Department for Work & Pensions

British Steel Pension Scheme:

Public consultation

26 May 2016

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Introduction

1. This paper sets out various options for potentially helping the British Steel Pension Scheme as a part of a wider package of Government support to do what we can for UK Steel, steel workers and affected localities.

2. This is in response to proposals put forward by the British Steel Pension Scheme and supported by Tata Steel UK. It is important to note that the Government has not yet taken any decisions on the proposals set out in this paper. The exceptionality of the situation means that we need to think seriously about all possible options. The legislative and parliamentary process is also such that, in order to have changes to regulations in place if that is what is required to enable a satisfactory resolution for steel production, the Government needs to start the consultation process in before the hope of any deal is confirmed.

3. The financial situation of the British Steel Pension Scheme is not responsible for the wider issues in the British steel industry. However, the scheme does itself give rise to issues that need to be resolved as a part of any long-term viable solution for Tata's steelmaking operations in the UK and to provide clarity and security to the members of the British Steel Pension Scheme. The Scheme has therefore asked the Government to look into various options that would increase its chances of a sustainable future.

About this consultation

Who this consultation is aimed at

4. We welcome comments from those who live or work in Port Talbot or in steel making communities across the UK, work for Tata Steel UK, in the British steel industry more generally or are members of the scheme. In addition, we welcome comments from those who are connected with occupational pension schemes or

employers paying the Pension Protection Fund levy for schemes that they sponsor, and anyone with a general interest in pensions.

Why we are publishing this consultation

5. Some of the proposals under consideration would require secondary legislation – and we have a statutory requirement to consult on such legislation. More widely, however, the Government believes that the unusual nature of the situation, the scope of some of the proposed solutions and the current crisis in UK steelmaking means that we need to think widely about the issues and search out the widest possible range of views.

6. We understand the vital importance of pensions to the people involved. We think it is right that people have an opportunity to comment on the questions that have been raised about how best to resolve the issues.

Purpose of the consultation

7. This consultation:

   - seeks views on the regulatory options we are considering;
   - invites views from the pensions industry about the proposals; and
   - seeks evidence on how we can best bring any measures into effect.

Scope of consultation

8. This consultation applies to England, Wales and Scotland.

Duration of the consultation

9. The consultation period begins on 26 May 2016 and runs until 23 June 2016. Please ensure your responses reach us by that date as any replies received after that date may not be taken into account.

How to respond to this consultation

10. Please send your consultation responses and any queries to:

Pensions Consultation Team
Department for Work and Pensions
1st Floor, Caxton House
6 – 12 Tothill Street
London
SW1H 9NA
E-mail: bsps.consultation@dwp.gsi.gov.uk

11. When responding, please state whether you are doing so as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled. We will acknowledge your response.

Government response

12. We will aim to publish the Government response to the consultation on the GOV.UK website. The consultation principles encourage Departments to publish a response within four weeks. The report will summarise the responses and the action we will take, or have taken, in respect of them.

How we consult

Consultation principles

13. This consultation is being conducted in line with the Cabinet Office consultation principles published in January 2016. These principles give clear guidance to government departments on conducting consultations. The key principles are:

- departments will follow a range of timescales rather than defaulting to a 12 week period, particularly where extensive engagement has occurred before;

- departments will need to give more thought to how they engage with and use real discussion with affected parties and experts to make well informed decisions;
- departments should explain what responses they have received and how these have been used in formulating policy;
- consultation should be 'digital by default', but other forms should be used where these are needed to reach the groups affected by a policy; and
- the principles of the Compact: the agreement between government and the voluntary/community sector will continue to be respected.

Feedback on the consultation process

14. We value your feedback on how well we consult. If you have any comments about the consultation process (as opposed to comments about the issues which are the subject of the consultation), including if you feel that the consultation does not adhere to the values expressed in the consultation principles or that the process could be improved, please address them to:

DWP Consultation Coordinator
2nd Floor
Caxton House
Tothill Street
London
SW1H 9NA
Email: caxtonhouse.legislation@dwp.gsi.gov.uk

Freedom of information

15. The information you send us may need to be passed to colleagues within the Department for Work and Pensions, connected bodies and other relevant Government Departments, published in a summary of responses received, and referred to in the published consultation report.

16. All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this.

17. To find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact the Central Freedom of Information Team: Email: freedom-of-information-request@dwp.gsi.gov.uk

18. The Central FoI team cannot advise on specific consultation exercises, only on Freedom of Information issues. Read more information about the Freedom of Information Act.

Tata Steel UK, the British Steel Pension Scheme and the British Steel Industry

Tata Steel UK

19. Tata Steel UK ('TSUK') is a subsidiary company owned by Tata Steel Limited ('TSL' or 'Tata'). TSUK has a number of plants in Wales, the Midlands, and North-East England, employing around 11,500 people in total. The largest single plant is currently the Strip Products UK steel plant in Port Talbot, which employs over 4,000 people.

20. Tata has also created a separate company encompassing its Long Products Division, Long Steel UK Ltd, centred around the blast furnace operation at Scunthorpe for which it is in advanced commercial negotiations to sell to Greybull Capital Ltd.

