Options for Defined Benefit schemes

Department of Work & Pensions
Public consultation
23rd February – 19th April 2024

Response by the BP Pensioners Group (BPPG)

Summary

- The Old World, when sponsors, trustees, and members were aligned, collapsed with the closure of most UK DB schemes. We are now in a New World, where sponsors and members have opposing interests, and trustees are caught in the middle.
- Very large DB fund surpluses (currently total £359bn), and liability exit strategies, are increasingly driving corporate tactics that harm pensioners.
- The DWP Select Committee Report[1] recognised this, expressly referring to this consultation when recommending: *"DWP should conduct an assessment of the regulatory and governance framework that would be needed to ensure member benefits are safe and take steps to mitigate the risks before proceeding*."
- To prevent failure of government policy, that "*the security of member benefits should be paramount",* significant additional measures are necessary to protect members. This is now even more pressing, given Government proposals to make it easier for sponsors to extract surpluses.
- Significant additional measures are necessary in the following seven areas:

[1] Work & Pensions Select Committee report HC144 'Defined benefit pension schemes' 26Mar24, para 70

1. Expect evasion: The financial stakes are enormous and the employer-pensioner compact is over: attempts to evade will be legion. We urge ministers and TRP to consider exceptional over-arching incentives to hinder evasion of regulations and enable hard penalties for breaches (para 17(a));
2. Sharply define "… *members' benefits in full*." We urge ministers and TRP to define the baseline of "…*what pensioners can reasonably expect*…"[2] with crystal clarity (in expectation of every word and comma being scrutinised for a workaround to trim back or entirely remove every benefit possible). 17(b);
3. Discretionary cost of living awards. We propose government/TPR reliance on compliance with scheme Rules be expanded to include established custom and practice; and TPR to use its new DB Funding Code of Practice to prevent the broad principle "*adverse impact on an employer's sustainable growth*" being abused as a loophole. 17(c);
4. Fund governance. We propose: fund chairs to be independent experts and hold the casting vote; at least one-half of trustees to be member-nominated trustees; and other controls reinforcing independence from the sponsor. 17(d);
5. Sponsor company incentives. We propose: require sponsor, on surplus extraction, to take out an insurance policy covering return of the extracted money should the fund fall into deficit; and management not being personally rewarded for any surplus extraction. 17(e).
6. Fair sharing of the surplus. We propose: eligibility for the proposed 25% reduced rate of tax on extraction of funds being contingent on

[2] https://hansard.parliament.uk/Lords/2004-09-09/debates/f41794cd-95c7-46e9-8e2f-bf2906dd0049/OfficialReportOfTheGrandCommitteeOnThePensionsBill?highlight=september%202004

first making good eroded benefits; and extracted funds matched by simultaneous fair benefits to members – with fairness enforced via member's agreement to the formula via 66% majority vote. 17(f);

7. Involvement of beneficiaries. We urge ministers and TRP not to rely solely on pensions law and fiduciary duty, but to require that the members be explicitly involved. We suggest how. 17(g).

- In this context, on the specific questions raised by this consultation our responses are restricted to Chapter 1:
    - Statutory override: (Q1-5). Members are best served by the surplus being used to reinstate eroded benefits. If surplus extraction is enabled by law, it will not be in the best interests of the members unless explicitly constrained via compliance with unambiguous regulations with fairness enforced e.g. eligibility for the proposed 25% reduced rate of tax on extraction of funds being contingent on first making good eroded benefits; extraction contingent on members' explicit support; and material changes to fund governance requirements.
    - Taxation (Q6-7): We suggest that one-off payments to members be redefined as authorised member payments for tax purposes.
    - Safeguards for members' benefits (Q8-10): Of the listed options, we favour the low dependency funding basis plus a fixed margin e.g. 105% of the low dependency basis + insurance: the sponsor being required to take out commercial market insurance (not 'self-insurance' or a covenant), covering reimbursement of the fund with all extracted money (plus interest) if the funding ratio falls below the LD funding level or 100%. We also favour a separate TRP code and material changes to fund governance requirements.
    - Alternative safeguard: 100% PPF underpin. (Q11-14): No response

