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

Email: bsps.consultation@dwp.gsi.gov.uk

MACFARLANES

7 June 2016

Our ref CCXB

Dear Sirs

Public consultation – British Steel Pension Scheme (the "Consultation Document")

We are responding to the public consultation on the British Steel Pension Scheme (the "BSPS") commenced on 26 May 2016.

Macfarlanes LLP advises both trustees of occupational pension schemes and employers sponsoring such schemes. We advise both in relation to larger schemes (assets in excess of £2bn) and smaller schemes (assets below £50m). While many of our clients have well-funded schemes with good covenant support, we also have significant experience of advising clients with potentially unaffordable deficits and advising in relation to schemes that have transferred to the Pension Protection Fund ("**PPF**").

1 **Summary**

We think legislation could be amended to allow benefits to be reduced as suggested, subject to conditions. We consider that any change in legislation should apply equally to all levy-paying private sector DB schemes in the same circumstances.

2 **General comments**

2.1 Based on our experience of similar situations, we agree strongly with the statement at paragraph 47 of the Consultation Document that *"The kinds of problems TSUK and BSPS are experiencing are certainly not unique"*. What is less clear to us is that the scale and context of the situation, albeit "exceptional", warrants different treatment for this scheme and its members.

2.2 If there is to be any change in the legislation, it should apply equally to all defined benefit ("**DB**") schemes which pay the PPF levy.

2.3 The fact that in the economic circumstances of the 21st century, the pension promises of the 20th century may sometimes be unaffordable is a common reality. That they might be unaffordable was in fact envisaged in the original design of these schemes, which generally allowed for benefits to be reduced on termination and, in some cases, by amendment and often didn't hard-wire inflation protection.

2.4 The main current solution to the unaffordability issue is the PPF, effectively an aggregator scheme supported by the sponsors of the remaining DB schemes and limiting the loss of

Macfarlanes LLP is a limited liability partnership registered in England with number OC334406. It is authorised and regulated by the Solicitors Regulation Authority. Its registered office and principal place of business are at 20 Cursitor Street, London EC4A 1LT.

The word 'partner' is used to refer to a member of Macfarlanes LLP. A list of members is open for inspection at the above address.

benefit for individual members. This is supported by a raft of anti-avoidance measures and a number of carefully managed easements. Some additional easements may be appropriate.

3 Background on the funding of the PPF and challenges relating to border-line schemes

3.1 The funding of the PPF depends in part on transfers from schemes which do not create material funding strain to the PPF: i.e. schemes that cannot buy-out PPF-level benefits on the insurance market but where the assets may be above, or not materially below, the cost to the PPF of providing such benefits. Such transfers limit the cost to levy-payers and help ensure that compensation to pensioners from the PPF does not need to be cut (which could lead to calls for a contribution from the tax-payer).

3.2 The Pensions Regulator has in the past objected to would-be competitors to the PPF, i.e. arrangements intended to aggregate other pension schemes and provide benefits to members above PPF levels but on a non-insured basis (sometimes referred to as "non-insured buy-outs"). It is understood that this was in part because such vehicles might undermine the funding of the PPF by removing the better funded of the insolvent schemes that would otherwise transfer to the PPF, diluting its resources, while relying on the PPF as ultimate guarantor. Better for members but not for levy-payers.

3.3 The Pensions Regulator has also in the past asked trustees to trigger the transfer of their schemes to the PPF. This is usually by asking them to commence winding-up and triggering an unaffordable s.75 debt on the employer. Such requests have been made either where there is "PPF drift" (i.e. while the scheme remains outside the PPF, the levels of compensation expected to payable by the PPF in respect of the members are increasing more than the level of the scheme's assets) or "scheme drift" (i.e. the benefits payable under the scheme are increasing faster than the scheme's assets). "PPF drift" is generally due to members reaching normal retirement age, after which they are not subject to the PPF compensation cap or the 10% reduction but it can be due to revaluation and pension indexation.

3.4 While trustees are rarely able or willing to comply with these requests, the Pensions Regulator's point is that allowing border-line schemes to continue outside the PPF with benefits above PPF levels is prejudicial to the PPF and the levy-payers. Better for members but not for levy-payers.

