British Steel Pension Scheme

Annual Consultative Meeting
Scheme Actuary presentation

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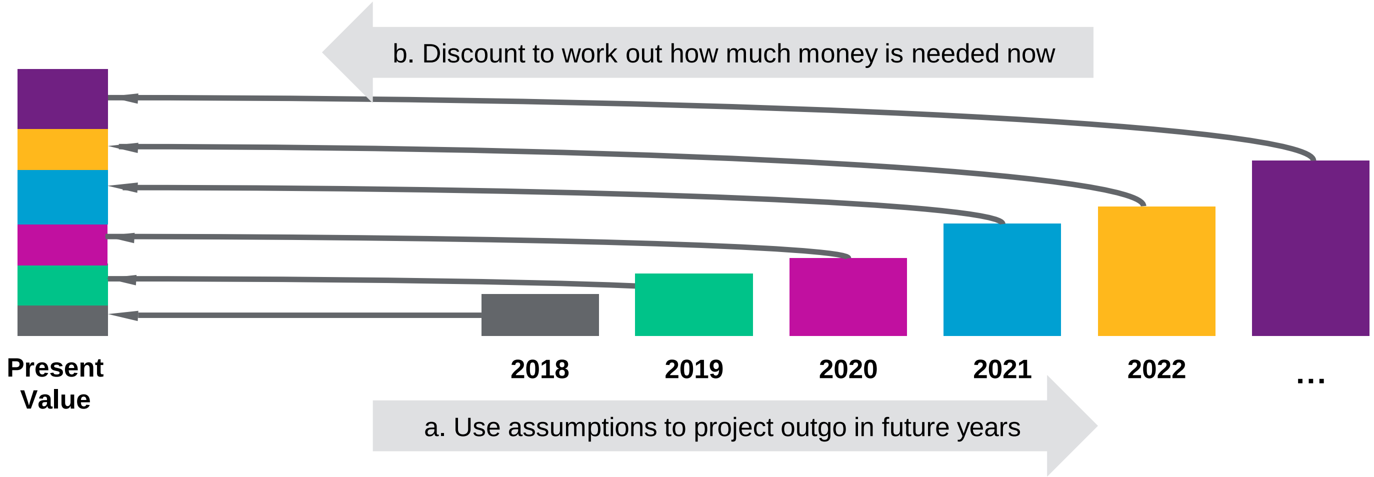
Topics I will cover in the next 30 minutes

1. The outcome of the Scheme's initial 2018 valuation
2. An update on Scheme funding as at 31 March 2019, including some commentary about membership developments over the year
3. A reminder about one of the Scheme's potential 'restoration' provisions, which may apply at the time of the next (2021) valuation
4. A brief update on actuarial factors

Reminder – what we do in an actuarial valuation

- The pension benefits that Members have earned in the Scheme will be paid for by one of three sources:
  1) Assets in the Scheme
  2) Investment returns on those assets
  3) Future contributions from Tata Steel UK (to cover any actuarial deficit)
- The valuation involves
  a. projecting future benefit payments to Members, and then
  b. discounting those payments back to a current value that we can compare with the value of the Scheme's assets.



- For this purpose, the discount rate used is a ***prudent*** assessment of the expected returns on Scheme assets.
- From a member benefit security perspective, you want money in the Scheme now rather than relying on (uncertain) future investment returns or additional contributions from TSUK to pay your pension. Reduced reliance on future ***long-term*** investment returns (ie use of a ***lower*** discount rate) = improved benefit security.

Key assumptions for the 2018 valuation

- When the new Scheme was set up, one of the issues that had already been agreed 'in principle' was the approach to funding. The Trustee agreed with TSUK the key assumptions for determining the Scheme's Technical Provisions (ie the present value of pensions payable to members) for the 2018 valuation as follows.

Key financial assumptions	New BSPS 2018 % pa*	*Old BSPS 2014* *% pa***
RPI inflation	N/A	*3.35*
CPI inflation	2.50	*2.60*
General pay increases	N/A	*4.35*
Increases to pensions in payment		
- Pre-April 1997 pension	Nil	*3.35*
- April 1997 - April 2005 pension	2.25	*3.35*
- Post-April 2005 pension	1.65	*3.35*
Investment return ("discount rate")		
- To value accrued benefits	1.80	*5.75 pre-ret*
- To calculate contributions required to finance future accrual of benefits	N/A	*3.80 post-ret*

* Rates shown for 2018 are single equivalent rates. In practice, term dependent assumptions were used.

** Pension increases shown applied to Main Section members only. Lower rates applied to post-2006 accrual for the 2014 valuation.

Key point: a very different Scheme and investment strategy in 2018 vs 2014 → very different assumptions

- **Demographic assumptions**: these are assumptions relating to what will happen to Scheme members eg when they retire, how long they will live, whether dependants' pensions are payable. The most significant assumptions are those relating to life expectancy, for which purpose the experience of the former BSPS was taken into account, together with allowance for improvements in life expectancy in future.