Context

1. This response is made on behalf of the BPPG, a group of over 2,900 members and beneficiaries of BP's primary UK Defined Benefits (DB) pension scheme. The BPPG was formed in May 2023 in reaction to BP's changed approach to its UK pensioners and has grown by word of mouth since.
2. This response is from members of the BP pension scheme. But it aims to provide a foretaste of what many UK DB pensioners can expect in future.
3. There are 8.9m UK DB pensioners, in 5,051 schemes, with total assets of £1,404bn, liabilities of £1,045: a technical surplus of £359bn[3].
4. The BP scheme has some 59,000 members, incl. some 14,000 in their 80s and 90s[4]. It has been closed to new members since 2010, and to existing member accruals since 2021. The scheme's average pension is £16,700 pa[5]. The scheme has current assets of £20bn[6] and has a £5bn surplus[7].

Issues:

5. The UK private sector DB landscape is going through profound change, evident from the closure of UK DB schemes to new members now reaching 88%[ibid]. This transition is recognised by government, and TPR as a "*moment of change*"[8], and measures are being taken to achieve an orderly evolution[9].

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3 The Purple Book 2023

4 BP Pension Fund - Trustee's Annual Report and Financial Statements 31Dec22 p10

5 Benefits paid (BP Pension Fund - Trustee's Annual Report and Financial Statements 31Dec22 p24) / no. pensioners + dependents (p10)

6 BP Annual Report 2023 s24 p216 - $26.0bn (UK) converted at 1$ = £0.79

7 The $26.0bn fair value of the UK assets minus the $19.6bn future UK benefit obligations at 1$ = £0.79

8 Nausicaa Delfas, CEO TPR, speech 12Mar24

9 Including DWP's Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2024, and TPR's General Code & Funding Code

6. However, severe unintended consequences for members are emerging – driven by the collapse of decades-old employer-pensioner compacts and accelerated by sponsors eyeing the prize of massive DB fund surpluses, currently £359bn (technical basis).
7. How has the employer-pensioner compact collapsed? In the Old World, for decades DB pensions were an integral part of many private sector employment contracts. Good DB funds were seen as corporate assets and an essential tool to attract and retain the best talent.
8. Sponsor companies supported their fund(s) and discretionary promises, as part of employment terms / offer, and paid what was essentially 'deferred salary' into the fund. This meant that, in practice, employees accepted a lower salary (typically discounted by 20%) throughout long careers. In addition, many employees were encouraged to augment their company DB pension entitlement by 'salary sacrifice' of up to 15% of gross salary or via AVC contributions. In the case of mergers and acquisitions[10] the employees of acquired companies generally chose to join the acquirer's DB scheme. Fund trustees tended to be experienced and have DB pensions themselves.
9. But this decades-old employer-pensioner compact has collapsed. The scale of this reversal cannot be over-emphasised. In this New World, having closed their DB pension funds to new entrants, many sponsor companies now view them very differently – either as liabilities on their balance sheets or as assets with surpluses that might be captured for the benefit of shareholders and executive reward. So the fate of DB pension funds is to be dealt with/disposed of at the least cost.
10. Sponsors' corporate behaviours in this New World are those that inevitably come with managing liabilities: drive down the costs, drive up the exit profit

[10] E.g. Amoco UK and Britoil staff on absorption into BP

and cash. These behaviours are already having severe consequences for pensioners. For example, BP now:

i. uses veto powers over their pension funds to minimise all payments to members[11];
ii. strives to swell the surplus at every opportunity;
iii. aims to avoid a penny of funding payments ever again (Low Dependency is being implemented as Zero Dependency)[12];
iv. refuses to deny plans to wind-up their fund via a BuyOut;
v. wants 100% of the surplus[13]; and
vi. are already crediting their plc accounts with 100% of fund surpluses (despite accounting standards making this contingent on an unconditional right to any refund of surplus)[14].

11. This collapse of the employer-pensioner compact is increasingly putting fund trustees under stress. Their fiduciary duty to act in the best interests of the members is now in conflict with the actions and aims of their sponsor company. Company nominated directors/trustees (CNDs) in particular may feel unable to challenge, especially if remaining checks and balances are reduced[15]. It can be extremely difficult for trustees to effectively challenge a parsimonious sponsor, whilst maintaining good working and personal

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[11] BP has made plain, including by veto, that no discretionary payments will ever again be made by the Fund, regardless of promises over decades. This has already resulted in 42,000 BP DB pensioners (pensions in payment, average £16,700 pa) being deprived of 11% of their expected pensions – in perpetuity. That money, over £1bn, is now in the surplus and credited to BP plc accounts.

