

Consultative meeting 2004

ISSUED TO ALL MEMBERS, PENSIONERS AND DEFERRED PENSIONERS OF THE BRITISH STEEL PENSION SCHEME

The tenth Consultative Meeting was held on 23-24 September in Barford, Warwickshire, attended by representatives from the Trustee, Corus, Retirement Associations and Works Committees.

Left to right: Staf Wouters (Director, Human Resources, Corus Group), Bob Avis (Trustee Chairman)



Works Committees' Nominees

Billy Ayre Teesside
Peter Currall Corby
Paul Evans Trostre
David Ferris Port Talbot
Sue Mather Rotherham
Dave Oldfield Scunthorpe

Pensioner Organisations

John Batstone NABSP* Scunthorpe
Arnold Berry Cumbria Retired
Colleagues Association
Norman Bielby NABSP* Teesside
Thomas Bowman NABSP* North East

Richard Hewitt London Retirement
Association

Bob Leonard Port Talbot Retired
Employees' Association

Don Thomas NABSP* South Wales

Ian Veitch NABSP* Scotland

* National Association of British Steel
Pensioners

Pension Scheme Trustees

Shaun Corten
Geoff Deeley
Ray Hill
Allan Johnston
Charles Radcliffe
Austin Senior
Sarah Smith

Officers

Stewart Colley Manager, Investments
Jim Cumming Director,
Group Pensions
Mike Donohue Pensions
Administration Manager
Alex Kelly Communications Manager
Martin Ross Pensions Technical
Manager

BRITISH STEEL

PENSION SCHEME

CHAIRMAN'S PRESENTATION

The Chairman highlighted the key points from the Scheme's Annual Report & Accounts for the year to 31 March 2004 and commented on the main issues of Administration arising during the year.

He reviewed the Fund's two portfolios - the Maturity Portfolio and the Discretionary Portfolio. The Maturity Portfolio of bonds provides the Fund with stability and protection against the vagaries of the equity markets. It was established primarily for security and broadly covers pensioner liabilities over the next 15 years. In a year when equity markets performed well, bonds did not fare as well, and the Maturity Portfolio achieved a relatively modest return of 5%.

By way of balance, the Discretionary Portfolio contains a very high proportion of equities, aimed at achieving a higher level of long term investment return. Following three very difficult years, the Discretionary Portfolio's annual investment return improved to 26.6% in 2003/04.

The Total Fund value during the year increased by **£527 million** to **£7,731 million** at **31 March 2004**, mainly due to the Discretionary Portfolio benefiting from the recovery in the financial markets. While the increase in Fund value was notable, the Chairman reminded delegates that an assessment of the overall health of the Scheme had also to include consideration of its increasing long term liabilities.

The British Steel Pension Scheme (BSPS) accounts showed investment income was its main source of cash flow. This regular income meant that it need not sell large amounts of

equities to pay pensions when stock markets were low. On the expenditure side, the payment of monthly pensions was obviously by a long way the largest item of regular expenditure and given the Scheme's increasing maturity, this would continue to be so.

The Scheme currently has twenty two Pensioners who are aged 100 or over. A further nine may reach their 100th birthday in the current Scheme Year, illustrating the trend of improving longevity.

Other notable events in the year included:

- **Scheme administration**

BSPS continues to provide an excellent pension administration which ensured that our system continues to work effectively. In June of 2004, the Pensions Office in Glasgow had enlarged its administrative role, taking over the administration of another Corus UK pension scheme (the Firsteel Group Pension Scheme).

- **Annual Audit by KPMG**

The audit of both the Scheme and the Fund progressed very smoothly. KPMG confirmed there were no major control deficiencies.

Annual Review of Scheme Advisers

The trustees again conducted the annual review of the Scheme's three main professional advisers, which identified no major issues. They have reappointed Watson Wyatt (Scheme Actuary), KPMG (Fund Accountant) and Mayer Brown Rowe and Maw (Scheme legal advisers) for a further year.