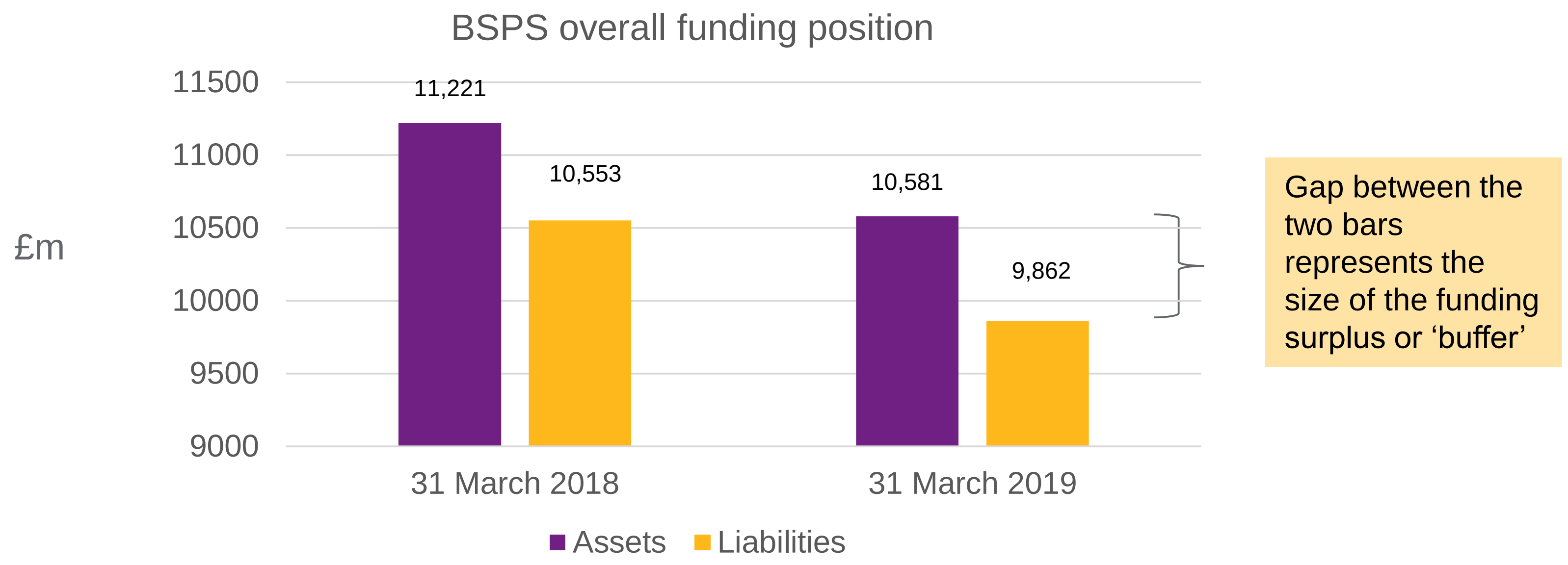
Summary of 2018 valuation results

	As at 31 March 2018 £m
Value of benefits accrued to 31 March 2018	
- Deferred members	2,886
- Retired members and dependants	7,479
plus GMP equalisation reserve[1]	47
plus PPF levy reserve	89
plus reserve for operational expenses	52
Total value of accrued benefits (“Technical Provisions”)	10,553
Market value of Scheme assets	11,221
Surplus/(deficit)	**668**
Funding level	106.3%

[1] The GMP equalisation reserve is to cover the potential additional costs arising as a result of a October 2018 judgment in relation to the Lloyds Bank pension schemes which confirmed that schemes must equalise for any differences in benefits between men and women arising as a result of the (unequal) “GMP” part of members’ pensions earned after May 1990. Some members may receive a small uplift to their pension in due course as a result.

Key point: more than enough assets to pay members’ future benefits, on a very prudent basis.
No additional contributions expected or required from TSUK

Movements in funding position over the year to 31 March 2019



- In years where there is no formal actuarial valuation (such as 2019) I am required to prepare an annual report on developments affecting the Scheme's funding position.
- This annual report takes into account changes in market conditions (eg inflation) and views on future investment returns, as well as any differences between what we expected to happen to members compared with what actually happened over the year.
- My 2019 report shows that overall, both assets and liabilities reduced in value over the year to 31 March 2019 – but with liabilities reducing by a bit more than assets, so that overall the surplus (or 'funding buffer') increased slightly.

Key point: the Scheme's financial position improved slightly over the year to 31 March 2019. All other things being equal, this is what we would expect as the funding assumptions are intended to be prudent

So what happened to Scheme liabilities over the year to 31 March 2019?

Financial market conditions

- Long-term inflation expectations increased slightly – this increases the value of both Scheme liabilities (higher pensions expected to be paid to members in future) and Scheme assets (because the Scheme hedges its inflation risk).
- Gilt yields (which are the reference measure used to determine assumed investment returns) reduced slightly, reducing the discount rate and increasing the value placed on future benefit payments.

