19 March 2014

Dear Robin and Janet

RE: Mowlem Staff Pension and Life Assurance Scheme
Carillion B Pension Scheme
Carillion Staff Pension Scheme
Alfred McAlpine Pension Scheme
Planned Maintenance Engineering Limited Staff P&AS
(together, “the Schemes”)

Actuarial valuations as at 31 December 2011 (“the 2011 Valuations”)

1. We write further to our meeting on 11 March 2014 and specifically with regard to the current proposal (“the Proposal”), in respect of the 2011 Valuations, as detailed in the company’s letter to Robin Ellison of 10 March 2014.

2. The purpose of this letter is to provide both sides with our observations and comment on the Proposal, as well as to clarify our expectations and the proposed next steps, should the trustees choose to accept this.

Our observations

3. We are mindful that the negotiations in respect of the 2011 Valuations have been long running and have taken considerable time and resource on both sides. As we have explained previously, it remains our preference for the parties to work collaboratively and to reach an agreement without the need to consider use of the Regulator’s powers in the absence of agreement.
4. You have recognised the importance of keeping the Regulator's case team sighted on the recent progress of the funding negotiations, to ensure that any proposal being considered did not present any areas of concern to us. After careful consideration and deliberation and as explained verbally to the trustees, we do not anticipate that we would carry out any further investigation or have further queries in relation to the Proposal, should the trustees decide to accept it and submit the 2011 Valuations to us on that basis. We would however make several points in relation to the Proposal.

**Level of deficit repair contributions relative to covenant strength**

5. As part of our engagement, we have sought to understand better the business model and challenges being faced by both by Carillion and the wider industry sector in the short to medium term. We do recognise that firms in the construction sector have been through tough times and that affordability constraints exist. We are therefore accepting of the need, in these circumstances, to be flexible in this regard in the short term.

6. We remain of the view that the level of contributions is still low, particularly up until 2017. The fact that the group is indicating that it is constrained from paying higher contributions, which was also the case in respect of the 2008 valuations, appears to be inconsistent with the company's assertion of a moderately strong covenant. For a covenant deemed to be at the stronger end of the spectrum, we would ordinarily expect that covenant to be able to cope with increases to the deficit by being able to pay more contributions to the Schemes as and when necessary and with less need to retain a relatively long recovery period.

7. We are encouraged by the ratchet structure of the Proposal and the step up in payments which the Schemes can expect to receive from 2017 and onwards. The Proposal also envisages reducing the contributions to £39m pa from 2022 (from the current £42m pa), should the funding position be ahead of expectations. However, we note there is no downside mitigation or contingency planning as a quid pro quo for this. We would therefore urge the trustees to be vigilant about tracking the deficit and any fluctuations in between the effective valuation dates and to seek additional contributions and/or support, if necessary.

8. In light of the flexibility afforded to the company by the trustees in the structure of the contributions, in particular the relatively low level in the short to medium term, we consider that some form of linkage to dividends is appropriate and that dividend payments should not increase at a higher rate than payments being made towards the Schemes. The Regulator would consider any increase in dividends to be evidence of increased affordability and would expect the Schemes to be treated equitably in these circumstances. The Schemes should be able to share in the upside of the economic cycle, given that they have shared the pain in the economic downturn.

**Investment risk and longer-term objective to de-risk**

9. Furthermore, given the apparent anomaly between the perception of a strong covenant and requiring a relatively long recovery period to address the funding deficit, we have concerns that the covenant strength has not been demonstrated to be strong enough to underwrite all downside investment scenarios. Therefore, we
continue to have concerns that the level of investment risk which will be retained over the length of the recovery period remains substantial.

10. In addition, it is still not clear to us that the company has proven the fact or given objective evidence that the covenant can underwrite this risk now or in future. Therefore, the investment strategy remains an area of real focus for the Regulator. In particular, we would like to understand the plans that the trustees and company will have over the next few years to look at a longer-term objective with plans either to de-risk or to develop a sustainable covenant of adequate strength. A coherent plan in this regard would in time mean that the Schemes would become less exposed to the current mismatch between risks and covenant. Were a longer-term de-risking objective to be adopted, this would also enable the company to be less exposed to potential volatility in the Schemes’ deficit.

Expenses

11. Our understanding is that the recovery plan payments contained in the Proposal are inclusive of administration and investment expenses incurred by the Schemes, but not the PPF levies, which are to be paid by the company.

2013 Valuations

12. We understand that the next valuations as at 31 December 2014 are to be brought forward to 31 December 2013. We reserve our position in this regard and will comment, as appropriate, following completion and submission. However, we note that the estimated position at 31 January 2013 was used as a reference to develop the recovery plan in the Proposal. Consequently, we would expect the recovery plan to be adopted for the 2013 valuations to be likely to be of the same structure and substance as that for the 2011 Valuations. For the avoidance of doubt, we would not expect the 2013 recovery plan to result in an agreement which sees the level of deficit repair contributions lowered from the current Proposal, given the indication that the Schemes remain in deficit at that valuation date.

Expectations going forward and ongoing engagement

13. In tandem with the negotiations for the 2011 Valuations, we are aware that the parties established a Joint Working Party (“the JWP”) and that a considerable amount of work went into the recent longevity swap exercise. We note that this exercise was funded by the company and comprises part of a wider, long-term, liability management strategy.

14. As suggested previously and verbally agreed at the meeting on 11 March, the Regulator would like to continue our engagement with the company and trustees on an ongoing basis. This would be with a view to understanding the work being undertaken in relation to a longer-term objective and de-risking for the most part. As noted above, given our reservations around the investment risk, we are keen to see progress in this area. We would anticipate that this arrangement would involve a number of meetings a year, coinciding with key milestones in the longer-term journey plan and allow all sides to obtain an update and express their views.

