Association of British Insurers

Consultation Response: British Steel Pension Scheme

Executive Summary

1. The ABI welcomes the opportunity to respond to the DWP consultation paper regarding the British Steel Pension Scheme.

2. A number of the ABI's members are insurers focused purely on providing de-risking solutions for Defined Benefit Pension Schemes and other life insurance companies. These members have significant experience in working with pension schemes who have reached the point in their lifecycle where it has become inevitable that meeting members' full benefits is not going to be possible. For a large number of paying schemes this means that they enter the PPF and benefits are reduced, however a significant minority find themselves in a position where they are able to secure benefits in excess of those provided by the PPF.

3. In summary, we would advocate that the various anomalies that exist within the PPF need to be addressed to minimise the impact that any inconsistencies may have on members' benefits. We are also strongly opposed to the setting up of any shell entities, as posited in option 4 given it is unclear who the backers of the successor scheme will be and what capital would back it up.

4. More broadly, we recognise the importance of preserving jobs in the British steel industry, and all avenues are worth exploring with that in mind. However, it is important no dangerous precedents are set which could undermine other pension schemes as well as the integrity of the wider system in which the PPF operates.

5. The situation with British Steel, and with BHS, should be a wake-up call on the state of the defined benefit (DB) market, which is operating with massive deficits. We welcome the fact that Frank Field, Chair of the Work and Pensions Select Committee has already announced an inquiry into DB schemes more widely, which will hopefully explore this issue.

Views on consultation proposals

6. Whilst any instance where a pension scheme needs to reduce benefits is extremely regrettable, we believe the current system where the PPF acts as a backstop works reasonably well. However, there are a few exceptions which could easily be addressed, and doing so would in our opinion change the issues facing the BSPS, as well as many other DB pensions.

7. Firstly, the fact that PPF compensation is measured at a specific point in time and benefits are then fixed creates anomalies whereby anyone who has chosen to take a bridging pension (a higher pension from the scheme before the State Pension commences in return for a lower pension from State Pension commencement onwards, in essence creating a

flatter total income as measured over an individual's life expectancy) never sees their pension step down. This could be addressed by allowing the PPF to apply the necessary step down at State Pension Age.

8. However, the consequence of bridging pensions is only one of the many anomalies of DB pension schemes. For example, at GMP payment age (65/60) an ongoing scheme must increase the pension for the amount of GMP revaluation applicable to the member, but the PPF compensation does not provide this step up (though the member's state pension is reduced as though the PPF benefit had been increased). The PPF should address these inconsistencies in its benefits structure.

9. Secondly, whilst the PPF is there to provide a back-stop/safety net for DB pension schemes, the "cliff-edge" nature of applying a compensation cap related purely to a Scheme's NRA creates situations where individuals can lose a very significant proportion of their benefits. The implementation of service dependent maximum PPF compensation has already been passed by Parliament, so this should be implemented with immediate effect for all schemes.

10. However, for any scheme to enter the PPF the associated employer(s) must be insolvent, therefore all pension schemes of that insolvent employer(s) will fall to the PPF at the same time. Applying a common employer-wide NRA on all schemes of that insolvent employer(s) has merit.

11. With these changes introduced we believe a number of significant issues faced by the BSPS would be largely addressed, i.e. the circa 5000 pensioners who have taken a bridging pension would no longer be entitled to a "windfall" within the PPF. There would be some relief for the 776 members of the BSPS impacted by the (current) PPF compensation cap if the scheme was assumed by the PPF. When the long-service compensation cap takes effect, 500 of these members would no longer be impacted. We understand this would further reduce the deficit the PPF would assume by the order of £500m, a figure which would otherwise be borne by all other levy payers.

12. The Scheme could pass through the usual PPF assessment in the same way as hundreds of others have (and will do in the future).

13. The identification of the issues with PPF compensation which have been made so transparent by BSPS seems to be a clear rationale to fix the issues rather than just leave the inequalities in place for all other Schemes.

In or out of the PPF

14. Consultation question 4 asks whether there is a case for making regulatory changes to allow trustees to transfer scheme members into a new successor scheme with reduced benefit entitlements without consent, to ensure they would receive better than PPF level benefits.

15. Despite their current robust financial position, it is important to recognise the extent of the risks facing the PPF. Current figures show that nearly 5,000 DB schemes (out of a total of around 6,000) are unable to afford to secure with an insurer a level of benefit equivalent to that which the PPF would provide. The aggregate shortfall across these schemes was estimated to be £332 billion, dwarfing the PPF's current surplus of £3.6bn. If an unexpectedly high number of these schemes were to fall into the PPF, the levy may need to be increased or the level of compensation paid to members needs to be reduced.

16. However, the consultation is entirely silent about who the backers of the new successor scheme will be, and what capital would back up the pension scheme. If the new entity has to put up less capital than an insurer, this will effectively allow them to arbitrage the rules. This also appears to leave open whether the new scheme will continue to be eligible for the PPF.

