



Institute
and Faculty
of Actuaries

British Steel Pension Scheme

IFoA response to the Department for Work and Pensions

23 June 2016

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.



Pensions Consultation Team
Department for Work and Pensions
1st Floor, Caxton House
6-12 Tothill Street
London
SW1H 9NA

23 June 2016

Dear Sirs

IFoA response to DWP Consultation into the British Steel Pension Scheme

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to DWP's consultation into the British Steel Pension Scheme (BSPS). The consultation raises significant issues for advisors and trustees of defined benefit schemes. These issues include section 67 provisions, bulk transfers, employer debts, funding assumptions and scheme governance. Members of the IFoA's Pensions Board, who have experience in these areas, have written this response.
2. Given the importance of the consultation and the consequences for pension schemes, the IFoA would like to discuss with DWP the issues raised in the consultation in respect of all schemes.

General Comments

3. The consultation paper includes an explanation of the benefits of legislative intervention for the BSPS. The IFoA will not comment on the specific reasons for that intervention, as it is a matter for Parliament alone. However, there are a number of considerations that could have implications for other employers and their pension schemes:
 - The establishment of the current regulatory framework offered members of distressed pension schemes significant protection for their accrued benefits. It is unclear whether the proposed intervention is about the ability of the framework to deal with a single large scheme (even if circumstances are deemed unique), or if the DWP is looking to hear views about other outcomes that lie outside the existing legislative framework.
 - We would be concerned if the Government's view is that the current arrangements are inadequate to deal with other employers with significant scheme deficits. As many schemes continue to face large funding shortfalls, it is unlikely that the long-term challenges will disappear. Trustees, advisors, members and sponsors currently have some assurance around the pensions safety net; any changes could reduce the trust all participants have in the existing framework.
 - The consultation also raises a question about the adequacy of current PPF benefits. The design of PPF benefits was a compromise between affordability and member compensation. The IFoA would welcome clarity whether the Government believes the current PPF benefits remain appropriate.

London 7th Floor · Holborn Gate · 326-330 High Holborn · London · WC1V 7PP · **Tel:** +44 (0) 20 7632 2100 · **Fax:** +44 (0) 20 7632 2111

Edinburgh Level 2 · Exchange Crescent · 7 Conference Square · Edinburgh · EH3 8RA · **Tel:** +44 (0) 131 240 1300 · **Fax:** +44 (0) 131 240 1313

Oxford 1st Floor · Park Central · 40/41 Park End Street · Oxford · OX1 1JD · **Tel:** +44 (0) 1865 268 200 · **Fax:** +44 (0) 1865 268 211

Beijing 6/F · Tower 2 · Prosper Centre · 5 Guanghua Road · Chaoyang District · Beijing China 100020 · **Tel:** +86 (10) 8573 1000 · **Fax:** +86 (10) 8573 1100

Hong Kong 2202 Tower Two · Lippo Centre · 89 Queensway · Hong Kong · **Tel:** +11 (0) 852 2147 9418 · **Fax:** +11 (0) 852 2147 2497

- One simple solution, if an alternative is essential, would be to introduce the PPF long service cap provisions.
 - If government deems one scheme to be a special case, many other employers may wish to explain why they too are special cases.
 - The consultation sets out the consequences of failure on Port Talbot. There are many other employers, who are significant within a local community, possibly on a different scale. There could be a case for special measures for such employers and their schemes to prevent further economic deprivation, or indeed to prevent those areas facing future deprivation.
 - Other pension schemes with large deficits are likely to act as a deterrent to corporate activity. Firms may be willing to buy other companies, but not with the attaching pension scheme. The argument set out in paragraph 35 of the consultation could apply to many other employers and schemes.
 - The Employer Debt legislation rests on the principle that, as long as a solvent employer backs the scheme, accrued benefits in respect of service to date are fully protected and cannot be reduced. Allowing such a change in past accrual for BPS could encourage sponsoring employers to challenge whether this remains a fair cost for employers who leave multi-employer schemes, particularly where covenants are weak.
3. The proposal is to alter pension increases, but other benefit changes could also reduce pension liabilities, if that is the Government's aim. The proposed changes have the most significant impact on members with pre-1997 pension accrual, who would receive no increases on this part of their benefits. Other changes would impact different groups of members in different ways, but it is not clear whether the government has considered other alternatives.
4. As a general principle, if the government decides it is appropriate to make the proposed changes, the IFOA would prefer to use a transfer mechanism rather than an override of the Section 67 provisions. The transfer mechanism is already more flexible than Section 67. The "opt out" provisions would give members an active choice in whether they would like to move to any new arrangements. Section 67 provides protections for all members of all schemes and has been a fundamental part of the pensions legislative framework since 1997. We believe that overriding these protections should be avoided if possible.
5. When the government changed its policy on statutory revaluation, the outcome was largely dependent on the form of documentation of the trustees' lawyers. Some schemes rules meant an automatic change to CPI, others have a Trustee and or/Employer option to change and others must continue to use RPI for as long as it continues to exist. We would encourage the government to consider whether it wishes to introduce broader changes to address these differences, given the "lottery" based on historic drafting..

Q1 Would existing regulatory levers be sufficient to achieve a good outcome for all concerned?