15. We welcome the openness shown by the company and trustees to continue to work with the Regulator.
Formal position in relation of our review

16. From our review of the Proposal, we confirm that, as long as the final documentation in respect of the 2011 Valuations reflects our current understanding of the Proposal, we do not anticipate that we would carry out any further investigation or have further queries following submission of the 2011 Valuations.

17. If the 2011 Valuations submitted differ materially from the Proposal, or there is a material change in circumstances and/or we receive information which is materially different from that which has been provided, we may undertake a further assessment of the 2011 Valuations upon submission. This could potentially result in the use of our powers under section 231(2) of the Pensions Act 2004 ("the Act").

18. This letter does not provide any confirmation as to whether the 2011 Valuations comply with any or all of the requirements of Part 3 of the Act (which is the responsibility of the trustees). Nor does the letter relate to (or provide any comment on) the exercise (or potential exercise) of any of the Regulator’s other powers.

Closing points and next steps

19. We should be grateful, if you would please provide an indication of when you intend to submit the formal valuations through our online Exchange system and a copy of the finalised valuation reports for our records.

20. As explained above, we would welcome and are expecting a continuing dialogue with both the company and the trustees. We therefore look forward to hearing from you shortly with a view to making the associated arrangements.

21. For further details of the formal position in respect of scheme funding requirements, you should refer to Part 3 of the Act, the Code of Practice 03: Funding Defined Benefits, and the related guidance available on our website.

Yours sincerely

Case Manager | DB Funding
Direct Line: 01273 648442
Dear Jeremy

RE: Mowlem Staff Pension and Life Assurance Scheme
Carillion B Pension Scheme
Carillion Staff Pension Scheme
Alfred McAlpine Pension Scheme
Planned Maintenance Engineering Limited Staff Pension and Assurance Scheme
(together “the Schemes”)

Actuarial valuations as at 31 December 2011 (“the 2011 Valuations”)

Thank you for your letter dated 11th October and the additional information you provided.

We are also aware that the trustees presented the company with a further proposal in writing (dated 8th October), but understand that a response to this is still outstanding. We note from your letter that a further meeting was to be arranged to discuss future cash contributions and it would be useful to know the outcome of that meeting once it has taken place.

As expressed previously, it remains our preference for parties to work together and reach an acceptable agreement without regulatory intervention. However, you will be aware that we have previously referred to the powers available to us under s231 of the Pensions Act 2004 and we may have no option other than to consider engaging this power, if there remains a failure to agree an appropriate recovery plan. In that regard, we will consider the appropriateness of pursuing that route, if there is no evidence that material progress has been made by the end of this month.

Affordability and pension contributions

In your letter, you refer to the short term pressure that the company is experiencing in respect of its cash flow, pointing out that analysts expect this to improve significantly in the future. We note that this is reflected in the Chairman’s statement in the 2013 Half Year Report, which confirms the expectation that net borrowing at the year-end will be lower than that at the half year, as positive cash flow is generated following completion of the rescaling of the group’s UK construction activities. We also note confirmation of the group’s committed borrowing facilities of over £1.1 billion.

At present, we have not seen sufficient evidence or reasoned rationale behind the company’s claim that it is restricted in being able to afford more towards deficit contributions before 2016 than it has proposed. Furthermore, we have not seen evidence to clearly demonstrate the other calls on cash flows for the company which necessitate retaining the pension contributions at the current proposed level. Where an
employer cites investment or cash flow constraints as the reason for suggesting particular pension contribution structures, we would expect that a coherent case to be made and presented. Based on the information we have seen to date, it would appear that more cash is reasonably affordable.

We do not consider that the comparison included in your letter (which we appreciate reflects the company’s arguments on this matter) between the increase in deficit contributions and dividends to be relevant to the issue of current affordability. The company should be well aware that the expectation of the Regulator and of the Trustee following the 2008 valuation for the Schemes is that, from the 2011 valuation onwards, the company would meet the administration and investment management costs. This was a negotiated compromise to enable agreement to be reached on the 2008 valuations and recovery plans. The inclusion of these expenses in the company’s obligations towards the scheme should not now be characterised as an example of the company giving relative preference to the Schemes over other stakeholders. With respect to recent dividend history, the experience since FY11 contrasts markedly with the experience of FY07 to FY11, when the average annual increase in dividends per share exceeded 11%. Our concern remains that the Schemes have not been given sufficient weight in the company's cash flow priorities in recent periods – we are not looking at the current 12-24 month period in isolation.

Covenant ability to underwrite investment risk

In parallel, we also note the company’s suggestion that it has the ability to underwrite the risks associated with the current investment strategy. We would expect such assertions to be evidenced with analysis that shows that this is indeed the case. This analysis should include understanding what level of cash could be made available, and over what period, to make good any underperformance of the investment strategy. Again, we would request that you point us to the evidence to support this.

Next steps

We note that the company is offering a further meeting to discuss its business model and the associated constraints. Our preference would be to understand first whether there is likely to be further progress in addressing the Trustee’s concern over the level of cash contributions immediately available to the Schemes. If you wish to discuss this further, please feel free to contact me. Otherwise, I look forward to hearing from you further to confirm the Company’s proposed next steps by the end of November.

As with previous correspondence, we are providing a copy of this letter to the Trustee.

