

Business, Innovation and Skills Committee with the Work and Pensions Committee

Oral evidence: The sale and acquisition of BHS, HC 824

Monday 9 May 2016

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Members present: Rt Hon Frank Field (Chair), Iain Wright, Mhairi Black, Richard Fuller, Richard Graham, Craig Mackinlay, Steve McCabe, Amanda Milling, Jeremy Quin, Amanda Solloway, Michelle Thomson

Questions 1 - 197

Witness: Alan Rubenstein, Chief Executive, Pension Protection Fund, gave evidence.

Chair: Before I ask you to identify yourself for the sake of the record, I will just put on our record that, while I am chairing this one, the next session, which will hear from Arcadia's advisors, will be chaired by Iain. I will chair the one on the trustees and Iain will chair the one with Dominic Chappell et al.

Q1 Mr Wright: Alan, welcome. To what extent does the entry of large schemes such as the BHS pension scheme and others, such as the British Steel Pension Scheme, damage the PPF's balance sheet?

Alan Rubenstein: I do not think it damages the balance sheet as such in the sense that, if we look at the impact of the BHS scheme, that scheme will be accounted for in our results for 2015-2016, and so is already taken into account. Clearly there is a cost. On the basis of the written evidence submitted to the Committee, we estimate at this stage that the shortfall between the value of the assets of the scheme and the value of PPF liabilities that will be taken on is approximately £275 million between the two schemes.

Q2 Craig Mackinlay: What might the entry of the BHS scheme into the fund do to the levy payable by other members into the future?

Alan Rubenstein: In the first instance there will be no impact because we anticipate each year that a number of schemes will fail, and we try to set levy on a long-term basis. The failure of any individual scheme does not impact the levy. Obviously, in the longer term,

the greater the number of failures, the greater the amount of levy and vice-versa: if we see fewer failures or schemes that are better funded when they fail, then the levy needs to be less because the levy is the balancing item between the amount of assets that schemes bring in and the liabilities.

Q3 Craig Mackinlay: Are you saying that the BHS scheme is not enough to cause an upwards blip of the levy amount on its own?

Alan Rubenstein: That is correct.

Q4 Craig Mackinlay: You could probably factor it in with your thoughts for the year.

Alan Rubenstein: Indeed.

Q5 Chair: When you do these difficult calculations, do you have a list of risk companies that you think might well end up in the PPF?

Alan Rubenstein: We have a regular dialogue with the Pensions Regulator about companies that are in the lower realms of our insolvency numbers. Those companies change because insolvency probabilities vary.

Q6 Chair: Do you think your powers are adequate when you have those discussions, or do you have no powers?

Alan Rubenstein: We have no powers. The system is set up such that the Pensions Regulator has the job of supervising the funding of pension schemes and has the anti-avoidance powers to prevent people from taking advantage of the system; the Pension Protection Fund, which is us, is responsible for charging the levy on pension schemes and for paying compensation to the members of schemes whose employers have failed and where there are inadequate amounts in the scheme to meet the liabilities promised.

Q7 Chair: When did BHS cross your radar scheme as a worry?

Alan Rubenstein: The first time BHS crossed our radar would have been in 2012, and that was because at that stage we were conducting an exercise on the guarantees that employers had provided to their pension schemes. BHS was one of a number of schemes that would have seen their levies rise. They asked for a meeting to talk about the guarantee, which we attended, and they subsequently withdrew that guarantee. That was the first time.

Q8 Jeremy Quin: That is fascinating. Presumably that was prior to the 2012 recovery plan being submitted to the Pensions Regulator.

Alan Rubenstein: Yes, it would have been well ahead of that because the meeting would have been in March and the valuation would have been done probably six to 12 months after that.

Q9 Jeremy Quin: Prior to the submission to the regulator of the 2012 recovery plan, it was on the radar as a source of concern.

Alan Rubenstein: Yes, to the extent that there were a number of schemes who had offered guarantees that we felt were not justified, and so we had written to a number of schemes, of which BHS was one, and they requested a meeting to discuss it. As a result of that meeting, they subsequently withdrew the guarantee that they had put in place for the previous year.

Q10 Chair: How soon afterwards did you talk with the Pensions Regulator about their concern?

Alan Rubenstein: That was a specific guarantee-related issue, which we would have raised with the Pensions Regulator pretty much straightaway. We have regular meetings to share information and that is the kind of intelligence we would share with them. We also shared it with Ministers because at that time Sir Philip indicated that he was unhappy with the policy and wished to discuss that with the Pensions Minister, which I believe he subsequently did.

Q11 Chair: How many meetings do you have with the Pensions Minister registering concerns?

Alan Rubenstein: We have regular meetings with the Minister—typically quarterly—to discuss matters of interest—normally his or her interest, I should say. We would normally have a quarterly meeting with the Pensions Regulator to discuss the schemes that were of concern to them or to us in order to share intelligence.

Q12 Amanda Milling: You have got processes in place and you have got a dialogue in place and you have meetings with the regulator. Does the BHS episode suggest that the early-warning system that has been designed to prevent pensions being dumped into the Pension Protection Fund is actually inadequate?

Alan Rubenstein: I am not sure it necessarily does. Clearly there are lessons to be learned here but the exchange of information took place and the regulator then had to evaluate the 2012 recovery plan when it came in. They have two duties: one is to protect the PPF; the other is to balance that against their growth objective. That is really a question that they are better placed to answer than me in terms of what they did with that information.

Q13 Amanda Milling: You mentioned at the start that there are lessons to be learned. Could you outline what you feel those lessons are?

Alan Rubenstein: Certainly we have learned that 23-year recovery plans are rather ambitious, and so I think one of our concerns would be for the Committee to think about whether or not there ought to be some natural limit within the flexibility that is offered to schemes. There has to be some flexibility in the system for funding, clearly.

Q14 Richard Fuller: You just mentioned the 23-year recovery plan—that is the 23 years of British Home Stores' recovery plan. How many other plans have you seen with a 23-year recovery period or longer?

Alan Rubenstein: We would not normally see that; the regulator is responsible for supervising plans and agreeing the lengths of the plans with the trustees and the companies.

Q15 Richard Fuller: Do you have a 23-year period recovery? Is yours a 23-year period of recovery?

Alan Rubenstein: I am not quite sure what you mean.

Q16 Richard Fuller: When you put together a recovery plan for all the plans that you see and that come to you, in order to get them into balance, do you use 23 years or substantially less?

Alan Rubenstein: In our case it does not work in quite the same manner. The PPF is, as you know, funded by a levy on solvent schemes and the objective we have set ourselves is that by 2030 we should be in a position where the only levy we would charge is to cover any fresh claims; in other words, by 2030 we want to be in a position where we have sufficient funds to meet the long-term cost of all plans.

Q17 Richard Fuller: So the PPF takes the funds that are the most troubled and which cannot be met by the assets of the companies where the funds are in the first place and, for the recovery of those funds, you have a target of 14 years to get that back into balance.

Alan Rubenstein: No, that is not quite accurate. In fact, the only time schemes come to us is if the employer is insolvent, so there is no choice involved in it. The scheme transfers to a PPF simply if the employer becomes insolvent and the pension plan is under-funded. That is met by a combination of taking over the assets and liabilities, investment returns, recoveries and the levy; so, if you look at our current position for example, you will see that we are in fact about 115% funded, so we have a reserve of about 15% or around £3.5 billion at present.

Q18 Richard Fuller: The reason I am pressing you on that is because 23 years, which you deftly avoided, sounds exceptional as a recovery period. I am just querying why a company would look for a 23-year recovery period when most other companies have substantially less. There used to be a 10-year period. Why would a company want 23 years?

Alan Rubenstein: I think the question of any individual case is probably something for the regulator. What I can say is that, if you look at the average recovery period, that started off at about eight years back in 2006 and has in fact grown slightly to around nine years now. In those circumstances, certainly a 23-year recovery plan is more than twice the average.

Q19 Richard Fuller: If I was to call it exceptional, that would be a fair comment.

Alan Rubenstein: I believe so, yes.

Q20 Chair: When did the PPF learn it was a 23-year recovery plan?

Alan Rubenstein: Not until we got involved in discussions about re-structuring, which would have been much later on.

Q21 Chair: Would you have had a view if it came to you earlier?

Alan Rubenstein: We were always going to be of the view that the shorter the recovery plan the better, and the obvious reason for that is that the better funded a scheme is the less risk there is of a large call on the PPF, which ultimately, as we have said, has to be met by other schemes. We would always push the regulator to keep the recovery plans as short as possible, but that is easy for me to do because I have a single purpose whereas the regulator has to balance their objectives between competing forces.

Q22 Craig Mackinlay: Just to pursue that a little further, once the insolvent company schemes have landed in your lap, and you have reviewed what sort of recovery periods were there, have you noticed a pattern of very long recovery time periods, such as 23 years or 15 years? Have they all been fairly long? I am trying to get to why they are so long so they would be in some distress for some time.

Alan Rubenstein: We would not normally focus on the recovery period for a plan that has failed. Our focus would be on the members and making sure that we can assess the liabilities and the assets of the scheme as quickly as possible and to make sure that we can provide certainty for the scheme members as quickly as we can.

Q23 Jeremy Quin: You just mentioned your remit, which is very clear and which puts you in an easier position than some. In the case of the regulator, as you have already alluded to yourself, they do have split objectives as part of the 2004 Act and the 2014 Act in terms of what they are required to do. 23 years is an extraordinary length of time but are there other options that you would regularly see in the circumstances of a loss-making company with a limited asset base?

Alan Rubenstein: The question of agreeing recovery plans is really one for the regulator because they have the full picture. The picture we get is of some measure of the financial strength of the company, which feeds into our calculation of the levies since the levy is overwhelmingly risk-based. As I mentioned before, companies that come down the bottom of that list will naturally be topics of conversation with the regulator at our regular risk meetings.

Q24 Jeremy Quin: Would you say it is a difficult remit for the regulator to meet?

Alan Rubenstein: It is a challenging remit but, broadly speaking, they do a reasonable job at it. Nearly a quarter of a million people are better off today in terms of the pensions that they can now receive than they would have been had the legislation not been there. The regulator has used their anti-avoidance powers in the past so, broadly speaking, we are on the right track; but, as I said before, that does not mean we cannot make things better.

Q25 Michelle Thomson: Hello. Thank you for coming along today. In terms of the communication between the Pensions Regulator and yourself, do you have sufficient oversight of what potentially might be coming down the track from the regulator, given that you have to extrapolate and to forecast in order to meet the levels that you need to pay out in regards to 2030 and how you need to change the levy and so on? Do you have sufficient

oversight of what is coming down the track from the Pensions Regulator or are you continually on the back foot?

Alan Rubenstein: I am not sure I would call it “oversight”. We have our own model that predicts the likely level of insolvencies going forward to 2030. It is a stochastic model that looks at a number of scenarios.

Q26 Michelle Thomson: How much specific input do you get from the regulator for that model? Is it sufficient for you to forecast accurately in order to meet your compensation levels?

Alan Rubenstein: We do not get any specific input from the regulator for that model other than data they provide us about the scheme funding. In terms of specific cases where we have a concern or they have a concern, the regulator will let us know when they are concerned about a company or, typically, when they have been approached by a company that wishes to carry out a regulated apportionment arrangement—in other words to effectively make part of the company insolvent and for the pension scheme to pass to the PPF. In those cases, we do have a very lively—

Q27 Michelle Thomson: Do you get it early enough? Are you always on the back foot in terms of the forecasting that you need to do?

