From Margaret Downes  
Chairman of the Trustees of the Bhs Pension Scheme and the  
Bhs Senior Management Scheme from July 2000 to December 2013

For the attention of Ms Margaret McKinnon  
Work & Pensions Select Committee, Second Clerk  
House of Commons  
mckinnon@parliament.uk

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Dear Ms McKinnon,

THE Bhs PENSION SCHEMES’ DEVELOPMENT - JULY 2000 to DECEMBER 2013

Thank you for your email inviting me to supplement the evidence previously provided. I hope the following summary of events will be helpful to the Select Committees.

1. **HISTORY**: A Sale & Purchase Agreement with Storehouse provided for new defined benefit pension schemes to be set up for BHS - as mirror-images of the Storehouse Schemes from which they were carved-out. At Day One/July 2000, the new BHS schemes comprised active, deferred and retired members of the Storehouse Schemes whose current/last employer was BHS and “share of fund” transfer values were agreed by each side’s actuary to establish the ongoing pension arrangements for Storehouse and BHS. I and a second independent trustee were appointed to the BHS Schemes and a number of BHS staff became directors of a third, corporate trustee.

2. **THE SCHEMES HAD A £43m SURPLUS ON DAY ONE; WHY WEREN’T THEY BOUGHT OUT THEN?**

   When they were set up in 2000, the BHS Schemes had a combined surplus of £43m - however, this was calculated on what is called an “ongoing “ basis; the cost of a full buy-out with an insurance company would have been substantially greater than £43m. It is also usually the case that sponsors, rather than trustees, propose a scheme buy-out - and to do so at the beginning of a scheme’s life, while members are actively building-up benefits, would be rather unusual.

3. **INTERACTION WITH THE COMPANY**: Following the Schemes’ establishment in 2000, there was regular interaction between the Trustees and the Company:

   a. One of the original trustee directors was on the BHS main Board and assisted in channeling information to and from the Trustees and the Company; he briefed the Company on how the Schemes were being managed and provided updates during valuation discussions.

   b. The Chief Operating Officer participated in meetings of the Trustees’ Funding Committee from 2000 to 2009/2010 - actively fulfilling the role as Company/BHS Board go-between. The Chief Operating Officer was asked to provide regular Company financial information to the Trustees and did so approximately twice a year, in addition to providing me with ad hoc updates that I fed through to the Trustees. The Chief Operating Officer was the Company lead on valuation discussions, whilst Sir Philip Green attended Trustees’ meetings a couple of times during 2002, when funding and asset allocation were discussed.
c. The Arcadia Group Finance Director took on the role as the Company’s representative and provider of regular financial updates for the Trustees from 2010 onwards.

4. RESPONSE TO COMPANY-LED INITIATIVES: The Trustees always had an open ear and, over the years, considered/agreed many Company-led proposals:
   
   a. August 2001: Scheme entry to be by member application, rather than automatic, as had hitherto been the case
   b. February 2003: the Trustees accepted a Company proposal to switch from “final salary” to “career average” accrual, but the Company did not progress this
   c. June 2005: the Company closed the Schemes to new joiners from July 2005
   d. January 2006: introduction of an 80ths accrual option and pension increases capped at 2.5%/RPI
   e. March 2009: the cessation of future DB accrual which ended, following statutory consultation, in August 2009
   f. June 2009: integration into Arcadia/Taveta - advocated as putting BHS in a stronger financial position
   g. July 2010: supported a Company-led enhanced transfer value (ETV) exercise
   h. March 2011: endorsed the Davenbush guarantee, enabling BHS to mitigate PPF levy costs
   i. July 2012: dialogue/meetings with Goldman Sachs, appointed by the Company to advise on pensions investments
   j. October/November 2012: meeting(s) initiated by Sir Philip Green, involving Trustees/advisers and Goldman Sachs to discuss investment strategy - although this did not result in any changes.

5. FEES: Figures previously quoted included investment management fees as well as those of the advisers; a chart is attached which splits out these costs.

6. TESTING AFFORDABILITY: The Trustees had extensive discussions with the Company in relation to funding the Schemes and the level of Company contributions - by way of example:

   a. June 2002: the £3m a year prevailing level of Company contribution was said to be “the maximum sum the Company would wish to contribute to the Scheme in the future”
   b. May 2006 onwards and particularly during the 2009 and 2012 triennial valuation discussions: the Trustees repeatedly made requests for any form of security; guarantees; funds in escrow - but these were said to be “constraints on the Company’s trading activities” and the Company declined to provide them
   c. November 2006: on being asked to raise contributions to eliminate the increased deficit of £18.6m in the main Scheme, the Trustees were told “the Company could do better by investing the additional money in the business … which should give the Trustees greater comfort about the strength of the Company’s covenant”
   d. February 2007: a further request for additional contributions was declined on the basis the Company was unwilling to increase payments beyond its current committed level
   e. May 2009: the Trustees again sought increased contributions to the Scheme, but these were not forthcoming
   f. October 2012: I attended a meeting at which Sir Philip Green stressed his commitment to BHS and to funding contributions over the long-term - referencing 20+ years or as long as the Schemes need funding - but also emphasising that the Company’s budget for pension contributions will not stretch beyond the £10m a year it was then paying.

   g. Baker Tilly were appointed by the Trustees as their independent covenant assessors in 2009. Baker Tilly’s rolling financial reporting confirmed BHS’s continually weakening covenant and declining financial strength culminating, in July 2013, with the
assessments that BHS could not afford to pay any more than it was currently paying to the Schemes.