[12] In 2020, actuaries Mercer wrote, in the 3-year Actuarial Valuation Report, that the BP Fund was substantially hedged against inflation and interest rate uncertainties. However, BP's CFO has now claimed (Information Session, 20Feb24) that the possibility of adverse future circumstances over the next 55 years to 2080 means that 100% of the surplus must be retained in the Fund instead of a portion being used to protect the real value of member pensions at a time of exceptional inflation.

[13] The BP fund Deed provides for sharing the surplus between beneficiaries and sponsor – subject to BP veto.

[14] The relevant accounting standards are IAS19 & IFRIC14 – which require that the company has an unconditional right to a refund of surplus for it be recognised in full. Where the Company does not have an unconditional right to a future refund of the surplus, recognition in plc accounts must be restricted to nil. Note that BP fund Rules say extraction on wind-up is conditional on company veto of any trustee proposal to share w/beneficiaries.

[15] At the time of the first crucial decision, in early 2022, not to seek BP's consent for a discretionary inflation award, four CNDs were BP employees and the chair was an ex-BP NED. Their average CND tenure was 1 year 5 months, and among them were three recent hires and two US citizens - none with a DB pension. The previous CNDs may have been better able to grapple with these decisions and pressures - having over 10 years' average experience, and all having DB pensions. They all stepped down as CNDs in the prior 3 years.

relationships and fulfilling their fiduciary duty, when such large sums of money are in play. Proper fund governance is at risk.

12. The above examples (and footnotes) illustrate the lengths sponsors such as BP are already going to, to manage their DB funds as liabilities and credit the maximum possible profit and cash on exit, to their plc accounts. Given that these companies are blue-chip UK corporate leaders, it is inevitable that they are being seen as the blueprints for the other 5,051 DB fund sponsor companies – and will be copied. The losers are already, and will increasingly be, the UK's 9 million DB members.
13. The W&P Select Committee Report[ibid] recognised this, expressly referring to this consultation when recommending: *"DWP should conduct an assessment of the regulatory and governance framework that would be needed to ensure member benefits are safe and take steps to mitigate the risks before proceeding*."
14. The proposals in this consultation are to make it easier for sponsor companies to access DB fund surpluses. The proposals increase sponsors' incentive to do so. Based on what is already happening, and the enormous prize of accessing the DB fund surpluses, we support the Select Committee's recommendation and believe that the proposals outlined in this consultation will, unless powerful counter-incentives are put in place, enable practices like those in the examples above to proliferate and lead to many of the UK's 5,051 DB pension schemes failing to provide members with the pensions they are expecting. This would be a failure of the government's primary DB policy objective[16].
15. The BPPG, and probably the 8.9m UK DB pensioners, absolutely agree with ministers when they say, for example, "*the security of member benefits*

[16] Ministerial foreword, Options for Defined Benefit schemes, 23-Feb-24 https://www.gov.uk/government/consultations/options-for-defined-benefit-schemes/options-for-defined-benefit-schemes

should be paramount in any major reform of the pensions landscape"[17], and "*the primary purpose of a defined benefit pension is to pay the promised benefits in full*" [ibid].

16. However, the surplus prize is so large that intense lobbying (incl. via responses to this consultation) is inevitable, and enormous resources and pressures will be deployed to find ways around all regulations and laws intended to protect members – to the gain of sponsors and the financial services industry, and to the disbenefit of members.

17. Recently TPR and Ministers confirmed their view that the interests of scheme members should remain paramount, and decisions should be made by trustees in line with their fiduciary duties. Nausicaa Delfas, Chief Executive of TPR, said the prime focus for both the regulator and trustees was to protect savers' interests[18]. Therefore, if the policy intent of "… *allow[ing] the opportunity to share any surplus resources of the scheme between members as well as sponsoring employers*[19]" is to succeed and not be deflected at every turn, **we urge ministers & TPR to significantly enhance controls in the following seven areas**:

    a. Expect evasion. Given the incentive of the large surpluses (less than the technical surplus total of £359bn but still substantial) and collapse of the compact, it is inevitable that sponsor companies and the financial services industry will invest enormous resources and leave no stone unturned as they search for ways through and around the regulations to maximise their gain, however well-intentioned and carefully drafted the regulations are. The measures proposed in this consultation further increase incentives on sponsor companies and

