HOUSE OF COMMONS LIBRARY

BRIEFING PAPER

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Digital Equipment Ltd's pension scheme

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1. Summary

Before April 1997 there was no general obligation on Defined Benefit (DB) schemes to increase pensions in payment, although many schemes did apply some form of inflation protection on a voluntary basis. Limited Price Indexation (LPI) – a requirement to increase pensions in line with the Retail Prices Index (RPI) capped at 5% was introduced in the *Pensions Act 1995* (s51), in respect of rights built up from April 1997.

The 'Digital Section' of the Hewlett Packard Retirement Plan contains provision for indexation of pre-1997 rights at the discretion of the employer. The Hewlett Packard Pensioners Association (HPPA) says that although pensioners received increases before 2002, they have since only had "two token 1% rises" and that this has resulted in a considerable diminution in the buying power of their pensions. It wants the law to be changed to require pension rights built up before 1997 to be index-linked in future.[1]

This briefing was prepared for the Westminster Hall debate on Tuesday 17 January on the 'Digital Equipment Ltd's pension scheme' and has been updated since[2]

2. DEC Ltd pensions

The Digital Equipment Company Ltd had a staff pension plan. Digital was acquired by Compaq in 1997. Compaq was then acquired by Hewlett Packard (HP) in 2002. The assets and liabilities of the Digital Plan were transferred to the Hewlett Packard Ltd Retirement Benefits Plan in October 2006. The rules of the 'Digital Section' of the HP plan provide for increases of pre-1997 pension rights, at the discretion of the principal employer.[3]

The company explained its approach to indexation in a letter to pensioners of 2002:

> The granting of such increases in the UK is the responsibility of the sponsoring employer, Hewlett-Packard Ltd. Any increase granted has to receive approval from Hewlett-Packard Company, HP Ltd's ultimate parent company.
>
> Factors which are considered when granting discretionary increases in the UK. When carrying out the annual review HP takes into account:

[1] HPPA Briefing Paper, Defined Benefit (DB) pensions and the need for legislative change, December 2016; Digital (HP) Pension Brief – update, January 2017
[2] HC Deb 17 January 2017 c270-284
[3] Determination by the Pensions Ombudsman, PO-4065, 2014

> 1) Inflation -Both the Retail Price Index (RPI) and what is commonly termed 'Pensioner Inflation' are considered.
>
> 2) Affordability -Any increase that is applied causes an increase to the company's Profit and Loss charge under US accounting standards.[4]

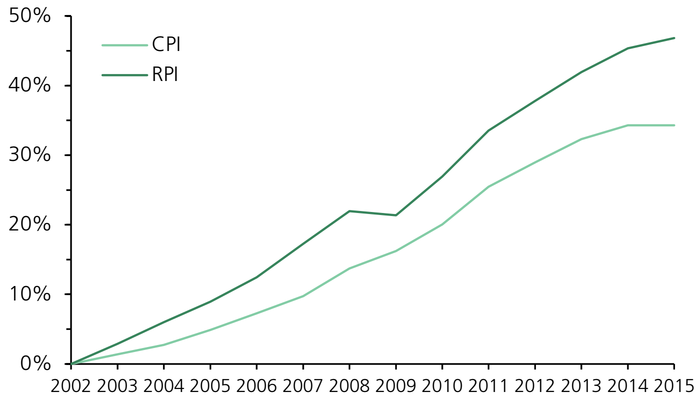
In 2014, the Pensions Ombudsman decided not to uphold a complaint from a member with pre-1997 rights. The complainant argued that the "provision of discretionary increases in excess of 0% was an established custom" before the merger but not after and that this had caused him "substantial financial loss". The Ombudsman said:

> […] I am satisfied that HP UK has exercised their discretion properly in respect of pension increases in accordance with the requirements set out in the Plan's governing documentation. The complaint about the Trustees is not upheld because the provision of discretionary increases in excess of 0% was never an established custom. Accordingly, the Trustees were under no obligation to protect it in the Merger Deed.[5]

