Pension
Protection
Fund

Rt Hon Frank Field MP
Chair of the Work and Pensions Committee
House of Commons
London
SW1A 0AA

20 February 2018

Dear Mr Field

Carillion defined benefit pension schemes

We are grateful for the opportunity to contribute this submission to the Committees' inquiry into the insolvency of Carillion plc.

Before setting out our past involvement in relation to Carillion plc and its 13 PPF-eligible defined benefit pension schemes,[1] it may assist the Committees for us to briefly provide some reassurances on a number of points of potential interest.

Firstly, the c.27,500 scheme members can be reassured they are protected by the Pension Protection Fund (PPF). At the time of writing, 12 of the 13 PPF-eligible schemes have entered PPF Assessment, and the remaining scheme would do so when the last of its sponsoring employers are put into liquidation. We recognise that the collapse of Carillion plc, leaving behind a substantial aggregate deficit in its pension schemes, will have caused uncertainty and distress for scheme members. We hope though that members can draw some comfort from knowing that we will ensure they receive at least PPF levels of compensation.

Secondly, we recognise that claims falling on the PPF are a cost to our levy payers (i.e. the 5,588 remaining defined benefit schemes and their c.15,000 sponsoring employers). We can though provide our levy payers with some reassurance that there will be no immediate impact on their levies as a result of this claim.

We have no plans to alter the total amount of levy we will look to collect next financial year (the 'levy estimate'). As first announced back in September 2017 and confirmed in our Levy Determination last December, we will look to collect £550 million in levy next year (2018/19), which is 10 per cent lower than the estimate for the current financial year (£615 million in 2017/18). This is because we set the levy on a long term basis, anticipating potential future large claims, so the amount we collect is broadly stable year-on-year relative to the volatility in actual and expected claims.

Thirdly, we trust both members and levy payers can draw some comfort from our current robust funding position. Our last published accounts showed we had a funding ratio of 121.6 per cent and a reserve of £6.1 billion. We cannot of course be certain what volume of claims

[1] In addition, there are various defined contribution schemes associated with Carillion plc, and one further defined benefit scheme which will not enter PPF Assessment.

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we may receive in the future, and in this case it is too early to accurately forecast what the eventual claim might be from the Carillion schemes, albeit we expect this could be one of our biggest claims since we opened for business in 2005. Nonetheless, should the eventual claim on the PPF be in the region of £800-900 million as per our initial estimate at the point of insolvency[2], given our current £6.1 billion reserve we are well placed to absorb this.

While our current funding position is healthy, we remain highly vigilant to the significant risks we face given the challenges in scheme funding. The majority of the schemes we protect are in deficit, and as at the end of January 2018, the aggregate deficit of these schemes on a PPF basis stood at £51.0 billion.[3] We continue to rigorously monitor and evaluate our progress in achieving our funding goals through our Long Term Funding Strategy, which we update and publish annually. Our current 'probability of success' in meeting our funding objective is 93 per cent.[4] So while this means in 93 per cent of the one million scenarios we model we do meet our funding target, there are of course extreme adverse scenarios where we do not.

The PPF's statutory role

To set in context the engagement we had with Carillion plc and its associated schemes prior to insolvency, it may be helpful to briefly summarise our statutory functions and how they differ from those of The Pensions Regulator (TPR).

The legislative framework, which set up the PPF alongside TPR, makes a clear distinction between the two organisations. The PPF was set up to pay compensation to members of defined benefit pension schemes in the event their sponsoring employer becomes insolvent and the scheme has insufficient assets to cover at least PPF levels of compensation. TPR has statutory duties to protect the benefits of members and minimise any adverse impact on the sustainable growth of employers, as well as a duty to 'reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund'. To put it in very simple terms, TPR has regulatory powers and its focus is the funding and governance of DB pensions, while the PPF is focused on providing compensation.

We do though engage with our colleagues at TPR in two broad areas: firstly in relation to their overarching work to improve scheme funding levels, and secondly where appropriate with regard to their case specific investigations and interventions.

