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THE BHS SETTLEMENT AND THE PENSIONS GREEN PAPER

THE BHS SETTLEMENT

Sir Philip Green has agreed to pay up to £363m to fund a rescue for the BHS pension schemes.

Members of the current BHS pension schemes will be given three options:

- remain in the current BHS pension schemes and transfer to the Pension Protection Fund (PPF);
- transfer to a new scheme with benefits above the PPF level but reduced post-retirement increases; or
- opt to receive a lump sum if they have a small pension of up to £18,000 in value.

The structure enables benefits to be reduced but without the full reduction that would follow from a transfer to the PPF. Members will be given the same starting pension as they were promised under the BHS pension schemes.

The settlement is expected to ensure the new scheme will have sufficient funds to provide those benefits without further contributions, although it is understood that the new scheme will not be barred from the PPF in the future. Its board will be made up of three independent trustees to ensure robust governance.

Anti-avoidance action continues against Dominic Chappell and Retail Acquisitions Limited but this may not affect benefits.

THE GREEN PAPER

The events surrounding BHS and the public consultation in relation to the British Steel Pension Scheme have raised doubts about the current defined benefit pensions regulatory framework. The Green Paper seeks views on a range of proposals drawn from the report of the Work & Pensions Committee of the House of Commons.

Mandatory clearance

Clearance is currently a voluntary process. A mandatory clearance regime has been proposed. The Department for Work & Pensions (DWP) notes that a mandatory clearance regime would be difficult to design, even if narrowly drawn, and could be potentially detrimental to legitimate corporate activity and the economy. In particular, the DWP notes that it could have an undesired effect on the rescue culture, leading to more business insolvencies and resulting job losses. The DWP suggests a high threshold for any mandatory clearance.

Severance from stressed schemes

Under current legislation, in very limited circumstances, it is possible to separate the scheme from a sponsor by way of a regulated apportionment arrangement (RAA). An existing limitation on the RAA is that it is only available where insolvency of the sponsor is likely within 12 months. The DWP are seeking views on removing this requirement to deal more effectively with schemes that cannot get funded.

Stressed schemes and benefit reductions

In the DWP's view, a case has not been made for facilitating benefit reductions generally. However, it acknowledges a case for "stressed" schemes, i.e. those that can't realistically be funded by their sponsors even over time, to preserve value and jobs. The key question is how "stressed" a scheme has to be before easements become available.

The DWP is seeking stakeholders' views but envisages that the Pensions Regulator (Regulator) and the PPF may need to make a case-by-case judgment on affordability issues similar to the approach currently taken in relation to RAAs. Understandably, if easements are to be introduced, the DWP expects a very high threshold to be met.

The easements proposed include "conditional indexation". Pension increases could be frozen if the scheme was in deficit and the sponsor was unable to make up the deficit. Increases could recommence following financial recovery.

A further option is allowing schemes that have hard-wired RPI increases to switch to CPI under a statutory override.

Scheme specific funding

The Green Paper seeks comments from stakeholders on various proposals including:

- reducing the timescale for triennial valuations from 15 to 9 months;
- requiring more frequent valuations for "stressed" schemes;
- limiting the length of recovery plan, subject to affordability; and
- interim funding targets and monitoring requirements, including "special measures", for "stressed" schemes.

Winding-up powers

The Regulator has an existing power under the Pensions Act 1995 to wind-up pension schemes in the interest of the generality of members. Given the financial uncertainties and potential implications of triggering a scheme wind-up, including employer insolvency and resulting job losses, the scheme wind-up power is yet to be used by the Regulator.

The Green Paper considers extending the wind-up power by reference to reducing calls on the PPF. The DWP notes the likely conflict between the interests of the PPF, sponsors and scheme members.

Nuclear deterrent fines

One of the more controversial recommendations made by the Work & Pensions Committee was to allow the Regulator to issue punitive "nuclear deterrent" fines of up to three times the scheme's deficit on parties to corporate transactions that cause a material detriment to a scheme. The DWP notes that such powers must be proportionate, workable and not detrimental to the functioning of the economy.

Information powers

Proposals include the imposition of an "overall duty" to co-operate with the Regulator and further powers for the Regulator to interview parties supported by sanctions for non-compliance.

Scheme consolidation

While mandatory consolidation is rejected, the Green Paper considers the potential to consolidate small defined benefit schemes to create efficiencies.

COMMENT

The Green Paper's review of the defined benefit landscape is both timely and welcome. It takes a measured view of the proposals considered by the House of Commons Work & Pensions Committee. Increasing the powers of the Regulator is not something to be taken lightly. This is acknowledged by the DWP.

Notwithstanding much criticism in the past six months, the Regulator has achieved significant settlements in relation to the BHS pension schemes (£363m) and the Coats pension schemes (£255m) using its existing anti-avoidance powers. Its powers work well as a deterrent, which is the real reason it uses them so rarely. The DWP appears cautious about expanding the Regulator's anti-avoidance powers and the clearance regime. Additional powers will require additional resources and this is most likely to be met from further levies.

Any changes to legislation to allow benefit cuts on affordability grounds are likely to be contentious. A high threshold and Regulator oversight should be expected.

A statutory override to switch from RPI to CPI may be more welcome as the current differences between schemes largely derive from arbitrary drafting choices.

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