The Hewlett Packard Pensioner Association (HPPA) represents around 3,500 members of the Plan with rights accrued before 1997. It says that since 2002, Hewlett Packard has paid only "two token 1% rises". It says that this has resulted in a diminution of the buying power of their pensions of almost 50%over 14 years (compared to the position if they had been index-linked by RPI). It argues this is unfair to pensioners given the financial position of the sponsor.[6]

The chart below shows that between 2002 and 2015 consumer prices (CPI) increased by 34% and retail prices (RPI) by 46%:

Percentage change in inflation, as measured by the Consumer Prices Index (CPI) and Retail Prices Index (RPI) compared to 2002



Sources ONS RPI All Items: Percentage change over 12 months; and ONS CPI: Consumer Prices Index (% change)

3. The campaign for change

HPPA is calling for the Government to change the law to require pension rights built up before 1997 to be indexed in future.[7] It says that the Government has so far resisted this on grounds of cost and the likely impact on scheme closures:

4 Response from HP UK Pensions Manager, 21 May 2002
5 Determination of the Pensions Ombudsman, Hewlett Packard Retirement Benefits Plan (PO04065)
6 HPPA Briefing Paper, Defined Benefit (DB) pensions and the need for legislative change, December 2016
7 HPPA Briefing Paper, Defined Benefit (DB) pensions and the need for legislative change, December 2016

> The Minister for Pensions has been invited to state what objections there might be to implementing this change, and he has commented as follows:
>
> *When the statutory requirement to increase pensions was introduced, it was not backdated to cover pension rights accrued before 1997. To have introduced the requirement with retrospective effect would have meant imposing very substantial costs on workplace pension schemes. As schemes would not have had the chance to build up funding to cover these extra financial liabilities, the effect would have been widespread scheme closures, in some cases extending to the scheme winding up with insufficient resources to pay out pensions in full. This would be even more likely in the current economic climate should we consider extending the statutory requirements.*[8]

The HPPA question this analysis, arguing that many schemes already provide increases on pension rights built up before 1997.

The table below, based on data from the ONS Occupational Pensions Scheme Survey, shows that in 2015 there were around 5.2 million Defined Benefit schemes in payment in the UK with rights accrued before 1997. Of these, 0.4 million (8%) were paid no increase in 2015. Around 2.1 million (60%) were paid an increase of below 2%.[9]

Number of private Defined Benefit pension in payment, by increase paid in given year, UK
Millions

Increase received	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Pensions in payment with rights accrued before 1997										
No increase	0.4	0.4	0.3	1.2	2.0	0.6		0.5	0.4	0.4
0.01% to 1.99%	0.1	0.0	0.0	1.2	0.1	0.0		0.0	0.3	2.7
2.00% to 2.99%	2.9	0.2	0.1	0.3	0.7	0.2		1.7	2.4	1.4
3.00% to 3.99%	1.3	2.2	2.1	0.5	1.0	1.2		2.3	1.2	0.6
4.00% or more	0.1	1.8	2.1	1.5	0.7	2.5		0.1	0.3	0.1
Total schemes	**4.8**	**4.6**	**4.6**	**4.7**	**4.5**	**4.5**		**4.6**	**4.6**	**5.2**
Of which receiving an increase of 2.00% or more	4.3	4.2	4.3	2.3	2.4	3.9		4.1	3.9	2.1
Percentages										
No increase	*8%*	*9%*	*7%*	*26%*	*44%*	*13%*		*11%*	*9%*	*8%*
0.01% to 1.99%	*2%*	*0%*	*0%*	*26%*	*2%*	*0%*		*0%*	*7%*	*52%*
2.00% or more	*90%*	*91%*	*93%*	*49%*	*53%*	*87%*		*89%*	*85%*	*40%*

Source ONS Occupational Pensions Schemes Surveys

4. Statutory requirements

Defined Benefit (DB) schemes provide pension benefits based on salary and length of service. There are statutory minimum requirements on them to index pensions in payment in line with inflation, capped at 5% for benefits accruing from service between April 1997 and April 2005, and at 2.5% for benefits accruing from April 2005. This is known as Limited Price Indexation (LPI).[10]

Before April 1997 there was no general obligation on Defined Benefit schemes to increase pensions in payment (although there was a requirement on schemes that were contracted out of SERPS to provide indexation capped at 3% on rights accrued from 1988).[11]

