Written evidence from WH Brignall (PPF0096)

BACKGROUND
I retired from British Steel/Corus in 2005 having worked for the company for over 36 years with considerable knowledge of the company having worked in Corby, Ebbw Vale, Port Talbot and Sheffield. From this background and experience I make the following comments based on the experience of the British Steel Pension Scheme in particular and, defined benefit schemes in general.

SUMMARY
The main elements of any “pensions solution” must include the following elements:

- Inflation protection to CPI level
- More realistic scheme valuation based on a mixture of higher growth assets and realistic bond yield
- The Pension Regulator should do their job and make Companies meet their responsibilities
- Companies to be held to account for the mis-selling of defined benefit schemes
- The composition of Boards of Trustees to reflect the demographics of the scheme membership
- Good communications throughout the change process between Trustees and scheme members
- Transparency critical to good decision making
- New role for the Pension Protection Fund
- Work required to define the exact size of the problem and a sensitivity analysis for different bond yields and inflation rates
- Restoration of the belief in Pensions

The changes needed to enable a “pension solution” maybe summarised under 8 broad headings:

Inflation
Any long term “pensions solution” must address the issue of inflation. Inflation is not benign and will have significant impact on the value of pension payments. A person retiring at 65 can expect to live on average for a further 20 years. In the last 20 years the inflation rate measured by CPI was 40.3% and by the RPI 56.0% and the effect of inflation has not diminished recently, in 2011 the CPI rate was 4.6% in a single year. In effect the value of a pension will half over the lifetime of the pensioner. The effect of inflation on widow/widowers pension must not be forgotten, widow/widowers start with a pension that is only half of that of the original pensioner, reducing to a quarter with the effect of inflation.

The “pension solution” must contain inflation protection to at least the level of CPI.
Scheme Valuation and Bond Yields

A more realistic means of evaluating Pension schemes assets and liabilities needs to be found, rather than a knee jerk reaction to pension deficits that are largely hypothetical. Because the numbers associated with many schemes are so large, small changes in underlying assumptions produce very large changes in scheme liabilities. Coupled with this is the present low bond yields that have to be used in assessing future expenditure.

The Government is trying to stimulate the UK economy by reducing interest rates and has in the process destroyed the income of people relying on their savings and the British pension industry. Long-term bond yields are not just low by recent standards. They are the lowest returns seen in the UK since the Bank of England was founded in 1694.

Today’s world of historically low bond yields and negative real interest rates create a massive headwind for individuals trying to build up long-term savings for retirement. At a time when we should be developing policies to help deal with an ageing population, monetary policy is creating incentives in totally the wrong direction. Current policies are discouraging long-term savings and businesses are being forced to divert resources away from productive investments to support ailing pension funds.

Because pensions are very long term schemes they should be able to take a longer view of bond yields and the resultant scheme valuations.

The question is how could a more realistic yield be established?

Part of the solution could be allowing more high-growth assets to sit within funds, albeit adding to investment risk in the process. Beyond this, expanding innovations that allow pension money to fund construction and infrastructure projects could provide part of the solution, with long-term returns from roads, tunnels and commercial properties. This could be in a form of high yielding pension bonds specifically for annuity and pension schemes.

Pension schemes need more flexibility within new pension guidelines to invest a proportion of their funds in high growth assets and a longer term view needs to be taken on bond rates.

Company’s Responsibility

Companies will be eager to get rid of the pension liability on their balance sheet. In a single stroke it will decrease their costs, reduce their liabilities and improve their stock price. The winners will be the share holders who will receive bigger dividends as a result.

The Pension Regulator needs to do its job and force companies to meet their responsibilities to their pension schemes. The Pension Regulator already 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. In addition under the Flexible Appointment Arrangements other pension schemes and employers in the corporate group could take over the assets and liabilities of a pension scheme.

The Pension Regulator needs additional powers to enable them to investigate companies which have undertaken ‘financial engineering’ in order to remove assets from within the reach of the pension trustees.
**Pension Scheme Contracts**

Pensioners should not be penalised, they have fulfilled their part of their contract, by contributing to the pension scheme and to the company. In a lot of cases it was in condition of employment and employees had no option but to join. The Employer must be held to their part of the contract.