Alan Rubenstein: From our point of view, we have enough information because we will always be involved if there is a regulated apportionment arrangement since the requirement is, first, that the company must be insolvent otherwise; we test that out. Secondly, we make sure that the recovery that is offered from the company to put the scheme through the RAA is a better outcome than we would have otherwise achieved through the insolvency. Thirdly, it is a requirement that the PPF as a creditor is treated fairly in that process, which does not necessarily mean equally but certainly means that everybody should share some pain. Finally, one of our other conditions is that the regulator must not feel that the use of their anti-avoidance powers would generate a better outcome for the fund than taking a deal. Those are the tests that we put through.

Q28 Chair: The first time you had worries about BHS, was it you raising it with the regulator or the regulator raising it with you?

Alan Rubenstein: If you go back to 2012, it was simply us passing on the piece of intelligence, which was that the company had been looking at using one of the Arcadia Group companies to guarantee a pension fund and had, in the end, withdrawn that guarantee. Later on, the regulator brought us into discussions when they received proposals from the company about restructuring.

Q29 Chair: So Arcadia withdrew a guarantee. Was that before large dividend payments were disbursed?

Alan Rubenstein: That I could not tell you. In March 2012 they decided not to recertify the guarantee.

Q30 Steve McCabe: Good afternoon. You were quoted in the *Financial Times* last year as calling on the regulator to be as robust as possible. What did you mean by that and what were you calling on the regulator to do?

Alan Rubenstein: That is an extract from a minute of the regulator's board meeting at which they had asked me to present. As part of our arrangements to make sure that we act in a joined-up manner, I attend meetings of the regulator's board and Lesley Titcomb, their chief executive, attends our board. At that meeting I had been asked to give an update on the PPF, and one of the points I was making was that scheme funding was still not very strong. The PPF 7800 index at the end of March suggested that the combined deficit of UK pensions on a PPF basis—that is not a fall-back basis; it is simply the amount required to meet PPF liabilities—was around £300 billion, and that five out of six pension schemes were in deficit; there are roughly 6,000 defined benefit schemes still around in the UK today. Against that background, you would probably expect the chief executive of the PPF to encourage the TPR board to do as much as it can to deal with that problem.

Q31 Steve McCabe: To be a bit tougher. Is that a fair assumption?

Alan Rubenstein: I recognise that they have competing priorities and so I am fortunate that I have a single role to fill, which is to protect members of pension schemes against losing all their pensions. I acknowledge that it would be tough for them.

Q32 Steve McCabe: Would it be reasonable to conclude from the answers you have given earlier that the 23-year recovery period is not exactly an example of the robustness that you were seeking?

Alan Rubenstein: I do not know the circumstances that led the trustees and the company to discuss and propose that. I also do not know what the reaction of the regulator necessarily was. That is a question that you need to put to Lesley.

Q33 Steve McCabe: I understand that and I understand that you cannot speak for them, but, if you are saying that you were worried about resources and you were worried about the number of schemes and you were trying to be frank and as robust as possible, were you at all surprised to discover that a 23-year recovery scheme had been proposed? Is that consistent with the message that you were trying to give the regulator at the joint meeting?

Alan Rubenstein: It is clear that I would like recovery periods to be as short as practically possible, and I will continue to press the regulator to do that, but I do recognise that they have issues that they need to address in terms of company profitability and solvency, and do not want to push companies over the edge.

Q34 Chair: Did you say “as robust as possible”? Were they your actual words that were supposedly recorded in the minutes?

Alan Rubenstein: I honestly cannot remember.

Q35 Chair: Presumably you checked the minutes, did you not? You had a copy of them.

Alan Rubenstein: Yes, I would have seen the minutes but I took them to be a paraphrase of quite a long presentation.

Q36 Chair: We obviously could ask the Pensions Regulator for a copy of those minutes, could we not?

Alan Rubenstein: I think those minutes use those words, because their minutes are actually published on their website.

Q37 Chair: Was there a discussion on whether your comments were fair or not?

Alan Rubenstein: No, I think the regulator understood my view on recovery plans. I certainly regard the minutes as a fair reflection of the discussions.

Q38 Richard Graham: You have very succinctly described the focus of the PPF as compensation, whereas the focus of the Pensions Regulator is on supervision, so, in a sense, we are discussing the other way around, which is, if the schemes end up as part of the PPF liabilities, how you would handle it and what the implications of that would be. One of your three ways of effectively generating assets and returns from the PPF is by claims on insolvent scheme employers. At this stage, what do you think the likelihood of the PPF trying a claim on the insolvent BHS is likely to be?

Alan Rubenstein: The current position, as you know, is that the section 75 deficit on both schemes is £571 million; and, in the circumstances of an insolvency, we take over the trustees' right as claimants so we have a claim on BHS for £571 million as an unsecured creditor. I am not yet in a position to say what the outcome of that would be, because we need the administrators to do rather more work. As you also know, the regulator currently has an inquiry into the circumstances surrounding that; until that concludes, we will not know the actual recovery for the PPF, and hence the scheme will stay in assessment until we know that outcome.

Q39 Richard Graham: If you assume the worst from the PPF's point of view, and that there will be nothing that comes out of any claim that you might make, and given the size of the PPF deficit, which I assume is based on a 90% pay-out to scheme members, what is the necessary investment return required, bearing in mind the duration of the liabilities and so on, that you would need to generate to be able to effectively pay it off using simply the assets of the scheme that you take in?

Alan Rubenstein: First, can I just clarify that, for members who have passed the scheme retirement age, the pay-out is 100% of their current benefit, not 90%.

Q40 Richard Graham: For the 6,000 existing pensioners.

Alan Rubenstein: For the existing pensioners, correct. For the deferred pensioners, the structure of the compensation is that they will receive 90% of their accrued benefit up to a cap, which, based on our calculations, will not affect any members of the main scheme but will affect approximately 10 members out of the senior staff scheme.

Q41 Richard Graham: Focusing on the main scheme then, and the existing pensioners and the remainder of their lives and then the 13,500 deferred members, what calculation have you made?

Alan Rubenstein: The calculations we would make are, first, about the size of the deficit. Obviously, we have yet to make detailed calculations and the £270 million number that was in our written evidence is still an estimate based on the 2012 valuation for both schemes with the assets and liabilities rolled forward. I would say it is reasonable to think that it is somewhere between £250 million and £300 million with £275 million as our point estimate, which we have included in our balance sheet as at 31 March.

Q42 Richard Graham: Just to be clear for the Committee, that includes an assumption about investment return.

Alan Rubenstein: Yes.

Q43 Richard Graham: Which is what, roughly?

Alan Rubenstein: That includes a discount rate that is similar to the value an insurance company would use on buy-out, and that is mandated in the Pensions Act 2004; we have to use that kind of approach.

Q44 Richard Graham: So, in simple terms, effectively the liabilities of the scheme for both existing and deferred members again would have to be subsidised by assets from elsewhere.

Alan Rubenstein: Yes. The funding of the PPF is composed of the transfer of assets, the recovery from insolvent employers and the levy and the returns on the asset pool.

Q45 Richard Graham: Yes. But clearly if your own fund performance exceeds the assumptions made in your calculation, that is going to be a benefit in reducing the liabilities that have to be subsidised from somewhere else. However, if the reverse happens, then of course that figure increases.

Alan Rubenstein: Correct, although ultimately that would flow through in levy.

Q46 Richard Graham: Right. Earlier you said in answer to a question from the Chairman that you were not anticipating any increase in the levy from taking on BHS pension scheme liabilities. Does that hold true under any circumstance or should the investment performance be very different?

Alan Rubenstein: The way I tend to think about it is that any individual claim should not trigger a change in levy, because levy payers have been very clear to us that they want a levy approach that is stable and predictable, and therefore allowing ourselves to move the levy up or down according to claims in an individual year would not be welcome. Ultimately, of course, you are right that if our investment returns exceed the assumptions that are in a buy-out, then the levy would come down because the levy is the balancing item. If, on the other hand, we failed to achieve those returns then the levy would have to go up. Our investment philosophy is one that is relatively conservative given where we are, and so we would aim to not see levies go up because of that.

Q47 Richard Graham: Effectively, in many ways, when you take on a scheme's liabilities the immediate impact on the balance sheet is to flatter it, because you take on the assets as well; surely the longer-term impact of taking on large schemes like this one, with significant deficits, is actually to weaken it and therefore makes the PPF's task harder. That presumably is what lies behind the natural enthusiasm for the PPF to ensure that TPR is on the case as early as possible with schemes that might be running into trouble.

Alan Rubenstein: I do not think that is quite correct. The immediate impact of the BHS scheme is a hit to our balance sheet as of March of approximately £275 million. That is what we will be recognising and that is the difference between the assets that we have taken on and the value, as we assess, of the liabilities. If, in time, we manage to invest those assets that we have taken on, along with the rest of our assets, and do better than our objective then clearly the levy will come down. However, we already make some assumption about those returns in the levy calculation. I know there is some thought that whenever we take on a scheme we make immediate profit but that is absolutely not the case. Whenever we take on a scheme we make an immediate loss and our funding position is weakened; it is only if we achieve our investment targets over the long term that we flatten that out.

Q48 Michelle Thomson: Following on a similar theme, can you ever envisage a set of circumstances where the PPF itself could become insolvent and, if so, what would that set of circumstances or that scenario be?

Alan Rubenstein: It is clearly possible that, with a total deficit out there of around £300 billion, the PPF could be overwhelmed, but I would argue that, in such circumstances, we would probably be worrying about other things as well as the PPF. In normal circumstances, we model the distribution of likely claims and, based on that, we could absorb well into the tails of the expected claims distribution without having to immediately change levies, although, clearly, over time, as we have discussed, the higher the draw on the PPF the higher the levies would be, and the better funded the schemes are the lower the levies on those schemes that are having to fund it.

Q49 Chair: Do you think, Alan, that, taking this long-term view of your responsibilities, the PPF scheme may well need some major reforms?

Alan Rubenstein: I honestly do not think so. One of the advantages of the way Parliament set the PPF up was so that it could have the functions of an insurance company but without the constraints in terms of capital cost insolvency, and so there will be periods, as now, where the PPF is in surplus. There may be periods in the future when the PPF is actually in deficit. We were in deficit, for example, to the tune of about £1 billion in 2009, but the long-term nature of this structure enables us to, in most cases, ride out the fluctuations in claims that I guess are inevitable and meet people's compensation requirements in the long term. Clearly, there are cases where that will not be possible but, at the moment, the probability that we would put on being able to meet that 2030 target I spoke of before is just over 90%.

Q50 Chair: Is that based on more optimistic returns on capital or what might be a new long-term low trend returns on capital, which may be the world that we are in up to 2030?

Alan Rubenstein: No, it is based on a very conservative approach that seeks to hedge out most of our risk of inflation and duration risk and, at the same time, achieve a return over Libor on our assets of 1.8%, so, if you look at the risk that we take as an investor compared to the typical risk of a pension plan, we are probably taking about a third of the amount of risk, which I think is appropriate for funding our position.

Q51 Mr Wright: In terms of the long-term viability of the PPF, what discussions have you had regarding the British Steel Pension Scheme at the moment?

Alan Rubenstein: We are obviously aware of the discussions that are taking place and, as you know, the Government are trying to work with partners to find a solution to that. We are clearly waiting to see what the outcome of that is but it would be my view that, should the PPF be forced to step in and pick up the British Steel Pension Scheme, then we would be able to do that, albeit obviously, by definition, our immediate funding level would drop, because clearly it would not come to us unless there was a shortfall on PPF benefits.

