The Water Companies (Pension Fund) Trustee Company

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Mr S Timms
Work and Pensions Committee
House of Commons
London
SW1A 0AA

9 May 2022

Dear Mr Timms

Water Companies Pension Scheme - Bristol Water plc Section

Proposed return of surplus to the employer following completion of wind-up

We refer to your letter dated 19 April 2022 regarding the Trustee's decision to return surplus funds in the Bristol Water plc Section (the Section) of the Water Companies Pension Scheme (the Scheme) to Bristol Water plc once all members' benefits have been fully secured and we write to provide the further information requested.

Executive Summary

In summary:

- The Trustee believes it has fully and at all times complied with its obligations and duties under the Rules and the law in the process of securing member benefits in full and winding up the Section.
- In exercising its power to distribute surplus (and in particular in determining not to exercise its discretion to augment members' benefits) the Trustee has followed the correct process, taken account of all relevant factors and has considered the matter very carefully. It remains of the view that it is appropriate for the surplus to be returned to Bristol Water plc.
- The Trustee believes it has provided adequate notification and extensive explanations to members as part of the consultation exercise and otherwise.
- The Trustee has engaged with and provided all information to the Pensions Regulator, as required.

- The Trustee has been advised by its professional advisers (legal and actuarial) throughout.
- The composition of the Trustee Board and the appointment of member nominated directors in particular is compliant with the legislation as it applies to a "relevant centralised pension scheme".

We provide more details below.

1 Background to the Water Companies Pension Scheme and the Bristol Water plc Section

Before responding directly to your questions we thought it would be helpful to provide some background to the Scheme and the current circumstances of the Section.

The Scheme commenced on 1 April 1974 and was originally called "the Water Companies' Association Pension Scheme". It was established under Section 27 of the Water Act 1973 which required statutory water companies to participate in a scheme that provided benefits no less favourable than those provided under the standard water authority scheme.

The Scheme is a trust-based occupational pension scheme, governed by its Rules, and subject to regulation by the Pensions Regulator. It is funded, which means that there are assets set aside to pay the benefits promised under the Rules. It does not benefit from a Crown or any other form of government guarantee.

The Scheme is and always has been "sectionalised". This means that the assets and liabilities for each Section are held separately from those of the others. Initially there were 28 "Sections" within the Scheme. However, as requirements to provide a certain level of benefits have fallen away (the Water Act 1973 was repealed on 1 September 1989) many Sections have transferred out of the Scheme and some others have wound-up. The number of Sections has reduced to 6, including the Bristol Water plc Section (the Section).

The Section provides pension benefits that are primarily "defined benefit" in nature. As you will be aware, in a defined benefit scheme all of the risk that contributions paid turn out not to have been enough lies with the employer, in this case Bristol Water plc.

Members who joined the Section prior to July 1994 receive pension benefits similar to those offered by many public sector pension schemes at the time – a pension based on the member's final pensionable salary plus an automatic cash lump-sum. Members who joined after June 1994 built up benefits on an alternative benefit scale that still offered a (lower) final salary pension, but the cash lump-sum was invested on a "defined contribution" basis and so was not defined benefit in nature.

A summary of the current membership and benefits is set out below:

	Pre-July 94 joiners ("80ths scale members")	Post June-94 joiners ("100ths scale members")
Membership (as at 31 March 2022)		
Deferred members yet to retire	104	117
Retired members	426	40
Dependant pensioners	111	5
Total	**641**	**162**
Benefits		
Pension	1/80th of Final Salary for each year worked	1/100th of Final Salary for each year worked
Automatic cash lump-sum in addition to pension	3x pension	Defined contribution pot
Retirement age	25 years after joining the Scheme, subject to a minimum of age 60 and maximum of age 65	65
Member contributions	Up to 5% of salary prior to 31 March 2005 (lower rates for under age 25s), 6.5% of salary in the year to 31 March 2006 and 8% of salary thereafter	3% of salary for Pension benefits, plus additional discretionary contributions for the DC lump-sum benefit (with an element of employer matching up to 1.5%)

The vast majority of the pension benefits within the Section, and in particular those received by 80ths scale members, are fully inflation-linked by virtue of annual increases being set in line with the Pension Increase Revaluation Orders (PIRO increases) made by the Government. As you will be aware, PIRO increases are currently set with reference to the Consumer Prices Index (CPI). In other words, most pension benefits will keep pace with the current high inflation rate. There is an element of capping on inflation-linked increases in payment for 100ths scale members (at 5% a year); this capping is not unusual and in line with many other pension schemes.