The trustees are reviewing the audit requirements of the Scheme in the light of new regulatory requirements

from emerging legislation and will take the opportunity to put the role of Scheme Auditor out to tender in 2005.



Left to right: Sarah Smith, Alex Kelly, Sue Mather

Audit of Pensions in Payment

All pension schemes seem to be affected by the common problem of overpayments caused by the failure to report deaths of some pensioners. The trustees have always ensured that Scheme records were thoroughly and systematically checked to detect any overpayments. In recent years, Scheme records have been checked against the computerised records of the General Register Office for England & Wales for deaths occurring in the years 1994 through to 2002. The records for the years 1990 – 1993 would be reviewed in the coming months.

The Chairman illustrated the scope of the problem by referring to the latest exercise, covering 1994 and 2002. This had identified 55 unreported deaths involving overpayments for the 1994 cases of £22,553 and £38,720 for the 2002 cases. The Chairman emphasised the requirement to recover these overpayments and reported that already £11,000 has been recovered in respect of two of the three 1994 cases.

As part of the development of the audit of pensions in payment, the trustees had decided, in principle, to participate in 2006 in the Audit Commission's bi-annual National Fraud Initiative. By comparing

Scheme records for Pensioners and Deferred Pensioners against the Department for Work and Pensions records, we will identify any unreported deaths within the Scheme's Pensioner and Deferred Pensioners population, and be able to stop any further overpayments and seek the recovery of the overpayments made to date. It would also alert Scheme Officers to any unreported deaths of Deferred Pensioners and identify the possible need for Scheme benefits to be paid to their beneficiaries.

The Audit Commission has confirmed that Scheme data would be used solely for the purposes of identifying relevant deaths and would be destroyed on completion of data matching.

Business Continuity Plan

A full Business Continuity Plan has been prepared for the Glasgow Pensions Office and the London Investment Office to ensure the continued operation of essential Scheme services in the event of disaster scenarios. Ten major risks have been identified (loss of premises, computer systems, power failure, etc.) and arrangements were in place to react to a range of adverse circumstances.

Investment Management of CES Scheme

The Fund's investment management company, Pension Services Limited, took over the management of the assets of the CES Scheme on 1 December 2003, on behalf of the CES Trustees.

Special AVC exercise

Following completion of the 2002 Actuarial Valuation, the Scheme Actuary amended the terms for transfers in and out of the Scheme

and also for the rates for the purchase of added years. A special exercise, which allowed applications for AVC purchases at the "old rates" through to 31 March 2004, resulted in 1,021 purchases being made by Members. 79 Members subsequently cancelled their purchases.



Left to right: Austin Senior, Ray Hill, Sarah Smith, Dave Oldfield

STEWART COLLEY Manager, Investments

Stewart presented the background to the Fund's structure and a detailed analysis of how it performed in 2003/04. He also referred to issues affecting the Fund and provided an assessment of a wide range of investment issues affecting the Fund.

The Fund – structure and performance

The Trustee's investment policy had seen a planned move from equities to bonds completed in the period 1997 – 1999. Further controlled measures to add to the security of the Scheme meant that the Fund now had about 52% of its assets invested in bonds, (with another 40% in equities and about 5% in property). The Maturity Portfolio, with 98% of its assets invested in bonds, had provided an enviable level of security when compared to most other UK pension schemes. The Discretionary Portfolio had been

created with longer term performance in mind and it was therefore encouraging to note that it had recorded good overall returns over the year, primarily due to the improved equity markets – in which 83% of the assets were held.

Over half of the Fund's £377million property investment was in the retail sector with most of the remainder invested in the office and industrial sectors. While property required considerable active management compared with other asset classes, it provided the Fund with an important form of asset diversification and a welcome source of income over the years.

The trustees were in the process of transferring assets totalling over £500 million from the Discretionary Portfolio to the Maturity Portfolio in the period leading up to the next Actuarial Valuation in March 2005, in recognition of the increasing maturity of the Scheme. Considerable progress had been made towards achieving this target – mainly by means of the transfer of investment income from the Discretionary Portfolio and a modest sale of equities. He emphasised the need to avoid undermining Fund value by selling equities at an inappropriate time.

