal advisers took a longer term approach to indexation. Where scheme rules dictated that RPI was used for revaluation of benefits, since these count as an accrued right under Section 67, it has not been possible for them to change this.

The result has been that, despite being an outdated inflation index (CPI is commonly accepted methodology now); schemes have been unable to update their scheme rules

to remove reference to RPI and reflect modern practice. Since CPI is typically lower and more stable than RPI this has prevented schemes from amending their benefit indexation where they have perceived this to be in the best interests of their members.

Outside of this consultation, the PLSA firmly believes that this ‘drafting lottery’ needs to be addressed and we will be addressing this issue through the work of the DB Taskforce. For the purposes of this consultation, dis-applying Section 67 for the BSPS, to permit the amendment of scheme rules regarding inflation indices for future indexation and revaluation would have a lesser, but not insignificant, impact on member benefits than were the scheme to fall into the PPF.

Many of the issues faced by BSPS in this regard are not unique to the scheme, and the Association has long argued for a legislative system that provides schemes with greater flexibility around certain aspects of benefit provision. A clear balance must be struck between the safeguarding of members’ accrued rights and the sponsor’s ability to support the scheme with full or rationalised benefits and the trustees’ ability to make decisions in the best interest of scheme members. Whilst member expectations of promised benefits must be protected, the pensions legislative regime should also enable scheme sponsors to have the scope to consider sensible rationalisation of scheme rules and structures. For example, to help streamline complicated scheme rules to remove complexity and frictional costs to provide outcomes that are ultimately better for the scheme membership.

These broader issues all will need addressing, and any general question of amending Section 67 more broadly requires a more considered debate than is possible during a four week consultation.

We are persuaded however, that this variation of option 3 will enable the BSPS to provide a sustainable outcome for its members, and could be executed swiftly in line with the timetable that Government has outlined. It is preferred to ‘option 3’ as put forward by Government insofar as it makes minimal amendments to member benefits whilst still achieving a good outcome.

We believe that this option would secure a sustainable solution for its members in a timely fashion and would not be detrimental to the sustainability of DB provisions more broadly, providing it meets the following features:

- ▶ the Government ensures legislative changes are scheme specific to the BSPS;
- ▶ the Government ensures that the PPF and TPR agree whether the scheme is eligible for PPF protection and what legal entity will continue to support the scheme, ensuring that all necessary securities are put in place; and

- ▶ The Government commits to a broader review of the legislative challenges facing DB schemes in order to avoid setting a legal precedent without a clear strategy in place for supporting schemes.

#### **OPTION 4**

*Enable schemes to undertake a bulk transfer of members to a newly set up scheme that offers reduced (but higher than PPF) benefits, where the reduction (as in option 3) applies to inflation protections. This would be achieved by making regulations under section 73 of the Pension Schemes Act 1993 amending the Occupational Pension Schemes (Preservation of Benefits) Regulations 1991 so that all trustees would be able to make bulk transfers to a scheme with reduced benefits under an opt out arrangement. It seems to be envisioned that there would be a solvent or semi-solvent employer remaining as sponsor of the scheme.*

This option differs from option 1 in that:

- ▶ Under this proposal, the consent requirement would be met so long as the member did not opt out.
- ▶ Those members who opt out would fall into the PPF, though it is not clear what role the PPF would have in negotiating the terms of the arrangement.

In order to take this course, Government suggests that:

- ▶ Tata UK would need to confirm the identity of the new sponsoring employer;
- ▶ there should be an independent assessment of the scheme's funding;
- ▶ That the scheme should close to accrual; and
- ▶ That the trustee agrees it was in the best interests of the members and that the scheme would otherwise fall into the PPF.

#### **The PLSA view**

The consultation document proposes that this amendment would apply to all schemes. It is not clear whether the process would be applicable to other sorts of benefit reduction or is time limited, ie further reductions or increases would be permitted in the future depending on the level of scheme funding.

We believe that this option in its current form (applicable to all trustees) risks undermining the sustainability of broader DB provision by enabling other schemes to take action without an appropriate consultation period to fully explore the risks that this presents. In a diluted form, whereby the regulations were scheme-specific to the BSPS, this option is unnecessarily complicated (achieving the same outcome as option 3 but via convoluted means) and thereby poses a greater risk of introducing loopholes and may not be achievable in the stated timescales.

This approach would still require some form of a RAA as there would need to be a statutory employer attached to the new scheme. In order to help ensure the long-term future of the scheme, and minimise the ongoing risks the new employer will need to demonstrate it is sustainable.

The alternative outcome would be that the scheme is expected to run as a 'closed scheme' carrying all funding risks by itself and only attached to a 'shell' employer. The Government will need to consider the broader impact on the regulatory framework, including the scheme's continued eligibility for the PPF and the oversight of the scheme's long-term funding plan. Should this option be allowed for all schemes, as is implied by the consultation document, then the Government needs to give serious consideration to the impact of similar arrangements becoming common practice.

The advantage of this proposal over the traditional RAA is that member consent will be easier to obtain and therefore more members are likely to go to the new scheme than to the PPF, and achieve better benefits (for many) than they would otherwise.

As stated above, a clear balance must however be struck between the safeguarding of members' accrued rights and any decision to rationalise or support changes to scheme benefits in the long-term interests of members. As with the proposed changes to section 67, these issues also impact schemes more broadly and require a more considered debate than that which can be had during a four week consultation.

In large, complex, schemes such as BSPS these types of bulk transfer exercise are typically complicated, can be expensive, and can take time to be carried out. To ensure the proposed outcome, a significant degree of certainty around achieving the outcome would need to be established before the legislation is amended.

The consultation has identified that this option may face stumbling blocks with respect to the bulk transfer of a scheme that previously offered contracted out benefits. We believe that this option, requiring broad amendments to the current regulations will be difficult to legislate for and cleanly ring-fence.

Finally, we believe that important safeguards to prevent moral hazard, such as PPF or TPR involvement in the process, are missing from this proposal. We encourage Government to make the role and responsibilities of all parties in any arrangement very clear in its response to the consultation.