Bristol Water plc took the decision to close the Section to new joiners in 2001, and eventually to the build-up of further benefits in 2016. Bristol Water plc carried out consultation processes with members at the relevant time. As part of the closure to the build-up of further benefits active members at the time (of which there were 134) were granted a benefit augmentation (of an additional year's pension benefits), and 3 year protection of certain ill-health and redundancy benefits. Members were not asked to contribute towards these additional benefits; Bristol Water plc provided the augmentation at their cost and risk.

The Scheme is run by a Trustee Company (the Trustee), which has a number of member nominated and employer nominated Trustee Directors from across the Sections. Due to the sectionalised structure of the Scheme special provisions apply to its make-up (see section 5 for further details); however, the role of the Trustee Directors is the same role as all trustees of occupational pension schemes – to run the scheme in accordance with its Rules and the law to ensure that members' promised pension benefits are paid on time and in full.

To fulfil this duty, the Trustee's ultimate aim has been to secure members' benefits with a reputable insurance company and it has been specifically targeting this since the mid 2000's as this was considered to be in the best interests of the membership as a whole. As you will be aware, securing members' benefits with an insurance company is often considered the "gold standard" for member security.

Over time, and particularly following corporate activity around 2005, the Trustee has looked to minimise risks to the Section and its members, and in particular to reduce the level of investment risk in the Section with a view to achieving this aim. This has also been in line with the Trustee's understanding of the general direction of regulatory travel since scheme specific funding requirements were introduced with the Pensions Act 2004. As you will be aware, the Pensions Act 2004 also explicitly requires the Trustee to fund the Section "prudently" which only impacts Bristol Water plc's contributions (not members').

Bristol Water plc has been supportive of this approach and has paid significant additional contributions to support this risk reduction and low risk investment strategy. In particular, between 2005 and 2016 Bristol Water plc paid additional contributions (ie on top of their regular contributions in respect of the benefits being built-up, such regular contributions being calculated on a prudent basis) of over £16m into the Section in order to fund both a material de-risking of the Section's investment strategy and a more prudent funding strategy to protect members against adverse future events.

With hindsight it is the Trustee's strong view that it is the prudent funding and low-risk investment strategies, coupled with the additional contributions paid into the Section by Bristol Water plc between 2005 to 2016, that is the reason the Section is in the healthy position it is, and without which there would most likely be no surplus.

It is worth noting that under the Rules of the Scheme, the Trustee has the power to set a minimum contribution rate, and thereby effectively a funding target, for each Section without agreement from the sponsoring employer. This is not the case in many schemes, where agreement from the employer is required. Given the balance of powers contained in the Rules, the Trustee has sought to follow a cash funding plan to meet the objective of securing members' benefits in full, rather than exploring (as many employers have requested or required their trustees to do) alternative approaches that would have been less likely to result in a surplus arising eg provision of a guarantee or cash in escrow. It is also worth noting that the Trustee has never had to rely on this power to enforce contributions in relation to the Section, as Bristol Water plc has always been willing to meet the cash contributions proposed by the Trustee. The funding targets were always set (prudently) with a view to securing members' benefits that have been promised; there was never any intention to fund for a surplus.

The cost of securing benefits with an insurance company varies over time, based on factors such as market conditions, insurer capacity, and the availability of assets insurers can use to support writing business. In 2018, a market pricing opportunity arose that enabled the Trustee to secure members' benefits in full at no additional cost at the time to Bristol Water plc. At a high-level, the position arose because the Trustee had previously adopted a prudent funding target based on insurance companies struggling to price the insurance of CPI-linked benefits competitively due to a lack of suitable assets. An increase in the availability of CPI-linked assets and hence more competitive insurer pricing meant that, with hindsight, this level of prudence was not required. In line with its aim of ensuring members' benefits get paid on time and in full, the Trustee secured members' benefits in full in June 2018. Since then, the Trustee has been undertaking work in order to complete the transfer to the insurance company and wind up the Section.