The Fund – other issues

- Corporate governance – the Government continues to commission reports on this subject and the trustees re-assess the Fund's policy in light of the findings of these reports. The policy centred around the need to be generally supportive of management while bearing in mind the need to exercise shareholder voting rights conscientiously and make decisions based on the individual

merits of each case, particularly when relating to important issues or those likely to attract widespread interest.

- Review of the Fund's investment management – a review of the Fund's in-house investment management had been conducted by the trustees. This review had regard to key factors such as the significant size of the Fund, its investment performance over the years, management costs, appropriateness of controls and the need for flexibility in investment strategy. It was recognised by the trustees that the Fund benefits from the current arrangements, as they could readily exert influence over in-house arrangements. The investment management culture had been developed to suit the Scheme's circumstances (recognising the respective roles of the Trustees, Investment Committee, Investment Manager, Actuary and Company) and conflicts of interest can be minimised. Another relevant consideration was the benefits brought through continuing with the same investment management team and their familiarity with the composition of the existing Fund assets. On balance, the internal investment management arrangements were considered more beneficial to the Fund and it was decided to continue with them, supplemented by the appointment of specialised external investment managers where the required expertise was not available internally.

These arrangements would be subject to a 5 yearly review.

External factors

Equities worldwide staged a recovery from the poor performance in recent years. In 2003/04, total returns generally for UK equities were 31% and for non-UK equities, the returns were 25%. These figures contrasted sharply with the negative returns seen in 2002/03 (-30% and -31% respectively). This reversal in performance was welcome relief for most UK pension funds which were still heavily invested in equities in contrast to the more balanced position of the BS Fund.

JIM CUMMING

Director, Group Pensions

Actuarial valuation

Jim explained that a formal valuation of the British Steel Pension Scheme took place every 3 years, with annual checks in between. The current 3 yearly valuation programme was:

- **2003 – a “health check” for the Scheme;**
- **2004 – interim actuarial assessment; and**
- **2005 – formal valuation.**

The interim assessment confirmed that the ongoing funding level of the Scheme had fallen from 111% to 107%. Surplus had dropped from £710 million at the last formal Valuation in 2002 to £448 million at the interim assessment as at 31 March 2004. This decrease was mainly due to poorer investment returns when compared to the actuarial assumptions and the surplus support for employers' contributions in the Main Section. Investment performance was one of a number of important factors which

were considered as part of the actuarial valuation process. Other factors included increasing longevity, pay increases, inflation and additional costs arising from the additional regulatory burden. Whilst the Scheme Actuary had regularly increased allowances for improving longevity within the BSPS, there was evidence that pensioners were living longer and there was great uncertainty about the rate of future improvement. Substantial improvements in longevity would have a major effect on the BSPS liabilities and its funding position. The Scheme Actuary was therefore undertaking a detailed study on the effect of life expectancy improvements in the Scheme ahead of the next formal Valuation as at 31 March 2005.

The outcome of the 2005 Valuation would very much depend on experience up to 31 March 2005. Consideration of the Company's contribution rates would form part of the formal Valuation process and, on current experience to date, it is likely that Company contributions to the Main Section will require to be re-commenced following the outcome of the Valuation.



Left to right: Richard Hewitt, Bob Leonard

Recent Government actions for Defined Benefit Schemes

Government changes in recent months have provided greater security for members of occupational pension schemes. There was, however, a lot of uncertainty as to the extent and

timetable for implementation of the security measures: the Pensions Protection Fund (PPF) is expected to come into force from 6 April 2005 but the Government's Financial Assistance Scheme of £400 million may not be enough to cover those estimated 65,000 members who had already suffered pensions loss following employer insolvency.



