EXPLANATORY MEMORANDUM TO

THE RAILWAY PENSIONS (SUBSTITUTION) (AMENDMENT) ORDER 2017

2017 No. 153

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Transport and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This Order defers certain payments to the 1994 Pensioners Section (the "Section") of the Railways Pension Scheme, in order to ensure cost effectiveness for the tax payer.

2.2 Deferring payments will have no impact on the security of members' benefits; these will continue to be paid from the Section and as necessary funded by the Secretary of State in accordance with the Crown Guarantee.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

4.1 The Transport Act 1980 imposes a liability on the Secretary of State to make payments in respect of unfunded obligations associated with specified British Railways pension schemes no later than the date on which those obligations fall to be paid or are incurred. The 1980 Act allows the Secretary of State to make a substitution order which terminates this liability and instead imposes an obligation on the Secretary of State to make a number of substitution payments being the capital value of those unfunded obligations, plus interest, at a later date.

4.2 At the time of privatisation of the railway industry in 1994 the Secretary of State was liable for unfunded obligations in respect of the Section of approximately £390m. The Railway Pensions (Substitution) Order 1994 substituted that liability for two 35-year payment schedules (Table A and Table B). Table A payments commenced in 1995 but Table B payments could be deferred for at least ten years, or indefinitely if the Section was adequately funded, see further paragraph 7.3. The Railway Pensions (Substitution and Miscellaneous Provisions) Order 1995 and the Railway Pensions (Designation, Substitution and Miscellaneous Provisions) Order 2001 established similar substitution payment schedules in relation to the unfunded obligations of additional railway pension schemes that were subsequently transferred into the Section.

TNA/EM/10-2015.1

5. Extent and Territorial Application

5.1 The extent of this instrument is the United Kingdom.

5.2 The territorial application of this instrument is the United Kingdom.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation no statement is required.

7. Policy background

7.1 At the time of privatisation in 1994 both past and present British Rail employees were members of the British Rail Pension Scheme (“BR Scheme”). On 1 October 1994 all the assets and liabilities of the BR Scheme were transferred into the Railways Pension Scheme (“RPS”), an industry-wide pension scheme created to provide a secure platform for pension arrangements in the privatised multi-employer railway industry.

7.2 All pensioners in receipt of benefits and deferred pensioners in the BR Scheme at the time of privatisation were transferred into a separate section of the RPS called the 1994 Pensioners Section. The Secretary of State fulfils the role of ‘Designated Employer’ for the Section. It currently has around 111,000 deferred and pensioner members who are not required to contribute to the Section. Although the Section is part of the RPS, its assets and liabilities are identified separately. The Section has within it a Special Reserve Fund (“SRF”), which is what remains of the Secretary of State’s share of previous triennial valuation surpluses. The Section also benefits from a Crown Guarantee, which was given at the time of privatisation to provide security for the then existing pensioners and deferred pensioners. Emerging deficits in the Section are covered by transfer payments from the SRF, made over a ten year period. Once the SRF is exhausted and holds insufficient assets to cover an emerging deficit, payments are required from the Secretary of State under the Crown Guarantee.

7.3 In accordance with the 1994, 1995 and 2001 Substitution Orders the Secretary of State is obliged to make substitution payments that relate to unfunded obligations of various British Railways pension schemes, determined as at the time those schemes were transferred into the Section. The 1994 and 1995 Substitution Orders structure these payments into two schedules (Table A and Table B amounts). This was a device to secure financial efficiency. The payments of Table A amounts commenced in 1995 but payment of Table B amounts could be deferred for at least ten years, or indefinitely if there were adequate funds available in the SRF to offset the value of the relevant Table B amounts. At the time it was anticipated that there would always be surpluses revealed at valuations of the Section, increasing the value of the SRF and meaning the SRF would always hold sufficient funds so that the Table B amounts would never need to be paid.

7.4 The 2001 Substitution Order established a single substitution payment schedule (Table B) in respect of the unfunded obligations of the schemes transferred into the Section in 2001 and, consistent with the Table B schedules provided in the 1994 and 1995 Substitution Orders, deferred those payments for at least ten years. The Substitution Orders provide for interest to be paid on the Table B amounts, which can also be deferred depending on the value of the SRF.