2 The Section's winding-up rules

Now that the Section is winding up and all the promised benefits have been fully secured with an insurer, the Section's Rules (specifically rules 28.5 (for pre July 1994 joiners) and rule 29.5 (for post June 1994 joiners)) give the Trustee the discretion to "*increase all or any of the benefits or provide additional benefits to any extent that it considers just and equitable".* However, this is subject to a requirement to first consult with the Designated Employer (being Bristol Water plc in this case).

If the Trustee decides not to increase benefits under the Rules the remaining surplus once the Section's wind-up is complete must be paid back to the Designated Employer.

The Trustee did carefully consider whether to augment benefits, and we set out in the next section the reasons for its decision not to do so (the key points of which we have already referenced above).

3 Reasons the Trustee decided not to exercise its discretion to increase members' benefits on wind-up

The decision was reached by the Trustee after full and careful consideration of all relevant factors, including the party that had borne the risk during the operation of the Section, the reasons the surplus had arisen, and having received input from its actuarial and legal advisors. The Trustee also consulted with Bristol Water plc and the membership as required by the Rules and legislation.

The key factors that influenced the Trustee's decision are:

- For the duration of the operation of the Section, all of the "downside" risk lay with Bristol Water plc.
- Bristol Water plc has been very supportive of the Trustee's funding and de-risking strategy and has paid significant additional contributions to fund for prudence and the Section's low risk investment strategy. This includes over £16m of additional contributions paid between 2005 and 2016.
- The level of Bristol Water plc's contributions (both regular and additional) have been set by the Trustee in order to fund "prudence" (ie to protect members' benefits against future risks that may arise). With all such risks having (fortunately) not materialised, it does not seem fair or appropriate for Bristol Water plc to be, in effect, penalised for having been willing to facilitate and fund the Trustee's prudent approach to reserving for these adverse, unrealised contingencies.
- The Scheme Actuary has provided the Trustee with details of the movement in funding position since 1999, when the current firm of actuaries were appointed and the Section was around a third of the size it is today. It is clear from this analysis that the key reasons the Trustee was able to secure all members' benefits in full as early as 2018 were the Trustee's prudent funding strategy (supported by Bristol Water plc), combined with the low risk investment strategy the Section had adopted since 2005 (funded by additional contributions from Bristol Water plc), further combined with a reduction in actual insurer pricing at this time relative to the Trustee's prudent – in the event unnecessarily prudent - funding target.

Some of the other factors that were considered include:

- Members will receive their promised benefits in full and most members' benefits are fully inflation-linked (and those that are not are inflation linked up to 5%). Those members still in-service when Bristol Water plc closed the Section in 2016 received an augmentation of an additional one year's benefits.

- The analysis carried out also highlighted that since 2000 Bristol Water plc has paid in more than 5 times the amount paid in by members over the same period. The Trustee acknowledges that there were some periods in the 90's and early 2000's when the company paid reduced levels of contributions, but they were to ensure the Section did not fall foul of the then severe tax penalties that could be imposed on pension schemes for "overfunding". The amounts involved are materially smaller than subsequent contributions paid.
- Members have of course contributed to the Section historically (as summarised in the table above). However, the Scheme Actuary has confirmed that a typical member of the Section who is entitled to a guaranteed cash lump-sum will have received more as their "as of right" lump sum at retirement than they ever paid in as member contributions. In other words, they will have received back more as a tax free lump-sum than they paid in, even before considering the annual guaranteed pension. The Members have therefore received good value for the contributions they have paid.

In light of all the above, the Trustee determined that it would be reasonable to not exercise its discretion to augment members' benefits under the Section's Rules. As a result, any surplus will be paid back to Bristol Water plc, less tax at the prevailing rate. The Trustee is of the view that this is an appropriate and fair approach to the distribution of surplus.