Defined benefit pension schemes were seen as part of the remuneration package, many saw the pension as a form of deferred pay. Although companies may not have paid the top rates, employers promised a first class pension scheme, the pension was sold to employees as part of their total pay package.

In the financial sector we have already seen massive payouts for mis-selling of financial products such as Payment Protection Insurance. Why shouldn't companies be held responsible in a similar way for mis-selling the benefits of a defined benefits pension scheme?

**Communication and Transparency**

There needs to be good communications throughout the process. The financial information is hard to understand, poorly presented, usually historical and out of date. Major assumption have to be made to forecast the surplus or deficit of a pension fund. These assumption need to be spelt out. The various options need to be described and costed so that scheme members can evaluate the risks and benefits of each. Very often scheme members are only made aware that a scheme is in serious trouble when it is too late and as a result are presented with a fait accompli by pension scheme trustees.

Scheme Trustees should present the information in a timely manner, so pension scheme members can understand the assumptions which sit behind any analysis presented to them regarding pension risks and deficits.

Transparency is critical to avoid making inappropriate decisions.

**Pension Scheme Governance**

Pension scheme trustees must be representative of the whole membership. For example the British Steel Pension Scheme Trustees might not be considered as representative. There are at present 13 trustees including the chairman, of these 13,2 are retired members, 7 are still employed by the company, 3 are union representatives also working for company and the final member is the Investment Officer. With a 10:2 bias towards the present employees is it not surprising that the present proposal for the scheme is vastly more beneficial to employees rather than the majority, which is 64% of the scheme members who are retired.

The composition of a Board of Trustees needs to reflect the demographics of the scheme membership, particularly of the 4 major groups of active, deferred, pensioners in receipt of pensions and any dependants of former pensioners.
If not representative, Trustees may seek to put a certain spin on one proposal. All views of existing scheme members should be sought and accurately reported on, through a proper and legal consultation process.

**The Role of the Pension Protection Fund (PPF)**

The Pension Protection Fund is not independent it has a vested interest. Because of the apparent short fall in defined benefit schemes, a scenario could occur where all defined benefits schemes are taken over by the PPF with the associated reduction in pensioners benefits, only for the underlying assumption of low interest rates to change. The PPF would then run a massive surplus. What would then happen to this surplus?

The PPF appear to be more supportive of taking on defined benefits schemes from companies which wish to continue trading, without taking equity in the parent company as they have demanded in the past. Are PPF calling the bottom of the market in bond yields?

The terms of reference of the PPF needs to be changed, it needs to be charged with delivering a pension solution which looks at the problem as a whole.

A substantive piece of work needs to be undertakes to establish the real size of the pensions problem. Wildly varying figures of the deficit for defined benefit schemes are banded about with every change in Bank rate. What is the best independent estimate of the deficit. What would this become if bond rates moved to 2% or 3%? What would be the effect of paying pension increases in line with CPI. What other financial instrument, like an infrastructure bond, could be used by pension schemes? A sensitivity analysis needs to be undertaken which looks at bond yields, inflation and live expectancy.

The PPF could then recommend a yield and risk profile that pension schemes could follow.

Although not perfect, a prediction of likely outcomes would present a much better position on which to base these long term decisions rather than adopting a knee-jerk reaction to the latest decrease in bond yields. The decisions to be taken are momentous and not to be taken light heartedly, the decision will affect millions of people for many years to come.

**The Pension Time Bomb and Why Should People Save**

Present Government financial policy has produced a pension time bomb. Company defined benefits schemes appear to be in serious trouble, defined contribution schemes returns will be minimal and the Government wants to reduce the cost of the state pension by both changing the date it starts and by withdrawing the triple lock. Whilst the Government strives at every opportunity to encourage people to save for their retirement it seems to weaken pension’s legislation at every turn.

Belief in Pensions need to be restored so that people are encouraged to save for their retirement.

*September 2016*