Yours sincerely,

[Redacted]

Case Manager: IBB Regulation
Email: [Redacted]
Direct Line: [Redacted]

Cc: Tina Rushworth, Secretary to Trustee (by Email only)
Dear Jeremy

RE: Mowlem Staff Pension and Life Assurance Scheme
Carillion B Pension Scheme
Alfred McAlpine Pension Scheme
Planned Maintenance Engineering Limited Staff Pension and Assurance Scheme
(together the Schemes)

Actuarial valuations as at 31 December 2011 ("the 2011 Valuations")

Thank you for your letter of 14th November 2013 in response to ours of 8th November 2013.

We reiterate once more our position. We are unable to accept the views put forward by the company, both with regard to cash flow availability and to the ability of the covenant to underwrite long term investment risk.

Overall, we are disappointed and increasingly concerned by the lack of progress made to date. We note that the longevity swap has been the main focus of attention in recent weeks. However, we do not consider this an acceptable justification for the ongoing delays. You will appreciate that the 2011 Valuations should have been completed back in March 2013 and the failure to complete them is a material breach of a key piece of member protection legislation. We do not consider that a longevity swap being put in place should take precedence over finalising an appropriate funding agreement. In our judgement it is therefore inappropriate that this has taken precedence over valuation negotiations. This concern is further heightened when provided as an explanation for the delay in responding to the trustees’ letter of 8th October.

We understand that the company is proposing to discuss matters further in a meeting currently scheduled for 9th December. However, we are unconvinced that this discussion will be of any real value in the absence of fresh and compelling material being provided in advance. Moreover, we are mindful of information requests made ahead of previous meetings following which the information was not forthcoming in sufficient time to allow us to consider and form a view.

We reiterate that we cannot wait indefinitely for an appropriate agreement to be reached and, in the absence of any significant progress, we are now considering engaging the powers available to us under the Pensions Act 2004. We would suggest that this be included as an agenda item for the meeting on 9th December and we will explain once more what this will entail and the immediate next steps. We suggest the company bear this in mind when they consider the case they will be presenting to us at the meeting. If you have new evidence to share please let us have it by 4 December.
A copy of this letter will be provided to the trustees. We have also made them aware of the meeting on 9th December and suggested that a representative of their side attend, with a view to maintaining transparency.

I will be in touch to finalise the necessary arrangements.

Yours sincerely,

[Redacted]

Case Manager | DB Regulation
Email: [Redacted]
Direct Line [Redacted]

Cc: Tina Rushworth, Secretary to Trustee (by Email only)
Dear Jeremy

RE: Mowlem Staff Pension and Life Assurance Scheme
    Carillion B Pension Scheme
    Carillion Staff Pension Scheme
    Alfred McAlpine Pension Scheme
    Planned Maintenance Engineering Limited Staff Pension and Assurance Scheme
    (together 'the Schemes')

Actuarial valuations as at 31 December 2011 ("the 2011 Valuations")

Thank you for meeting with us and the scheme actuary on Friday 30 August to discuss in more detail the progress being made in relation to the 2011 Valuations and also the possible long-term funding options which are currently being considered. I summarise briefly below some of the areas discussed at our meeting, to ensure a consistent understanding on all sides. I should emphasise that none of the comments below should be taken to imply any change in the Regulator's position in respect of the 2011 Valuations. This, as discussed at the joint meeting on 17 July and confirmed in our subsequent letter to the trustees and to Carillion of 22 July, is that we are considering whether use of the power conferred under section 231 of the Pensions Act 2004 may be appropriate, if there continues to be a failure to agree appropriate valuations and recovery plans for the Schemes.

2011 Valuations and Recovery Plans

We understand that the company and the trustee board have had further discussions regarding how more funding may be made available to the Schemes. In particular, the parties are exploring the possibility of a cash share provision which would see the Schemes benefitting from additional funding, if the group's annual free cash flow ("FCF") exceeds a specified level. We understand that this proposal is in the early stages and as yet no details have been provided which would enable the trustees to assess the potential impact on the funding available for the Schemes. We also note that the current suggestion by the company is that such an arrangement may commence from 2016 onwards.

As explained at our meeting, two concerns we have over this development are (i) any contingent payments cannot be factored in to a formal schedule of contributions, so the Schemes may still be facing long recovery plan periods; and (ii) if the intention is to capture some benefit for the Schemes from a cash-flow performance which exceeds management's expectations, we do not understand why the arrangement cannot commence immediately rather than from 2016 onwards.

In addition, we understand that Carillion is prepared to consider discussing its intentions with respect to future dividend policy with the trustees, although there is as yet no intention to link increases in future...
dividends with deficit contributions to the Schemes. Whilst we see the company’s willingness to consider a dialogue along these lines as positive, we think that a formal link between deficit contributions and dividends may be required. It would clearly be anomalous if an additional deficit contribution arrangement based on FCF resulted in no additional payments to the Schemes whilst higher dividends continued to be declared.

We mentioned one possible proposal, which I believe you thought was worth considering, which we have seen adopted on valuations for other schemes where immediate funding is constrained. This is the idea of contingent funding, whereby the sponsoring employer or group commits to increasing future deficit contributions, if the actual returns experienced on schemes’ investments are below a specified level. This is on the basis that as the employer asserts that the covenant is strong enough to underwrite the investment risks, then they demonstrate this strength by way of additional contributions should the investment returns not be forthcoming. However if the company is unable to commit to this type of underpin we would question whether indeed the covenant strength was strong enough to underwrite the investment risk being run, and this would call into question the appropriateness of the investment strategy and whether de-risking on the investment side is implemented and additional cash is re directed to the Schemes which in turn may require a review of the company’s dividend policy.

