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Carillion – the Role of the Pensions Regulator

Carillion entered into liquidation on 15 January 2018. With 13 UK defined benefit pension schemes comprising 27,000 members, and an estimated £900 million deficit, it is likely to be the biggest ever call on the Pension Protection Fund.

As inevitably follows a high profile case such as Carillion, the blame game is well underway, with the Work and Pensions Committee's Chairman, Frank Field and Robin Ellison, the Chairman of Carillion (DB) Pension Trustee Limited (the trustee of six of the 13 pension schemes) questioning the Pensions Regulator's role.

Is the Regulator able to take the tougher stance that some are calling for or will new legislation be needed? With a White Paper due in the Spring, trustees and sponsoring employers going through the valuation process should be aware of the messages expressed by the Government and interested parties.

Background

Carillion was a major supplier to the public sector in the UK, delivering around 450 contracts with the Government across a range of areas. At some stage the government's willingness to continue to place contracts with Carillion as its financial difficulties became apparent may become an issue.

In July 2017 Carillion announced a £845 million profit warning and dividend payments were suspended. In recent years Carillion has made a number of large dividend payments to shareholders. Its 2016 dividend of £78.9 million exceeded the company's 2015 profit of £73 million.

The Trustee of the six pension schemes had sought to agree higher contributions from the company at each of the 31 December valuations in 2008, 2011 and 2013, but Carillion had made it clear that it was constrained in what it could afford to pay by cash flow. In both the 2008 and 2011 valuations the Trustee was unable to reach agreement on the valuations by the due date under the Pensions Act 2004. The Pensions Regulator was involved in discussions during both valuations with both the Trustee and Carillion.

In August 2017 the Trustee of five of Carillion's pension schemes (including the three largest) was approached by Carillion with a request to defer contributions for a period. The Trustee agreed to defer eight months of

contributions on the basis that failure to agree would have led to the banks not lending new money to Carillion and its collapse at that time.

A compulsory liquidation order was made against Carillion on 15 January 2018, shareholders and suppliers are unlikely to get any money back, and the pension schemes are heading into the Pension Protection Fund.

The Pensions Regulator

Robin Ellison confirmed in his evidence to the Work and Pensions Committee that the Regulator had been involved since 2008 and was “proactively engaged” for the last few years.

This is clearly another embarrassment for the Regulator following on from previous high profile cases such as BHS. Hindsight is a wonderful thing, but it’s difficult to see how the Regulator could have acted very differently. The Regulator is now conducting an investigation to decide whether or not it can use its anti-avoidance powers.

This has not stopped the Work and Pensions Committee’s chairman Frank Field making adverse comments about the Regulator, damning its current actions as “tentative and apologetic” and suggesting “Once again, TPR has questions to answer”. Both Robin Ellison and Chris Martin, chair of Independent Trustee Services and a director of the Trustee since 8 January 2018 have expressed the view that the Regulator has conflicting statutory objectives having to balance the interests of pension scheme members, the employer and the Pension Protection Fund.

The Government

In its February 2017 Green Paper ‘Security and Sustainability in Defined Benefit Schemes’ the Government stated that “virtually all stakeholders” thought the regulatory regime for defined benefit pension schemes was “satisfactory”. There might, said the Government, be a case for limited changes to regulation to help employers and trustees manage liabilities more effectively in some cases. It asked for views in relation to a number of changes.

On 11 January 2018 the Government promised a White Paper in the Spring. Then four days later Carillion went into compulsory liquidation.

The Prime Minister, Theresa May, writing on 21 January for the Observer, promised “tough new rules” will be set out in the Spring to crackdown on pensions abuse. She was concerned about companies who pay large dividends and bonuses ahead of plugging deficits in company pension funds.

Is anyone to blame?

It’s not the Regulator’s fault that the Government has given it conflicting statutory objectives. Neither is it the Regulator’s fault that Carillion appears to have been mismanaged or that the Government continued to award contracts to Carillion when it knew, or ought to have known, it had financial difficulties. While the Regulator has been aware for some years of issues with Carillion, at the end of the day recovery plans are agreed between the employer and trustees. Moreover, there was an independent trustee as chairman of at least six of the 13 Carillion schemes, something which may have given some comfort to the Regulator.

It is unlikely that the Trustee was at fault either. It involved the Regulator over a number of years, and sought a greater commitment from Carillion at each of the last three valuations. However, where an employer covenant is not strong and the company has constraints on cash flow there is only so far a trustee board can go. When the

banks (back in September 2017) were only prepared to lend further money to Carillion if the Trustee agreed to defer contributions, the Trustee had little choice. Had it refused and caused the collapse of Carillion and loss of jobs then it would have faced some criticism. By then the demise of Carillion may have been all but inevitable.

What can trustees do in such circumstances?

It's obviously important that trustees continue to monitor their employer covenant on a regular basis. The Regulator expects trustees to adopt an integrated approach to managing the key risks in a pension scheme, covering the areas of covenant, funding and investment, known as integrated risk management (IRM). Trustees should consider IRM regularly and document their discussions and framework for dealing with it carefully. All schemes need to put contingency plans in place to mitigate downside events.

Where there are warning signs of a weakening in covenant, trustees should actively reconsider their investment and funding strategies. They should also open discussions with the employer and enact any contingency plans that have been put in place for such circumstances.

Where an employer could increase contributions, the Regulator expects an appropriate balance to be struck between funding the pension scheme and payment of dividends. Schemes are expected to have relatively short recovery plans where employers are paying more in dividends than deficit recovery contributions to the scheme.

At the end of the day it is inevitable that big companies will from time to time cease to exist. When they do, trustees of their pension schemes need the appropriate paper trail in place to prove they have acted reasonably over the run up to the company's collapse.

Comment

With the collapse of Carillion in the press and the Work and Pensions Committee and the Business, Energy and Industrial Strategy Committee holding a joint enquiry, the Government will be keen to be seen to be doing something. Watch out for the White Paper due to be issued in the Spring.

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