Back row, left to right: Norman Bielby, Geoff Deeley, Don Thomas. Front row, left to right: John Batstone, Ian Veitch, Tom Bowman

New Accounting Standards

From next year, Accounting Standards were to change and pension costs in company accounts would be charged to operating profit without an offset from past service pension scheme surplus. This would lead to increased pressure on future service pension costs and could discourage employers from providing defined benefit pension schemes. Financial market volatility added to the problems associated with the accounting changes as pension scheme funding movements would be reflected in company balance sheets. Media reports had highlighted the total collective deficits in schemes operated by the top 100 UK companies at around £50 billion. The BPS had seen its Accounting Standards "surplus" of over £1 billion in 2001 fall to around £300 million in 2003.

Under the new standards, future allowances for longer life expectancy are likely to be required and its effect would be to further

depress pension schemes' funding positions, assessed on this basis.

Emerging UK legislation

Jim confirmed that major changes to the provisions of occupational pensions were being introduced by the Government, although much of the detail of the new legislation was still awaited.

PENSIONS BILL

It was considered unlikely that all of the Pensions Bill's provisions would be in place in time for the scheduled effective date of 6 April 2005, with the likelihood that the Government would concentrate on putting in place the Pensions Protection Fund (PPF) by that date.

Pensions Protection Fund (PPF)

There was a significant difference between the limited cover available for pension scheme members who were below a scheme's Normal Pension Age (NPA) and the more comprehensive cover for pensioners over NPA and for those who had retired early on ill-health. If a scheme could not meet its pension obligations but had sufficient assets to meet PPF liabilities, it would fall on the trustees to reduce Scheme benefits relevant to the assets available in line with priority orders.

Pension schemes would be required to pay levies to the PPF, initially on a flat rate per member basis. Estimates of the levies payable by BPS ranged from £1.8 million initially to a potential maximum of £7.2 million per annum, including a risk-based component.

New Pensions Regulator

The main functions of the new Regulator were to actively protect pension scheme members and

reduce the risk of claims on the PPF. The new regulator would have wide-ranging powers to intervene in scheme matters and enforce remedial actions on trustees, sponsoring employers and associated companies.

New Influences on Funding

Trustees generally could expect a greater role in setting the funding standards of schemes, when the basis for future funding responsibilities is related to a scheme specific standard rather than the present Minimum Funding Requirement, which proved to be ineffective in providing security of benefits.

Trustee Role

There had been much discussion about the future role of trustees and the qualities and training they would need in the new regulatory environment. BPS trustees already receive regular and suitable training to perform their duties. Additionally, time is now set aside at meetings to update trustees on subject matters relevant to the operations of the Scheme.

Member-Nominated Trustees (MNTs)

Many employers who sponsored smaller schemes had "opted-out" of the minimum requirement to have one-third member representation. Employer opt-outs would no longer be possible and Codes of Practice will be issued by the Regulator, setting out requirements for the nomination and selection process. The constitution of the BPS Management Committee already involved a 50-50 representation between Company and trade union appointments for the past 35 years.

Simplification of Dispute Procedures/Consultation Process

A single stage approach was proposed for pension schemes' dispute procedures to replace the two-staged process as at present. There was also a proposed requirement that consultation with employees or their representatives takes place before significant changes are made to pension schemes. Corus has, in any case, always consulted with the trustees and trade unions before introducing any changes to BSPS, so the proposed consultation requirement in the Bill would not materially impact on existing BSPS practices.

Implications for Benefits

A reduction to the minimum statutory Limited Prices Indexation (LPI) requirements on pension increases from 5% to 2.5% per annum on future service accrual was intended to partly offset the additional costs that sponsoring employers would face from the new legislation.

Further, as the Inland Revenue would no longer restrict occupational scheme members to a limited number of ways of making their pension provisions, occupational pension schemes would not have to make an AVC facility available in the future.

Transfer of Undertakings (Protection of Employment) Rights

The current Transfer of Undertakings (Protection of Employment) Rights provisions, or TUPE as it is commonly known, largely excluded occupational pension issues. This was due to change, with limited pensions cover to be continued by the receiving employer.