3.5 Related arguments may need to be relied on by the Pensions Regulator (using its own powers) to trigger the winding-up of schemes that may never be able to fund but whose employers remain solvent.

3.6 We highlight the above issues, not because we have any view on the circumstances in which schemes should be permitted to operate outside the PPF, but to ensure the issues can be understood and taken into account.

4 Consultation question 1: Would existing regulatory levers be sufficient to achieve a good outcome for all concerned?

4.1 A "good outcome for all" is likely to be subjective.

4.2 We would assume that a new investor in TSUK or its business would be extremely unlikely to be willing to assume the pension liabilities.

4.3 We understand the Government is restricted in what it can do under EU "state-aid" rules.

4.4 We also note that stricter funding rules apply under European law to pension schemes that do not have a sponsoring employer guaranteeing funding. This may be an issue (or an additional

issue) if the BSPS (or a replacement scheme) is to continue without a substantive sponsor (effectively a "non-insured buy-out").

4.5 We would suggest the key stakeholders (in the sense of "good outcome for all") are:

4.5.1 The members and beneficiaries of the scheme;

4.5.2 The PPF and its levy-payers;

4.5.3 TSUK and its employees.

4.6 On some views, a good outcome would be achieved if:

4.6.1 The members and beneficiaries receive PPF level compensation;

4.6.2 The PPF is not disadvantaged or exposed to additional risk;

4.6.3 TSUK is enabled to continue trading or restructured in a manner that protects (some) jobs, presumably with new investment but free from pension liabilities.

4.7 The view is arguably the view of the architects of the PPF and the Pensions Act 2004.

4.8 Existing regulatory levers should be sufficient to achieve a good outcome on this basis. A "regulated apportionment arrangement" ("RAA") can be used if appropriate to avoid a restructuring of TSUK (as described the Consultation Document).

4.9 It may also be possible to provide benefits above PPF levels by effecting a transfer to a new scheme as described in paragraphs 70-73 of the Consultation Document.

4.10 We note that the conditions set out at paragraph 65 of the Consultation Document are PPF policy, not statutory requirements. Although we support the PPF in having a clear and consistent policy that protects the interests of levy-payers and ensures fairness between DB schemes and members accessing the PPF, these conditions could be relaxed if the PPF considered that there were sufficient and appropriate reasons to change its policy or to treat the BSPS differently from other DB schemes.

4.11 The 12 month condition referred to at paragraph 64 of the Consultation Document is statutory and can occasionally create an obstacle to resolution for a scheme that is unlikely to ever be fully funded.

4.12 In our view, if members and beneficiaries are to receive better than PPF compensation, it should not be on a basis that disadvantages the PPF or its levy-payers by putting greater risk on the PPF (through "PPF drift" or otherwise) or that dilutes the PPF's standard conditions for RAAs, as this could be unfair to other levy-payers and members of other DB schemes that have transferred or may transfer to the PPF in similar circumstances.

4.13 If members are to be invited to move to a new scheme with reduced benefits, we would expect the PPF to consider the risk of future calls on the PPF by such scheme prior to agreeing to the RAA. If the new scheme were set up without a substantive sponsoring employer but so as to comply with the stricter EU funding rules for schemes without a sponsoring employer, this risk may be sufficiently addressed (i.e. these may be reasonable conditions for a "non-insured buy-out").

4.14 If the BSPS is to transfer to the PPF without insolvency and without meeting the PPF's conditions (per paragraph 65 of the Consultation Document), it should be on the basis that the PPF is at least no worse off than on insolvency.

5 **Consultation question 2: Is it appropriate to make modifications of this type to members' benefits in order to improve the sustainability of a pension scheme?**

5.1 Yes.

Trust law and statutory protections

5.2 Pension benefits are earned benefits and should be paid but they are earned only on the terms of the trust providing for them. There is nothing inappropriate about permitting modifications that would have been permitted under the terms of the trust under which the benefits were earned.