**Long-term funding objectives**

It was useful to understand the direction of travel in relation to the longer term funding of the Schemes and we note that a longevity swap is to be agreed and executed imminently. As agreed, we would like you to provide us with a short summary of what the swap covers, the terms, and the anticipated risk reduction that this will bring to the Schemes on a self-sufficiency basis.

Other areas we discussed at the meeting and that have been considered by the employer (in conjunction with the trustees) include:

- Inflation swap with the sponsor
- Liability management exercises such as enhanced transfer values (“ETVs”) and pension increase exchange exercises (“PIEs”)
- Investment strategy changes
- Long-term target to reach self-sufficiency funding in 25 years time on a gilts+0.7% pa target basis.

From what we understand, the inflation swap is not a current consideration. In addition, liability management exercises involving ETVs and PIEs will be looked at in 2014, given the other work that is currently going on.

We are currently aware that the investment strategy is in the process of being amended and we continue to have concerns in this area. In particular, we have not been provided with enough evidence to date to suggest that the covenant can support the current or indeed the future level of investment risk being run. This is a key area of concern which we have discussed previously.

Furthermore, we are not sighted on the explicit rationale for adopting a 25 year self-sufficiency target based on a gilts+0.7% pa basis and the broad plan (including the intervening investment strategy) over the term of the journey plan. By the standards of other schemes discussing similar approaches this is a relatively long journey to a relatively weak position. We understand you will be able to give us more information in this regard so we can better understand the degree of reliance on investment risk versus cash being paid into the Schemes in order to reach this target.

We consider the substance behind a longer term plan is the cornerstone of understanding whether the shorter term plan to reach full funding on the technical provisions basis is coherent in terms of appropriate levels of cash being paid in, whether the investment strategy is progressing in an appropriate direction (e.g. pace and nature of de-risking) and whether there are sufficient contingency plans built into the overall funding plan to ensure that the Schemes are in a better position to weather downside risks.

We look forward to receiving more information with regard to the longer term self-sufficiency target and the rationale behind the form and substance. In addition, we would want to understand the rationale for the future investment strategy over the term of the journey plan and what risks are currently being run. I understand analysis exists which demonstrates the range of outcomes over the longer term based on a range of differing investment strategies and contributions structures. This analysis will enable us to understand the degree of risk being run by the Schemes.

Overall, although the discussions at our meeting were useful, all of the information we have received to date does not presently alter the Regulator’s view that the current funding proposals that we have been privy to
are satisfactory. We therefore encourage the trustees and employer to continue to negotiate the level of cash for the Schemes and, in particular, noting our comments in this letter and in previous communications. However, we would want to see this additional information as soon as possible and we would want to be sighted well before any agreement on a funding plan is reached by the trustees and the employer.

Next Steps

As discussed, we would appreciate you providing us with the additional investment material referred to in the meeting and above. Following this I will get in touch at the end of September for a further update on the discussions. As we said on Friday, whilst we do not wish to be involved in the detailed discussions between the company and the trustees at this stage, we do feel it is important that we understand the direction of travel of any negotiations, so that we can assess to what extent positive progress is being made in respect of the 2011 Valuations.

For transparency, I am copying the trustees into this letter.

Yours sincerely,

[Signature]

Case Manager | DB Funding
Direct line: [Redacted]
Email: [Redacted]

Cc: The Trustees, c/o Tina Rushworth (via email only)
Dear Robin and Janet

RE: Mowlem Staff Pension and Life Assurance Scheme
Carillion B Pension Scheme
Carillion Staff Pension Scheme
Alfred McAlpine Pension Scheme
Planned Maintenance Engineering Limited Staff Pension and Assurance Scheme
(together “the Schemes”)

Actuarial valuations as at 31 December 2011 (“the 2011 Valuations”)

It was helpful to meet with both parties on Wednesday 17th July and to discuss the outstanding valuations for the Schemes. As agreed, this letter provides a follow up to those discussions, in particular explaining the likely powers available, if the parties feel unable to revisit the current proposals and agree appropriate revisions.

Failure to agree

As we explained, it is our preference to work collaboratively with parties and to reach a position where all sides are happy to agree an appropriate funding solution for their schemes. However, as the 2011 Valuations remain outstanding, we do consider your Schemes to be in a ‘failure to agree’ – a position which the Regulator cannot tolerate indefinitely. Consequently, we will now be taking steps to consider how to address this non-compliance.

Regulator’s powers

When faced with a ‘failure to agree’ an actuarial valuation under Part 3 of the Pensions Act 2004 (“the Act”), the Regulator has extensive statutory powers that can be applied if it is considered, amongst other things, appropriate to do so. Under section 231(2) of the Act, the powers available include (but are not limited to) the:

1. imposition of Technical Provisions;
2. imposition of a Recovery Plan;
3. imposition of a Schedule of Contributions;
4. modification of future accrual.

As a precursor to using one of these powers, the Regulator may issue a notice requiring the provision of a Skilled Persons Report (under section 71 of the Act) to:

(a) a scheme’s trustees,
(b) its employer, or
(c) any person who is otherwise involved in its administration

requiring them to provide us with a report on one or more specific matters (for example, a covenant review) which are relevant to the exercise of our functions.

We would reiterate that it is our preference to explore all avenues with a view to allowing the parties to reach agreement. We would hope to avoid having to use a Skilled Persons Report, since the conclusions may well be similar to those of a trustee-commissioned report, but the totality of cost to the Schemes and/or employer could be much higher. Moreover, we would hope that it will not be necessary to exercise our powers under section 231, as this is a potentially lengthy and costly process, unlikely to provide a result which both parties consider satisfactory.