Q52 Mr Wright: But it is not a material risk that would undermine the long-term viability of the PPF.

Alan Rubenstein: I would not expect it to undermine our long-term viability based on what we currently know about the scheme and what the trustees have disclosed about their funding.

Q53 Mr Wright: Short-term viability?

Alan Rubenstein: No, certainly not.

Q54 Chair: Have you not considered from what you have said—which could be interpreted as very happy news for pensioners whose companies go belly up: that they would be getting their pensions—when we look at the risks coming down the tracks, it seems to me that there is a moral hazard here? While the levy is divided into two parts, we are asking the righteous, who actually look after their pension schemes and pay money in when they have got large dividends to distribute, to bail out those that have failed. Have you thought that maybe an alternative to that pressure on the good employers and the risk to jobs if they are dragged under is to actually have the levy on individual members, for it is the members who have most interest in taking their pensions?

Alan Rubenstein: The basis of the levy is of course set out by Parliament and we have sought over the years to make most of the levy risk-based so that those who pose a greater risk to the PPF pay the highest premiums, and the model that we launched with Experian for the 2015–16 year moves that further towards that risk-based approach and was widely welcomed in fact by the industry. Nobody likes paying their insurance premiums but, if they feel the basis is broadly fair, that is what we would aim to achieve.

Q55 Chair: Do you think it is fair though?

Alan Rubenstein: What we find is that there are certainly companies out there that feel unfairly treated, but they are actually quite a minority. It is not the nature of the beast that the companies that are satisfied with their levy take to the airwaves. We consulted widely, before we brought in the new model, with industry, with small businesses through the BCC, and with trade associations like the PLSA, and the general consensus and the feedback that we got to our consultation document was that the new method, which is an improvement in terms of reflecting the curve of claims that one sees, was a positive step forwards.

Q56 Chair: Would you say there is a moral hazard for you in that the more the charge goes on those who are risky, the more chance the company will go under?

Alan Rubenstein: There is clearly a challenge for the regulator in that position in terms of their agreement on funding but, when you look purely at the PPF, the overall cost of the PPF is around £600 million a year; the levy for 2016-17, the year we have just started, is estimated at £650 million. That is covering liabilities of around £1.6 trillion and a current estimate as at 31 March, on a PPF basis, of around £300 billion. So, on the basis of how much it costs to insure against default with the PPF, I actually think that it is pretty good value for money.

Q57 Jeremy Quin: Earlier in your evidence, you referred to some 5,000 schemes being in deficit currently, and others have suggested as many as 600 or 1,000 are in serious difficulty. You also referred to the length of time for the average recovery plan stretching out to nine years. To what extent do you think these plans are adequate? I know it is the regulator that builds them and not yourself but you must have a gut instinct. Are we looking at a situation where the industry is assuming that yields are going to change and that, if they do not and we continue in the current apparently abnormal market conditions, we are going to have a very serious problem on our hands in the next two to four years?

Alan Rubenstein: It is certainly my sense that there is a fair degree of hope out there about the future course of interest rates. Clearly we can only deal with what we see today but I do recognise the issues the regulator has in terms of balancing their various objectives. As I say, if I had a free choice and if it came cost-free, obviously I would want to see recovery plans as short as possible; but I recognise that life is not that simple.

Q58 Richard Graham: You and I have communicated over the frustrations of a few DB schemes in my constituency, which are family-owned companies that have been going for more than 100 years who have found the new basis on which the levy is charged to have increased their subscription considerably; for a small company that is very frustrating because it prevents them from expanding, taking on more employees and so on. If I were one of them, I would be looking at a situation like this and saying how frustrating it is, when you have a long-term commitment to a business and a workforce, to then find that there are companies whose owners apparently have a much shorter-term approach, which includes significant pay-outs of dividends to the owners and then leave a company with an enormous deficit on its pension scheme, which then has to be funded effectively by people like them through the PPF. What would you say to them and what do you think can be done to reduce that feeling of frustration by people who have seen the risk levy that is applied to property

collateral, in particular on their type of long-term businesses, become much more expensive while others appear to be able to exit, leaving these problems?

Alan Rubenstein: I would say, first, that I can understand their frustration, but I would point out to them that the levy they are charged on a risk-based approach is a function of the insolvency probability, recognising first of all that companies that had defined benefit pension plans in general are less risky companies overall because typically they will be longer established, like the ones you talk about, and they will also have more employees. If you look at the insolvency figures you see most failures among young companies and companies with small numbers. We are talking about relative rather than absolute numbers here, but I would say, first, that it is due to the insolvency probability and, secondly, it is due to the funding situation of their particular pension plan. The levy is designed that no matter what your insolvency risk, if you have a pension plan that is fully funded on a PPF basis then you will pay no risk-based levy. It is deliberately set up that way to try to encourage people to fund their pension plans.

We have tried in our latest development of the levy to make sure that the algorithms we use are reliable. The measure that one tends to use for these kind of things is something called the Gini coefficient. Whereas if we had a coefficient of 100% we would have a perfect fit and we would be very suspicious of it, a typical model might have a Gini coefficient of somewhere between 40% and 55%, and 55% would be deemed good. The Gini coefficient for our latest Experian model is approximately 70%, which suggests that overall it is getting the picture about right, although I can understand that in individual cases it feels uncomfortable.

Richard Graham: Chairman, can I just log that although I think the Gini coefficient is probably a useful tool, nonetheless it does not take away from the frustration of small, family-owned, over-100-year-old companies. There are many in the north of England that really struggle with the implications of the levy while watching some of the bigger companies going into administration and leaving these vast deficits. It is something we ought to just log.

Chair: There is not just one moral hazard here, is there, Richard?

Q59 Craig Mackinlay: We are living in an era—and quite a long era, which I do not think any of us expected—of quantitative easing, low interest rates and low gilt yields, which has expanded the problem that the DB schemes have. I can see that old DB schemes are becoming a bit of a blockage in M and As and restructuring of big corporates. Do you think that we are likely to see, unless we have some legislative change to prevent it, more exotic and imaginative routes to get away from these old liabilities, just to make the market keep moving?

Alan Rubenstein: My experience is that the market will always keep looking for ways and we need to be on our guard; the regulator in particular needs to be on their guard. One of the things that I would like to suggest to the Committee is that we think about making it easier for the regulator to intervene proactively. At the same time we have to be very careful that we do not get ourselves into a position where we suggest that every time there is an M and A deal to be done, the regulator has to provide clearance. That part of the system works quite well, in the sense that you have a choice: you can apply for a clearance from the regulator. It probably takes a bit of time. It probably has some cost in terms of

increased security, depending on the actual deal involved. Alternatively, you can decide that you do not wish for clearance, in which case the regulator is free to use their anti-avoidance powers if they suspect that there has been an abuse. Overall that works reasonably well. From my point of view, what I would like to see, on the basis that prevention is better than cure, is perhaps some way of the regulator being more active before we reach that situation.

Q60 Richard Fuller: Can I just take you back to when you said that the British Home Stores pension fund first came across your radar, which was in March 2012? You said you were conducting an exercise with a variety of employers and were providing guarantees. You said that as a consequence of that, the guarantee in the British Home Stores pension fund case was withdrawn, and I think you said that Sir Philip Green said he was going to discuss it with the Pensions Minister. You also said that the guarantee in this case was not justified. Why do you feel it was not justified?

Alan Rubenstein: At that time the deficit in the British Home Stores scheme was around £200 million or perhaps a bit more than that. We looked at the company providing the guarantee. I should restate what I said: it was not so much withdrawn as not recertified, because it had been certified for one year and then the following year, when we raised an objection, it was not recertified.

Q61 Richard Fuller: Who was it recertified by?

Alan Rubenstein: A guarantee has to be accepted by us, and the second year after the discussions the company did not put it forward to be recertified.

Q62 Richard Fuller: Up until now, I assumed that you sat behind the regulator in any dealings with funds that were going into trouble. What you have just said is that there was an instance where a fund had a deficit, there was a guarantee and you could leap over the regulator and not certify that.

Alan Rubenstein: No, if that is the impression that I have given you then I have not conveyed it clearly. Normally we would absolutely stand behind the regulator. We pay the compensation and the regulator does the supervisions as Mr Graham said. However, in the case of a levy bill we will allow companies to provide guarantees that will reduce the cost of their levy if there is value in the guarantee. That to me makes sense. If, for example, you were pledging a property worth £200 million against your pension fund in the event that the company became insolvent and your deficit was £200 million, then that reduces the risk to the PPF and ought to rightfully be recognised. In this particular case, the company that was offered up to provide the guarantee when we looked at it seemed to us incapable of providing a guarantee of £200 million.

Q63 Richard Fuller: What was that company?

Alan Rubenstein: It was called Davenbush I seem to recall. It is a member of the Arcadia Group.

Q64 Richard Fuller: But it was not Arcadia Group itself that was behind the guarantee.

Alan Rubenstein: Correct.

Q65 Richard Fuller: So it was withdrawn because you felt that it did not have sufficient assets to justify the guarantee.

Alan Rubenstein: We said that the guarantee from that company could not meet, in our view, the value of the shortfall that it was being pledged against, and because of that the company chose not to recertify it for a second year.

Q66 Richard Fuller: When that happened, did you then notify the pension regulator.

Alan Rubenstein: Yes.

Q67 Richard Fuller: So they knew that this guarantee that had been in place was now going. What replaced the guarantee?

Alan Rubenstein: Nothing. They simply paid a higher levy.

Q68 Richard Fuller: Was the guarantee on the pension fund deficit?

Alan Rubenstein: Yes.

Q69 Richard Fuller: You took away their guarantee, their levy went up but now there is nothing to look after the debts on the pension fund?

Alan Rubenstein: I am obviously misunderstanding slightly.

Q70 Chair: Are you saying that the company was worthless, generally speaking, and therefore could never cough up the guarantee had you required it?

Alan Rubenstein: The company that was requiring the guarantee? Yes, pretty much.

Q71 Richard Fuller: I am very curious, Chairman, that the company can be sitting there as a guarantee of a pension fund liability and that in 2012 you can go in, identify, essentially as the Chair has just said, that there is nothing there and it is all smoke and mirrors, and the consequence of that is not some immediate investigation but just, “We will have to increase you levy next year”. Have I got that right?

Alan Rubenstein: Not quite, because this was something that was not, as I said, unique to BHS. There were a number of advisers out there from respected firms who were advising their clients on ways to reduce their PPF levy. One of the ways you could reduce you PPF levy was to provide a guarantee. When we became aware that this was being abused—and we felt it was abuse—

Q72 Chair: How was it being abused?

Alan Rubenstein: That was not the only case of companies providing a guarantee from an entity that could not have supported that guarantee when it was called.

Q73 Mr Wright: Which firms were advising clients on that?

Alan Rubenstein: Probably many of the major accountancy firms were involved.

Q74 Richard Fuller: On the guarantee that had been put up at British Home Stores at that stage, would I be right in saying that that essentially was a worthless guarantee in your assessment?

Alan Rubenstein: It was not worthless but it certainly could not have withstood a claim for £200 million.

Q75 Richard Fuller: Subsequent to that guarantee being lost, just to confirm, as far as you are aware nothing was put in place as a guarantee on the liability of the pension fund.

Alan Rubenstein: Yes, but remember the way that the levy works is that companies are assessed on their insolvency probability and their shortfall. If a company wishes to put a guarantee in place to improve their insolvency risk that is fine, and clearly, if that guarantee would have provided full protection that effectively reduces the liability. If there is no guarantee provided by a parent or an associated company that does not mean the system falls apart. It simply means you pay a levy based on the sponsoring company's financial health and the scheme's deficit. That was essentially all that happened, but clearly it is the kind of thing that we brought to the regulator's attention.