6. The design of the existing regulatory levers, including Regulated Apportionment Arrangements (RAAs), was intended to cover schemes in the same conditions as the BPS. We believe RAAs have been applied successfully in the past. Other than the circumstances set out in the consultation paper, (since the regulatory regime prescribes the level of PPF compensation), we do not see a compelling reason why the existing levers could not provide adequate protection for scheme members in accordance with the intention of the legislation.

7. The PPF has proved an effective mechanism for providing compensation to members whose employer becomes insolvent. However, it is possible that many of the criteria the PPF uses (for example, determining whether a scheme should enter the PPF or seeking to buy benefits out with an insurer) do not work as well for a scheme as large as the BPS. Even so, the Government should have a compelling reason why the BPS members, in particular, should receive different treatment to members of other schemes in a similar situation. This could provide justification for alternative provisions.
8. One clear advantage of using an RAA is that there is no obvious need for new legislation. The RAA would introduce some clarity and would enable tPR to exercise appropriate influence in the future provision of the BPS.
9. If an RAA is the only step taken, it seems likely that the scheme could enter the PPF. If the objective is to keep members out of the PPF, we expect additional steps (such as those considered under Options 3 and 4) would be required.

Q2 Is it appropriate to make modifications of this type to members' benefits in order to improve the sustainability of a pension scheme?

10. We have noted in our general comments that we would prefer a transfer mechanism rather than the modification of Section 67 protections, where possible. This would prevent, as much as possible, further requests for special treatment from other schemes.
11. The trustees could only agree to the use of modifications if, in their view, this provided a better outcome for members as a whole. This would be a challenging decision for the trustees to make.
12. Improving the sustainability of the scheme may not prevent it entering the PPF in the future. There will be a residual element of uncertainty after any modifications. Communicating this uncertainty is important for scheme members. Understanding the uncertainty is also important for regulators, the PPF and PPF levy-payers. Although it seems unlikely that any members' PPF compensation could be lower in future than it would be if the scheme entered the PPF immediately, it is possible that the PPF's risk exposure could increase.
13. Allowing BPS to modify benefits could lead to other schemes asking for "unique" treatment in dealing with liabilities. Many smaller schemes in distress may also question why only a very large scheme is eligible for special treatment. Setting a precedent could lead to an erosion of confidence in DB schemes, which may be unacceptable for scheme members.

Q3 Is there a case for disapplying the section 67 subsisting rights provisions for the BPS in order to allow the scheme to reduce indexation and revaluation if it means that most (but not all) members would receive more than PPF levels of compensation?

14. We would comment again that introducing modifications to benefits may not prevent the scheme entering the PPF in the future. This is a matter that will require clear communication to the affected members, but also more generally, to PPF levy payers.

Q4 Is there a case for making regulatory changes to allow trustees to transfer scheme members into a new successor scheme with reduced benefit entitlement without consent, in order to ensure they would receive better than PPF level benefits?

15. The consultation indicates that some members would be better/worse off as a result of the PPF structure. This is a natural consequence of the design of the PPF compensation. If the Government is persuaded that there is a compelling case for making a regulatory change to allow the reduction of benefits without consent, our preference would be to use a transfer mechanism. This will give those members the ability to opt out and choose PPF compensation instead.

Q5 How would a new scheme best be run and governed?

16. The IFoA believes that tPR has existing powers that would allow the exercise of best practice in the running of the BPS. In particular, the trustees will have to apply strong risk management principles and meet high levels of governance.

Q6 How might the Government best ensure that any surplus is used in the best interest of the scheme's members?

17. If there were to be a future surplus, the IFoA would consider providing "lost" pension increases as the most appropriate use of surplus, although it seems likely that some cohorts of member might not benefit from this approach. It would be a political matter to determine whether deferred or pensioner members first received the benefit from surplus.
18. As a practical point, the ease of finding an alternative sponsor for the scheme may be to some extent related to any provisions regarding future surpluses. If, as seems likely, the employer were to be a shell company, the trustees would have to focus on long-term sustainability. It seems unlikely that any "surplus" would arise before the scheme had become very mature. One consideration might be that surplus could only be distributed as part of securing members' benefits with an insurance company.

Q7 What conditions need to be met to ensure that regulations achieve the objective of allowing TSUK to reduce the levels of indexation and revaluation payable on future payment of accrued pension in the BPS without the need for member consent, balancing the need to ensure that member's rights are not unduly compromised?

19. If it were possible to amend increases from RPI to CPI, the only remaining issue of indexation would be for pre-97 benefits. We believe that using member consents would be legally effective in dealing with pre-97 benefits (ie within the current legislative framework).

Q8 What conditions need to be met to ensure that regulations achieve the objective of allowing trustees to transfer members to a new scheme without the need for member consent, balancing the need to ensure that members' rights are not unduly compromised?

20. The use of a membership "cut-off" is arbitrary and is not helpful in establishing a robust process. Obtaining member consents is laborious, but the PPF exists as the provider of last resort if members cannot be traced, or do not consent to transfer to a new scheme.

21. Should you wish to discuss any of the points raised in further detail please contact Philip Duggart, Technical Policy Manager (Philip.duggart@actuaries.org.uk / 0131 240 1319) in the first instance.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'FM', with a long horizontal flourish extending to the right.

Fiona Morrison
President, Institute and Faculty of Actuaries