Please note that the Regulator reserves the right to consider using its other powers, should they be appropriate.

Next steps

We have committed to review the bulk of information (relating to the long term strategies and joint working party) the company provided recently. We anticipate coming back to you on this over the course of the next few weeks and it may be that we have further information requests at that stage.

In the interim, we would urge the parties to continue, in parallel, their negotiations to try to find a solution.

If the parties come close to an agreement, we would appreciate early sight of the proposed terms before formal completion. We can then provide any comments and feedback which we may have at that point.

Please can you circulate this letter to the relevant individuals on each of your respective sides. With a view to being transparent, we will assume that you are happy for us to share and discuss all future correspondence with both parties, unless you explicitly state otherwise.

Yours sincerely,

[Redacted]

Case Manager PDB Funding
Direct Line: [Redacted]
Date: 17 July 2013
Subject: Tripartite meeting between the Pensions Regulator ("TPR"), Carillion plc (the "Company") and Carillion (DB) Pension Trustee Limited (the "Trustee")

Attendees:

1. Introductions
   1.1 Attendees introduced themselves and confirmed that they had seen a copy of the Company's letter to TPR dated 04 July 2013 (the "Company's Letter").
   1.2 TPR confirmed it received the documents listed 'to follow' in the appendix of the Company's Letter (the "Additional Documents") but had not had sufficient time to review them before the meeting. They asked attendees to bear this in mind when listening to their comments.

2. TPR's concerns with the 2008 valuation
   2.1 ST explained that the backdrop to the 2008 valuation included a failure to agree and an understanding that there was a need to be reasonably flexible in view of the Company's position. For this reason TPR had taken a "flexible approach" to the 2008 valuation with the proviso that a number of points would be addressed at the next valuation. These included mortality assumptions and de-risking.
   2.2 ST wished to make clear that, at the time the 2008 valuation was signed off, it was TPR's understanding that from 2013 administrative and investment
expenses of the Schemes\(^1\) would be met by the Company and would not be paid from the Schemes' assets. It was on this basis TPR became comfortable with the agreement reached on the 2008 valuation. TPR had assumed that the payment of investment expenses would come online from this year.

2.3 The Trustee Representatives confirmed that they are of the opinion that the Company must meet both the administrative and investment expenses from 2013 onwards under the current valuation papers.

2.4 JM said that, from the Company's point of view, there is a lack of clarity around the treatment of investment expenses. The Trustee and TPR both confirmed that they do not believe there to be such a lack of clarity.

2.5 TPR referred to a letter from the Trustee to the Company during the negotiations around the 2011 valuation in which the Trustee said it believed the Company must meet investment expenses of the Schemes. TPR believed this made the position of the Trustee clear.

2.6 JD explained that the Company's intention was that administrative expenses would be picked up at the next (i.e. the 2011) valuation, and for that reason they are fully capitalised in the Company's current contribution proposal, but that investment expenses would be still be an outstanding point. RA agreed saying that the question over whether investment expenses should be capitalised results over a difference in interpretation. The Company believed that administrative expenses had to be taken into account in the 2011 valuation but that investment expenses were to be discussed.

2.7 ST explained the 2008 SoC unambiguously covered all expenses being met by the Company from 2013 onwards and that any increase in deficit reduction contributions would not be recognised by TPR as an 'increase' in contribution levels to the extent it was attributable to the capitalisation of expenses. The Trustee Representatives agreed with this view.

2.8 TPR had expected that the points it had raised on the 2008 valuation would have been implicitly taken into account in 2011 valuation.

3. **TPR concerns with the proposals in relation to the 2011 valuation**

3.1 As TPR had not reviewed the Additional Documents it was yet to understand the longer term journey plan work. TPR would go away and look at these documents as they considered them to be important.

3.2 ST asked for confirmation of the Company and Trustee contribution proposals that were currently only the table. ET confirmed that the Company's proposal was £33.4 million p.a. (which included capitalised expenses) and that the

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\(^1\) The Alfred McAlpine Pension Plan, the Carillion B Pension Scheme, the Carillion Staff Pension Scheme, the Mowlem Staff and Life Assurance Scheme and the Planned Maintenance Engineering Ltd Staff Pension and Life Assurance Scheme.
Trustee accepted these contributions but required them to be increased with effect from 2016 to £39 million p.a. (which included capitalised expenses).

3.3 ST explained that TPR had seen various figures representing the global technical provisions ("TPs") and deficit and, broadly, the Company and Trustee appear to have reached a deficit of between £600 million - £700 million. ST understood there were subtleties regarding post-valuation updates to take into account. The Trustee Representatives and Company Representatives agreed.

3.4 ST asked queried the main reason for the gap between the Company and Trustee position on the deficit. JM explained that the gap represented approximately 0.5% surrounding the weakening of the Company covenant. ET explained that at the Trustee position was that at the valuation date the global deficit was £770 million. This figure was discussed with the Company and as at January 2013 the Trustee's bottom line was a global deficit of £605 million allowing for post valuation experience and including a step-up in view of a weakening of covenant. ET explained that the Company wanted to reduce that £605 million to £530 million by disregarding the covenant step up.

3.5 ST explained that when looking at the TPs and deficit there were no "showstoppers" from TPR's point of view. Broadly, the £600 million - £700 million range for the deficit was broadly in the range of acceptance subject to the level of investment risk and what was 'baked in' the longer term funding work undertaken by the joint working group regarding the transition of investments. TPR noted the Additional Documents may assist with looking at these points and may be able to get TPR comfortable on the TPs and deficit. Although ST noted that she had seen references to re-risking.