I should be clear that this was something that we had spotted and therefore we moved to change the rules so that trustees ultimately had to take advice and certify that, if they were provided with a guarantee from a sponsoring employer, they had taken advice on the value of that guarantee, and that they would be essentially liable for saying that that guarantee was worth what it was claimed for.

In a sense we are engaged; going back to the point we had before, people generally do not like paying insurance premiums and they will do what they can to reduce them. We generally find that we have to close off avenues now and then, and that was one of the avenues that we closed off.

Q76 Chair: What is the role of Arcadia in this? Did this company have funds before to pay the guarantee or did nobody check?

Alan Rubenstein: The company providing the guarantee was a member of the Arcadia Group.

Q77 Chair: What responsibilities does the Arcadia Group have to a company that cannot fulfil its obligations?

Alan Rubenstein: That is not a question I can answer, I am afraid.

Q78 Jeremy Quin: From the point of view of the BHS pension fund, the trustees had to take a view on the covenant that was being used to guarantee them, so the trustees of that company, Davenbush, had to take a view on the covenant.

Alan Rubenstein: Historically they would not have been asked to certify. When we discovered that people were using companies that could not support the guarantees one of rule changes we made was to require trustees to certify them, so now they have to.

Q79 Jeremy Quin: To clarify, it is the company that is responsible for paying the levy and therefore it is the company that is taking a view as to whether or not that covenant is satisfactory.

Alan Rubenstein: Technically, the levy is payable by the pension fund, not the company, but most pension funds have an agreement with their sponsor that their bill can be passed straight on to the sponsor. In most cases companies will pay, but that is not the technical position.

Q80 Jeremy Quin: That is a shade of grey I was exploring. It was the pension trustees' responsibility to ensure the levy was paid. They were released partly of that obligation because of the covenant and the guarantee being provided by the second company, but it is actually the company itself that was in communication with the regulator.

Alan Rubenstein: In most cases where the levy is passed on, which I think is the vast majority, any reduction in the levy obviously benefits the sponsoring company.

Q81 Jeremy Quin: You identified this as an historic abuse, and it is no longer an abuse because the trustees are required to certify that they have taken advice and there is adequate covenant to support the guarantee that is being provided.

Alan Rubenstein: Correct.

Q82 Craig Mackinlay: On the existence for I do not know how many years of the guarantee by Davenbush, do you think in discussions with the Pensions Regulator it would have given them some warmth and assurance to perhaps have accepted this long, 23-year restructuring? Would that give the Pensions Regulator some assurance that it looks like you have got some powerful guarantor in place?

Alan Rubenstein: To answer the first of your questions, the guarantee was in place for just one year and then withdrawn.

In terms of the financial strength of the company and whether that guarantee, had it still been there, would have influenced the regulator, I do not know, because they will look at a whole range of indicators and they will talk to the trustees. They would have had to satisfy themselves about what value was being provided from that, but clearly having been alerted—

Q83 Craig Mackinlay: Was it about the same time that this 23 years was being negotiated?

Alan Rubenstein: No, that would have been afterwards, because the discussion was prior to the 2012 valuation.

Q84 Richard Graham: On this point of guarantees that did not prove as substantive as you might originally have assumed, was this quite a common practice, particularly for larger schemes, and were actuaries and consultants also recommending this as a route for pensions schemes to take?

Alan Rubenstein: I could not tell you offhand how common that was, in terms of the percentage of claims. I could look into that and write back to the Committee if you would like. Yes, actuaries and consultants were also involved in this. It is a common thing, as I said, that people seek ways to reduce their PPF levies, and if we see abuse of the system then we act to try to stamp that out.

Q85 Richard Graham: Technically that advice was being provided to the employer and the business, presumably, rather than the pension scheme, because the guarantee was coming typically from a subsidiary of the owners.

Alan Rubenstein: There I would be speculating because obviously we were not part of those discussions. What we saw was guarantees offered up, and we became suspicious of the backing for these, so we investigated a sample and when we investigated that sample we discovered the abuse was reasonably widespread and therefore we took steps to stop it.

Q86 Richard Graham: Were the offers coming from the pension scheme and the trustees or from the employer direct?

Alan Rubenstein: That I could not tell you, but clearly the guarantees have to be provided by the parent through means of either a parent company guarantee or through an asset to the trustees, and the trustees were then effectively signing off on that. In the early days, the trustees were not required to examine the value of the guarantee that they were offered. We changed the rules to make sure that they were.

Q87 Richard Graham: Did you change the rules or did the Pensions Regulator?

Alan Rubenstein: We did, because we set the rules as to what is admissible and what is a guarantee in calculating the levy.

Q88 Richard Graham: With the situation today, would it be true to say that some of those guarantees still exist but pension scheme trustees have signed off that they are comfortable with them, and the Pensions Regulator and yourself have both looked at them and you accept them, and that then enables a reduction in the levy?

Alan Rubenstein: The Pensions Regulator would not look at the guarantees from the point of view of levy because that is not part of their responsibilities. They may well look at them when looking at funding plans. In terms of how we look at them, yes, you are absolutely right that we require the trustees to certify that they have taken advice and the guarantees are worthwhile. We then spot-check a sample just to make sure that we agree with the trustees that the value of the guarantee covers the amount that it is being offered up for.

Q89 Richard Graham: You would review that, would you, because in theory presumably you could have a situation where an entity like Davenbush—let us not us that as

the example—might appear to have significant capital behind it one year but might, through various transactions, be very different a year or two later?

Alan Rubenstein: It has to be recertified every year so it gets freshly looked at.

Q90 Chair: One last question, Alan, and thank you for your time with us. It follows Richard's point. What happens from year one to year two, where a company in year one you think is good for a £200 million guarantee but in year two it is not? Have you experienced companies just leaving their assets around like this?

Alan Rubenstein: No, I think—and it is purely speculation, but based on what we saw elsewhere—advisers had indicated that if you have got a strongly financed entity, no matter whether it could afford to pay the guarantee or not, then by using that as a guarantor you could have its financial strength rather than the actual sponsoring employers' financial strength recognised in the calculation of the levy.

Q91 Chair: When you say you saw this going on elsewhere, do you mean elsewhere in BHS or in companies generally?

Alan Rubenstein: No, in the pension scheme universe. In this regard BHS were not a particularly special case.

Chair: That is a concern, but, Alan, thank you very much for the evidence you have given us.

Examination of Witnesses

Witnesses: **Lesley Titcomb**, Chief Executive, The Pensions Regulator, and **Nicola Parish**, Director of Case Management, The Pensions Regulator, gave evidence.

Q92 Chair: Lesley, I think you know the format. Might you introduce yourself and then your colleague, or your colleague can introduce herself?

Lesley Titcomb: I am Lesley Titcomb. I am the Chief Executive of the Pensions Regulator.

Nicola Parish: I am Nicola Parish. I am the Director of Case Management.

Q93 Jeremy Quin: Lesley and Nicola, thank you for joining us. Welcome to the Committee. When did you receive the 2012 recovery plan?

Lesley Titcomb: We received it 17 months after 31 March. It was due 15 months after and it was slightly late.

Q94 Jeremy Quin: That would have been August 2013.

Lesley Titcomb: Yes.

Q95 Jeremy Quin: Between August 2013 and March of this year—if I am out by a month I apologise—following your receipt of the plan and March of this year, may we ask what you did with it?

Lesley Titcomb: Sure. So in September 2013, on receipt of the plan, we opened what we called a recovery plan case. Typically in those situations that is because it is unusual in some way, in terms of perhaps the length of its recovery plan, the strength of the employer, maybe the investment strategy or any other assumptions in that recovery plan that we have an issue with. What we do there is we engage with the trustees, typically, and we did not issue a closure letter in respect of that recovery plan. We had not accepted it as it were. It was still an open matter. The employer then came to us at various points during the following months with propositions as to the way forward and how this could be dealt with, and then we reached the point where the sale to Retail Acquisitions happened. At that point we immediately opened an anti-avoidance case.

Q96 Jeremy Quin: But there was over a year in which not a great deal happened.

Lesley Titcomb: There was engagement with the employer and the trustees about the recovery plan and trying to understand why, for example, an atypical recovery period was in place. Do you want to add anything on that?

Nicola Parish: The other thing to add is that over that period of time there were, as you said, other issues going on in the background—things that we probably cannot touch on too much today because of the investigation that is ongoing, but there were other solutions being discussed. It was not that there was not much happening, as you said. There was quite considerable activity over that period of time.

Q97 Jeremy Quin: I am conscious you were here when Alan our previous witness said that concerns had been flagged as early as March 2012. I wondered whether this would not have been a situation in which you sprang into action immediately on receipt of their recovery plan in 2012 and got to grips with it immediately.

Lesley Titcomb: As I said, we did open a case immediately on the receipt of the recovery plan.

Q98 Jeremy Quin: In this length of time, when would you have taken a more formal step regarding this recovery plan if it had not been for the takeover?

Lesley Titcomb: It is a little difficult to say on that because all these situations tend to be scheme-specific. It will depend on what responses we are getting from the trustees and the employers. It will depend on other things that happen. As Nicola said, there were further developments during the period, so it is not easy to give a timescale on this. If we feel we are not getting any traction then we will start to move towards the consideration of whether more formal powers are engaged.

Q99 Jeremy Quin: How often have you used those more formal powers?

Lesley Titcomb: We have got to the point of nearly using them many times. Do you want to talk a little bit about this?

Nicola Parish: The point is that the industry is aware of our powers in relation to scheme funding and that we have been on the point of using our scheme funding powers on a number of occasions. Very often discussion with the trustees and the employers and explanation of the powers that are available to us is often a good way of bringing people around the table and coming to a realistic view of what an appropriate recovery plan would be. It is true to say that as of now we have not had to resort to going to our determinations panel to ask them to exercise powers. We have managed to influence and bring about a satisfactory solution before that stage.

Q100 Jeremy Quin: In every case you managed to secure an agreement with which you are comfortable.

Lesley Titcomb: Yes, we have reached the point where we have either got something changed or we have understood why things are as they are and been satisfied.

Q101 Jeremy Quin: This is my last question; I know that Mr Wright want to come in. You had a previous recovery plan, the 2009 recovery plan, which I think was a 12-year recovery period. This is a near doubling of the recovery period three years later, and the covenant would have deteriorated in that period. This must be one of the most dramatic reversals in fortune of a pension fund you have seen. I am coming back on to the timing again as to when exactly you would have been issuing formal notices.

Lesley Titcomb: I cannot comment specifically, not having been there at the time. What I would say is that recovery plans of 23 years or more are very atypical. The vast majority that we see are between, say, seven and 12 years. That would be far more usual.

Q102 Chair: Would all of the schemes, Lesley, that have ended up in the PPF be ones where you had this very British conversation around the table, and then they went belly-up on you?

Lesley Titcomb: Typically the system is predicated on the funding principally being an issue for resolution and agreement between the trustee and the employer. The regulator is there and we can try to assist, for example, if that conversation is not going well, and we can step in if they fail to agree. We can then take issue if we feel that, for example, assumptions are not prudent and that type of thing, but the system is not set up in a way that means we are exercising active ongoing supervision. The engagement is very much built around a three-year valuation process and then the submission of a deficit recovery plan if the scheme is in deficit.

