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Consultation on the British Steel Pension Scheme – Good Intentions Making Bad Law?

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It would be difficult not to have sympathy with the government's reasons behind the proposals set out in its consultation of 26 May 2016, designed to help the British Steel Pension Scheme (BSPS) and its principal employer, Tata Steel UK (TSUK). The proposals, as they currently stand, are complex and may be a case of good intentions making for bad law.

The consultation proposal explains that the steel industry is in crisis worldwide due to over-capacity, lower demand and falling prices, with TSUK reporting losses of £2 billion in the last five years. Against that backdrop, the deficit in the BSPS on a buy-out basis (i.e. on the assumption that the BSPS's liabilities are secured with an insurance company) is large, estimated at £7.5 billion. Tata Steel Limited has announced that it will need to restructure and sell TSUK to cut losses in the UK. This could result in job losses, the impact of which would be felt in the most deprived areas in Wales.

Central to the government's proposals are legislative easements to enable the BSPS to amend its rules to reduce increases to pensions in payment and revaluation of deferred pensions to the bare statutory minimum (i.e. CPI-based increases). This is, of course, the measure of inflation that now applies in public sector pension increases and revaluation.

Reasons Behind the Proposals

In the consultation, the government is exploring proposed regulatory changes which would have the following aims:

- To enable TSUK to be separated from the BSPS (i.e. by TSUK ceasing to participate in or terminating its liability to contribute to the BSPS), as it is very unlikely that a potential purchaser of TSUK would wish to fund the significant defined benefit liabilities of the BSPS. (Because TSUK has said it will not be able to pay any employer debt that may be due on its exit from the BSPS, it is envisaged that the debt would be apportioned by one of the methods of apportioning employer debt liabilities under the Pensions Act 1995 to another employer[1].)
- To keep the BSPS from being tipped into the Pension Protection Fund (PPF) . If this were to happen, the benefits of members who have not yet retired would be scaled back to PPF compensation levels i.e. they will receive 90% of their promised benefits and be subject to an annual cap of, currently, around £34k).

  The consultation explains that TSUK and the BSPS trustees believe that by improving the BSPS's funding position through reducing increases to members' benefits to the statutory minimum, it can be kept out of the PPF with most members receiving higher benefits than the PPF would provide.

BSPS-Specific Exemption

The consultation states that, under section 67 of the Pensions Act 1995, a change to increases to members' benefits would require member consents. (Reading between the lines, we believe that the Retail Prices Index must be hard-coded into the BSPS rules, although the consultation does not make this clear.)

The government is proposing to introduce a regulation-making power that will enable the section 67 requirements (which protect accrued rights) to be waived for a named pension plan. The resulting exemption would be narrow in scope, i.e. as proposed it will apply only to the BSPS and no other pension plan, and would not enable the BSPS to make wider changes to members' benefits.

An exemption applying to one specific pension plan would be unprecedented, and it raises obvious questions of fairness for other pension plans and employers. Like many other plans, the BSPS is funded below PPF levels. There are plenty of other pension plans which have sponsoring employers who are struggling to fund their defined benefit liabilities who may have a case as strong as that of the BSPS and TSUK for government assistance, but who would not be able to use the proposed section 67 exemption to reduce their liabilities.

Wider Exemption, But Size Matters

The second proposal attempts to achieve the same objective (i.e. to allow a change to members' revaluation/indexation rules without consent) but through a transfer of benefits into a new pension arrangement which will then pay lower levels of indexation and revaluation.

The preservation regulations currently only allow a transfer of members' benefits without consent where the benefits in the new pension plan are "broadly no less favourable" to the rights transferred (as certified by an actuary). These requirements would be relaxed under the proposal. Members would however have a right to opt-out of being transferred automatically into the new pension plan.

This proposal appears more even-handed than the BSPS specific exemption in that the easement would also be available to other pension plans. However, there are still a number of problems with it:

- The current intention is that the exemption will only apply to "very large schemes" (i.e. those with over 100,000 members) – the government considers such schemes to have particular difficulties in obtaining member consents because of the sheer logistics.

1 Regulation 7A of the Occupational Pension Schemes (Employer Debt) Regulations 2005 (SI 2005/678)

We agree but, in our view, the main obstacle to obtaining consents is simply getting members to agree to any measures that will reduce their benefits. If this exemption is introduced, there is a strong case that the easement should be made available to all pension plans, irrespective of size.

- The proposals are highly prescriptive, in that they stem from TSUK's particular circumstances and therefore could have limited appeal. They can only be used in the context of employer debts being apportioned after an employer has exited from the pension plan; the trustee must also reasonably believe that the pension plan will enter a PPF assessment period within 12 months. Pension plans that are not in such circumstances and whose employers are not undergoing a restructuring of this nature would not be able to use the easement to change their rules on increases to members' benefits.
- Use of the easement would result in two pension plans – in the case of the BSPS, the original BSPS which would have in it members who have opted-out of the transfer (but which will presumably still have a risk of entering the PPF) and the new receiving plan (offering reduced increases) but with a better scope for being kept out of the PPF. This may be undesirable, particularly where the two pension plans remain in the same employer group.
- It is also intended that regulations would require transferring trustees to confirm that the ensuing reduction in increases to members' benefits would be in members' best interests (and in the case of the BSPS-specific exemption, the trustees' confirmation would need to be unanimous). Trustees are already required under their fiduciary duties to act in members' best interests and, in our view, it would be unusual and unnecessary to put this requirement (as seems to be the intention) on a legislative footing.

Strong Case for a Statutory Override for All Pension Plans

The consultation highlights the difficulties faced by pension plans in changing their revaluation/indexation provisions. Ever since the government changed the statutory basis for increases to pensions in payment and revaluation of deferred pensions from RPI to CPI, the ability to switch to CPI (other than for future benefits still to be earned) has depended on how individual pension plan rules are worded.

The decision of the High Court in the Qinetiq case[2] was helpful in confirming that pension plans whose rules allow the trustees to select an alternative index to RPI for the purposes of increases to pensions in payment and revaluation of deferred pensions could switch to CPI without breaching section 67 of the Pensions Act 1995. However, that case is limited by reference to the particular construction of the rules. Pension plans where RPI is hard-wired into the rules and where there is no similar power to select an alternative index still face considerable difficulties.

2 *Danks and others v Qinetiq Holdings Ltd and another* [2012] EWHC 570 (Ch)

Perhaps this consultation is the opportunity that the industry has been waiting for to encourage the government to create a level playing field by introducing a statutory override that would allow pension trustees to amend their rules by resolution to switch to CPI (which currently depends on a mere quirk of the rules), without having to comply with the safeguards of section 67 of the Pensions Act 1995 (i.e. obtaining member consents). Of course, trustees would still need to ensure that any such change would be in the members' best interests and in any particular case this will depend on a myriad of different issues that are specific to the pension plan's individual circumstances. Employer consent should also be required and additional safeguards could be built in before the power can be exercised.

Such an approach would place an onerous responsibility on the trustees but in appropriate circumstances, including those which apply to the BSPS, could be a more straightforward and fairer solution than the more complex but narrow proposals on which the government is currently consulting.

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