4 The consultation process

The process the Trustee has followed has been in line with its understanding of Section 76 of the Pensions Act 1995, which covers "Excess assets on winding up". Broadly speaking, Section 76 enables a return of surplus on winding-up to an employer provided the liabilities have been fully discharged, there is the power to do so under the Section's Rules, and appropriate notice has been given to members of the Section.

The notification requirements are set out in The Occupational Pension Schemes (Payments to Employer) Regulations 2006. The Trustee believes it has complied with all relevant requirements, including splitting the notice into two parts which were appropriately spaced more than 2 months apart, providing an estimate of the surplus to be distributed, and inviting written representations from members.

A broad timeline of the whole process and key member communications since the Section's benefits were fully insured is as follows:

- 27 June 2018 – initial announcement of buy-in with Aviva (this informed all members of the buy-in with Aviva and the then expectation that the Section would move to wind-up in the next year or so).

- September 2018 – A detailed Q&A sheet regarding the buy-in was provided to all members with the 2018 Summary Funding Statement.
- 8 May 2019 – An update was sent to all members informing them of the need to carry out GMP equalisation ahead of winding-up the Section.
- 30 September 2020 – Consultation on the proposed conversion of GMP benefits to remove inequalities (only sent to those members in scope of the exercise and the communication sent depended on the current status of the member).
- October 2020 – personalised data verification letters were issued to all members.
- March to June 2021 - All members were sent personalised letters confirming their final verified pension benefits in the Section and explaining any updates (where relevant) for data verification, GMP conversion and GMP equalisation.
- 20 July 2021 - First notice of proposed return of surplus to Bristol Water plc as required by the Pensions Act 1995 (also confirmed that the Trustee had formally triggered wind-up of the Section).
- November 2021 - Following a high volume of member queries and replies to the first section 76 notice the Trustee wrote to members to provide further details of the reasons for its decision. This included Question and Answer sheets with detailed responses to key member questions raised. Please let us know if it would be helpful to provide a copy of this communication.
- 28 January 2022 - Second notice of proposed return of surplus to Bristol Water plc as required by the Pensions Act 1995 (also provided an update on the winding-up process).

Throughout the notification process under Section 76 of the Pensions Act 1995 Members' queries and representations were considered in detail. However, the Trustee did not consider that any of the representations made presented new information or arguments which changed the initial view it had formed for the reasons outlined above. The Trustee responded to many members' representations and queries directly, as well as issuing its detailed response to the first notification to all members in November 2021 as described above.

The 2006 Regulations prescribe in what circumstances notice can assume to have been given. In particular, they state that notice is to be treated as having been given where that notice has been sent by post to the address at which they were last known to be living (or employment address if an active member). The Trustee has sought to exceed this requirement by carrying out an extensive "tracing and verification" exercise to contact members. The Trustee is aware of only 5 members where this exercise was not successful and where alternative tracing methods are currently being explored.

It may be the case that some members have received communications from the Trustee that others have not over the period since securing the Section’s benefits. This is primarily due to some members having “GMPs”, and there was a need to communicate with just these members regarding equalising these benefits between men and women as outlined in the previous section.

As part of the second notification, and in accordance with the 2006 Regulations, members were invited to make representations to the Pensions Regulator with regard to the process and some members did so. This prompted the Pensions Regulator to engage with the Trustee in relation to understanding the process followed. The Trustee has provided the Pensions Regulator with all the information it has requested.

5 The Scheme’s Trustee Board

The Scheme is required to comply with the Pensions Act 2004 regarding the constitution of the Trustee Board. However, as a “relevant centralised scheme” for the purpose of pensions scheme legislation it is not required to comply in the same way as most other schemes. Modified provisions apply to it by virtue of its unusual structure (it being a segregated scheme in which non-associated employers participate). Very broadly this means that it must maintain at least a third of directors who are “independent” or “independently selected” by members (the latter of which are commonly referred to as member nominated trustee directors) but it is otherwise exempt from the detailed requirements under Section 242 of the Pensions Act 2004 as they do not work practically for a scheme of its nature. This means the Trustee Board has flexibility to ensure an appropriate and practical nomination and selection process is in place. The process is regularly reviewed.