[17] Consultation introduction para 3 https://www.gov.uk/government/consultations/options-for-defined-benefit-schemes/options-for-defined-benefit-schemes
[18] Work & Pensions Select Committee report HC144 'Defined benefit pension schemes' 26Mar24 - para 95
[19] Minister Paul Maynard letter to Sir Stephen Timms, February 2024

the industry and reduce barriers. We urge ministers and TRP to consider exceptional over-arching incentives to hinder such evasion and enable hard penalties for breaches.

b. Sharply define "members' benefits in full". Core to government pensions policy is "… *ensuring that scheme members can be confident they will get the benefits they were promised and have worked hard for*"[20]. Scheme liabilities are grounded on "*The amount needed to pay members' benefits in full*"[21]. But this is not solid ground. We are already seeing sponsor companies finding imaginative ways to redefine member benefits. Their logic is relentless: drive the benefits down - and so to swell the surplus, reduce the cost of BuyOut, and pocket the largest possible amount of remaining cash. The spotlight is currently on discretionary cost of living awards (17(c) below). But most schemes' Deeds and Rules can be expected to include numerous items including e.g. unmarried dependents' pensions, children's pensions, disabled dependents' terms, death in service etc., which will inevitably be trimmed back or entirely removed upon transfer to the insurer (there are likely many other discretionary items in scheme Deeds and Rules that don't actually use the word 'discretion'). The Minister has emphasised that it is "*particularly important that funding standards are crystal clear*" [ibid]. We urge ministers and TRP to define the baseline of "…*what pensioners can reasonably expect*…"[22] with crystal clarity (in expectation of every word and comma being scrutinised for a workaround) and not to rely on the courts or the Ombudsman to resolve disputes – because the 9

[20] Minister's foreword, Government response: The draft Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2023, 29Jan24
[21] TPR, Understanding the different ways of valuing a defined benefit (DB) scheme, Mar21
[22] https://hansard.parliament.uk/Lords/2004-09-09/debates/f41794cd-95c7-46e9-8e2f-bf2906dd0049/OfficialReportOfTheGrandCommitteeOnThePensionsBill?highlight=september%202004

million DB beneficiaries are set up to be victims, having little power, little money, and generally not organised or pension experts.

c. <u>Discretionary cost of living awards</u>. This is about the requirement to increase pensions in line with the cost of living, up to 5% after which sponsor company consent is required (the 'discretionary award'). This was intended, via the 5% then 2.5%, to protect weak sponsor companies in times of high inflation. But, with the collapse of the compact, this well-intentioned government policy has been turned on its head and the 5%/2.5% now increasingly widely referred to as a hard 'cap' – above which no award can be made. The Minister has noted that "*Although schemes must provide at least the statutory minimum, they can provide for more generous increases, and if scheme rules provide for more generous increases, those must continue to be paid …. such discretionary increases are paid is a matter for the scheme trustees and the sponsoring employer*" [ibid]. The Minister also said "… *the Government's role is to ensure that the fundamental promise of the defined benefit scheme, as set out in the scheme rules, is met"*[ibid]. At issue here is the government's, and TPR's, reliance on the scheme Rules, when they may differ from practice and assurances given to employees over decades by employment brochures and retirement guides etc.[23]. The recent W&P Select Committee report recommended that "*DWP and TPR should explore ways to ensure that scheme members' reasonable expectations for benefit enhancement are met, particularly where there has been a history of discretionary increases*"[24]. We foresee

[23] For example, BPPS Freedom of Choice Guide for Members 1992 stated that, despite the 5% guarantee in the Rules "*the Trustee, with the agreement of the Company ….intend to follow a policy of increasing pensions in line with the cost of living … provided the Fund has sufficient resources…*". BP is now quoting this as a 5% cap.
[24] Work & Pensions Select Committee report HC144 'Defined benefit pension schemes' 26Mar24 - para 89.