Benefit payments

- All other things being equal, we would expect the value of the Scheme liabilities (and the assets) to reduce gradually over time, as pensions are paid out (pensions paid in Scheme year 2018/19 £475m).
- In addition, there was an exceptional one-off reduction in liabilities (and assets) at the start of Scheme year 2018/19 as a significant volume of transfer values were paid out, representing the final tranche of payments to members who elected to transfer out in conjunction with the 'Time to Choose' exercise (TVs paid out in Scheme year 2018/19 £647m).

Member experience

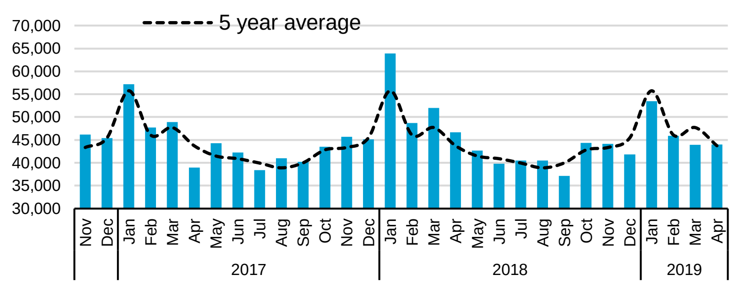
- We have analysed the mortality experience of Scheme pensioners over the year. This showed that there were fewer deaths amongst Scheme pensioners than we were expecting. Scheme liabilities therefore reduced by less than expected.
- This is consistent with more recent trends in wider population data, which have showed – for the first time in a while – a reduction in recorded deaths and a pick-up in life expectancy.

2019 mortality statistics (12 mths to April 2019)

6,000	4%
YTD reduction in death numbers (v 5-year average)	**Q1 mortality improvement*** (v Q1 2018)

**Age-standardised to allow for changes in the population*

England & Wales – monthly death registrations (Source: ONS)



What might lead to some benefit restoration in 2021?

- As noted earlier, benefits (or more specifically increases in benefits) are lower in the new Scheme than in the old BSPS. This was necessary for the new Scheme to be affordable. When the new Scheme was established, the Trustee and TSUK agreed some specific mechanisms whereby restoration payments could potentially be paid to some or all members in certain circumstances. One of these is the **2021 AV increase**.

What is it?	Who might benefit, and in what circumstances?
A one-off opportunity if the Scheme's financial position at the time of the 2021 actuarial valuation (AV) is better than expected	Members with some pre-April 1997 pension in payment at 31 March 2021 would be eligible for a lump sum payment if the actual 2021 position turns out to be better than assumed

How scope for restoration may arise

- In order to generate scope for 2021 AV restoration payments, the **actual** surplus at the 31 March 2021 valuation must exceed the **expected** surplus. This will only happen if actual Scheme membership experience is different from that assumed in the 2018 valuation, or investment performance is better than expected, leading to a gain for the Scheme. In particular:

Experience item	'Unexpected' additional surplus could arise if:
Investment returns	Investment returns over the three year period to 31.3.2021 are higher than a 'best estimate' rate
Inflation	CPI inflation is lower than assumed over the period
Mortality experience	More members die than is assumed
Retirements and commutation	More members retire than is assumed **and** commute more than 25% of pension on retirement
Proportion married	Of those members dying during the period, fewer than assumed have an eligible dependant

- In practice, actual experience for any of these items could also be **worse** than expected, reducing the likelihood of restoration.

Key point: the likelihood of restoration in conjunction with the 2021 valuation is largely out of the Trustee's control

Have there been any changes to actuarial factors this year?

- The Scheme uses actuarial factors to implement certain provisions of the Rules where members have options regarding their Scheme benefits eg converting part of their pension to tax-free cash (‘commutation’) at retirement.
- Following the completion of the 2018 actuarial valuation we reviewed the Scheme’s current actuarial factors and agreed the following with the Trustee.

Member option	Any changes?	Comments
Commutation	No	▪ The Company determines these factors, and reviews them as part of each triennial valuation. Any change from the Scheme’s initial factors needs to be reasonable ▪ No justification for a change at the present time
Transfer values	Yes	▪ Regulations require that transfer values should represent (at least) the Trustee’s best estimate of the cost of providing the member’s pension from the Scheme ▪ The Scheme’s transfer value terms were therefore updated to reflect latest views on expected future investment returns on Scheme assets. The impact of this was a small **increase** in transfer values - of around 1% on average ▪ More generally, transfer value calculations continue to incorporate an allowance for changes in market conditions. As gilt yields fall, transfer values increase (and vice versa)
Early retirement	No	▪ Reduction applied on early retirement should be ‘cost neutral’ ▪ These factors are less sensitive to a change in the underlying economic basis, and updating for the change in expected future investment returns referred to above has negligible impact. The practical impact is no change to previous terms
Late retirement	No	▪ Uplift applied on late retirement should be ‘cost neutral’ ▪ Same considerations as for early retirement – no changes apply
Trivial commutation	Yes	▪ These factors were updated to reflect the change in expected best estimate investment returns. This resulted in a small **increase** in lump sums payable

Key point: there were not many changes in actuarial factors arising from the 2019 review – any changes made were small and in members’ favour

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