21. In March 2016, Tata announced that it needed to cut its losses in the UK. It stated that TSUK had reportedly lost £2bn in five years, and that Tata was unable to sustain that exposure. It said that it would explore all options for restructuring the UK steel business, and wanted to move quickly to secure a sale of TSUK.

22. On 11 April Tata launched their sales process. Tata has said that it is committed to running a meaningful sales process.

Government actions on steel

23. The steel industry is currently dealing with unparalleled global economic conditions. There is a world-wide crisis in the steel production industry.

24. Britain's steel industry is an important part of our economy but some parts of it have struggled in the face of overcapacity in global steel markets, lower global

demand for steel and falling prices. The global price of steel has reduced sharply since 2011, due in part to excess steel capacity of around 35% across the world.

25. It is not just the UK that is facing the threat of job losses. The demand for steel in Europe as a whole remains below 2008 levels. There have been dozens of plant closures across Europe. The number of workers in steel manufacturing across the EU has fallen by over 70,000.

26. This Government has made very clear its commitment to ensuring an on-going British Steel industry. This Government has taken clear action to help the British steel industry, delivering on key steel industry requests. We have already:
    - secured state aid to compensate for energy costs;
    - secured flexibility over EU emissions regulations;
    - ensured that social and economic factors can be taken into account when the Government procures steel;
    - tackled unfair trading practices at an EU and international level;
    - set up a Steel Council to work with the industry and unions in order to develop the long term vision and strategy for the sector; and
    - supported affected communities with up to £90m of support packages.

27. Since Tata announced their decision to sell the steel plant in Port Talbot and their wider TSUK assets, this Government has been working closely with the company to ensure the best possible outcome for all parties involved.

28. Our absolute priority is to look after the workers and wider community as we work with Tata and the Welsh government to develop a package of measures to help secure a sustainable future for the Port Talbot plant and the other TSUK sites.

29. At the time of writing this consultation document, the Tata sales process is progressing with a number of interested parties. However, given that we need to consult on any regulations we might wish to make and that we may need to move

quickly once the way forward is known, the Government thought it prudent to embark on this consultation now, before the eventual elements of the deal are known, so that we can be ready to make any necessary regulatory changes, having heard and reflected on the perspectives of those affected by any change.

30. Specific options for the British Steel Pension Scheme must be considered in the context of the wider package of support being put together for the British steel industry, and are therefore subject to some uncertainty until the final arrangements are in place.

The British Steel Pension Scheme

31. TSUK is the principal sponsoring employer of a very large Defined Benefit (DB) pension scheme called the British Steel Pension Scheme ('BSPS').

32. The scheme has 130,000 members. Of these, 14,000 are active (i.e. they are currently employed by TSUK or another sponsoring employer of the scheme), 32,000 are deferred (i.e. no longer employed by TSUK but below the scheme's normal pension age and with a pension not in payment) and 84,000 are pensioners.

33. According to December 2015 figures, the scheme has assets of £13.3 billion and liabilities based on running on with a solvent sponsoring employer of around £14 billion, so has a deficit estimated at around £700 million on a technical provisions basis. However, the scheme is around £1.5 billion short of what would be needed to buy out benefits equivalent to Pension Protection Fund compensation levels (this is known as a section 179 basis in pensions legislation). The deficit to buy out the benefits in full is estimated to be around £7.5 billion.

34. These estimates are based on a 'roll forward' of the funding position from the previous formal actuarial valuation relating to 31 March 2014 by the scheme

actuary and accordingly is an estimate and subject to uncertainty. The figures have been produced on the basis that the scheme remained open.

Why is the scheme a concern?

35. Were Tata to sell TSUK, it is highly unlikely that a purchaser would be willing to take on the pension scheme as a part of the deal – the cost and risk to the purchaser would be too high for a successful sale. The scheme therefore needs to be separated from TSUK.

The reasons for ensuring a sustainable future for Port Talbot and TSUK

36. The Government wants to see steel making continue in the UK and a sustainable future for blast furnaces in Port Talbot and Scunthorpe. TSUK's largest site is in Port Talbot in South Wales. Neath Port Talbot has 14 wards in the most deprived 10% in Wales, and a further 14 in the next most deprived decile, according to the Welsh Index of Multiple Deprivation 2011.

37. The Port Talbot works employ over 4,000 staff (approximately half the steel workers in Wales).

38. Port Talbot is the area of the UK likely to be most significantly affected by a failure to achieve a good outcome for TSUK. Other areas in England and Wales would also be affected including areas of economic deprivation in comparison to the UK as a whole.

39. With 130,000 members, the BSPS is one of the largest defined benefit schemes in the UK. Unlike the majority of the UK's very large scheme, however, BSPS members are concentrated in a small number of locations, most of which are heavily dependent on the steel industry for the basis of their local economy. Even comparatively small reductions in income levels can have a disproportionate impact in already deprived communities.

40. For these reasons, the objective of this consultation is to find a solution that achieves separation of the BSPS from TSUK, subject to its funding position being strong enough to exist outside the PPF and finding a new employer willing to sponsor the scheme, whilst also achieving the best outcome for BSPS members.