Past PPF involvement

To assist the Committees we have sought to set out how and when we have had substantive engagement related to Carillion plc and its associated schemes. This broadly falls into three time periods.

Prior to July 2017

Prior to last year, the direct engagement we had with the pension schemes and their sponsoring employers was in regard to PPF levies payable. By way of brief background, as set out in the Pensions Act 2004, the PPF charges a compulsory annual levy on the schemes we protect to help fund the compensation we provide. The levy is payable by the scheme,

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[2] The initial estimate was based on a 'roll forward' of scheme return information previously provided to us by TPR. It is therefore subject to future revision as the schemes come into PPF Assessment.

[3] PPF 7800 Index, January 2018 update

[4] PPF Long Term Funding Strategy Update, July 2017

although in practice it is often paid by the sponsoring employer(s). We therefore engaged directly with the schemes each year with regards their levy charges in the usual manner.

We were not directly involved in scheme valuation exercises as these fall under the regulatory remit of TPR, although we would have subsequently used the outcome of valuation exercises to price the risks through the PPF levy.

July 2017 – December 2017

In light of the publication of the trading statement on 10 July 2017 by Carillion plc, we initiated internal work to assess and closely monitor the company's financial position and proactively engaged with TPR colleagues and external advisors.

Between August and October, while not directly involved ourselves, we were kept informed by TPR colleagues of their discussions with representatives of the company, schemes and advisors in relation to the proposal to defer deficit recovery contributions.

We recognise that the wider backdrop to these discussions was one of the company facing immediate and serious liquidity issues. Nonetheless we did convey to TPR colleagues our discomfort with the deferral proposal, which related to whether the deferred contributions would eventually be made and the treatment of the schemes as against other creditors.

We do though recognise that our focus in these scenarios is singularly on protecting the interests of our levy payers from the risks posed by potential insolvency and ongoing 'PPF drift'.[5] In contrast, we appreciate TPR's requirement is to balance our interests with its other statutory objectives.

December 2017 – January 2018

Our first direct engagement with representatives of Carillion Plc was in early December 2017. We initiated the meeting given our growing concerns about the company's deteriorating financial position as detailed in the 17 November stock exchange update. We set out that if the company wished to pursue a restructuring proposal, it would need to meet our published criteria.[6]

We were subsequently invited to a meeting on 8 January with representatives of the company and the group's advisors to discuss options including a potential Regulated Apportionment Arrangement (RAA).

Following this meeting, on 9 January 2018 we (and TPR) received an initial, high-level proposal for an RAA. We assessed that the proposal failed to meet our published criteria and communicated this to the company on 11 January, as well as our willingness to engage in constructive dialogue. We did not receive a revised proposal prior to the insolvency event occurring on 15 January. Our view was that by that stage the company's financial position

[5] 'PPF drift' is the term we commonly use to describe how the PPF deficit can increase over time. In these types of situations, the longer schemes run on before the sponsor becomes insolvent, the greater the eventual cost generally is to the PPF, and ultimately our levy payers, of us providing compensation. In the case of Carillion, we think it probable there will be cost in 'PPF drift' attributable to the period from the deferral agreement to insolvency, but from the information we currently have we are unable to quantify this accurately.

[6] The PPF Approach to Employer Restructuring, August 2016 http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/Restructuring_and_Insolvency.pdf

had deteriorated to such a point that an RAA was increasingly unviable and in any event it would not, in isolation, have changed the end result.

I hope this information is helpful, and I am more than happy to assist further if you or colleagues have any further questions. It may also be of assistance to Committee members, particularly in dealing with queries from affected constituents who are scheme members, to encourage them to contact their relevant trustees in the first instance as they will continue to remain in day-to-day charge of running the schemes during the Assessment Period.

Yours sincerely,

Andy McKinnon
Acting Chief Executive

CC: Rachel Reeves MP, Chair of the Business, Energy and Industrial Strategy Select Committee