Q103 Mr Wright: Chair, I want to follow up on the line of questioning that Jeremy pursued and go back to the 2009-10 recovery plan. That, as Jeremy said, was a 12-year period in which the scheme would move into balance by January 2022. The nature of that recovery plan had the employer paying £5.5 million in 2010-11, £7.5 million in 2011-12 and £10 million in 2012-13 and thereafter increasing contributions by 10% a year. Was the regulator happy with that arrangement?

Lesley Titcomb: We had some engagement with the trustees around that plan, so it did not get closed down straightaway. We opened a case and we looked at it but we then were satisfied at that point. It reflects the flexibility that is built into the system. We could, for

example, have a system that required all liabilities to be fully funded at all times. It would be expensive to industry. We do not have that. We have something that has a statutory funding objective, which the employer and the trustee have to aim for, and we as the regulator have to consider whether we think their plans are realistic. If we feel they are not, we then have to have regard as well to the ongoing sustainability of the employer and hold all these things in balance: what is the best thing to do in the circumstances to try to ensure the security of the scheme and the protection of the members' benefits, to try to protect the Pension Protection Fund, but also to give businesses the chance to progress, to invest and to grow? We believe that a strong sponsoring employer is the best way of supporting these schemes.

Q104 Mr Wright: I am still unclear as to whether you were happy with that 2010 recovery plan in broad terms.

Lesley Titcomb: We were content in the end with the 2009 one that was signed, yes.

Q105 Mr Wright: Then you fast-forward to 2013 and you have a 23-year recovery period with the employer paying less—£9.5 million per year—and you were not happy with that. How active can you be, in terms of the powers laid down by Parliament, to step in and say, “That is not good enough”?

Lesley Titcomb: Typically what we would do in such circumstances is to talk to both the trustees and the employers to understand why they felt it was necessary to move to that, and to then consider whether we think that is reasonable, taking into account the balance that I indicated. If not, we would then start to indicate where our areas of concern were and see if the employer was prepared to move on that. We would take the trustees along with us as well and try to explain to them why we were not happy with what we were seeing, because of course if they can bring pressure to on the employer as well—

Q106 Mr Wright: Can I just push you on that? In terms of the trustees' scheme, when Retail Acquisitions bought BHS in March 2015, the trustees for members of the scheme provided an update. In that update it refers to the £9.5 million paid by the employer and it states, and I quote, “The trustees would have preferred to receive more than this, but they acknowledged that BHS could not afford to pay any extra”. Did the trustees come to you with these concerns? If so, what did you do with them?

Lesley Titcomb: I am not aware that they did come to us with those concerns. When we launched the anti-avoidance case in March 2015, that was off our own initiative on the basis of the reports of the sale.

Q107 Mr Wright: You did not have an investigation any earlier than that.

Lesley Titcomb: Not an anti-avoidance investigation, no. We had the open situation with the 2012 valuation.

Q108 Mr Wright: What checks and work do you do to ensure that in this case BHS could not have afforded to pay any more into the pension scheme?

Lesley Titcomb: Those would be exactly the type of questions, checks and assessments that we would be doing whilst looking at a recovery plan with an employer.

Q109 Mr Wright: What did you do in this specific case?

Lesley Titcomb: I cannot ask specifically on what we were doing.

Nicola Parish: I can talk typically about how we might deal with that. Within our case team we will have people who are very skilled and experienced at looking at companies and looking at their accounts and seeking to understand the strength of an employer—its trading record, for example, or if the employer has put out any forecasts around what the business might look like—to build a picture, from our perspective, of how strong we think that employer is and how able that employer is to stand behind a pension scheme.

Q110 Mr Wright: As part of that work, would you look at the dividends policy of the company and the level to which case had been taken out of the company in previous years?

Nicola Parish: Certainly whether dividends had been paid or not would be something that we would look at. We would also look at whether there was any plan to pay dividends in the future, and it is something that you will find in our guidance that we very strongly signpost trustees to take into account as well when they are having their discussions with employers around recovery plans.

Q111 Mr Wright: What happened in this case in terms of looking at dividends policy in previous years of BHS?

Lesley Titcomb: If I may, we would rather not go into that. It is germane to our open investigation at the moment, so I would rather not discuss in too much detail precisely what we are looking at in terms of past history.

Q112 Mr Wright: It makes our job very difficult. Do you have the powers, if you are looking at dividends policy, and cash has been extracted out of the business and yet there is a pension deficit with regards to this, to say, “You really need to put more money back into the pension scheme for the employer”?

Lesley Titcomb: This is exactly where we come to with, for example, the anti-avoidance type case that we are running at the moment. We essentially can look at two ways forward. One is to secure a financial support direction for the scheme, which is usually a decision in principle from our determinations panel with a particular person or an organisation that has some connection with the scheme that needs to provide support to it. There is then a matter of discussion as to the level of that support and the period for which it is provided, and that type of thing. The alternative course that we can do is to seek to secure what is called a contribution notice, which is for a specific amount, and again it is principally usually against individuals.

Q113 Chair: Can you put a charge or take control of any of the property of the company?

Lesley Titcomb: We would not typically. We would be looking to the trustees to try to secure better and stronger scheme funding; for example, a charge over assets somewhere else would be something that they could take into account and try to secure in order to bolster that covenant.

Q114 Chair: Do you advise trustees ever to do that?

Lesley Titcomb: We encourage them to look for alternative sources of strength, but of course we then have to consider their value, if anything, and whether they are worth the paper they are written on, to be quite frank. That is where it is essential for the trustees to take the appropriate advice to ensure they are getting something worthwhile.

Q115 Chair: There was a stage where the shops of this organisation were very valuable and they were sold and then leased back. Would you have the powers to suggest to trustees that they make moves on that front?

Lesley Titcomb: We can suggest almost anything to the trustees, though whether they choose to take us up on it is a different matter. You are illustrating exactly the type of discussion that would happen in those situations: “What other sources of comfort are available to you as trustees in these circumstances?”

Q116 Jeremy Quin: I have two questions, but just following immediately on after that, you are beholden in that respect to the calibre of the trustees. Do you have any powers to recommend a change in trustees? Do you ever question how competent a trustee panel are in executing their duties?

Lesley Titcomb: Your point is absolutely right, Mr Quin. The whole system is very, very dependent of the calibre of trustees. We have no initial approval power over trustees. In a number of circumstances, not just DB schemes, we can seek to have a trustee replaced or we could appoint an independent trustee. I should say it is a power that we have only tended to use where there is a real record of several inappropriate actions and that type of thing. A typical example of where we have used it is in scam situations, but we tend to try to achieve more through educating, enabling and facilitating the discussion between the trustees and the employer.

Q117 Jeremy Quin: I get the impression that you are quite sparing in the use of all your powers.

In terms of the 18 months after the receipt of the plan—I am sorry to come back to it—in an M and A and a takeover situation, people are reviewing pension funds in a matter of weeks and taking decisions and having those discussions. I appreciate there is stuff that you cannot tell us, but can you give us some flavour as to what process you go through in order to test the adequacy of that recovery plan and engage with the trustees? Is it a matter of you looking at it over a month and then speaking to the trustees, or is it a six-week period? How do you undergo that process?

Nicola Parish: In terms of timescale, the first thing to bear in mind is we will be looking for the co-operation of the trustees and the employers to help us. We opened a case very quickly after the 2009 valuation and then the subsequent 2012 valuation was received. In terms of timescales, six weeks would be too long. We would be looking to engage much more quickly with the trustees and the employers in the vast majority of cases. These discussions can be, as you would appreciate, pretty complex at times. There will be a lot of information that we will want from the trustees and the employers to understand why

they would think that what they had put forward was an appropriate recovery plan. That can take some time to analyse.

There is also a role here for us to educate trustees and employers. Where they might have thought something was reasonable, we would be explaining all of the different ways of looking at that as a situation and encouraging them towards a solution. We would look to do that as quickly and as efficiently and effectively as we possibly can. There will come a point at which we will realise, as Lesley said, that we now have to move to the use of our powers. That very much depends on the scheme, the risk it poses and the attitude and approach that we perceive from the trustees and the employer.

Lesley Titcomb: The other point to make is that there are a number of schemes where we engage proactively with the trustees and the employer before the valuation is due, to make quite clear what our expectations are and to try to iron out some of the potential difficulties. We find that a more effective way of tackling these situations than acting after the event, once the recovery plan and valuation are in. On some of the biggest and more risky schemes, we seek to engage proactively.

Q118 Jeremy Quin: There are some hundreds of schemes that might be at risk. Do you have the resources and the ability to go through each of these and do them in a timely fashion, or is there a whole string of similar circumstances out there?

Lesley Titcomb: We, like any regulator, do have to make choices. We receive about 1,400 to 1,500 recovery plans a year at the moment, from the volume of schemes that are in deficit. We put all those through a calibration process basically looking for certain risk indicators and we then follow up on those. We make these risk-based choices. We have a significant amount of regulatory resource within the organisation. We have to make choices about how we use it across the range of our responsibilities as well, so it is not just choices within DB regulation but also with the other regulatory areas.

Q119 Jeremy Quin: There are some hundreds of schemes that might be at risk. Do you have the resources and the ability to go through each of these, and do them in a timely fashion, or is there a whole string of similar circumstances out there?

Lesley Titcomb: As any regulator has to, we do have to make choices. We receive about 1,400 to 1,500 recovery plans a year at the moment from the volume of schemes that are in deficit. We put all those through a calibration process to basically look for certain risk indicators. We then follow up on those. We make those risk based choices. We have a significant amount of regulatory resource within the organisation. We have to make choices about how we use across the range of our responsibilities as well. So it is not just choices within DB regulation, but also with the other regulatory—

Q120 Mr Wright: In terms of that proactive stance, I take it that BHS was not part of that proactive position.

Lesley Titcomb: I believe that is correct, yes.

Mr Wright: Why not? Was it not considered a risk?

Nicola Parish: There are various factors that go into determining the highest-risk schemes.

Q121 Mr Wright: Do you have a risk register? What are the criteria to be included on that proactive bit?

Lesley Titcomb: The most significant criterion on that is probably the strength of the employer. As I have said, that is absolutely key here.

Q122 Mr Wright: We have just heard from the PPF that, in terms of any guarantee, it was not worth anything.

Lesley Titcomb: If I may, that is an entirely separate issue here. There is the strength of the employer, the sort of investment assumptions and projections that are assumed in the recovery plan, investment strategy and that type of thing. There is past history as well: what do we know about how they have tackled this challenge of the valuations in the past?

Q123 Mr Wright: Is the 18-month period relatively unusual? You would prefer weeks. I can understand the complexity, but is 18 months a long time?

Lesley Titcomb: The time it takes to deal with the recovery plan does vary hugely. Some of them are very simple; some of them are quite small as well. This would have been one of the more complex.

Nicola Parish: It would have been one at the more complex end. As discussed, other solutions were being put forward as well, which are difficult to go into now. That does mean that there is added complexity and length of time needed in order to properly assess the situation. All of these other solutions are things that, as it says, are solutions and therefore are certainly worth considering, investigating and inquiring into.

Q124 Chair: Can I just ask you before I go to Richard, Lesley, did I hear rightly that you said that when the discussions were underway you did not view the BHS scheme to be at risk?

Lesley Titcomb: No. We have to be careful about our terms here. I said that it was not one of the schemes that we engaged in proactively, as I confirmed to Mr Wright. It did not, at that point, meet the threshold for us to engage proactively. I have not gone back and examined in detail why that was, as yet.

Chair: That might need revision, might it not?