41. This consultation first sets out the current regulatory framework and the actions necessary for scheme separation. It then sets out four routes through which scheme separation may be achieved.

Scheme Separation and Its Consequences

42. Tata, TSUK, and the BSPS trustees are all agreed that the best outcome is to find a way of securing the future of TSUK and that separating the BSPS from TSUK is necessary for securing a long term sustainable future for the Port Talbot business.

43. Because the BSPS is underfunded, it could not continue to operate without TSUK's support unless a new sponsoring employer was found who was willing and able to support it and pay down its deficit.

44. Equally, the scheme's financial position means that it is unlikely to be able to afford to secure as annuities the benefits currently promised to members.

45. The challenge is therefore to find a way forward that separates the scheme from TSUK whilst securing the best outcome for both members and employer. It is clear that if the scheme continues to be underfunded, and lacks a sponsoring employer, the most likely result is that the scheme will enter the Pension Protection Fund and members will receive PPF compensation payments.

46. The severity and exceptionality of the situation mean that the Government is considering a wide range of options, including proposals suggested by Tata and the BSPS, in order to ensure we find the best outcome for the steel industry, scheme members and the affected region.

The Pensions Regulator and the Pension Protection Fund

47. The kinds of problems TSUK and the BSPS are experiencing are certainly not unique – it is the scale and context that makes the situation exceptional. There are a number of standard routes TSUK could use for managing their occupational pension scheme which are available to all companies where the sponsoring employer is experiencing serious financial difficulties.

48. The Government set up the Pensions Regulator ('tPR' or 'the Regulator') to be robust, flexible and independent in this kind of difficult situation. The Regulator can help to manage negotiations between the sponsoring employer and the pension scheme, and can step in to help both parties find the best way forward.

49. In the event of employer insolvency, a pension scheme will usually enter a Pension Protection Fund (PPF) assessment period whilst the final funding position of the scheme is established. The members receive benefits at PPF compensation levels.

50. During the assessment period, the scheme's funding position is examined in detail. If the scheme has sufficient funds, member's benefits will be secured through an insurance company at or above sum the members of the scheme would otherwise receive as PPF compensation.

51. If the scheme does not have enough assets to secure members' pensions at above PPF compensation levels, the scheme will then enter the PPF, and members will receive PPF compensation. Mechanisms also exist to separate the scheme without insolvency in certain circumstances, and which potentially provide better outcomes than the PPF. These are discussed further below.

The Pensions Regulator

52. The Pensions Regulator ('the Regulator' or 'tPR') is the UK regulator of work-based pension schemes. The Regulator works with trustees, employers, pension specialists and business advisers, giving guidance on what is expected of them.

53. The Regulator's principal aim is to prevent problems from developing. The Regulator has powers to enforce the payment of liabilities by a sponsoring employer. If necessary, the Regulator also has anti-avoidance powers enabling it to act where it believes that an employer is deliberately attempting to avoid their pension obligations. Where appropriate, the Regulator has the power to pursue further financial support for a scheme from both the sponsoring employer and "associated and connected" companies within the corporate group – for example, if there is evidence that a connected company had deliberately extracted value from the sponsoring employer to push it into insolvency as a way of getting rid of the pension scheme.

54. The Regulator's objectives include:

- to protect the benefits of members of occupational pension schemes;
- to reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund (PPF);
- to maximise employer compliance with employer duties and the employment safeguards introduced by the Pensions Act 2008; and
- to minimise any adverse impact on the sustainable growth of an employer.

The Pension Protection Fund

55. The PPF is an independent 'life boat' fund established to provide mutual compensation arrangements. It helps members of private sector occupational defined benefit pension schemes who have lost their pension as a result of employer insolvency or impending insolvency. The PPF is funded by a combination of a levy on all defined benefit schemes and by taking ownership of the assets of schemes entering the PPF. The framework under which the PPF operates means

that favouring any one group will place a corresponding burden and risks on other levy payers and the PPF members.

56. The PPF pays compensation to members of DB schemes that are underfunded following the insolvency of their sponsoring employer. Compensation is based on 100 per cent of the accrued pension in payment to all those who are over their scheme's normal pension age at the date of the employer's insolvency (or to members under normal pension age who retired on ill-heath grounds). All other scheme members are paid compensation based on 90 per cent of the accrued pension, subject to a cap.

57. For those subject to the PPF cap (i.e. all those under normal pension age), the 2016 cap means that the maximum compensation that can be paid is £33,678 annually. This compares to an average annual income from a private pension of £11,440. Around 600 people are currently subject to the PPF cap.

The PPF Long Service Cap

58. In the Pensions Act 2014, the Government legislated for a long service cap. Anyone with pensionable service over 20 years will get a three per cent uplift in their cap for each full year of service above 20 years, with a new maximum of double the standard cap.

59. This means that, after the legislation is commenced, a person with 40 years pensionable service will have an increased cap of £59,872 (i.e. they cannot get more than £53,884 in compensation). Recipients of PPF compensation with a long record of pensionable service in a scheme may therefore see an increase in their compensation payments once the legislation has been commenced.