sponsors and trustees using this government-endorsed reliance on scheme Rules, with disregard of decades of promises, as a tool to get rid of discretionary cost of living increases forever. This could, of course, be left to the courts to decide: what they have termed "*reasonable expectations of members*" as a "*relevant factor*" that should be taken into account when trustees or sponsors make decisions. However, this is a time consuming and expensive process, so will likely not help most of the 8.9 million DB pensioners who may well be the losers from this corporate greed. We propose that options to re-establish equity between members and sponsors should include:

i. the government/TPR reliance on compliance with scheme Rules to be expanded to include established custom and practice, and this to apply in annual awards and in Low Dependency and BuyOut terms; and
ii. TPR's key funding principles require a reasonable balance between the need to pay promised benefits and minimising any adverse impact on an employer's sustainable growth. We recognise that *"… a strong and solvent employer is crucial because it provides scheme members the best possible protections*"[25] but we urge TPR to use its new DB Funding Code of Practice to prevent abuse of this broad principle (*"adverse impact on an employer's sustainable growth*" being a loophole open to self-serving interpretation by extremely strong and solvent sponsors vetoing fully funded discretionary rises in order to swell the surplus to their gain).

[25] Minister Paul Maynard letter to Mr NC Coleman, ref MC2024/03354, 1Feb24

d. Fund governance. Ministers have noted that *"All trustees, no matter whether they are employer-nominated, or member-nominated, must comply with the rules of the scheme and have a duty to act in the best interests of their members at all times[26]"* and *"TPR can remove and replace trustees with an independent trustee, or add an independent trustee to a board, should it have concerns about the existing trustees' capability or behaviour"* [ibid]. Given the diametrically opposed interests of sponsors and members in this New World, with the trustees stuck in the middle and often conflicted, we are increasingly sceptical that existing controls are sufficient to assure the protection of members[27], let alone if these proposals are passed. We urge ministers and TPR to reinforce scheme governance controls, via the TRP code of practice, to embed new incentives and sanctions on trustees so that proper primacy of members' interests has a chance despite the tectonic shift to the New World. We propose:

   i. Appointment and role of the chair[28]: to be a professional expert, on TRP's independent trustee register, not associated with the sponsor or a fund beneficiary - and to hold the casting vote;

   ii. Arrangements for member-nominated trustee appointments[29]: at least one-half of trustees to be member-nominated trustees (MNDs); and

[26] Minister Paul Maynard MP's letter to Dr Ben Spencer MP 27-Feb-24

[27] BP has had the same independent trustee for the last 27 years, including the recent period of going back on decades of discretionary award promises.

[28] https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice/the-governing-body/board-structure-and-activities/appointment-and-role-of-the-chair

[29] https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice/the-governing-body/board-structure-and-activities/arrangements-for-member-nominated-trustee-appointments

iii. Role of the governing body[30]: regulatory requirement for trustees to provide proof of acting independently, with suspension (then disqualification on repeat offence) of trustee directors if failing to act demonstrably independently of the sponsor.

e. Sponsor company incentives. Powerful incentives already exist for sponsor companies to reduce members' benefits and maximise the surplus. These are already being exploited e.g. booking the surplus to sponsor plc accounts (via interpretation of accounting rules[ibid]). The recent tax change proposal and proposals in this consultation further increase these incentives. We suggest that powerful counter-incentives be put in place to balance this. For example:

   i. should these surplus extraction proposals become law, and sponsors extract substantial portions of the surplus, and then economic conditions change… the funds could need support despite Low Dependency requirements. Rather than expect years of negotiations resulting eventually in reluctant re-funding spread over, say, another 5 years, there should be a requirement for the sponsor to take out an insurance policy, where the insurer immediately reimburses the Fund with extracted money (plus interest) if the funding ratio falls below, for example, the LD level. This should apply, regardless of the status of the Employer Covenant, until any BuyOut is completed; and

   ii. executive management in the sponsor can stand to gain personally, via their performance contract terms, from surplus

[30] https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice/the-governing-body/board-structure-and-activities/role-of-the-governing-body

extraction. To prevent such incentives, sponsor company management should be prohibited from being rewarded for any surplus extraction.