8 Ibid
9 ONS Occupational Pension Scheme Surveys, 2006 to 2011 and 2012 to 2015.
10 *Pensions Act 1995*, s51
11 SN-04956 Guaranteed Minimum Pension – annual increases (2015)

Importantly, these are statutory minimum requirements. There is nothing to prevent schemes from making more generous arrangements through their scheme rules.[12]

Despite the fact that indexation was not made mandatory for rights accrued before 1997, it appears that many schemes did apply some form of inflation protection to pensions in payment *on a voluntary basis* and many applied LPI retrospectively to service before 1997.[13]

Development of the rules

In 1993, the Pension Law Review Committee, chaired by Professor Roy Goode, pointed out that, from the individual's perspective:

> Most important is the uncertainty with regard to inflation. The individual is concerned not with money amounts but with what the pension will buy.[14]

Despite this, the Committee did not recommend making LPI retrospective. This was because it:

> […] recognised that to require all earnings-related schemes to introduce LPI for pension rights accrued before the appointed date would place a considerable burden of costs on such schemes.[15]

The Labour Government legislated to reduce the LPI cap to 2.5% for rights accrued from April 2005 in the *Pensions Act 2004* (s278-9). Following a consultation, it had decided that "mandating some level of protection from inflation remains desirable" but that lower inflation levels made a reduction in the cap appropriate:

> In 1995, when the legislation introducing LPI was passed, long-term expectations of inflation were significantly higher: the 5 per cent cap was only intended to provide for partial cover against inflation. But the Government's success in reducing inflation means that mandatory indexation has effectively become full inflation cover, something which is proving disproportionately expensive for some schemes to provide.[16]

In December 2006, an independent review looked at whether LPI should be removed. However, the reviewers – representing the employer and union sides - were unable to agree.[17] The Labour Government decided not to remove the requirement on the grounds that it was an important protection for members and there was no clear evidence that removing it would have a direct and significant effect on employer provision.[18]

From April 2011, the Coalition Government changed the measure of inflation used for determining the annual minimum increases from the Retail Price Index (RPI) to the Consumer Prices Index (CPI).[19] The change was controversial because the CPI inflation tends to be lower than RPI inflation.[20] The impact of the legislative change on individual schemes would depend on what their rules said.[21] In its recent report on Defined Benefit pension schemes, the Work and Pensions Select Committee said schemes that had

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12 HC Deb, 19 July 2010, c4
13 Lewin and Sweeney, Deregulatory Review of Private Pensions- a consultation paper, March 2007
14 *Pension Law Reform. The report of the Pension Law Review Committee*, para 3.1.10
15 *Pension Law Reform. The report of the Pension Law Review Committee*, vol 1
16 DWP, Simplicity, security and choice: Working and saving for retirement. Action on occupational pensions, June 2003, Cm 5835, p23, para 9
17 Lewin and Sweeney, Deregulatory Review of Private Pensions. A Consultation Paper, March 2007
18 DWP, Deregulatory review – Government response, October 2007, p5-6
19 HC Deb, 8 July 2010, c14-16 WS
20 Work and Pensions Select Committee, Defined Benefit pension schemes, HC 55, April 2016; OBR, Working paper No. 2: The long-run difference between RPI and CPI inflation, Ruth Miller, November 2011
21 DWP, Impact of the move to CPI for occupational pensions, 12 July 2011

latitude in their rules to switch to the CPI had tended to do so.[22] It recommended that the Government consult on "permitting trustees to propose changes to scheme indexation rules in the interests of members":

> **Pension promises are just that. Any change to the terms of them should not be taken lightly. In circumstances where an adjustment to the scheme rules would make the scheme substantially more sustainable, however, a reduction in benefits could well be in the interests of members.**[23]

For more detail, see Library briefing paper SBP-05656 Occupational pension scheme increases (November 2016).