60. We estimate that 776 members of the BSPS would be affected by the current PPF cap. Of these, 665 people (85 per cent) have more than 20 years' service so would benefit from the introduction of the long service cap.

61. DWP estimate that around 500 of these individuals would not be subjected to the cap following the implementation of the three per cent uplift. The other 166 would benefit but potentially to a lesser degree.

Regulated Apportionment Agreements

62. While the best form of support for a defined benefit pension scheme is that of an on-going sponsoring employer, it is sometimes inevitable that such support may no longer be available where the employer is at serious risk of insolvency.

63. A Regulated Apportionment Agreement (RAA) allows an employer to agree an apportionment of their debt in respect of the pension scheme, and continue to trade, sometimes under new ownership, without those pension liabilities. The arrangement has to be agreed by both the Regulator and the PPF.

64. RAAs are only possible where employer insolvency seems inevitable and a scheme is already in a PPF assessment period, or is expected to enter an assessment period within 12 months.

65. Strict conditions must be met, for example the Regulator and the PPF must be satisfied -

    a. that the scheme will be significantly better off than in an insolvency;
    b. that the scheme is treated fairly alongside other stakeholders; and
    c. that a better outcome cannot otherwise be achieved for the scheme by recovering assets from a related business or party (including through the use of the Regulator's powers where relevant).

66. To protect members and PPF levy payers, the Regulator and the PPF will not agree to such arrangements lightly. However, where the conditions are met these arrangements provide a well-established and familiar mechanism for dealing with companies in financial difficulties.

Flexible Apportionment Arrangements

67. A Flexible Apportionment Arrangement (FAA) allows a sponsoring employer to exit a multi-employer pension scheme such as the BSPS without paying its full exit debts, provided other pension schemes and employers in the corporate group take over the assets and liabilities of the scheme.

68. For an FAA to be viable, the following conditions must apply:

    a. the scheme cannot be in wind up or in a PPF assessment period;
    b. the trustees must be satisfied that a PPF assessment period is unlikely to begin in the 12 months after FAA takes effect;
    c. both the departing employer and new employer(s) must be employers in relation to same scheme and both must employ (or have in the past employed) at least one active defined benefit scheme member;
    d. both the departing employer and the new employer(s) must not be subject to an insolvency event; and
    e. one or more of the new employers must take over responsibility for all of the departing employer’s liabilities, as they stand immediately before FAA takes effect.

69. Assuming the above conditions are met, before agreeing to an FAA the trustees must:
    a. be satisfied that it is in the members' best interests, (if not the trustee should consider other mitigation);
    b. consider the scheme's position after the FAA relative to its position before the arrangement takes effect, comparing the overall employer covenant prior and after the FAA; and
    c. consider requiring a part payment of a section 75 debt (or equivalent) made by or on behalf of the departing employer.

Option 1: Use existing regulatory mechanisms to separate the BSPS

70. The RAA approaches outlined above could be used, with the consent of the Regulator, to facilitate a separation of the scheme, and provide a mechanism to reduce benefits to a fully funded level. In order for an RAA approach to be successful, the agreement would need to demonstrate that the scheme is likely to be better off, or at least no worse off, than in an insolvency.

71. One possible way would be to move the scheme to a new employer, with the previous employer having no further liability. If the scheme is funded below PPF levels and the new employer cannot support the scheme, then after an insolvency event the scheme would enter the PPF. If the scheme is funded to above PPF levels then it can either buy-out at above PPF levels if funding is available, or a choice can be offered to members – to move to a new scheme with reduced benefits that are better than PPF levels, or to enter the PPF.

72. Whilst the agreement would be a matter for the Regulator, there are certain actions which Tata could take, and the Government could facilitate, in order to achieve a separation.

73. Whilst there is clearly risk in this approach, it would use existing regulatory levers to achieve separation, and would not depend on the Government making legislative change.

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

Option 2: Payment of Pension Debts

74. Under the defined benefit pension scheme funding legislation, a sponsoring employer can chose at any time to end their relationship with the scheme – even if the scheme is in deficit. However, the employer must pay to do so.

75. If an employer ends their relationship with the scheme, either as a conscious decision or as a result of insolvency, a debt is triggered. This is known as the 'employer debt'. The employer debt is calculated as the amount needed to secure the exiting employer's liabilities to the scheme on the insurance market. In other words, the employer needs to provide enough capital for the scheme to be able to buy annuities for all the employer's members equal to the value of their total accrued pension rights.

76. Companies have historically used buy-out as a way of ending their relationship with a defined benefit scheme. If a company has sufficient capital, buy-out allows a company to ensure it has removed all of its liabilities to the scheme.

77. Trustees and employers can work with the Pensions Regulator through an FAA or RAA to agree a buy-out that would secure member benefits at above PPF compensation levels but below the value of the full member benefits.

78. A buy-out at reduced benefit levels is used in situations where a sponsoring employer is seeking to sever its relationship with a scheme. A scheme's trustees can and have decided that securing benefits at above PPF compensation levels provides the best outcome for members in the circumstances.