3.6 TPR noted that it could see from information in the public domain that overall the size of the global deficit versus the size of the Company meant that the Schemes were a large liability and a live issue.

3.7 ST explained that if TPR became comfortable with the current TPs and deficit range then the bone of contention was the level of cash contributions. At present TPR has real concerns about the level of cash contributions and cannot see how the assessment of covenant ties up with the contribution proposals on the table. TPR feels there is a disconnect.

3.8 PW went on to explain that from TPR's point of view it is a question of what is reasonably affordable to the Company. PW appreciated that as a plc the Company will have a prudent and cautious approach. He was aware that in 2016 the Company was facing re-financing obligations and understood the pressure on the supply chain that RA had explained at the previous tripartite meeting on 29 April 2013. However, with the Company's size and profitability as it is TPR believed it should be able to afford more contributions than currently proposed. He pointed to the Company's progressive dividend policy. PW said that, from public sources, it appeared that a dividend of over £70m was distributed in 2012 compared with a distribution of £26.4 million in 2007.
Tripartite meeting between the Pensions Regulator ("TPR"), Carillion plc (the "Company") and Carillion (DB) Pension Trustee Limited (the "Trustee")

RA said that these numbers were not correct but agreed that there was a 9.5% increase in distributions when comparing 2008 and 2012 figures. RA said that PW was ignoring the Company's acquisition of significant businesses during that time and the fact that, at same time, it had taken on a significant proportion of liabilities being now in the Schemes. RA said the dividend analysis should include a comparison of like for like post-acquisition distributions which would show a 6% increase. He went to state that the Company's 2013 half-yearly results would show a negligible dividend increase and that dividends were substantially less than the deficit reduction contributions proposed. RA also stated that Company performance had flat-lined and staff had seen no recent pay rises. In RA's opinion, in terms of stakeholder groups, the Schemes were doing "incredibly well."

3.9 RA stated that in 2008 the economic position of the Company and the industry, and in his opinion the economy, was in far better shape than it is today. He told TPR to look at the rest of the industry and they would see a comprehensive string of profit warnings from the Company's competitors.

3.10 RA said it was clear that the only part of the 2011 valuation on which the Company and Trustee differed was contributions post 2016 which fall around the time of or after the agreement of the Schemes' next valuations. He asked whether TPR had seen the Company's recently published trading statistics (which TPR had) which suggest the Group is flat-lining at the moment as it has effectively disposed of some PFI assets and is trading below where it was 12 months ago. RA went to say that the Group's net debt was £270 million at the end of H1 of 2013 (up from £155 million at the end of 2012) after disposing of £113 million assets in that period, which meant that the outflow of cash in H1 of 2013 was not far short of £0.25 billion. He said this was similar to the rest of the industry and is why the Company's proposal of £33.4 million contributions p.a. for 2013, 2014 and 2015 is sensible. He said that post-2016 there will be a Government election which may impact on the environment in which the Company operates (in particular with regard to the Government's infrastructure spending).

3.11 ST said the picture that RA painted of the Company sounded "all doom and gloom" which lead her to question how the covenant can be assessed as moderately strong. ST said that if she questioned the covenant this would naturally lead her to challenge whether the TPs, investment strategy and the deficit figure were appropriate.

3.12 ST reiterated that TPR may be able to accept an element of investment risk, reliance on returns and the TPs, if there is an adequate Company covenant to support them and the levels of cash contributions are acceptable. From her point of view RA's statements about the Company, its cash constraints and the industry as a whole does not marry with a moderately strong covenant to underpin the TPs and investment risk.

3.13 JM said that in TPR's 2013 annual funding statement there was an implication that a strong covenant would produce a positive cash flow but that was not
always the case. PW agreed from a short-term perspective but said that a strong company should eventually produce a positive cash flow. PW understood there may be temporary "blips" but that he would assume a company making around £200 million profit such as Carillion plc would recover its cash flow.

3.14 RA agreed but said there was a fine balance between covenant strength and cash flow. RA said that the Company was a top quartile organisation and some of its competitors will not make it through the next cycle due to lack of cash. He pointed TPR to the Company Letter and said it showed a sea change in the approach of the Company and the Trustee over the last two years. The Company and Trustee had a plan to deal with the Schemes' deficit over a practical and affordable timescale and had taken good advice in reaching that agreement. They wanted to take advantage of any mechanism they could to deal with the Schemes' deficit and that the valuation only formed part of, or a fraction of, the entire position.

3.15 RA said the longer term plan was just one way of dealing with the deficit and, for example, an alternative would be for the Company to pay the entire deficit tomorrow which would probably create a liquidity crisis. He went on to explain that the Company and Trustee had focussed on a number of initiatives and that they were "on the verge" of putting in place a longevity swap and were looking at how they could reduce pensioner liabilities. He emphasised that the Company and the Trustee wanted to eliminate the Scheme deficits as quickly as they can. He also touched on the move in bond yields saying that on IAS 19 figures the deficit was a £300 million reduction in Q2 of 2013 and could vanish in Q3 if bond yields move. RA said this shows how events outside anyone's control can help funding levels. He said that in time quantitative easing will have to disappear. RA concluded saying that the point he was making was that the Company take the funding of the Schemes seriously but that the valuations were just a part of the long term strategy. He said the Trustee and the Company had invested a huge amount in getting and taking the best advice available in coming up with that strategy.

3.16 PW acknowledged there were events outside peoples' control but that the payment of dividends was within the control of the Company. He questioned whether it was right to pay 6.5% increase in dividends every year. RA disputed this and said that in 2012 the dividend increase was 2% and the 2013 half yearly dividend will see an increase by 1% – 2%. RA instead thought that TPR should panic if the Company starts to decrease its dividends as this would lead to a loss of equity stakeholders which would see the supply chain leave. RA said the Company had many stakeholders to deal with and for the last 18 months there were no dividend increases by any measure.

