Patrick Hosking

The battle to come over bulging pensions funds' surplus billions

By any measure, it's a fair-sized wad of money, £359 billion. That's one official estimate of the aggregate net surplus that has recently built up in the nation's 5,000 traditional pension schemes. It amounts to an average of £72 million per scheme, skewed heavily to the bigger ones, obviously.

No wonder employers and their advisers and shareholders are starting to wonder whether they might be able to get their hands on some of it. Equally, the nine million members of private sector defined-benefit schemes (DB), many of them hit by the cost of living squeeze, are hoping some of this excess might be channelled their way.

A consultation looking at ways these surpluses could be accessed closed last week. The government is proposing measures to make it easier for employers to bag them. They include a so-called statutory over-ride which would trump the rules of the many schemes that currently make surplus clawback impossible, as well as a reduction on the tax payable from 35 per cent to 25 per cent.

It's all part of the chancellor Jeremy Hunt's plan to get more pension fund money going into productive investment in the UK rather than retreating to gilts. The cash going back to employers could in theory be used for new capital investment. The reforms might also encourage employers to "run on" their schemes — and therefore switch to a more productive asset mix.

Those hopes look a bit forlorn. The sponsors of the biggest DB schemes tend to be mature companies with their fast-growing years behind them. They are far more wedded to share buybacks and dividends than innovative new capital investment. After struggling with deficits for years, they tend to see their DB schemes as tiresome legacy issues. Many can't wait to park them with a willing insurer through a buy-out deal and walk away.

One question is how real these surpluses are anyway. Assumptions about yields, inflation and life expectancy going decades into the future can lead to violent swings in the present-day values put on liabilities and therefore in the perceived health of DB schemes.

Everyone at least pays lip service to the notion that meeting pension promises in full is paramount. No surplus should be touched without a meaty asset buffer being built up. No sponsor should be allowed to extract cash without showing a strong covenant — providing reassurance that it will still be around to pick up the pieces if things go wrong.

But even those safeguards aren't nearly enough to fully protect members, according to a trenchantly argued submission from a ginger group of BP pension fund members, the BP Pensioners Group. Attempts by employers to evade their promises will be "legion" it says; they will "trim back or remove any benefit possible"; they will "abuse loopholes" in the rules to maximise their clawbacks. They will push hard to minimise what members should "reasonably expect".

It also warned that the prospect of executive bonuses being fattened up by success in grabbing back surpluses will be far more potent in driving company behaviour than any residual feeling of responsibility to ensure schemes pay every last penny of promised pensions. The message is that it could all end up in an unseemly scramble.

The 2,900-member BPPG has form. It has been battling BP ever since the oil company decided not to use its discretion to award extra cost of living increases to pensioners. It accuses BP of breaking a past promise to use its discretion so long as the scheme can afford it — which it can: it is £5 billion in surplus. BP has argued that favouring UK pensioners in this way would be unfair on staff in other countries.

The bitter dispute with BP is just "a foretaste" of how relations between many other DB pension fund members and their former employers are going to sour if the surplus-grabbing reforms are pushed through without proper safeguards, BPPG argues. The old world is dead.

The traditional "compact" between employers and pensioners has already collapsed, now that almost all private sector DB schemes in the country have closed to new members and new accrual. Relations are set to get uglier still if employers push too aggressively to access that potential £359 billion prize. The fiduciary duty to act in the best interests of members is now in conflict with goals of the sponsoring employer.

BPPG is unusual in being noisy, articulate and well connected. It has the ear of MPs on the work and pensions committee and has even raised £80,000 to take BP to court. It argues persuasively that governance of schemes needs to be strengthened to fend off the predations of over-eager employers. That means a majority of member-nominated trustees on the board and an independent chair. It's hard to disagree that trustee boards will need more backbone in the face of potentially very strong pressure to disgorge. There also needs to be far more transparency.

Employer attitudes to the DB schemes they once bent over backwards to support are hardening. A string of top UK employers including Pfizer, American Express and KPMG are refusing to use their discretion to lift some former employees' pensions in line with inflation.

Fifty per cent of DB schemes are now so well funded they could do an insurance company buy-out and still have spare cash left to return to the sponsor, according to new figures from the Pensions Regulator on Wednesday. If the reforms go through and shareholders start to sniff an easy windfall, the tiny trickle of pension surpluses returned to employers (just £180 million worth in the past five years) could turn into a torrent.

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The BP pensioners' group believes bosses "will abuse loopholes"

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