79. When a scheme enters into the PPF assessment period, benefits will be bought out on the insurance market if the scheme has sufficient funds available to secure them at or above PPF compensation levels.

80. Tata have indicated that TSUK would not be able to make such a payment, and that - having invested £1.5 billion in capital expenditure, several billion in operational and working capital support, and not having taken a dividend - this would be unaffordable.

Option 3: Reduction of the Scheme's Liabilities Through Legislation

Reducing indexation and revaluation payable on future payment of accrued pension rights within the BSPS

81. As a part of their engagement with Government over TSUK, the BSPS and Tata approached the Government with a proposal that they believe would deliver a better outcome for most members than PPF entry whilst also allowing for a separation of the scheme from TSUK.

82. The scheme trustees have a duty to act in the best interests of the scheme members as a whole. The trustees argue the scheme is funded to above PPF levels on an on-going basis and that as a result most members would be better off if a way could be found to pay benefits outside the PPF.

83. The BSPS trustees believe that they have sufficient assets to pay members at above PPF levels of benefit on an on-going basis – in other words, the trustees believe that they could not pay members the amount of pension they were originally promised, but should be able to pay most of them the same as or more than they would receive should the scheme enter the PPF. Tata also support the proposal.

84. Tata and the BSPS trustees have asked the Government to legislate to allow them to amend the scheme rules in order to reduce the levels of indexation and revaluation payable on future payment of accrued pension rights. The trustees would reduce indexation and revaluation to the minimum level required by law.

Indexation and revaluation

Indexation refers to the annual increases in pensions once in payment.

Revaluation is the measure of inflation protection applied to the preserved pension of a member who has left the employment of the sponsoring employer, or otherwise left the scheme before retirement age.

85. The proposal would reduce the level of future inflation increases payable on all BSPS pensions in payment and deferment to a similar or slightly better level than that paid by the PPF. If adopted, this would mean that in the future existing pensioners would receive lower increases to their pensions than they would under the current scheme rules, or possibly no increases at all. Deferred members would also receive a lower increase to their preserved pension when they reached normal pension age, and would then receive the lower increases to their pension payments.

86. Because less pension would be paid to members under the proposal, the BSPS trustees believe that making these changes would improve the scheme's funding position to the point that it would no longer be in deficit on an on-going basis. It should therefore be able to continue to run on with a sponsoring employer outside the PPF, paying out pensions that were above PPF compensation levels for the majority of scheme members.

87. The Government would need to be satisfied that this indeed would be the case before legislating as proposed.

88. This approach is not without risk – which is why it is not routinely used. Although the intention would be for the scheme to take a low risk investment strategy, there is always residual longevity and investment risk, and it is possible that the scheme

would fall into deficit in the future. In the event of scheme failure, the downside risk would ultimately be covered by the PPF and its levy payers.

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

Member outcomes

89. The proposed changes to indexation and revaluation would reduce members' future pension payments in real terms. This is because the amount by which pension rights are increased in future would be reduced.

90. While the outcomes under the trustees' proposal are the same or better for most people than they would get in the PPF, they still represent a substantial loss to many members compared with the pension they would have expected.

91. PPF compensation already provides a substantial safety net for members. As a result, for many members (around 70,000 - chiefly those currently above normal retirement age) there will be little difference between the proposed reductions by the scheme and the level of benefit members receive in the PPF. However others (around 50,000 - chiefly those below normal retirement age) would see a further reduction of 10% and under 800 people could see more substantive reductions as a result of the cap on PPF compensation levels. PPF compensation is funded through a levy on other pension schemes, so there is a balance struck between the level of compensation paid to individual members and the cost to other schemes.

92. The members who would stand to benefit the most under the proposal are the 776 members of the BSPS who would be subject to the PPF cap. The majority of these

members could benefit by up to 30% under the trustees proposal by avoiding the compensation cap.

93. The Government recognises that the PPF cap bites hardest on people who have worked all their lives for one employer, so we introduced legislation in 2014 to increase the cap for individuals with over 20 years' service. Once this is implemented, around 70% of the people already subject to the PPF cap may benefit from higher PPF compensation payments.

94. In the scheme's case, the effect of implementing this legislation will be even more significant as the majority of the 776 members who would be subject to the cap have long service. The Government believes that around 665 members (85%) would benefit from the increased cap and around three quarters of these would be lifted out of the cap altogether. However there is a significant minority of high earners that would not benefit as they have fewer than 20 years' service.

95. The members who would stand to lose the most under the proposal are those members with 'high/low' bridging pensions. Because of the particular way PPF compensation payments are calculated, if the scheme were to enter the PPF these members who are still under State Pension Age would receive a compensation payment equal to the higher pre-State Pension Age amount (albeit reduced by 10%, or more if the PPF cap applies) for the remainder of their lifetime. They would not face the deduction once they reached the State Pension Age.

96. By contrast, if the scheme was to stay out of the PPF, these members would currently see their pension payments reduced by £5,408 a year once they reached State Pension Age, in line with the benefit that they have been promised from the scheme.

