FINANCIAL NEWS

# Why isn't the Pensions Regulator chasing Lufthansa?

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**Staff at the small UK airline BMI, owned by German group Lufthansa, will have woken this morning to the unwelcome news that their pensions will likely be cut - but why is the UK's Pensions Regulator accepting this, when it has pursued foreign companies for pensions bailouts before?**

In a statement yesterday, Lufthansa announced that the British Midland Airways Limited Pension and Life Assurance Scheme will be transferred to the UK's Pension Protection Fund, which is a lifeboat for pension funds whose parent companies go bust.

Lufthansa will top the scheme up with a one-off payment of £84m before the transfer, and the Pensions Regulator, a government watchdog, has approved the deal, the company added.

The arrangement is part of a deal between Lufthansa and International Airlines Group, the parent of British flag-carrier BA and Spanish airline Iberia, to acquire BMI for up to £172.5m. While BMI has been lossmaking for some time, the company owns landing slots at Heathrow, the UK's busiest airport. These have been estimated to be worth at least £500m.

Pensions lawyers expressed initial surprise this morning that the Regulator had signed off on the pensions transfer - especially as the scheme is understood to be in deficit to the tune of about £180m, and will thus have a small, but certainly negative, effect on the PPF's own solvency.

Jennie Kreser, head of the pensions practice at Silverman Sherliker, said: "The Regulator has a statutory duty to protect the Pension Protection Fund, so it would have to have been pretty satisfied that the deal it has approved is a better option for everyone than pursuing Lufthansa with a Financial Support Direction."

And it is not just about protecting the solvency of the PPF, but also the financial interests of BMI's staff. The PPF will offer them only about 90% of the pensions they would have received if the BMI scheme and its parent company had continued solvent.

The PPF's pension 'compensation' is also subject to an overall cap of £34,049 per annum, meaning that pilots in particular, who are above-average earners, will likely face cuts to their pensions that are far steeper than 10%.

Staff unions are furious. Jim McAuslan, general secretary of pilots' union BALPA, said BMI's pilots were "rightly outraged" and said he would be seeking urgent meetings with the Pensions Regulator to press for a "fair outcome".

The UK's Pensions Regulator has two principal powers it can use to chase companies for payments to 'abandoned' schemes. But these powers require legal tests to be passed before they are deployed.

The first, a Contribution Notice, depends on the Regulator proving some kind of active misdemeanour on the part of the company - an effort to shuffle finances around, for example, to put money beyond the pension scheme's use.

The second, the FSD, has wider applicability. To use this the Regulator only has to prove that another company in the same group as the pension scheme's direct parent - in this case, Lufthansa - had financially benefited in some way from the pension scheme's existence.

This would seem an easier test to pass, as the BMI pension scheme has surely been a recruitment-and-retention benefit to BMI, and hence to Lufthansa.

Yet the Regulator's calculation in this case will probably have been "finely balanced", according to Kreser. The £84m the German group is stumping up will be ring-fenced from the rest of the scheme, meaning that it can only be used for the purposes of topping up the benefits promised by the PPF.

In its statement, Lufthansa stressed: "These top-up payments totaling £84m will compensate the bulk of losses [the differences between the expected pension payments and those paid by the PPF] for most members of the scheme."

If one accepts that, the deficit in the BMI scheme is immaterial. Deficit or no, the PPF is obliged to pay up to the 90%, though subject to the cap. The remaining 10% can be met out of Lufthansa's £84m. However, it remains doubtful whether the scheme's high-earning pilots will be compensated for the full value of what they had been promised.

If nothing else, companies and their corporate finance advisers can take two lessons from today's BMI announcement.

One, the powers of the UK's Pensions Regulator are not infinite, even if they might sometimes seem so. There are legal limits on when it can demand extra money from firms.

And two, it helps to be proactive. Lufthansa went to the Regulator with this proposal, not the other way around. It initially offered to continue to support the scheme in full, but in a way the Regulator found unsatisfactory. Today's announcement represents a compromise everyone could live with - except the unions and disgruntled staff, of course.

The Pensions Regulator declined to comment on specific cases.

***Update: This story was updated on 20/04/12 to add a paragraph explaining the operation of the PPF cap of £34,049 a year and its effect on pilots' pensions.