5.3 Prior to 2003, benefits under DB schemes were almost never "guaranteed" beyond the assets of the pension scheme and were therefore subject to reduction in certain circumstances. Trustees were generally empowered to reduce benefits, with or without terminating the scheme, if the employer terminated its funding obligation or if they considered the scheme was not sustainable.

5.4 The obligation to ensure the scheme only continues so long as it remains sustainable is the flip-side of the obligation to ensure benefits accrued can be paid.

5.5 Legislation has provided additional safe-guards to protect members but those safe-guards may be too rigid. It is not inappropriate to reconsider whether statutory safe-guards are working as well as they should.

EU law

5.6 EU law requires the government to protect members from losing benefits on the insolvency of the employer, but such protection need not be for 100% of scheme benefits. PPF levels are assumed to be adequate (as noted in paragraph 107 of the Consultation Document).

5.7 If PPF levels are appropriate under EU law reducing benefits to PPF levels outside the PPF should also appropriate, from a member protection perspective.

Government policy

5.8 The protections under legislation (particularly section 67 of the Pensions Act 1995) do not apply to public sector schemes and changes, including changes of the type proposed in the Consultation Document (switching revaluation and increases from RPI to CPI), have been made to public sector schemes.

5.9 So there is no government policy that such changes are inappropriate.

5.10 The issue is really as to the safe-guards that should be provided.

6 **Consultation question 3: Is there a case for disapplying the section 67 subsisting rights provisions for the BSPS 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?**

6.1 Yes, but only if the change is made for all DB schemes on the same terms and not for the BSPS alone.

6.2 The protection of accrued benefits against adverse retrospective changes under section 67 of the Pensions Act 1995 could be modified to allow for further exceptions subject to safe-guards.

6.3 We cannot see how it could be right to make a change in legislation for the BSPS that did not apply to all DB schemes. The difficulties are common to many private sector DB schemes.

Proposed relaxation to section 67 of the Pensions Act 1995

6.4 Currently, section 67 allows benefits to be reduced, with the consent of the trustees, if the affected members agree or if the alternative benefits are certified as actuarially equivalent. The difficulty is (as noted in paragraph 100 of the Consultation Document) that it is impossible for any large scheme (and indeed for all but the smallest schemes) to secure the consent of all members and it would be unjust to make an adverse change only for those who consent and not others.

6.5 A relaxation introduced in April 2006 provides that changes made in breach of section 67 are effective unless and until voided by the Pensions Regulator. However, there are sanctions for breaching section 67. This relaxation does not function as permitting changes subject to Regulator challenge or approval.

6.6 We'd suggest section 67 could be modified to allow amendments under the following conditions:

6.6.1 The trustees agree;

6.6.2 The sponsors agree;

6.6.3 The trustees consider that the amendments are reasonably necessary to improve the sustainability of the pension scheme;

6.6.4 Affected members have been notified and given an opportunity to make representations;

6.6.5 Benefits are not reduced below PPF levels or the changes are only to reduce non-statutory indexation and revaluation;

6.6.6 *[Optional: The PPF and the Pensions Regulator agree or do not object].*

Legislating relaxations for the BSPS alone

6.7 We would consider it unfair and wrong in principle to amend legislation for the BSPS while maintaining legislation to prevent other DB schemes from making similar changes under similar conditions, particularly if the rules of such schemes otherwise permitted such changes. It would be unfair to other sponsors and unfair to the members of other DB schemes.

6.8 The high/low bridges (see paragraph 95 of the Consultation Document) is an anomaly in the PPF compensation rules that should be addressed. It has affected other schemes that have transferred to the PPF of which we are aware and we understand the PPF has previously raised this with the DWP.

6.9 The PPF cap is another feature of the PPF compensation design. We appreciate that it may bite for some members of the BSPS but we see no difference between a retail manager, a pilot and a steelworker being affected by the PPF cap.

6.10 The difficulties of getting consents from all members under section 67 is not unique to the BSPS and affects all but the smallest schemes.