97. It is important to recognise the risks associated with this proposal. It presumes the existence of a sponsoring employer who is able to support the scheme in the long term, an investment strategy which will effectively manage risk in the long term, and most significantly it presumes that the scheme's current funding is sufficient to

pay the benefits once the reductions are applied. It is the PPF and the levy payers who will bear the risk for this scheme in the future.

The regulatory requirements for the BSPS Trustees’ Proposal

98. The legislative system protecting members’ defined benefit pension rights does not allow for a scheme’s trustees or sponsoring employer to reduce accrued pension rights without member consent.

99. However, pensions legislation prevents unilateral changes to member benefits in a way that is detrimental to members’ rights in the scheme.

100. Members of some defined benefit schemes have in the past consented to reductions in benefit (to above PPF compensation levels) where the alternative is PPF entry. However, the BSPS trustees have concerns about getting individual member consent to a reduction in indexation and revaluation levels. The sheer size of the scheme means that getting individual consent for a meaningful number of members would be difficult.

101. In order to make the proposed changes, the Government would therefore need to make regulations allowing the scheme to step outside the normal regulatory framework by making the changes without individual member consent.

Regulations under section 68 of the 1995 Act

102. Section 68 of the 1995 Act allows regulations to be made to enable trustees to modify a scheme by resolution with a view to achieving certain purposes. The BSPS trustees’ original proposal was for the Government to make regulations under section 68 allowing them to change their scheme rules in order to reduce members’ accrued rights. Having considered the proposal put forward, we have concluded that use of the power in section 68 in the way requested would be clearly unlawful.

Regulations under section 67 of the 1995 Act

103. Section 67 of the 1995 Pensions Act ('the subsisting rights provisions') provides that scheme rules allowing schemes to make changes can only be used in a way which affects benefits which members have accrued if:

- the changes are actuarially equivalent – this means that an actuary has certified there is no reduction in overall benefit entitlement, only in the way the benefit is paid (for example, indexation is reduced but initial pension level is increased to compensate); or
- the individual member consents.

104. It would be possible for the Government to make regulations under section 67 which would disapply section 67 for a named scheme. This would then to allow for changes to be made to a scheme's rules that would affect accrued member benefits without needing either member consent or actuarial equivalence.

105. The Government could therefore pass regulations exempting BSPS from the subsisting rights provisions insofar as would be necessary to allow an amendment to BSPS scheme rules in order to make the following changes:

a. increases to pensions in payment (indexation) from the commencement date of the rules change are only at statutory minimum levels – with statutory rates of indexation being applied to all accruals; and
b. increases to deferred pensions (revaluation) from the commencement date of the rules are only at statutory minimum levels instead of RPI – with this applying to all accruals.

106. Provided the scheme had a solvent sponsoring employer, BSPS members would therefore remain outside the PPF, and many would receive a higher income than they would in the PPF.

107. The Government is clear that in normal circumstances the level of compensation paid to individuals if their scheme enters the PPF is sufficient. There are currently 220,000 people in the PPF. We are clear that these people are

receiving a fair level of compensation for the failure of their pension scheme. While the failure of a DB pension scheme is unpleasant for members, we strongly believe that in normal circumstances entry into the PPF and PPF compensation payments is an adequate outcome.

108. However, we are also clear that there are very specific circumstances surrounding TSUK and the BSPS. It is imperative that the Government does everything in its power to support the steel industry and those directly affected by the situation at TSUK. We are therefore giving consideration to the proposal.

109. We are very clear that any regulations made under section 67 would contain safeguards to prevent TSUK from making wider changes to the members' benefits. If the decision is taken to allow TSUK to make the changes, TSUK would need to be able to make these changes quickly and in respect of all members. The proposed regulations would therefore allow the changes to be made unilaterally by the trustees and without member consent. However, the regulations would also require the BSPS trustees to agree unanimously that the changes to indexation and revaluation would be in the best interests of the scheme members. It may also be appropriate for the Pensions Regulator to agree to the changes being implemented.

110. We are aware that a number of other employers with DB schemes have raised concerns about the size of their liabilities and the possible impacts on their sustainability as a business. The Government has been exploring whether there is more we can do to ensure that the best possible outcomes are secured from the considerable sums being invested in DB pension schemes, including meeting with representatives of pension schemes, employers and the pensions industry. However, as set out above, we are also clear there are very specific circumstances surrounding TSUK and the BSPS. We are not, therefore, considering extending the proposal beyond the BSPS as a specific scheme.

Preconditions for any regulations

111. The Government is clear that we would only consider making regulations if they contained clear safeguards to ensure member protection was not further compromised.

112. In addition, we would also look to impose a series of conditions that the sponsoring employer would need to meet as a part of any agreement to facilitate a reduction in indexation and revaluation. These conditions could include:

- confirmation of who the sponsoring employer would be following any reduction in benefits;
- independent assessment of the scheme's funding following the 2016 revaluation; and
- confirmation that the scheme would close to all accruals.

113. The viability of this option remains subject to further detailed analysis of the impact on scheme members and potential safeguards that could be put in place, and whether it strikes the most appropriate balance as compared to other options.

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?

Option 4: Transfer to a New Scheme

114. This option would allow for bulk transfers without individual member consent to a new scheme paying lower levels of indexation and revaluation.