Lesley Titcomb: We would of course consider all the processes, the triggers and the risk indicators and so on in these situations. We learn from the experience as we go along. It is not a perfect science.

Q125 Richard Graham: On this point, there is a clear contradiction between two of your key objectives, potentially. One of the objectives is to reduce the risk of situations that may lead to compensation being payable for the PPF. The other is, in relation to DB schemes, which this is, to minimise any adverse impact on the sustainable growth of an

employer. Clearly, these two things come to a head at the moment where you might be looking at a contribution notice and effectively imposing that on an employer. In the case of BHS, at the moment when the owners were taking out significant amounts of dividends, and it looked as if the deficit of the pension scheme was increasing, what was your thinking then about whether a contribution notice was required?

Lesley Titcomb: If I may, there are a number of things we just need to pick up on there. First of all, our sustainable growth objective has only been in place since 2014. My understanding is that it only applies in situations where we are agreeing a recovery plan.

Nicola Parish: It is when we are looking at the funding of a scheme.

Lesley Titcomb: Yes, it is when we are looking at the funding of a scheme. The type of situation you are talking about there, Mr Graham, in terms of a contribution notice, would be when we were exercising our anti-avoidance powers. We just need to be careful about that. As I recall, in terms of the timings of the extraction of the dividends they were some distance away in the past. When we are thinking about funding, we would be looking at what is available now to put in: “What can the employer afford now? What other sources of funding are available?” It is when we feel that something has happened that has triggered our anti-avoidance powers that we start to go back into the past, looking at what happened, and who did something that could have been considered as them in some way walking away from their responsibilities.

Q126 Richard Graham: When you look generically at schemes and whether they might be at risk of having to come under the PPF, presumably you have always looked at whether there are guarantees there. At what stage did you communicate with the PPF about the value of this guarantee over the BHS scheme?

Lesley Titcomb: We were aware of the PPF’s particular exercise in terms of the guarantees that might be offered up in order to reduce the levy. What I cannot answer here off the top of my head is whether, in terms of the 2012 situation, there were any guarantees involved there in terms of dealing with the deficit in the scheme as distinct from trying to reduce the levy. You have two situations in which a guarantee can be used.

Nicola Parish: Can I just interrupt there to clarify? We were just checking; the guarantee that Alan was talking about was not relied upon for scheme funding purposes. That was a guarantee that he was looking at in the context of how much the levy should be, but it was not something that was taken into account for the purposes of scheme funding.

Q127 Richard Graham: If we may, Chair, because I think it would be helpful to this Select Committee’s inquiry, what was broadly the relationship between the trustees of this scheme and the corporate, the employer behind the scheme? That is a pretty crucial thing in any pension scheme’s strength of governance.

Lesley Titcomb: That is quite difficult for Nicola and me to comment on. Neither of us have direct experience of that relationship. I have no reason to suspect it was massively different to any other relationship at the time. I genuinely do not know. Nobody has brought anything to my attention in that regard.

Q128 Richard Graham: How strong would you assess the effective covenant behind the BHS scheme to be?

Lesley Titcomb: It would be fair to say that in 2009 we regarded it as reasonable. Certainly by the time we get to 2012 it could well have been one of the factors that triggered the situation with the 2012 recovery plan.

Q129 Richard Graham: Do you think that the key issue, in a sense, is the speed of the decline of the corporate performance, the level of money being taken out of the company and then eventually its sale, while at the same time the pension fund itself was seeing an increase in the deficit?

Lesley Titcomb: Those are typically the sort of things that we would see in a situation where there was, for example, an increase in the length of the recovery plan, change in the levels of contribution of deficit repair payments and that type of thing. You will understand that I am being careful not to comment on individual situations here.

Q130 Richard Graham: I do. At that stage, when the warning signals are there and you have your third priority—to promote employer compliance with their pension responsibilities—when do you sit down with the employer and say, “We have a problem”?

Lesley Titcomb: As I said, the main regulatory engagement here is through the three-year valuation. Parliament has not given us the power to approve those. Funds do not have to submit them to us for approval. They have to submit them to us, and we will then use them as a tool, as a regulator, to try to see whether we are okay with them, or whether any of our other powers are engaged, but we do not have to specifically sign off. As I said, if we have a plan presented to us that meets any of the triggers, then we engage with both the employer and the trustee.

Richard Graham: There was a 2012 tri-annual review.

Lesley Titcomb: That is correct, which was received 17 months later.

Q131 Richard Fuller: For good reasons or bad reasons, you do not sound like much of a regulator. You took 17 months to receive a plan. That plan had a 23-year recovery period, which sounds like it is twice the average. Your response was to “open a recovery plan case”. The fund had a £200 million deficit, which was growing, but you did not think it “required proactive response”. When you go after someone who has a fund that does not have enough money in it, your first question is, “How much can you afford?” You are not much of regulator, are you?

Lesley Titcomb: I do not agree with that statement.

Richard Fuller: I am just quoting back what was said.

Lesley Titcomb: As a regulator, we have to operate within the framework provided to us. The framework provided to us provides for the three-year valuation cycle, the submission of a recovery plan if a scheme is in deficit, and then for the vast majority of schemes it is possible either that they come up with a perfectly reasonable recovery plan or that we can, through engaging with the trustees and with the employer, ensure that anything necessary is rectified. I have to stress that it would be inappropriate to put a greater burden on the

vast majority of schemes and employers who behave responsibly, either through stronger types of regulation, more proactive, continuous supervision or meeting a minimum funding requirement, for example.

Richard Fuller: You could have tougher tools in your toolkit, which you could decide to use, than you currently have, could you not?

Lesley Titcomb: The Work and Pensions Committee is well aware that I am prepared to ask for more tools in my toolkit if I need them.

Q132 Richard Fuller: Can I take you specifically to the time of the sale of British Home Stores to Retail Acquisitions? When was the Pensions Regulator advised about the possibility of a sale?

Lesley Titcomb: We were not, that I am aware, advised in advance. We learned about the sale from the newspapers.

Richard Fuller: They just dropped it on you.

Lesley Titcomb: Yes. As I have indicated, we had been engaging with them over the period since the 2012 valuation. They had discussed a number of propositions with us, and then the next we heard that there was a specific development was the sale. At that point, we immediately triggered an anti-avoidance case, which is exactly what we should do in these circumstances. That is why the powers are there.

Q133 Richard Fuller: Just to be clear, in the time that British Home Stores, and the owners of British Home Stores, were involved in a detailed series of discussions with you about a massive deficit in the pension fund—their obligation to the employees—they did not have one conversation with you to say, “You know what? We are thinking of selling this company”?

Lesley Titcomb: I cannot say that. I am referring specifically to the sale for a pound to Retail Acquisitions.

Richard Fuller: That is what I am saying; they did not say—

Lesley Titcomb: Looking at what we would have known about the situation at BHS and so on generally, I cannot believe that those engaged would not have thought that a sale of some sort was possible. That was definitely a possibility. I cannot really say more. I was not directly involved with those discussions.

Richard Fuller: Just to clarify, the idea that a sale might be possible in the circumstances may have been something that was discussed. However, this particular company, Retail Acquisitions, the regulator found out via the newspapers.

Lesley Titcomb: That is correct.

Q134 Richard Fuller: You have certain powers, do you not, to act? Obviously, you acted after the sale. Were there any other powers that you could have invoked other than the anti-avoidance case?

Nicola Parish: We have talked already about the scheme funding powers. That is a set of powers that is available to us that enables us to impose a recovery plan, or enables us to impose deficit repair contributions. That is something that we would have had in our minds at the time. We were trying to bring the trustees and the employer towards a reasonable and appropriate recovery plan. That is a power that was available to us.

Q135 Richard Fuller: Could I just ask you specifically about third party notices? It is a power, if I have this right, to persons whose failure to do something is causing or has caused someone to contravene legislation. Can you just explain very briefly when you might invoke that power, particularly with relation to a transaction of the sale of one company to another company?

Nicola Parish: It does not obviously fit into a situation where you are looking at a transaction. One time when you might use a third-party notice, when you are talking about scheme funding, might be if the trustees were to come to us and say, “We need a particular sort of information and we cannot get hold of it, and that is causing us to be unable to agree a recovery plan”. We might then look to see whether we could use an improvement notice to require that third party to provide the information to a trustee, in order to enable the trustee to then be informed and be able to participate in scheme funding discussions and reach a plan. An improvement notice, which you have probably read, needs to set out specifically the steps that a party needs to take, and then is enforceable through the imposition of fines. Where those powers get you is often also worth bearing in mind in terms of whether it is a suitable power to use in the circumstances that you are looking at.

Q136 Richard Fuller: Just going back, if you had known that one of our finest retailers was being sold to Retail Acquisitions prior to the sale, would you have done anything?

Lesley Titcomb: Yes, absolutely. We would have gone and asked them, “What is the provision for the pension scheme in these situations?” Effectively, you are into a continuation and variation of the funding discussion. It is just that because here we have the sale, and it has happened, we decided to switch mode at that point and actually launch a formal investigation as to whether anti-avoidance was relevant, and whether any of the parties connected with all of this—of which there are a large number—had walked away from their responsibilities.

Q137 Richard Fuller: Just to be quite clear, is there anything specific in the nature of Retail Acquisitions, as an acquirer of British Home Stores, that particularly would have raised your concerns?

Lesley Titcomb: I do not want to comment too much on this because of the ongoing investigation, but typically in looking at such situations we will take into account the strength of the new owner, and the record, if you like, of the individuals connected with that.

Q138 Chair: Did you do that? Given that the main acquirer had two, if not three, bankruptcy orders made against it, did that not come up on your radar at all?

Lesley Titcomb: If I may, again, this is very much germane to the current investigation. Typically what happens is we launch an anti-avoidance investigation of who we think may be able to help us, which can go from the directly concerned parties to their advisers and other people. We did that in this case, and we received in response to those notices over 70,000 documents to review. I would prefer not to speculate on who we have targeted and why.

Q139 Chair: You could have found news about Mr Chappell from the web, could you not have? You did not have to send for 70,000 documents.

Lesley Titcomb: One can find an awful lot that is very interesting about people from the web. It is an extremely useful source of information. The point is that by the time we became aware of it the sale had happened, hence the choice to move into anti-avoidance territory.

Q140 Mr Wright: Just following on from that, did you have a good relationship with the former employer, in terms of BHS? I mean the former owner, prior to Retail Acquisitions.

Lesley Titcomb: Can you define “good”?

Mr Wright: That is a big question. Who owned BHS? In terms of the people that you were discussing, there were a number of propositions. Did you have a good relationship?

Lesley Titcomb: I do not think, necessarily, as a regulator, I would want the relationship to be good. It was constructive.

Mr Wright: It was open, honest and positive.

Lesley Titcomb: We were engaging with them on an ongoing basis. These are never easy situations, and we are the regulator, so we are not always welcome at the table.

Q141 Mr Wright: Just to clarify, in terms of what Richard was saying, one of the range of options and different propositions was, “We could be selling this”.

Lesley Titcomb: Yes. No one who was working on this type of case, having that sort of engagement with any employer in this sort of situation, would fail to see that a sale was possible.

Q142 Mr Wright: Does the fact that you heard about it in the newspapers indicate that the whole acquisition and sale process was very quick, and that Retail Acquisitions came along quickly and the deal was done in a matter of moments?

Lesley Titcomb: I really cannot speculate on that.

Q143 Chair: When you say you cannot speculate now, when will you tell us whether the scenario that Iain has just described is true or one where it is much longer?