Overall, there was a shortage of incentives in the Pensions Bill for employers to promote and retain defined benefit schemes.

FINANCE ACT 2004 (TAX SIMPLIFICATION)

Single Tax regime

The simplification of eight tax regimes into one approved basis with effect from 6 April 2006 was considered a very positive step for the majority of members, although not for the higher paid. The new single tax regime would effectively mean that there would be no limit on pensions savings, only on the amount of tax relief available. Concurrent membership of any number and type of pension arrangement would be permissible.

The Annual Allowance (AA) of £215,000 was set at a level that would impact on relatively few people. The Lifetime Allowance (LTA) of £1.5 million effectively limited pension provision to a level currently allowed by the Earnings Cap and would, therefore, affect considerably more people, both immediately and in the future. Those in registered schemes with pensions worth more than the LTA would face a new recovery charge of 25% on any excess not protected under transitional arrangements in addition to 40% income tax, resulting in a composite tax rate of 55%.

In the BSPS, traditionally many Members are long-serving employees and their Scheme pension provision could therefore be subject to the current Inland Revenue restrictions on the monetary value of pensions being no more than 2/3rds of final remuneration. That restriction would no longer apply after April 2006. However, high earners would

face these other new Inland Revenue restrictions (AA and LTA) on their pension provision.



Left to right: Dave Oldfield, Shaun Corten

Other Considerations

Under the single tax regime, there was generally the potential for higher tax-free retirement lump sums. The circumstances for the minimum early retirement age moving from age 50 to age 55 by 2010 were unclear at present although it was possible that some form of transitional protection could be available to existing members. It would be possible, under the new legislation, to receive a pension after age 55 without retiring from employment under flexible early retirement proposals. The framework for tax-effective provision of lump sum death benefits and commutations of small pensions would be generally improved under the new regime.

Again, much of the detail will be laid out in regulations and sponsoring companies will need to consider what changes should be made to the rules of pension schemes.

The Anti-Age Discrimination Directive

In line with an EC Directive, the Government has also to address age discrimination issues in the workplace by October 2006 and come to a conclusion on the appropriateness of compulsory retirement ages.

Civil Partnerships Bill

This legislation will allow same sex couples to register their relationship and acquire rights to future service benefits similar to married couples.

STAF WOUTERS, Director, Human Resources, Corus Group

Staf explained his background and working life to date and reported on Corus' 6 month results to the end of June 2004 and the Company's considerations about pensions against a wide range of difficulties and uncertainties for UK defined benefit schemes generally.

The Company's results

Staf was particularly pleased to report that the Company had recorded its first profits since the merger in 1999. Group operating profit of £147 million in the half-year of 2004 had improved by £204 million when compared to the same period in 2003. He attributed the upturn in the company's fortunes to two major factors. It was estimated that around 50% of the improvement had been achieved through the Company's "Restoring Success" programme which focused on safety, performance, service delivery and cost savings. The programme was designed to close the competitive gap between Corus and its European competitors within 3 years and these half-year results were an encouraging indication that the Company was making good progress in this respect. The other 50% of the improvement resulted from more favourable market conditions, in particular demand for steel from China. He predicted further progress in the second half

of the year from the "Restoring Success" programme and increasing steel prices. Longer term, he looked forward to a culture of continuous improvement, the developing of opportunities for profitable growth and an environment where the Company could record profits even during the downturn in the steel industry's cyclical demand.

Pension considerations

The Company was extremely aware of the scale of its pension exposure, the sensitivity of changing circumstances on assets and liabilities, and costs and risks associated with the provision of occupational pensions generally. The results of the interim actuarial valuation as at 31 March 2004 confirmed that the Scheme remained in reasonably good health however there was currently much uncertainty about pension provision in the UK going forward. Corus had concerns about the effect general economic factors over the next few months may have on the Scheme's 2005 Valuation results. Also, it required more clarity with regard to the Government's wide-ranging pension legislation programme and its potential impact for increasing costs and risks. Pension schemes were continuing to face difficult times given depressed and volatile investment markets, increasing life expectancy, new accounting standards and funding pressures generally.