7.5 The Table A and Table B amounts are considered assets of the Section and included as such in the triennial valuations of the Section. However for valuation purposes unpaid Table A and Table B amounts, and deferred Table B amounts (including interest), are recorded separately from the Section's invested assets (i.e. those assets currently available to the Trustee to invest and pay members' benefits). Making the payments of the Table A and Table B amounts should not affect the Section's deficit, all things being equal.

7.6 A formal actuarial valuation of the Section was undertaken by the joint actuaries (the Government Actuary's Department and Willis Towers Watson) as at 31 December 2013 and signed on 29 February 2016. This concluded that in accordance with the provisions of the Substitution Order the SRF was no longer of sufficient value to enable the interest on the Table B amounts, and possibly the Table B amounts themselves, to be deferred beyond March 2017 (the relevant Table B amounts were valued at £576m and the SRF at £828m). The Valuation also revealed a deficit of £1,051m which is being offset by payments from the SRF.

7.7 The Department's view is that the Section's invested assets (including the SRF) should be used to meet the benefits payable, and only once the invested assets have been depleted in their entirety should the Government start to make payments. This can be achieved by deferring Table B amounts (including interest) payable under the Substitution Orders and delaying any payments under the Crown Guarantee until the Section's invested assets can no longer meet the liabilities. This proposal will not have any bearing on the security of members' benefits. Members' benefits will continue to be paid from the Section and as necessary funded by the Secretary of State in accordance with the Crown Guarantee. This proposal represents good financial management and is more cost effective to the taxpayer.

7.8 The proposal does not interfere with the schedule of payments of the Table A amounts (currently approximately £5m per annum). These have been paid since 1995 and it is estimated that they will continue to be paid at a diminishing rate until 2030. The current amendments defer the payment of the Table B amounts until after 2030 at the earliest (and so after the Table A amounts have been paid in full), when the Department will take a further view on the funding of the Section.

Consolidation

7.9 The Department does not intend to consolidate the relevant legislation.

8. Consultation outcome

8.1 In accordance with Section 52D of the Transport Act 1980 the Department has consulted with the Trustee of the RPS. The Department has also consulted with the management committee of the 1994 Pensioners Section.

8.2 The original proposal as consulted on was to defer the payment of the Table B amounts until after 2094 and to cap the payments to the value of the remaining liabilities at that time. The Trustee expressed concern that such a long deferral could affect the value attributed to the Table B amounts as part of the triennial valuation of the Section. Subsequently, the Department decided to defer the payment of the Table B amounts until after 2030 rather than after 2094, and not to cap the payment of the outstanding balance of any Table B amounts in 2094. The Government Actuary's Department, as joint actuary of the 1994 Pensioners Section of the RPS, advised that in their view the deferral until after 2030 would not affect the current value of the Table B amounts for the purposes of the Sections' funding valuations, provided the

Secretary of State meets members' benefits on a pay as you go basis once the invested assets are depleted.

9. Guidance

9.1 The Department does not consider it necessary to provide any additional guidance as the deferral of payments does not impact on any other sections of the RPS nor will it have any bearing on the current or future pension payments made to the members of the Section.

10. Impact

10.1 There is no impact on business, charities or voluntary bodies.

10.2 There is no impact on the public sector.

10.3 An Impact Assessment has not been prepared for this instrument.

11. Regulating small business

11.1 The legislation does not apply to activities that are undertaken by small businesses.

12. Monitoring & Review

12.1 The 1994, 1995 and 2001 Orders, and this instrument, do not include the standard form review clause because they do not fall within the provisions of section 28(1) of the Small Business, Enterprise and Employment Act 2015. Review of the Orders will in due course take place as part of ongoing review of the funding of the Section as well as policy development and stakeholder consultation.

13. Contact

13.1 Sue Waring MBE at the Department for Transport, telephone: 020 7944 3946 or email: sue.waring@dft.gsi.gov.uk, can answer any queries regarding the instrument.