115. It is possible, and indeed not uncommon, for members of an occupational DB pension scheme to transfer out of their existing scheme and into a different scheme. This can be done individually or in bulk. A member can be transferred into a receiving scheme which offers a lower level of benefits provided the member consents to the transfer taking place.

116. The offer of a transfer to a scheme with reduced benefits has been offered to, and accepted by, members of DB schemes in the past. In an instance where the original scheme is likely to enter the PPF, members may feel that choosing to transfer to a new scheme offering benefits below those originally promised but above PPF levels is the better outcome for them.

117. Rather than reducing the indexation and revaluation on member benefits within the scheme itself, the BSPS trustees could therefore offer members the choice to transfer to a new scheme offering reduced indexation and revaluation – but with benefits above PPF levels.

118. A bulk transfer with consent has been used previously as a mechanism for managing exceptional problems around an employer and their DB scheme.

119. However, the BSPS trustees have concerns about getting individual member consent to a transfer. The sheer size of the scheme means that getting member consent for a meaningful number of members would be difficult and the transfer would only be viable if enough members consented to transfer. Setting up a new scheme and transferring members to it may also need to be done rapidly in order to facilitate a solution to the wider issues surrounding TSUK – and this would be

difficult to achieve in the necessary timescales if individual member consent to a transfer had to be achieved.

120. The Government has the power to make provision in legislation for bulk transfers without consent in prescribed circumstances. It would therefore be possible for the Government to make regulations to allow for transfers without individual consent in certain cases.

121. Members would be transferred to a new scheme paying lower levels of indexation and revaluation. The base pension (prior to inflation-linked increases) to which individual members are entitled would be the same in the scheme. However, the level of future inflation increases payable on members' pensions in payment and in deferral would be lower.

122. The new scheme could either be part of a solvent sale agreement or would need to be separated from TSUK, to allow it to run on independently with a new sponsoring employer. This separation could be achieved through existing mechanisms such as a Flexible Apportionment Arrangement, if it meets the funding test – i.e. the trustees are satisfied that it has a reasonable prospect of paying benefits when they fall due, or through a Regulated Apportionment Arrangement (RAA) or a pre-pack insolvency.

123. Members would be offered the choice not to opt out of the transfer to the new scheme. Members would be transferred automatically into a new scheme unless they chose not to be transferred.

124. The BSPS would then enter a PPF assessment period. In the circumstances that a member would in fact be better off in the PPF than the new scheme, they could therefore also benefit.

125. The member outcomes relative to the PPF would be the same as under the BSPS's proposal. However, the mechanism by which this would be achieved would be different, and would allow for an element of member choice.

The regulatory requirements for a bulk transfer

126. In order to make the proposed changes, the Government would need to make regulations under section 73 of the Pension Schemes Act 1993 amending the Occupational Pension Schemes (Preservation of Benefits) Regulations 1991. These would allow trustees to transfer a deferred member to a new scheme notwithstanding that the receiving scheme offers benefits at a lower level. Transfer of pensioner members would depend on scheme rules.

127. The Government would want to put safeguards in place. For example, we think it would appropriate to require that the trustees would only be able to transfer a member to the new scheme if:

a. the trustees considered it in the member's best interests;
b. the trustees notified the member and the member does not object within a prescribed time; and,
c. the trustees reasonably believed the scheme will enter into a PPF assessment period within 12 months.

128. In addition, we would also look to impose a series of conditions on Tata as part of any agreement to facilitate a reduction in indexation and revaluation. These conditions could include:

- confirmation of who the sponsoring employer would be following any reduction in benefits;
- independent assessment of the scheme's funding following the 2016 revaluation; and
- confirmation that the scheme would close to all accruals.

129. Where transfers are made from a scheme which was formerly contracted out of the additional state pension, there are restrictions on the type of scheme that a member may be transferred into so as to preserve the member's contracted out rights. With the ending of contracting out on the introduction of the new state pension in April 2016, it is no longer possible to create a new scheme that such members could be transferred into. Government is aware that this is an issue for BSPS and others that need to restructure pension schemes, and we are considering the best way forward.

130. The viability of this option remains subject to further detailed analysis of the impact on scheme members and potential safeguards that could be put in place, and whether it strikes the most appropriate balance as compared to other options.

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 than PPF level benefits?

High/Low Members

131. There are some BSPS members who would be better off in the PPF than they would be under the trustees' proposal for reduced indexation and revaluation levels.

132. The BSPS offers what is known as a 'high/low' pension option. If a member chooses this option, they receive a higher pension on retirement followed by a lower pension once they reach State Pension Age. The current level of deduction for members who reach State Pension Age in 2016/17 is £5,408 a year.

133. Because of the way PPF compensation payments are calculated, if the scheme were to enter the PPF those members who have chosen to receive a high/low pension and are under their State Pension Age would receive a compensation payment equal to the higher pre-State Pension Age amount for the remainder of their lifetime. They would not see an application of the deduction once they reached the State Pension Age.

134. By contrast, if the scheme was to stay out of the PPF, these members would currently see their pension payments reduced by £5,408 a year once they reached State Pension Age.