3.17 ST said TPR were looking for evidence of a sustainable plan and this will be contained in the new Code of Practice on DB Funding. TPR were expecting trustees and employers to have a better handle on the longer term. The shorter term plans slot into the long term and for this reason both must be consistent. ST explained that TPR does not disagree with concept of the
Company/Trustee long term funding plan and agrees with that workstream. In fact TPR are "incredibly keen" to understand the plan that has been agreed.

3.18 ST said that although TPR is increasingly expecting trustees to think about the long term she would like to know, in headline terms, what proportion of risk the longevity swap would remove when comparing the pre-swap and the post-swap position.

3.19 JM said that he needed to explain that the Company looked at de-risking activities in terms of unrewarded risk versus rewarded risk. Unrewarded risk was something like the longevity swap. Due to the current pricing of swaps this was one of the first things focussed on. He thought that the VAR was around £50 million to £100 million off an approximate VAR of £400 million. ST said it was therefore taking a small proportion off a bigger VAR. JW said that rewarded risk included investment strategy alterations (e.g. maximising return for risk).

3.20 ST said that the Trustee should only take on risk if it is supported by an adequate covenant. When looking at the Additional Documents and long term funding work the key question TPR will ask is - Can the Company's covenant support the risk? ST said TPR would need an answer to this question.

3.21 ST went to explain that where there is fundamentally a reliance on risk then the question is whether the company is good for that risk if it doesn't come through. ST said TPR will look at this in light of the Additional Documents. When reviewing those documents and the long term strategy ST expected to see funnels of doubt analysis and self-sufficiency projections as well as information downside triggers in glide path analysis. If this type of information is not contained in the Additional Documents TPR will need to be provided with it. TPR's ethos was about contingency planning (e.g. additional cash or security) and not "we will deal with this at a point in the future".

3.22 JM said that a lot of analysis like ST had outlined had been done. The aim was for the Schemes to be fully funded at a low risk level but no one had committed to hard and fast triggers either upwards or downwards.

3.23 What interested ST the most was the longer term plan and she committed to go back and review it. She said there would be further questions surrounding that plan. To date TPR remained unconvinced by the Company arguments about levels of cash contributions and how that fits with the proposed covenant. However, if the long term plan "makes sense" and supports the current covenant assessment and proposed level of cash TPR will not say that the plan cannot be carried out but TPR may raise questions about whether the covenant supports the levels of risk. Until the long term plan is fully understood TPR's view on the contributions proposed wavers and they think more could be made available. However, ST said TPR will be able to reach a firmer view once they understand the long term plan.
3.24 JM explained that no work had yet been done on why the current level of cash contributions proposed is appropriate and he will need to know what information TPR needs. ST said the proposed contributions need to tie up with the detail of the long term plan and the covenant.

3.25 RH said the Trustee is sympathetic to the Company’s short term position which is why they agreed to £33.4 million contributions but requested a step up from 2016.

3.26 ET explained that the Trustee is trying to extract the Company’s maximum affordability but would like a link to future dividends if Company profit and cash flow improved. ET said that, as implicit in the Trustee’s requested step up in contributions, if at the next valuation the greater contributions were an unacceptable burden on the Company the Trustee would take that into account and/or release the company from that stepped up longer term commitment and believes this is a reasonable proposal on the basis of a strong covenant. He noted that on the investment side there is a slight re-risking and the Trustee thought “so be it” in the circumstances but that in the main the Trustee would prefer to de-risk rather than defer to the next valuation.

3.27 ST noted that it could not be ignored that the Schemes were closed to accrual and had an aging population, which she said would bring to bear over the next 10 - 15 years. This would cause pressure points along the way on the proposed 25 year self-sufficiency plan. She pointed out it was in the Company’s interest to de-risk as it would diminish volatility.

3.28 ST said TPR would take all that was said today on board.

4. An explanation of the failure to agree process and the powers available to TPR

4.1 AD emphasised that TPR’s preference was for the Company and Trustee to reach agreement. However, TPR were giving serious consideration exercising their powers under section 231 of the Pensions Act 2004 (“s.231”). AD noted that the powers under s.231 included the imposition of a schedule of contributions.

4.2 AD said that in all probability TPR would exercise their power under s.71 of the Pensions Act 2004 (“s.71”) to request an expert’s opinion. At the moment AD thought that might be an independent covenant report due to questions raised about the Company’s covenant. However, as the covenant could impact on the TPs it may require an independent actuarial report as well. AD said that at the moment TPR would expect the cost of any report(s) to be shared between the Company and the Trustee (although the final decision of who bears the cost is that of the Determinations Panel (“DP”)).

4.3 AD said that the exercise of either power is a lengthy process. It would involve a warning notice to the Trustee and Company (as directly affected parties), after which either party could make representations. If
representations are made this could result in the withdrawal or revision of the warning notice but, in all likelihood, the matter would go up to the DP. The case will go up to the DP in paper form but the parties could request an oral hearing. However, AD stated that the exercise of powers can be a time consuming and expensive process.

4.4 With regard to s.231 she noted that any schedule of contribution imposed by TPR binds the Company and the Trustee for its duration and can only be varied by application to DP. Therefore TPR think the parties' preference would be to avoid the exercise of their s.231 powers.

4.5 AD confirmed that unless there are reasons of particular sensitivities the exercise of either s.231 or s.71 would be published on TPR's website.