f. Fair sharing of the surplus with members. The government's primary aim in these measures is to "… *[make] it easier to share scheme surplus with employers and scheme members*"[31]. This is a sensible and equitable aim. However, sponsors will inevitably lay claim to 100% of any extracted surplus, emphasising their funding of the scheme, despite it being an employment contract obligation with likely extensive funding holidays. Members will have contributed too: via employee foregone salary (typically 20% in BP's case) in the promise of an index-linked pension, by electing to transfer-in from other schemes on merger/acquisition, by remaining in the fund on retirement (when they could have transferred-out tax-free), and often investing heavily in salary sacrifice and AVCs (max 15% of salary). Nevertheless, the sponsor company will likely, as some are already doing, demand every penny of any surplus extracted. We suggest:
   i. as set out in 17(b) and 17(c) above, eligibility for the differential rate of Authorised Payments Tax Charge under s207 of the Finance Act 2004 (currently being reduced from 35% to 25% in the Budget) be contingent on making good all erosion of discretionary awards incl. full cost of living linkage of pension increments.
   ii. to comply with the government's primary aim, a legal requirement that any extraction of funds by sponsor companies be matched by simultaneous fair benefits to

[31] This DWP consultation: Options for Defined Benefit schemes, 23-Feb-24, para 21

members – with fairness enforced via member's agreement to the formula being required by 66% majority vote, or similar.

g. Involvement of beneficiaries. Pension scheme members have much at stake in the reforms set out in this consultation. Indeed, the most at stake. But, apart from this submission, they do not have a voice. They do not have any decision powers. There is no UK pensioner's representative body. Pensioners rely on trustees (who are now deeply conflicted) and on MNDs (who can be required to keep in line with the majority CND or be out-voted anyway). We urge ministers and TRP not to rely solely on pensions law and fiduciary duty, but to require that the members be explicitly involved: via mandatory consultation and in key decisions via votes. For example:
    i. via 66% member vote required on any rebate to the sponsor company;
    ii. via consultation and 66% vote on approval of a BuyOut – given the effort being deployed to redefine members' pension benefits down; and
    iii. via mandatory consultation and vote on any changes to scheme Deed and Rules akin to the process used in company law requiring Special Resolutions for changes to company Articles.

BPPG responses to consultation questions

Chapter 1: Treatment of scheme surplus

Statutory override

Members are best served by the surplus being used to reinstate eroded benefits. If surplus extraction is enabled by law, it will not be in the best interests of the members unless explicitly constrained via compliance with unambiguous regulations with fairness enforced e.g. contingent on members' explicit support.

As noted above, in the Old World trustees were aligned with the sponsor company. But with the breakdown of the compact, in the New World trustees can now be deeply conflicted. Especially the CNDs. Pressures to follow the lead of the sponsor company can already be intense - as set out in 17(d) 'Fund governance'. In addition, a CND's assignment is likely a part-time job, with their main job and long-term career still dependent on their employer – the sponsor. Furthermore, an indication from the sponsor that a BuyOut is favoured could well add pressure to get on with it and not to stand up firmly for the members.

The only current counter-balancing pressures to do the right thing for the beneficiaries are CNDs' fiduciary duty under law and regulations, and the possibility of TPR investigation – all of which they may well perceive as less tangible.

We see a clear need to re-balance these pressures on CNDs by reinforcing with powerful incentives their duty to serve the best interests of members, combined with severe penalties for not doing so. Similarly, MNDs are likely a minority, and may see little point in standing up for the members when inevitably out-voted by CNDs.

In 17(d) 'Fund governance' we propose appropriate adjustments to fund boards.

<u>Question 1</u>: Would a statutory override encourage sharing of scheme surplus?

We note the government's primary aim in these proposed measures: "*…making it easier to share scheme surplus with employers and scheme members*."[32]

However, as set out above, sponsor companies are already in action, intent on maximising the surplus by preventing its use to protect the value of pensions from inflation, and then extracting 100% of the surplus sooner or later. Some, such as BP, are devoting considerable effort to avoiding even one penny of the surplus being used, in perpetuity, for the benefit of members[33]. An unfettered statutory override would exacerbate this demand.

Therefore, absent an explicit, unambiguous, regulatory requirement to share, a statutory override would <u>not</u> encourage sharing of scheme surplus.

It follows that, if unfettered, a statutory override is not in the best interests of the members. Moreover, it would be unnecessary, interfering with the freedom for trustees to act in the best interests of their members, adding further pressure on CNDs to favour sponsors over members, and would give

[32] This consultation: Options for Defined Benefit schemes, 23Feb24, para 21, Government's aims

[33] BP's CFO has now claimed (Information Session, 20Feb24) that the possibility of adverse future circumstances over the next 55 years to 2080 means that 100% of the surplus must be retained in the Fund instead of a portion ever being shared with members. However, BP has simultaneously credit 100% of the surplus to its plc accounts.

trustees a rationale for complying with the wishes of sponsors – even to the detriment of members.

