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PRIVATE AND CONFIDENTIAL
Rt Hon Frank Field MP
Chair
Work and Pensions Committee
14 Tothill Street
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21 February 2018

Dear Mr Field

I write in response to your letter of 8 February 2018 concerning Carillion. I confirm that I acted as the Scheme Actuary for eight of Carillion's defined benefit arrangements, including the six under the Single Trustee arrangement of which Robin Ellison was Chair of the Trustees.

My response to your queries is as follows: I will deal with your first two questions together.

1. **What advice did you offer to the Trustees on the main assumptions to be used for the triennial valuations?**

2. **Was that advice subsequently followed in the assumptions put forward or were different ones used? If different assumptions were put forward, was that a result of pressure applied by the company onto the trustees, as alluded to by Mr. Ellison's remarks above?**

At the start of each full valuation, I delivered Preliminary Valuation Reports to the Trustee which set out an initial actuarial basis and explained the main drivers of the valuation process and the derivation of the estimated deficits. After discussion with the Trustee, an agreed summary of the preliminary basis and results was sent to the Company to start negotiations, with a view ultimately to reaching agreement (as required by the legislation for these schemes). The negotiation focused on two things: the underlying assumptions and the recovery plan contributions payable to address the deficit over time.

The main assumptions which drive the results are the discount rates used to calculate the present value of the expected benefit cash-flows and the mortality assumptions. The precise assumptions differed for each scheme and over time from one valuation cycle to the next. The discount rates are struck to represent a (prudent) estimate of the future returns expected to be delivered by the Trustee's investment strategy.

In the 2008 round of valuations (before the formulation of the Single Trustee, when the schemes operated under separate trustee arrangements), the final agreed actuarial assumptions, as reported in the formal

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valuation reports, represented an agreed compromise position with the Company, details of which were shared with the Pensions Regulator at that time. However, the Trustee made clear it wished to take a different approach on a number of issues at the 2011 valuations, namely:

- in the 2008 valuations, the Trustees were basically expected to meet future investment management (and other) expenses from the assets of the schemes, but this was not satisfactory to the Trustees in the longer term. Consequently, the Trustees insisted on a commitment that the investment management expenses would be met, from 2013, by the Company, either explicitly or through funded reserves. This assumption would be incorporated into the 2011 valuations;

- the Trustees wished to strengthen the mortality assumptions at the 2011 valuations;

- the Trustees wished to consider further de-risking of the assets following finalisation of the 2011 valuations.

The agreement reached with the Company on the assumptions in the 2008 valuations followed extensive negotiations with the Sponsor – at what was a difficult time just post the financial crash –resulting in the valuations missing the 15 month statutory deadline and the involvement of the Pension Regulator.

In answer to your second question, therefore, from my perspective, the 2008 assumptions **did** represent a compromise by the Trustee following pressure from the Company, in the context of the trading circumstances it was operating in at the time. As Scheme Actuary, I signed off the 2008 valuation reports, and so, whilst the advices set out in my preliminary valuation reports on the assumptions were eventually altered, taking some margins of prudence out of the basis and moving towards the lower end of the acceptable range of Technical Provisions assumptions, in my view, these were still reasonable.

The 2011 actuarial valuations (by that time, the Single Trustee schemes were being dealt with together – please see the valuation report of the five main schemes dated June 2014) followed a similar format in terms of process. After protracted negotiations (the valuations being signed off over a year late), the Trustee succeeded in addressing some of the issues referred to above, but it did **not** succeed, at that juncture, in agreeing a sufficient increase in the employer contributions being paid to enable it to undertake any material further de-risking of the scheme.

The 2013 valuations represented more of an update of the 2011 valuations on very similar assumptions (but reflecting the then prevailing market yields) and were signed off only six months after the (late) 2011 valuations, with limited further negotiation between Trustee and Company.

In summary, regarding your first two questions, the Trustee has had to negotiate hard over successive valuations (and this had repeated itself in the early discussions for the unfinished 2016 valuations,

although these were overtaken by Carillion's profit warning) with regard to the strength or level of prudence built in to the Technical Provisions assumptions. The Trustee has, as alluded to by Mr. Ellison, taken some degree of prudence out of its Technical Provisions assumptions, following negotiations with the Company.

3. Mr Ellison has also told us how the Trustees consistently pushed for higher deficit contributions into the schemes. What was your view as to the adequacy of the plans agreed? Did you believe the level of contributions were sufficient to close the deficits?

I absolutely concur that the Trustees consistently and persistently pushed for higher contributions. To an extent, they have been successful, with the quantum increasing over successive valuations. The (incomplete) discussions over the 2016 valuations on contributions were around demands for some tens of millions more in contributions.

As Mr Ellison explained to the Committee, trustees have to balance the desire to address a deficit as quickly as possible, with the affordability to the employer, taking into account the Company's duties to its other stakeholders. My view was that although the Trustee consistently asked for higher contributions, the recovery plans eventually agreed were, indeed, within an acceptable range, taking all circumstances into account.

You ask, further, whether I believed the level of contributions agreed were sufficient to close the deficits?

There are two mechanisms to close deficits: contributions and investment returns (and a mixture of the two). In an ideal world, trustees would be able to close a deficit immediately, by receipt of a lump sum payment on day one. This was unrealistic for the Carillion schemes (as it would be for most other defined benefit schemes) owing to lack of available funds.

If an immediate payment isn't possible, trustees might consider if cash contributions could be paid over a period of years, sufficient, in themselves to "close the deficit". For example, could a deficit of 100 be met by 10 payments of 10? My understanding was that this too was not possible for Carillion, given the size of the deficits over successive valuations; it could also be viewed as unrealistic to ignore the contribution that the scheme's assets could make. In practice, therefore, the Trustee, had to rely not **just** on contributions paid over the years, but **also** on investment returns, setting an investment strategy which could, without undue risk and with prudent assumptions in relation to future asset returns, deliver enough return to close the proportion of the deficits not already expected to be closed by contributions. Reliance on both contributions and investment returns as a funding strategy is an entirely typical approach within the UK.

In summary, based on the circumstances at the time, and the statutory funding regime, which allows Trustees to take future expected investment returns into account when considering how a scheme should

be financed, the contributions agreed to were, in my view, reasonable. Critical to those recovery plans, however, was the continued covenant of the Employer being sufficient (in simple terms, the Employer remaining in existence), over the full duration of the recovery plan, to be able to pay the agreed contributions to the schemes year by year. This is one reason why, as Mr Ellison explained in his evidence, the Trustee took advice on the strength of the covenant, including what this meant in terms of the contributions the employer could afford.

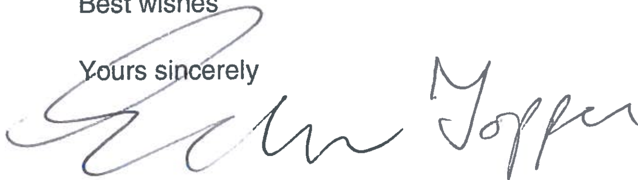
Finally, you say the inquiry is looking to establish which professional service firms were advising the Company (since 2008). I can confirm that I, as an employee of Mercer, supported by other actuarial colleagues, provided actuarial services to the Trustees (and **only** the Trustees) of eight of the Company's pensions schemes since before 2008 and colleagues have provided investment related services to the Trustees of those schemes over the same period.

Separately, different Mercer teams of actuaries and investment consultants have provided actuarial and investment services to the Company. Mercer will separately be providing further information in relation to those services.

I hope this letter answers your questions fully but if I can be of further help, please do not hesitate to contact me again.

Best wishes

Yours sincerely



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