4.6 AD said that TPR's view is that the Schemes cannot have a viable recovery plan in place and for that reason TPR would go down the s.231 route to resolve the matter. The "to-ing and fro-ing" cannot continue. However, again, TPR would prefer the Trustee and Company to reach agreement before this became necessary. TPR was also mindful that it had yet to read the Additional Documents and understand the long term funding plan of the Schemes before it reached any final decisions. But it would look at the exercise of its powers in parallel to reviewing that additional information.

4.7 ST said TPR wanted to be kept informed of discussions. If a valuation was agreed TPR was not comfortable with it could still use its s.231 powers.

4.8 JM said it may be more efficient to use the Trustee's and Company's current advisers, who had knowledge of the Schemes, to fill any gaps in TPR's understanding rather than a third party appointed under s.71. ST said that if the advisers had, for example, a difference of opinion over what was affordable an independent opinion may give clarity (unless of course the current impasse is resolved or information comes to light that strengthens one position over the other).

4.9 ST summarised TPR's position as:

4.9.1 If the parties seek to agree cash contributions within the current range proposed by the Trustee and Company (i.e. £33.4 million - £39 million) TPR would not be comfortable (unless they saw information that supported the view that these contributions truly represented maximum affordability).

4.9.2 If TPR took a pragmatic view and did not revisit the TPs and deficit there would need to be higher levels of cash contributions.

4.9.3 If cash contributions did not increase then TPR would have to look into the TPs and deficit figures.
Tripartite meeting between the Pensions Regulator ("TPR"), Carillion plc (the "Company") and Carillion (DB) Pension Trustee Limited (the "Trustee")

4.9.4 If TPR exercises s.231 then "all is up for grabs" (i.e. TPs, recovery plan period and schedule of contributions may all be subject to scrutiny and potentially set by TPR).

4.10 PW added that the recovery plan should reflect the current view of covenant. The issue should not be deferred until the next valuation. ST agreed saying the covenant is what support the Company can give the Schemes.

4.11 RA said no further work on the valuation had been done since TPR wrote to the Company and Trustee on 27 June 2013 saying 'don't agree anything'. TPR said the reason behind that request was to prevent an agreement being reached and papers signed which TPR would have been uncomfortable with (resulting in the valuation being unpicked or s.231 being exercised). This was the reason TPR wanted to organise the current meeting as soon as possible after that letter was sent out.

4.12 TPR encouraged the Company and Trustee to continue trying to reach an agreement, but just to share it with TPR to ensure they are up-to-date and comfortable with anything agreed.

4.13 BW said that the Trustee was very mindful of TPR's comments that it had been too accommodating at the 2008 valuation and one problem it faced with the current valuation was that the Company had not moved from the definitive contribution figure it had originally put forward. The Trustee in reality had nowhere to go as the Company position did not move. TPR made the point that the valuation process is supposed to be a negotiation with changing positions unless there are true constraints on affordability.

4.14 RA said he genuinely urged TPR to research the industry. He noted that the Company had halved its construction business whilst retaining Group strength and profitability. He said this was a very successful move and one which he was not sure competitors could do. RA emphasised that the Company needs a sensible solution in the 2011 valuation to continue to grow. This was because it faced short term contracts and a fragile industry.

4.15 PW said he understood the points RA was making and knew that to date the covenant was on the strong side as the Company was well managed. Yet for this reason TPR's question was when does that strong covenant get converted to cash flow and share with the Schemes. The current proposals do not look right when compared by TPR to other large schemes.

5. **Agreed next steps**

5.1 TPR will look at the Additional Documents and raise any questions directly with ET and JM. The Trustee and Company are happy to set up informal groups to assist TPR as may be required.
Tripartite meeting between the Pensions Regulator ("TPR"), Carillion plc (the "Company") and Carillion (DB) Pension Trustee Limited (the "Trustee")

5.2 The Trustee and the Company will carry on trying to agree the valuation and share any results with TPR. They will inform TPR of any intended agreement well ahead of its implementation.

5.3 TPR will follow up with a letter setting out the more technical aspects of the exercise of their powers.
Dear Robin & Janet

RE: Mowlem Staff Pension and Life Assurance Scheme
Carillion B Pension Scheme
Carillion Staff Pension Scheme
Alfred McAlpine Pension Scheme
Planned Maintenance Engineering Limited Staff Pension and Assurance Scheme together 'the Schemes'

Actuarial valuations as at 31 December 2011 ('the 2011 Valuations')

Thank you for your patience whilst we have been reviewing the information provided to us.

Since our meeting back in May we have further considered the funding proposals which are currently tabled by the trustee and company as part of the process for completing the 2011 Valuations.

The current proposals from both the trustee and company (which would broadly allow for annual deficit contributions in the region of £33m-£39m) are in a range that we would not consider acceptable based on the evidence we have seen. Therefore, given our position, we would strongly request that the trustee and company do not agree or formalise the valuations based on the deficit contributions which are currently being discussed.

We are now considering the options available to the Regulator going forward and would make you aware at this stage that outcomes could include (but are not limited to) the use of section 71 and/or section 231 of the Pensions Act 2004 ('the Act').

As a next step we would propose holding a further tri-partite meeting and anticipate using this discussion to explain our position in more detail as well as answering any questions you may have at this time. Our preference would be for this to take place by 17th July and in relation we should be grateful if you would liaise and come back to us with some suggested dates that work for both sides.

In the interim, please can you confirm who has the power to set the contributions for any (or all) of the schemes.

Yours sincerely,

[Signature]

Case Manager | DB Funding
Direct Line: [Redacted]