6.11 We do not see that the circumstances surrounding TSUK and the BSPS are materially different to the circumstances of other schemes which are currently not viable or potentially not viable and could be made viable if benefits were reduced to PPF levels in respect of indexation and

revaluation. If appropriate conditions can be set for the BSPS (as suggested above), the same should be available to other DB schemes.

7 **Consultation question 4: 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 benefits than PPF level benefits?**

7.1 Yes.

7.2 The issues have recently been explored in the case of *Pollock v Reed* [2015] EWHC 3865. Current legislation, as interpreted in that case, does not allow trustees to effect a without consent transfer where nominal benefits will be reduced even if the trustees consider that the improved security will make it more likely that higher benefits will be paid under the new scheme. The obstacle is current legislation.

7.3 We see no reason of principle why the legislation cannot be amended to allow trustees to act in the best interests of their members where there is no adverse impact on the PPF and levy-payers.

7.4 We consider however that such changes should be permitted on a consistent basis with any change to section 67 of the Pensions Act 1995 (discussed above). In other words, it makes no sense at all to maintain legislation that prevents benefit reductions within a scheme while amending legislation to permit such benefit reductions to be made by a transfer to a new scheme. Reducing benefits by a transfer to a new scheme is a far more convoluted and expensive way to reduce benefits than amending the rules of the original scheme. The same conditions and safe-guards should apply to both routes.

8 **Consultation question 5: How would a new scheme best be run and governed?**

8.1 We would expect the scheme to be run on the same basis as the BSPS subject to any changes the PPF require as a condition of their agreement to any RAA. We would expect the PPF and the Pensions Regulator to be consistent in its treatment of this new scheme and other levy-paying schemes.

8.2 We understand the proposal is for the new scheme to have a sponsor so that it will be subject to the same funding rules as any other levy-paying private sector DB scheme. If this were not the case, it would be a "non-insured buy-out" and should be subject to increased funding rules.

9 **Consultation question 6: How might the Government best ensure that any surplus is used in the best interests of the scheme's members?**

9.1 There could be provision in the rules to require surplus to be applied in the first instance to restoring indexation and revaluation up to the levels originally provided under the BSPS. Thereafter the surplus should be dealt with in accordance with the current surplus provisions of the BSPS.

10 **Consultation question 7: 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 BSPS without the need for member consent, balancing the need to ensure that member's rights are not unduly compromised?**

10.1 As for Consultation question 3, we'd suggest the conditions for an exemption from section 67 could be:

10.1.1 The trustees agree;

10.1.2 The sponsors agree;

10.1.3 The trustees consider that the amendments are reasonably necessary to improve the sustainability of the pension scheme;

10.1.4 Affected members have been notified and given an opportunity to make representations;

10.1.5 Benefits are not reduced below PPF levels or the changes are only to reduce indexation and revaluation to statutory levels;

10.1.6 *[Optional: The PPF and the Pensions Regulator agree or do not object].*

11 **Consultation question 8: 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?**

11.1 The conditions should be consistent with the conditions for an exemption from section 67 so that policy is coherent and transfers do not become a means of evading section 67.

11.2 We'd suggest:

11.2.1 The trustees of both schemes agree;

11.2.2 The sponsors of both schemes agree;

11.2.3 If the benefits under the transferee scheme are on less favourable terms, the trustees of the transferor scheme consider that, having regard to the sustainability of each scheme, the benefits likely to be paid under the transferee scheme are no less favourable than the benefits likely to be paid under the transferor scheme;

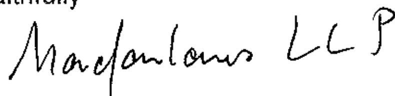
11.2.4 Affected members have been notified and given an opportunity to make representations;

11.2.5 Benefits under the transferee scheme are not lower than PPF levels for benefits under the transferor scheme or the changes are only to reduce indexation and revaluation to statutory levels;

11.2.6 *[Optional: The PPF and the Pensions Regulator agree or do not object].*

We trust these comments are helpful. If you require clarification or further comment or information, please contact Camilla Barry at camilla.barry@macfarlanes.com.

Yours faithfully



Macfarlanes LLP