135. Around 5800 pensioners in the BSPS are in this position.

Governance of the New Scheme

Governance of the BSPS

136. The British Steel Pension Scheme (BSPS) operates as a trust. The scheme is administered by B.S. Pension Fund Trustee Limited, a corporate trustee company set up for this purpose. The assets of the Scheme are held in the name of the trustee company and, as required by law, are separate from the assets of the employers.

137. The defined benefit section of the scheme was closed to new entrants in March 2014 and since then new employees have been offered membership of the scheme's defined contribution section. TSUK Limited is the principal company which sponsors the scheme.

138. The trustee board has 14 members, seven are nominated by the company and seven are member-nominated trustees. The role of the trustees is to ensure that the scheme is run in accordance with the scheme's trust deed and rules, and the pensions legal framework. The trustees' duties are also to ensure the proper governance of the scheme and the security of members' benefits.

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

Managing the new scheme's assets and surplus

139. Fluctuations in asset values and the ways future liabilities are projected and discounted mean that an underfunded scheme can move into surplus – that is, it can have more money than it needs to pay the members' benefits. It is possible that the new successor scheme could achieve a surplus at some point in the future, as the reduction in indexation and revaluation levels would mean that the scheme's liabilities would be reduced relative to its assets compared to the BSPS.

140. It is possible in some tightly prescribed circumstances for the trustees of a defined benefit pension scheme to pay a surplus back to the scheme's sponsoring employer(s).

141. It is important to be clear, however, that should the Government decide to regulate to allow the indexation and revaluation on BSPS members' benefits to be reduced, we would not want the new successor scheme to be able to make over a surplus to the sponsoring employer.

142. Similarly, should the Government decide to regulate to allow the BSPS trustees to transfer some members to the new successor scheme without consent, we would not want the trustees to be able to make over a surplus to the sponsoring employer.

143. Should the new successor scheme achieve a surplus, we would anticipate that the trustees would either wind-up the scheme and buy-out benefits on the insurance market to ensure member security or use the extra funding to increase revaluation and indexation levels going forwards. This decision would need to be made by the trustees on the basis of providing the best interests of the members.

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

Conclusion

144. The situation around TSUK and the BSPS is a very complex one. We have set out a wide range of possible options to help manage the scheme and ensure a positive outcome for everyone concerned. Some of these options have been used successfully in the past. Others would be unique options designed solely for TSUK and the BSPS.

145. In such a complex situation, the Government needs to listen to a wide range of opinions in order to decide what course of action we should take. We are therefore seeking views on the options and proposals set out in this paper. We would welcome both answers to the specific questions posed and also wider thoughts on the ideas discussed.

146. As stated, the TSUK sale process is still underway at the time of drafting, with possible solutions to secure a future for the British steel industry still being worked through. The shape of the final outcome reached will inevitably have an impact on the future of the BSPS.

What the Draft Regulations Would Say

Disapplication of the subsisting rights provisions to the British Steel Pension Scheme Regulations (section 67)

147. These regulations would disapply the subsisting rights provisions to changes made in relation to indexation and revaluation under the BSPS Scheme Rules. This would mean that TSUK can exercise the power in the existing scheme rules to reduce levels of indexation and future revaluation to the statutory minimum without member consent. We intend to make any disapplication of the subsisting rights provisions subject to certain conditions being met to ensure member protection is not further compromised.

148. These would include requiring the BSPS trustees to agree unanimously that the changes to indexation and revaluation would be in the best interests of the scheme members. We are also considering whether it may be appropriate to make it a condition that the Pensions Regulator agrees to the changes being implemented.

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?

Transfer Regulations

149. These regulations would provide for the bulk transfer of members to a new successor scheme without member consent, but allowing for member opt out, and subject to certain conditions being met to ensure member protection is not further compromised.

150. The regulations would not just apply to BSPS, but would apply where there are schemes in similar circumstances as BSPS – where the size of the scheme makes obtaining individual consent impractical and where the transfer would be in the members' interests due to the comparison with PPF level benefits. For example, we think it would appropriate for the regulations to require that:

a. the option may only be used by very large schemes (over 100,000 members) where obtaining individual consent is impractical;
b. it could only be used in the context of an RAA happening immediately afterwards; and
c. the trustees would only be able to transfer a member to the new scheme without consent if:

   i. the trustees considered it is in the member's best interests;
   ii. the trustees notified the member and the member does not object within a specified time period;
   iii. the trustees reasonably believed the scheme will enter into a PPF assessment period within 12 months;
   iv. the only difference in benefits offered by the new scheme relates to lower indexation and revaluation levels; and,
   v. the transferring scheme transfers to the new scheme the unreduced cash equivalent transfer value (CETV) for each member transferred.

151. It may also be appropriate for TPR approval to be obtained prior to any transfer.

152. If we were to pursue this option, we would also need to amend provisions in the Contracting-out (Transfer and Transfer Payment) Regulations 1996 so that, where a transfer is made in accordance with the proposed regulations, it would be possible to transfer members from a formerly contracted-out scheme to a scheme which has never been contracted out.

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?