17. Whether a large pension scheme be allowed to continue to run-on outside of the PPF is a fundamental question which needs to be addressed, alongside the resulting issue of whether continued eligibility to enter the PPF in future should be permitted. As the consultation paper notes, entry to the PPF would impose a cost of approximately £1.5 billion to be paid by other DB employers via increased levies, or reduce the PPF's current surplus by £1.5billion.

18. With this in mind, four scenarios must be considered here:

(1) Scheme does not go into the PPF, but continues to be eligible for PPF entry and

a. Outperforms investment expectations
b. Underperforms investment expectation

(1) a – Members in time are awarded revaluation and pension increase in excess of the PPF, and a good outcome is achieved.

(1) b – Members receive benefits from the Scheme in line with the PPF, funding levels decrease and the Scheme enters the PPF.

19. In these two scenarios it seems that a scheme will always have the incentive to run on outside of the PPF in the hope that the Scheme can realise asset outperformance and provide higher benefits to members. In order to achieve higher asset returns a scheme will need to take more risk and the question is then what happens if asset returns are lower than expected. At what point would a Scheme call it a day and ask to go into the PPF? Assuming that over this period the PPF deficit has increased, is it equitable that this increased deficit is picked up by all other PPF levy payers.

20. In the above scenario the members of the Scheme have only upside exposure, but are protected from the downside by all other levy payers.

(2) Scheme continues outside the PPF, but is now ineligible for PPF entry and

a. Outperforms investment expectations
b. Underperforms investment expectation

(2) a – Members in time are awarded revaluation and pension increase in excess of the PPF, and a good outcome is achieved.

(2) b – Members receive benefits from the Scheme in line with the PPF, funding levels decrease and the members benefits need reducing below those provided by the PPF. This seems likely to favour the older members of the Scheme who will take disproportionate share of the assets until a reduction to benefits is made.

21. As such outcomes 1a and 2a are clearly good the for scheme members but as the scheme is starting from a position of deficit it seems inequitable to other levy payers that the Scheme benefits from the PPF underpin (as well as to other schemes that have been forced into the PPF). In scenario 2, it seems that member consent should be sought as they are the ultimate risk takers.

22. Our conclusion is that the PPF compensation should be amended to the benefit of the BSPS and other schemes in the country and the usual assessment of affordability should take place.

23. Consideration should also be given to:
    - Utilising scheme specific mortality assumptions for BSPS in the S143 test as average mortality may not be appropriate. Whilst it may be logical that longevity risk for steel workers should be lower, this assumption might not hold for the executives/senior management in the scheme, who will also probably represent a large proportion of the liabilities. Consistency does require that similar occupation specific mortality should apply to all other PPF s143 valuations; such consistency could be avoided if the BSPS were to become a parallel PPF as described above.
    - Allowing the PPF to charge higher levies in scenario 1 above.

24. Allowing BSPS to avoid the normal PPF assessment would seem to set a dangerous precedent that would create confusion for other Schemes and seem unfair on the many tens of thousands of beneficiaries already in the PPF.

25. Alternatively, consideration should also be given to a solution that is focused on securing the pension benefits of the scheme members through the insurance regulatory regime. This approach would not require any amendments to existing legislation, therefore preserving the integrity of the existing system, nor would be it be at risk of falling into the PPF, either now or further down the line, thus removing any moral hazard.

26. The solution would involve only one adjustment in the level of the members' benefits and the Trustees would be able to secure member benefits at a level greater than PPF compensation, as genuine new money in the form of insurance capital is introduced to secure such benefits. Furthermore, the pensions are guaranteed within the rigorous life insurance regulatory framework. More widely, TSUK no longer has to support the risks and liabilities associated with the pension scheme, and can therefore become a functional business, supporting UK jobs, which could also facilitate a potential sale of the business to new investors.

Wider issues

27. As mentioned above, the 'ill-health' of the DB market is well-known, with over 1,000 UK pension schemes struggling to fulfil their benefit commitments – further demonstrated over recent months by both the BSPS scheme and that of BHS, which have brought the frailties of the DB market into the public eye.

28. The recent announcement by Frank Field regarding the inquiry into DB pensions is a welcome move and one we support. However, we would argue that this inquiry should take a broader look at the wider inequities between DB and DC schemes in the UK, particularly in how the pensions tax relief system works.

29. At present, there is a disproportionate allocation of tax relief to savers in DB schemes relative to savers in DC schemes. We have long-argued for any reform to the current system to create a level playing field between DB and DC, with an approach that does not actively penalise high earners but nor does it disincentivise pension savings in DC schemes – which due to the success of auto-enrolment - represents the future of pension saving in the UK.

30. We welcome the opportunity to work with the Committee over the coming months to look at the wider issues faced by DB schemes in the UK and ultimately, safeguard the interests of scheme members for years to come.

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