Lesley Titcomb: If I may, of course our anti-avoidance investigation, which is underway at the moment, is focused on the particular things that are relevant to us as the Pensions Regulator and the exercise of those powers. These are complex cases; they tend to take quite a long time. As you will be aware, the decision to, for example, issue a warning notice sits with us, but that then is not the final situation. That warning notice then has to be turned into a final notice by the determinations panel at the regulator, and somebody who is the target of that would have the right of appeal to the upper tribunal. Typically these cases are contested quite vociferously, so it may be some time before we reach a final conclusion on this. In such situations, we then publish what we call a section 89 report, which sets out what happened, what powers we exercised, why we did do this and why we did not do that. That will be the explanation of our role. I should of course remind you that there are other investigations going on, which are relevant here. For example, there is the one announced by the Insolvency Service, which may be much better placed to look at the actual nature of any M and A transactions that are relevant here. Our focus is very specifically on ensuring that the pension scheme gets what it is due.

Q144 Chair: I can see that. Can I just go back to an imaginary company? It is selling a going business to another company; if you looked on the web, you could find that they may have been bankrupted once, twice or three times. Oscar Wilde made that marvellous statement about losing one parent; they have been bankrupted three times? I am just wondering about how you approach this. Does no one do that preliminary work for you to see whether in fact the company that is going to acquire a going business is a prudent, proper company to sell to?

Lesley Titcomb: If the trustees come to us and say, “We are aware that the sponsor is looking to sell the business”, then absolutely we will work with the trustees to understand.

Q145 Chair: That is the trustees’ responsibility. What is your responsibility, given that you had this on your radar?

Lesley Titcomb: We can only act on the basis of what we know here. Our responsibility here will be in terms of the ongoing funding of the scheme in the event of a sale. The fact that we have launched an anti-avoidance investigation must suggest that, given the event which triggered that, we are concerned that as part of that sale there are situations where we have concerns that not all the parties are meeting their ongoing responsibilities.

Chair: No one seems to have blown the whistle, do they?

Q146 Jeremy Quin: Lesley, if I take you back to what you said to Mr Wright earlier, you try to build a good relationship.

Lesley Titcomb: “Constructive” I think was the word I used.

Jeremy Quin: Whatever; a good or constructive relationship with the regulator does involve an element of respect and even fear, dare I say it. I am just concerned with a situation where issues have been flagged in March 2012, they have been late getting their recovery plan to you and you have been working on it for 18 months. You were doing things; we do not know what they are, but you were doing things over that period. It

shows a marked lack of respect that you read about this in the papers. All we are talking about is a telephone call.

Lesley Titcomb: Indeed.

Q147 Jeremy Quin: In terms of the trustees, they have responsibilities in these circumstances, do they not?

Lesley Titcomb: They have ongoing responsibilities, yes.

Q148 Jeremy Quin: They should have been made aware of this transaction at an earlier stage. I cannot believe that it is just overnight. They should have been made aware. They should have been investigating implications for the deferred pensioners, and if they had any concerns they should have been flagging it with you. Is that correct?

Lesley Titcomb: That is correct.

Q149 Jeremy Quin: Are you aware that the trustees were aware, or, as far as you are aware—too many “awares” here—did the trustees read about it in the paper?

Lesley Titcomb: All I can tell you is that the trustees did not bring this specific sale to Retail Acquisitions to our attention.

Q150 Jeremy Quin: You cannot speak for them.

Lesley Titcomb: But I cannot speak for them otherwise.

Chair: We may ask them that question soon.

Q151 Richard Graham: That is certainly going to be a crucial step forward. Lesley, just in terms of the Pension Regulator’s powers—what you can do and have done—can you give us a sense of how often you have had these anti-avoidance investigations? How many cases have you had, say over the last five years? What, typically, has been the outcome of these? For example, are you able to require an individual or a corporate to actually put additional funding into a pension scheme?

Lesley Titcomb: Let me start and then Nicola will pick up. Yes, we can require, as I said, a variety of parties either to provide some form of ongoing financial support to an ongoing scheme, or to provide a specific amount that we think they should provide.

Q152 Richard Graham: You have done that historically.

Lesley Titcomb: We have done so, yes, absolutely.

Q153 Richard Graham: When you have done that, have the individuals or businesses involved paid?

Lesley Titcomb: I believe so. To be fair, they do not pay us. It is arranged between them and the trustees. I have no reason to suppose it has not materialised.

Q154 Richard Graham: Typically, a timespan is agreed within which those moneys should be transferred.

Lesley Titcomb: That is right.

Q155 Richard Graham: It is up to the scheme trustees to come back to you if that does not happen within the agreed time.

Lesley Titcomb: That is correct, yes.

Nicola Parish: Or if the scheme is in the PPF; then it would be a discussion with the PPF about payment.

Lesley Titcomb: Yes, because effectively then the PPF is in the space with the trustees.

Q156 Richard Graham: At what stage does that responsibility for effectively chasing the verdict of the anti-avoidance investigation move from you to the PPF? Does the PPF wait to take the scheme in until the results of your anti-avoidance inquiry, or does it take a scheme onto its books anyway, but your anti-avoidance investigation conclusions are still valid whether it has or has not been accepted in?

Lesley Titcomb: This gets a little complicated. The PPF runs what is called an assessment period when a scheme is heading for it. Effectively, it is when it is assessing what the real situation is in terms of the available assets and liabilities, what it might get in the insolvency and that kind of thing.

Q157 Richard Graham: And the scheme applies to—

Lesley Titcomb: Effectively it does, yes.

Richard Graham: The trustees of this particular scheme have already applied.

Nicola Parish: There will have been a trigger for a scheme to go into the PPF.

Lesley Titcomb: An insolvency trigger.

Nicola Parish: For example, it would have been the launch of a CVA or the appointment of an administrator, typically.

Q158 Richard Graham: Insolvency would be one trigger.

Nicola Parish: Yes, insolvency would be a trigger.

Richard Graham: At that stage the PPF is obliged to effectively—

Nicola Parish: The PPF then takes the scheme in, and it sits in that assessment period. The purpose of that assessment period is for the PPF to consider the circumstances of the scheme and what action the PPF might need to—

Lesley Titcomb: As Alan said, that does not preclude us at this point from using our anti-avoidance powers.

Q159 Richard Graham: In this case, you have already triggered the anti-avoidance investigation.

Lesley Titcomb: We had, yes.

Q160 Richard Graham: So there is no need for the PPF to ask you to do that.

Lesley Titcomb: Correct.

Q161 Richard Graham: The results of your investigation will take effect whether or not the scheme is already in the PPF. Is that correct?

Lesley Titcomb: That is right. There is perhaps one point we should say. If for any reason the assessment period were to have finished and it actually crystallised and was in the PPF in the final form, then our ability to use a financial support direction falls away because there is no ongoing scheme. You would then look at the contribution notice as the alternative means.

Q162 Richard Graham: What is the period of the assessment and how long will your investigation take? Is there any danger that your investigation will not finish before the assessment period?

Nicola Parish: Whether a scheme comes out of the assessment is pretty much in the gift of the PPF anyway. Clearly, we are working with the PPF.

Q163 Richard Graham: Very closely.

Nicola Parish: Yes, indeed.

Q164 Richard Graham: In order to make sure that the assessment period is finished.

Nicola Parish: Exactly, and that nothing prejudicial is done.

Q165 Richard Graham: How long will this go on for, effectively? How long would you expect your investigation to take?

Nicola Parish: You heard from Lesley that we have 70,000 documents at the moment that we are reviewing. We are hoping that we will be able to come to a view by the end of the year.

Lesley Titcomb: We expect to make significant progress by the end of this year.

Q166 Richard Graham: During that period, the trustees of the scheme are still there and they still retain the responsibility for the scheme.

Nicola Parish: The PPF has stepped into the shoes of the trustees at this point in time. They need to once it goes into the assessment period.

Q167 Richard Graham: As far as you are concerned, the trustees no longer have responsibility for the scheme.

Lesley Titcomb: They are still there, are they not? The PPF is effectively standing in their shoes. Everything significant to be done with the scheme has to be okay with the PPF during that period.

Q168 Chair: By the end of the year you mean this year?

Lesley Titcomb: I mean 2016, for the avoidance of doubt, yes.

Q169 Michelle Thomson: Just remind me when you started.

Lesley Titcomb: We started the anti-avoidance investigation in March 2015.

Q170 Michelle Thomson: Is that a typical timescale or is it hard to tell?

Lesley Titcomb: They really do vary hugely, these schemes. Above 10, yes, that is rare. Some of them resolve much quicker. It all depends on how much of the due process the targets choose to exploit as well. Do they want to appeal? Do they want to make representations? There are all of those kinds of things. There are checks and balances there.

Q171 Michelle Thomson: Moving on then, what specific actions can you take against both current and previous owners in cases such as BHS?

Nicola Parish: The main powers that we would be looking at are, as discussed, the avoidance powers. The first one is the financial support direction. Were that to be successful against potential defendants then we can be looking for a range of financial support. That can be hard cash. Depending entirely on the circumstances it can be, for example, a guarantee. Lesley alluded to financial support directions earlier. These are decisions made by a determinations panel, which is a panel entirely independent of the case team. They agree in principle to the idea of a financial support direction. How much that amounts to and in what form that comes is subject to agreements subsequent to the determination panel determining there should be financial support for a scheme.

Q172 Michelle Thomson: In terms of positive outcomes, what is your feeling of success in the case of BHS specifically?

Nicola Parish: Talking about the specifics of an investigation that is on foot would be very difficult.

Lesley Titcomb: One thing I would say, though, is that we have been running a year's investigation so far, and there is more to go. That is an expensive and time-consuming business. I do not disburse levy payers' money without very careful consideration of whether that is the right thing to do. We obviously re-examine the case at various

checkpoints to consider whether it is appropriate to continue. We have been going for a year and we are still going.

Q173 Michelle Thomson: What we have been exploring today is the somewhat opaque nature, and obviously you will have sight of certain elements of your case in terms of anti-avoidance. How equipped are you as a regulator to get that wider oversight, or will you be able to pull in other people as appropriate?

Lesley Titcomb: We can absolutely get in all the expert support we need, and we are doing that. I would stress again that as the Pensions Regulator we have a limited remit here, and I am pursuing the actions that I think are appropriate to trying to secure the position of the pension scheme. I am not doing a full investigation of the activities of the various companies, their directors, their owners or whatever in this situation. We are a regulator of limited remit.

Q174 Michelle Thomson: In terms of who ultimately has oversight of the success of your own investigation, who holds the accountability for that?

Lesley Titcomb: I do as the accounting officer for the Pensions Regulator, and I am accountable to Parliament through the DWP.

Q175 Richard Graham: Just on that very point, if I may, Chair, can you just confirm that when you reach the conclusion of your investigation, and let us suppose that it is a requirement on individuals or businesses to contribute to the pension scheme, is it legally mandatory for them to comply with that?

Nicola Parish: A contribution notice can be enforced through the courts in the same way as any other debt can be enforced. Going back to your questions earlier, were any moneys due under a contribution notice not to be paid up, the PPF would then be able to pursue that as a debt to the pension scheme.

Q176 Richard Graham: Would it have to go through the courts?

Lesley Titcomb: It would have RIPA procedures, yes.

Nicola Parish: I did not finish the question about contribution and the powers. I do not know if you want me to carry on.

Richard Graham: It would be very helpful, Chairman, to know the contributions.

Q177 Michelle Thomson: Just to pick up on that, in terms of jurisdiction for going through the courts, how does that work?