For a statutory override to meet the government's primary aim of "…*making it easier to share scheme surplus with employers and scheme members*." [ibid], compliance with explicit, unambiguous, regulations will be necessary. We suggest: (building on the Select Committee's recommendation) eligibility for the proposed 25% reduced rate of tax on extraction of funds being contingent on first making good eroded benefits; and any extraction of funds by sponsor companies be matched by simultaneous fair benefits to members – with fairness enforced via member's agreement to the formula being required by 66% majority vote, or by an equivalent percentage.

<u>Question 2</u>: What is the appropriate balance of powers between trustees and employers? Should a statutory override allow trustees to amend scheme rules around surplus at their sole discretion, or should such amendments be contingent on an agreement between trustees and the sponsoring employer?

The appropriate balance of powers between trustees and employers is one in which the trustees act in the best interests of the members and are not swayed by explicit or implicit pressure from employers/sponsors.

But, in this New World, given the powerful incentives on the sponsor to maximise and extract the surplus, the very difficult position the trustees are now in, and the almost non-existent powers of the members, we feel it is imperative that the balance of powers is reinforced in favour of the trustees – combined with emphasising their prime role of acting in the best interests of the pension scheme members.

I.e. a statutory override should allow trustees to amend scheme Rules around surplus only at the Trustee's sole discretion. We are convinced that the alternative option of making such amendments contingent on agreement between trustees and the sponsoring employer would, given recent corporate behaviours, not be in the members' best interests.

However, this alone will not be enough to assure decisions are in the best interests of the members. Therefore, we propose that any changes to the Deed and Rules, including the rules around surplus extraction, being made by the trustees under these proposals should be demonstrably in the best interests of the members - and contingent on member's agreement by 66% majority vote (akin to the process used in company law requiring Special Resolutions for changes to company Articles).

These proposals should also, as soon as possible, be reinforced by the changes in set out in 17(d) 'Fund governance' above.

Question 3: If the government were to introduce a statutory override aimed at allowing schemes to share surplus with sponsoring employers, should it do so by introducing a statutory power to amend scheme rules or by introducing a statutory power to make payments?

Given the powerful incentives already on the sponsor, in this New World, to maximise and extract the surplus (and recent corporate behaviours), we are convinced that the former option, introducing a statutory power to amend scheme rules, would be too open to abuse: in general the outcomes would likely result in changes that favour the company, and highly unlikely to be in the best interests of members.

The latter option, introducing a statutory power to make payments, is more in the interests of members – provided it is framed properly. What do we mean by this? As per 17(a) ‘Expect evasion’ (above), given the enormous scale of the prize, sponsor companies and the financial services industry can be confidently expected to marshal an army of accountants and lawyers to find self-serving ways through and around regulations. Therefore, we urge ministers and TRP to make any laws and regulations governing extraction of a surplus highly prescriptive, and even self-policing e.g. include a legal requirement that any extraction of funds by sponsor companies be matched by equivalent fair benefits to members – with fairness enforced via member’s agreement to the formula being required by 66% majority vote.

Again, these proposals should also, as soon as possible, be reinforced by the changes set out in 17(d) ‘Fund governance’ above.

Question 4: Should the government introduce a statutory power for trustees to amend rules to enable one-off payments to be made to scheme members, or do schemes already have sufficient powers to make one-off payments?

Our preference is for the surplus to be used to reinstate eroded benefits. Mechanisms exist for this but, despite affordability confirmed by actuaries, in this New World sponsors are blocking such actions - see 17(c) ‘Discretionary cost of living awards’ above.

Given that many schemes’ Deeds and Rules may prohibit lump sum payments to members, and the government’s policy intent of “… *allow[ing] the opportunity to share any surplus resources of the scheme between members as well as sponsoring employers”*[34], should the proposals in this consultation

[34] Minister Paul Maynard MP’s letter to Sir Stephen Timms MP, February 2024

come about then clearly a statutory power is required for trustees to amend Rules to enable one-off payments to be made to scheme members.

However, given the very difficult position of trustees in this New World and the pressures that can be put on by the sponsor company, any changes to the Rules around surplus being made by the trustees may end up biased in favour of the sponsor company despite their fiduciary duty. Therefore, any Deed/Rules changes being under these proposals should be contingent on member's agreement by 66% majority vote (akin to the process used in company law requiring Special Resolutions for changes to Articles).