5. Westminster Hall debate

Opening the Westminster Hall debate on the Digital Equipment Ltd: Pension Scheme on 17 January 2017, Corri Wilson drew attention to the impact on scheme members of not receiving indexation on pre-1997 pension rights:

> The Hewlett Packard Pension Association claims that withheld cost of living increases have so far cost pensioners an average of £24,000 compared with their colleagues whose contributions were made post-1997. That has led to severe financial hardship for many of those pensioners and has resulted in them being unable to afford an ordinary living pattern, being on the verge of poverty and requiring Government subsidies in the form of income support benefits.[24]

She called on the Government to address the issue in its forthcoming Green Paper on defined benefit pension schemes:

> The change that HPPA is seeking is for the discrimination between pre-1997 and post-1997 contributions to be removed from legislation, and the minimum permissible increases for all defined-benefit pensions in payment in future to be indexed in line with increases in the retail prices index. Will the Government look at that in their forthcoming Green Paper?[25]

Peter Bottomley though trade unions and shareholders should "ask HP whether it thinks it is socially responsible to discriminate between the different groups of UK employees it has taken over by acquisition."[26]

Opposition spokesperson Alex Cunningham said that the issue was one of "facing increased difficulty and being on the verge of poverty in many cases". He argued that HP was not fulfilling its moral duties:

> How has Hewlett Packard dealt with other pensioners in its group? Much, much better. Pensioners in all of Hewlett Packard's European subsidiaries, except in the UK, have received regular cost of living increases. This is a case not of a business being unable to increase pensions in line with the cost of living, but of a large international corporation using a loophole in UK legislation to give it a window to not fulfil what is a moral duty. I wonder what its problem is with treating its British pensioners the same as others.[27]

He said the Government should use the fact that HP was its largest IT supplier to "put pressure on Hewlett Packard" to "fulfil its moral responsibility, although not a legal one, to ensure that those workers are treated fairly in retirement."[28]

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22 Work and Pensions Select Committee, Defined Benefit pension schemes, HC 55, 21 December 2016
23 Ibid, para 110-11
24 HC Deb 17 January 2017 c272WH
25 Ibid
26 Ibid c274WH
27 Ibid c277
28 Ibid c278

The then Pensions Minister Richard Harrington responded that Government had a broad principle of not imposing requirements retrospectively:

> The Government have a broad principle in legislation, which I think is generally fair, of not imposing such retrospective changes, because of uncertainty. There is no doubt that this kind of change—this is not the only one we are lobbied about—will place unexpected and significant costs on employers.[29]

When legislation was first passed to require limited price indexation, the government of the time had been conscious of the need to balance the interests of different parties. The same applied now:

> We believe that the Government retrospectively changing the legislative requirements on indexation would be inappropriate and would have a significant impact on the schemes of employers involved. The legislation introduced in 1995, by Harold Macmillan's successors in a Conservative Government, was introduced to provide a limited level of inflation protection. The then Government were conscious of this balance between protection against inflation and the ability of the schemes, and the employers who stand behind them, to afford such protection. Of course, the financial deficits in defined-benefit schemes are very much a topic of conversation in this House and in the press—particularly the trade press—and are something that will be discussed in the Green Paper.[30]

Regarding the company's moral responsibilities he said:

> He said that the fact that the Government spend significant amounts of money with Hewlett Packard could be used as a point of pressure. I cannot really comment on that. I do not have anything in my office, to the best of knowledge and belief, from Hewlett Packard, but I know that the Government have strict rules about things they can and cannot use as investment criteria[31]

In March 2017, Mr Harrington said the company was meeting its legal obligations:

> I have met senior representatives from the company to present the pensioners' arguments and make clear my interest in the matter.
>
> However, the company is meeting its legal obligations.
>
> Any increases to pensions in payment are likely to mean significant additional expenditure for any scheme and its sponsoring employer. Therefore, the Government has no plans to require all schemes to pay increases on pre-1997 pensions.[32]

The February 2017 DB Green Paper contained no proposal to increase the requirements on employers regarding indexation of pre-1997 rights. Rather, it said there could be a case for allowing employers to suspend indexation in cases where they were stressed and the scheme underfunded.[33] It intends to publish a White Paper later in 2017.[34]

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29 Ibid c279WH
30 Ibid c281-2WH
31 Ibid c280WH
32 PQ 69179 30 March 2017
33 DWP, Security and Sustainability in Defined Benefit Pension Schemes, Cm 9412, February 2017, p61-5
34 HCWS48, 13 July 2017