Lesley Titcomb: In terms of the regulatory decisions that we take, as I said, first of all the executive do the work. The determinations panel, which is part of the Pensions Regulator but consists of people who do not work full-time with us, including lawyers and so on, makes a determination. We then get to the point where if somebody appeals it we go to the upper tribunal. We are into judicial procedure there within the upper tribunal, so it switches, and they hear it from scratch anew. That is about the regulatory decisions. For

the enforcement of the actual sanction we are into a different situation and, as Nicola said, you would be into the normal debt recovery.

Q178 Michelle Thomson: Do you have precedent to draw on for this sort of scale?

Nicola Parish: We have published a number of section 89 reports in relation to previous actions we have taken on avoidance. Probably the one that you are most aware of is the Lehman case; that resulted in a settlement of £184 million, which was full buyout for the members. All members got all of their benefits. That is probably one that is comparable.

Q179 Mr Wright: Lesley, as accounting officer, how do you decide where and how to allocate your resources?

Lesley Titcomb: First of all, I should say that I am aware, and I will tackle it head-on, that there have been comments about us having a reduced level of resources in our current corporate plan. As with all public bodies, we were faced with a spending review challenge. I want to make clear that we have maintained, nay increased, our level of frontline regulatory resource in this year. The savings we have made have been in our back office and support systems. We have maintained a level of resource, principally in Nicola's area here, but not solely, that we applied to frontline regulation. How we make choices in an area such as this is that we look at the various types of situation that we have to work at through cases. We determine what our risk appetite is, and we will try to allocate our resources to the riskiest situations or areas. We will review that, typically quarterly, through the year to see whether we need to adjust it, discuss it with our board and that type of thing.

Q180 Mr Wright: In answer to a previous question, and I am paraphrasing a little bit, you said in relation to this you will have access to all available experts. Experts are expensive.

Lesley Titcomb: They are, yes.

Q181 Mr Wright: How are you able to allocate resources regarding that?

Lesley Titcomb: We have a specific arrangement with the DWP where a certain amount of our budget is held as a case type reserve that we can draw on for these situations. I have also had specific conversations with the DWP that should we face, god forbid, a glut of avoidance cases, for example, that is exactly the sort of situation where we would expect to go to the DWP and ask for additional resources.

Q182 Mr Wright: How much significance do you anticipate, in terms of time and resources, BHS will now play in your organisation?

Lesley Titcomb: It will be significant, but it is very easy, if I may say so, for these cases to chew up a huge amount of the organisation's resources if we are not careful. It is my responsibility to ensure that we do not lose sight of our many other important responsibilities. Examples that I know are of interest to this Committee include what we are doing on master trusts and our responsibilities around auto-enrolment.

We have a very good team on this, but it is a limited team. We can buy in the additional expertise that we need to support it. If I threw all 500 people in the organisation at this case, would it make it go quicker? Almost certainly that would be an ineffective way of running it. You need a good, focused team of the right people, with the right skills, working closely together.

Q183 Mr Wright: Are you prepared to go long on it in order to get a result?

Lesley Titcomb: Yes.

Mr Wright: Like Chilcot.

Lesley Titcomb: I should perhaps not go there. As I said, I would hope we would have made significant progress by the end of this year. I am very conscious of the fact that justice delayed is justice denied. Every regulator will sit here and tell you that it would be great if we could do enforcement cases quicker, but it is jolly difficult when push comes to shove.

Q184 Amanda Solloway: Just to clear up on that point, I was just thinking in a situation like this I do not know who the recovery would be from. I wonder at what point it becomes not viable, because you are saying it is a very expensive process. Do you do an analysis at the start to see whether or not there will be any reward at the end of it?

Nicola Parish: Certainly, we do. Going back to the beginning, we would have a case strategy at the outset to have a look and see what the information that we have at that point in time tells us may have happened. As we go gathering information there is an ongoing process of assessing that information to determine, “Is that strengthening what we thought might be a case for use of our powers or not?” as well as how that might translate into support or contributions. It is an ongoing process of assessing that. Once we get to the end of it, then obviously we will take a final view on, “What does that now look like?” in terms of, for example, a cash figure attached to a contribution notice or to a financial support direction.

Q185 Jeremy Quin: We are all focused, or at least I am, on the length of time some of these things are taking, including the length of time it takes for you to be engaged and the length of time it takes for your actions to play out. I am not questioning your integrity or that of your staff in any way, shape or form, but you talk about the skills base. Do you have actuaries, legally trained professionals and transaction-oriented individuals?

Lesley Titcomb: Yes.

Jeremy Quin: You can have a team that has all of the skills.

Lesley Titcomb: Absolutely. We have actuaries, we have investment specialists and we have what we call business analysts who are very often M and A specialists and restructuring specialists.

Q186 Jeremy Quin: So you can do the job. You are not just passing it out and getting an expert in.

Lesley Titcomb: *Absolutely.* Let me pick an example where we might need particular help. We might need tax advice. We might need advice on valuations of properties and that type of thing. We might need advice on M and A situations and restructurings that goes beyond the experience of the people in the team, and so on and so forth. We very often engage external counsel because this is hard fought litigation and we will find ourselves probably with QCs up against us.

Jeremy Quin: **Thank you for answering my question, which is that** you do have the skill set inside the department to get a team that can do the job.

Lesley Titcomb: *Absolutely.* We supplement the team.

Q187 Jeremy Quin: **That is not the issue in terms of the time it takes.**

Lesley Titcomb: That is correct.

Q188 Chair: Lesley, the more these two sessions have gone on, it does seem to one member, me, that you have an impossible task, and that we should not ask you to perform it. First of all, when pension funds look as though they are in difficulty, you set a recovery plan over years. It seems to me that there is a public interest that there is a body to which you have to refer to see whether they agree with you on that. Thirdly, when it goes wrong you launch the inquiry. Do you not think they are three separate functions and it would be better for you to make the recovery plan, people question whether that is advisable or whether it pushes the firm over, and then when it is like BHS you, in a sense, are conducting one of the main inquiries?

Lesley Titcomb: I have worked in regulation for 25 years, and all of the regulators that I have worked in in their various forms have had objectives that at any particular time can be in tension. It is the challenge for the regulator to balance that and to try to resolve those issues of tension, and to apply the resources in the right place. I am not sure that a more fragmented structure would not necessarily mean that we would arrive at better decisions as a whole, or better outcomes if you like. We have been given steers at various points during the process, including the creation of the legislative framework that underpins the regulator, about what we should be focusing on. We also have to be an organisation that learns from experience, and takes account of the views of key stakeholders and the views of Parliament in what we are doing. Do I think necessarily changing the structure, on the basis of one particular case, is the right thing to do? I am not sure I do. We have to look at the whole situation and not just very difficult and unfortunate situations that we see now. The fact is the vast majority of employers out there are doing the right thing. We need to recognise that.

Q189 Chair: **The pressures on those employers** are going to increase, are they not, as we live longer?

Lesley Titcomb: They are, absolutely.

Q190 Chair: Maybe the returns on investments are going to be a lot less than we thought they would be when setting up the schemes.

Lesley Titcomb: I completely accept that, and I do think, particularly given the ongoing difficult economic circumstances, with low gilt yields and all of those types of things, it has proved to be very difficult for trustees and employers. We are publishing our annual funding statement later this week. The economic circumstances remain very challenging for defined benefit schemes. That will not come as a surprise to anyone. The fact is, if we use the flexibility that is built into the system, that says that you do not have to pay and fund everything today, and that you can, as a responsible employer, take the time, and the regulator will be understanding about what is affordable to your business, then I think we can genuinely work our way through this so that the DB schemes will play out. After all, the majority of them are now closed to future accrual. Of course, difficult situations like this do not help.

Q191 Chair: If they are, in a sense, like pyramid sales schemes then it is not always an advantage to close the scheme, is it?

Lesley Titcomb: I would not like to describe DB pension schemes in this country as like pyramid sales. It would be very unfortunate to say that.

Chair: They never are at the early stages, are they?

Lesley Titcomb: It is fair to say that DB pensions are long-term businesses and you have to take a long-term view. Providing the employer behaves responsibly that should not be a problem.

Q192 Chair: Before I bring Richard in to perhaps end this session, when you came before us earlier this year you were very robust about saying that you needed new powers. The Pensions Minister was equally robust in saying for these master trusts. Did you clear that view with her before you uttered it, so that if in fact you thought you needed new powers you could say that off your own bat?

Lesley Titcomb: To be quite honest, Chairman, I cannot recall whether I mentioned it. It was one of the first things that became apparent to me when I walked in the door as a regulator, because it was a key difference. It had also become very apparent to her very quickly when she took over as the Pensions Minister. We were singing from the same hymn sheet from a very early stage, so I cannot honestly answer your question there because I do not know. Do I feel confident that I could speak out and say where I felt that our toolkit was deficient? Absolutely, I do. Indeed, I also feel that I could go and talk to the DWP and I would receive a good hearing as well.

Q193 Chair: On your risk calculator, we have a number of schemes now that have no parent company, called zombie schemes, which is partly, I suppose, not to confuse them with orphan schemes. How important and worrying is that trend to you?

Lesley Titcomb: In both DB and DC schemes, we do have a number of schemes that are left without a strong sponsor and that kind of thing. That is something that we need to explore. There are mechanisms emerging within the market to consolidate some of those schemes. If you were to look at the type of thing that we discuss around what might be

useful powers, that would be one area for us, so that we could perhaps give the direction to trustees that they need to seriously think about it.

Chair: Some schemes, like the Trafalgar House scheme, are rather large.

Lesley Titcomb: There are number. It is not just the small schemes; you are absolutely right. One of the things we always have to have regard to is, for example, in the type of regulatory apportionment arrangement that Alan talked about—and that, not surprisingly, he is very interested in—is that situation's ongoing viability and sustainability. Otherwise, all that will happen is that he will get it 10 years down the track in a worse state than if he had it now.

Q194 Richard Fuller: Chairman, you provoked me to ask a question. I was not going to ask a question. I do think that Frank has raised a point about this balance between flexibility and rigidity, and the consequence of your, if I may say, somewhat undue faith in the benefit of flexibility, puts you in an almost impossible situation. With that flexibility, you are the ones that have to determine whether this is right or that is not right. I am not sure of the benefit of, “Let me see what I can do” versus “Rules are rules” is beneficial, particularly in the context where you are up against people whose interests where there is flexibility means they are going to push for flexibility. Does that not just end up with someone turning up one day and saying, “Here is the paper. Guess what? I sold the company”?

Lesley Titcomb: There will always be a few people that do not play by the rules.

Q195 Richard Fuller: They do not have to, because you believe in flexibility. There are no rules.

Lesley Titcomb: If I may, I am operating within the framework that has been set for me by Parliament here.

Q196 Chair: We keep asking you whether you want to change that.

Lesley Titcomb: Indeed. As I have said, I am always happy to look at what we learn from particular situations like this. The BHS situation, if I may point out, crystallised two weeks ago. I have not yet had a chance to reflect on all the lessons that might come out of such a situation.

Q197 Richard Fuller: That is the crux, is it not? Your belief in flexibility does not work, because you do not have enough teeth until it is too late.

Lesley Titcomb: No, I disagree. For the vast majority of schemes it does work. We see that if there is a strong, well behaved, responsible employer standing behind a scheme that is the best thing for it, and then it is then right to give that sufficient time to work through. It is difficult when there are people who are irresponsible. I agree it is difficult. I do not believe that that is the case in the vast majority of situations.

Chair: Thank you very much, Nicola and Lesley.