A final concern is that one-off payments to members could be used to 'bribe' members into agreeing to surplus extraction by the sponsor, that is one-sided – i.e the sponsor benefits disproportionately. Without clear rules imposed by the regulator, members will have no mechanism to negotiate and, even with a vote on any such proposal, no effective way to guarantee against a less than fair deal. This risk could be mitigated by the changes set out in 17(d) 'Fund governance' above.

Question 5: What impact, if any, would additional flexibilities around sharing of surplus have on the insurance buyout market?

Our preference is for the surplus to be used to reinstate eroded benefits. Mechanisms exist for this but, despite affordability confirmed by actuaries, in this New World sponsors are blocking such actions - see 17(c) 'Discretionary payments' above. If a requirement to reinstate eroded benefits to restore inflation protection were imposed before surpluses can be extracted, we believe that the restored benefits would be affordable within the buy-out insurance market considering the long view of interest rates and being able to hedge against shorter-term risks.

Taxation

Question 6: What changes to the tax regime would support schemes in delivering surpluses to distribute as enhanced benefits?

In order to simplify the process under which trustees can make one-off payments to members, we suggest that one-off payments to members be redefined as authorised member payments for tax purposes[35].

Question 7: Are there any other alternative options or issues the government should consider around the treatment of scheme surplus?

We have no further points on taxation.

Safeguards for member benefits

Question 8: Under what combination of these criteria should surplus extraction be permitted? If you feel alternative criteria should apply, what are they?

Given the now-common reluctance to grant any discretionary increases above the minimum guaranteed by scheme Deeds and Rules, there is a need to protect the discretionary element of schemes and enhance index linkage before a surplus can be distributed to the employer. We would therefore urge that eligibility for the proposed 25% reduced rate of tax on extraction of funds being contingent on first making good eroded benefits.

If we must choose between the other options proposed, we favour the first option: low dependency funding basis plus a fixed margin e.g. 105% of the low dependency basis + insurance. This is much the same as the third option

[35] https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm131000

(covenant requirement) but an insurance contract avoids the problems of a covenant being challenging to quantify and changing over time. We see the second option (variable margin based on investment risk) is more prone to manipulation / gaming in its interrelationship with the Low-Dependency funding itself.

Insurance: we foresee a material risk that economic conditions will change one day, and the funds need financial support. Given that sponsor companies are, and increasingly will be, determined never to put a penny more into their DB fund(s), when those funds fall below the LD level or 100% funding, protracted negotiations can be expected, perhaps lasting years and reaching the courts, before a reluctant re-funding over, say, another 5 years, is agreed. Therefore, we urge ministers to require that, on any extraction of funds from a surplus, the sponsor is required to take out commercial market insurance (not 'self-insurance'), with the insurer contracted to reimburse the fund with all extracted money (plus interest) as the first recourse if the funding ratio falls below the LD funding level or 100%. If the insurer pay-out is not sufficient to keep the funding level above 100%, then sponsor funds will be required as normal (though extreme reluctance can be expected).

This requirement to insure would also hedge against the level of investment risk and the strength of the sponsoring employer having a significant bearing on what level of surplus is 'safe' to extract.

<u>Question 9</u>: What form of guidance for trustees around surplus extraction would be most appropriate and provide the greatest confidence?

We favour introducing a separate code on surplus extraction, a stand-alone code of practice carrying more weight, as it would be harder to circumvent than TPR guidance and would engender greater confidence to trustees to share the benefits of strong investment returns with employers and members.

Question 10: What might remain to prevent trustees from sharing surplus?

We are sceptical that normal regulatory controls will be sufficient to assure the protection of members in the in the New World of lost compact, corporate greed and the massive incentive of extracting the surpluses.

We urge ministers and TPR to reinforce these controls to embed new incentives and sanctions on trustees to afford proper primacy to members' interests. Examples are set out in 17(d) 'Fund governance' above.

Alternative safeguard: 100% PPF underpin

Questions 11-14
No BPPG response

Chapter 2: Model for a public sector consolidator

Questions 15-40
No BPPG response

Chapter 3: Potential take-up and impacts

Questions 41-49
No BPPG response

Regards

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