The Trustee Board is comprised of a mix of member nominated trustee directors (MNTD) and employer nominated trustee directors (ENTD). It’s important to point out that an MNTD does not have a different role to any other trustee director. No director represents only the interests of any particular category of member or employer. Their duties are to run the Scheme in accordance with its Rules and the law.

It is not practical to have an MNTD for each Section, but historically we have attempted to ensure that each Section is represented somehow either with an MNTD or ENTD (and at all times within the minimum requirements set out in the legislation as described above). We have also sought to rotate, where practicable, the Sections which appoint MNTDs so that the membership of each Section gets a chance to participate. We think this is a practical and fair approach.

In terms of actual nominations for MNTDs, once the decisions have been taken regarding which Sections will be included in the nomination process, the process differs slightly depending on whether those Sections have active members or not. If you need more detailed information on this distinction please let us know. Then broadly speaking, the relevant group of individuals are written to and asked to provide nominations by a particular date. Nominees can only be nominated by members in their Section.

There need only be one nomination for a member to be a formal nominee. If there are no other nominees in that Section then the nominee will be appointed to the Trustee Board. If there is more than one nominee the position will then go to the next stage of selection by the membership. If there are insufficient nominees for a particular Section the Board may seek nominees from other Sections.

There is also a pensioner director appointed to the Trustee Board under a separate process.

Trustee directors serve a term of three years at the end of which they will normally retire or apply for re appointment following the same process as set out above. However, the terms can be extended if the Trustee Board sees fit (for example so that a director can see a complex project through to its conclusion). Any trustee director is eligible for re appointment if he or she wishes to continue at the end of his or her term.

We hope this provides reassurance that we do involve the membership in this process. We can also confirm that currently there are more member nominated trustee directors on the Trustee Board than is required by the legislation.

6 Summary

As described at the start of this letter the Trustee believes it has fully and at all times complied with its obligations and duties under the Rules and the law in this wind-up process (including in particular in determining not to exercise its discretion to augment members' benefits and in its consultation obligations).

We hope that this letter adequately answers the specific queries you raised. The Trustee would be happy to provide any further information that may be helpful.

Yours sincerely

David Sankey (Chair)
On behalf of the Trustee of the Water Companies Pension Scheme

Work and Pensions Committee

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19 April 2022

Dear Mr Sankey

Water Companies' Pension Scheme Bristol Water Plc Section – transfer of surplus to the employer

I understand that you have started winding up this Section and expect to complete the process by the end of this year, an annuity having been purchased in June 2018 to insure member benefits.

The Committee has been contacted by scheme members who say they are concerned that the Trustees have taken the decision to transfer the remaining surplus in the scheme (estimated at around £12.1 million) to the employer. They say that there is a provision in the Sections rules stating that the Trustee "may, in consultation with Bristol Water PLC, use any surplus to augment members' benefits if and to the extent that it considers it just and equitable to do so." Their understanding is that, despite this, the Trustees decided to transfer the remaining funds to the employer without, in their view, adequate consultation or explanation. We would be grateful if you could explain:

- Do the Section rules provide the power to use the surplus in the scheme on wind-up to augment benefits and, if so, was this considered?
- If the Trustees took the decision not to exercise this power, what was the justification for this? Was actuarial advice sought? If employee and employer contributions to the scheme were a factor, over what period were these considered?
- How were members consulted on any decision to return the surplus to the employer and what steps were taken to ensure all members were contacted?
- When each of the member-nominated trustees/directors were appointed and what arrangements were made for involving scheme members in the nomination and selection process.

My Committee rarely considers individual cases except where these illuminate more general policy and operational matters. In this instance, I am considering asking my Committee to discuss whether the legislative protections available to members of pension schemes regarding rights over surpluses and their ability to elect Trustees are effective and sufficient.

Yours sincerely,

Stephen Timms