- He understood concerns expressed about the future pension position of Members employed at Teesside Cast Products. The Company would seek to clarify with potential partners, issues relating to continuing BPS membership for employees of Teesside Cast

Products and matters should become clearer over the coming months.

- He also responded to questions on the Company's attitude to final salary pensions generally. He did not consider that the appropriate test of the strength of that commitment was based on whether certain new members of the Company's Senior Management team were BPS members.

It was encouraging to note that the Trustee's prudent guardianship had put BPS in a relatively sound position but it remained a difficult climate for final salary schemes generally and no-one could be in a position to give open-ended guarantees about the shape of future pension provision against an ever-changing pension environment. Important factors in the Company's need to continually take stock of its pension position were the level of investment returns, the increasing headline costs of the benefits package, the changing demands of UK pension legislation and the effects of increased costs and risks arising from such areas as improving longevity.

Some further points from the Question & Answers session

- While there had been many redundancies over the years, the Scheme Actuary had built-in factors in the funding assumptions to protect the Scheme's funding position. BPS surplus had deliberately been used conservatively spread over a period of time, unlike many other UK pension schemes. This cautious approach – combined with the Fund's substantial bond holdings -

had greatly contributed to the relative strength of the BPS and its ability to withstand many of the challenges faced by occupational schemes in recent years.

- The creation of the Maturity Portfolio in 1997-1999 was a bold move at the time and significantly



Jim Cumming and Bob Avis mixing with delegates during a break

strengthens the security of the Scheme. Most other UK pension schemes had retained a large holding in equities because of the upward progress of financial markets during the 1990s and expectations that this would continue.

- The Company were aware that they would invariably have to recommence paying contributions in respect of the Main Section. The Scheme Actuary's analysis of the results of the Scheme's 2005 Valuation would include an assessment of the required Company contribution rate to maintain the benefits payable under the Scheme. The Actuary would consult with both the trustees and the Company before formally certifying the level of contributions to be paid. It was too soon to speculate about the Company contribution as this

would depend on circumstances prevailing at the time.

- It was recognised that while the Scheme Actuary had made additional allowances for increasing longevity in his assumptions at successive valuations, the actual experience could yet warrant

further, and possibly substantial, additional provision in the funding assumptions.

- The advantage of the Company's policy of merging other UK pension schemes into the BPS was in developing a common core of pension terms for UK employees in one large pension scheme better placed to meet the costs and risks faced by final salary pension schemes. BPS surplus was not used to finance the transferring-in of other Company pension schemes. There were still other Corus UK pension schemes which had not been integrated within the BPS. The largest of these were CES and Firststeel pensions schemes which still retained the assets and liabilities in respect of members' accrued service prior to 1 April 2003, when they became eligible to join the BPS for future service.

- With regard to the most appropriate measure of "maturity" within the Scheme, while it was noted that the number of BPS pensioners was expected to continue to fall, the value of new pensions tended to be considerably higher than those in respect of older pensioners and therefore the Pensioner payroll was likely to continue to increase over the coming years.

- Tax simplification proposals for 2006 would require a fundamental review of the shape of occupational pension provision in the UK because of the less restrictive nature of the new single tax regime. Further easements would also apply in UK pension scheme membership criteria for associated companies and non-UK employees.

- With all that is being proposed for private pension provision, it is surprising that the Government are taking no remedial action on the complex nature of the State pension structure and its reliance on means-testing to provide a meaningful level of basic benefit.

- It was confirmed that in recognition of the often sizeable lump sum payments made following the death of a scheme member, the Trustee had a long-standing introductory arrangement with Momentum Financial Services Ltd, a firm of consultants which provided an advisory service on financial planning. Through this arrangement, Momentum could make contact with the beneficiary and assess whether their services were of interest. There was no obligation to use Momentum's services but if their services were engaged, the remuneration would be commission-based.