7. **ON BHS BECOMING PART OF TAVETA/July 2009**: Given the challenges that had beset BHS, the Trustees took comfort from BHS becoming a sister-company of Arcadia within the Taveta Group. This was forecast to bring myriad benefits including: access to Arcadia’s more favourable banking facilities; the Arcadia Brand inserts in to BHS stores and increased CAPEX. Key, new appointments were made - and the Trustees were told that SPG remained committed and very involved with the BHS business, notwithstanding its continued decline in profitability.

8. **WHAT ASSURANCES DID THE TRUSTEES SEEK?** On behalf of the Board of Trustees, I regularly sought comfort from the Company on its future commitment to the Schemes: in January 2006, the Chief Operating Officer advised “the Company keeps pension arrangements under regular review ... to ensure it maintains a balance between available financial resources and the needs of the business ...” and “the Company was comfortable with the investment strategy”. As part of subsequent Company financial presentations, the support from the wider Taveta Group was emphasized.

9. **INVESTMENT PERFORMANCE**: the Trustees took their responsibilities for managing the Schemes’ assets extremely seriously and investment-related discussions consumed a huge amount of time. A sub-committee was set up that met on average four/five times a year - or more frequently in some years. Overall performance was positive when compared with the Schemes’ benchmarks: At June 2012 - for the period from inception/July 2001 annualised returns versus benchmark were: Scheme 5.6% v 5.0% and SMS 5.8% v 5.0%.

The Trustees were very keen to de-risk the Schemes - as early as June 2002, the Trustees proposed significant switches from equities into corporate bonds and property. Post-2002, risk reduction continued to be an ongoing objective, leading the Trustees to diversify and invest in various new asset classes.

10. **ADDRESSING TRIENNIAL VALUATIONS**: This became ever more challenging from 2006, as BHS’s financial difficulties increased and affordability became a growing concern; the Trustees’ corresponding strengthening of their valuation assumptions had the effect of further inflating the Schemes’ deficits.

11. **MY RETIREMENT**: In July 2013 I confirmed my intention to retire by the end of 2013, once a suitable replacement had been appointed. With that objective having been met, I stood down on 31 December 2013.

Regards

Margaret Downes

Encl.
12. IMA trustee and BHS director; as well as trustee conduit, was able to provide insights to the Trustees: (March 2006 – that SPG could see no benefit in holding gilts; April 2008 – SPG views on world markets and investments and expressed the view that, at a combined cost of c.£250m, buy-out of the Schemes’ benefits was prohibitively expensive, although that must be the ultimate aim;

13. The Trustees provided the Company with a range of pension data on an ongoing/regular basis and for inclusion in Board packs. This included information on asset movements; investment allocation and performance and progression of the Schemes’ funding positions.

14. From outset Paul Coackley (PC) (former BHS Chief Operating Officer) participated in meetings of the Trustees’ Funding Level Committee (27 Sept 2000; 6 Oct 2000). PC would then follow-up, on behalf of the Company, to agree changes to benefit arrangements or contribution payments. PC was asked to provide regular financial updates to the Trustees and did so approx. twice a year. Additionally, PC would speak/update MD by telephone (10 Feb 2009); 2 March 2009. The Trustees took comfort from the assertions that BHS was a sister-company of Arcadia under the Taveta Group and this brought myriad benefits – including the Arcadia Brand inserts – CAPEX spend; key appointments made – also that SPG remained committed and very involved with the business [comments made in presentations - → 2012] – especially given BHS’s continued decline in profitability – albeit this was said to mirror the market and place BHS in the middle of the other Arcadia Brands [Oct 2012 IC]. [Oct 2012: at meeting with SPG, he emphasized his commitment to BHS and to funding contributions over the long-term – referencing 20+ years or as long as the Schemes need funding – but also stressed the Company’s budget for pension contributions will not stretch beyond £10m a year.]

15. From 2010 Paul Budge (Arcadia Group Finance Director) took on PC’s role as the Company’s representative and provider of regular financial updates for the Trustees.

16. Margaret Downes (MD) regularly sought assurances from the Company on its future commitment to the Schemes (Aug 2005); in Jan 2006 PC responded to say “the Company keeps pension arrangements under regular review ... to ensure it maintains an balance between available financial resources and the needs of the business ...“ PC said the Company was comfortable with the investment strategy and welcomes regular discussions; (May 2006)

17. IMA made presentations to the BHS Board on the Trustees’ behalf – for instance in relation to proposed investment strategy arrangements and to gain approval to the Trustees’ Statements of Investment Principles and ongoing adjustments (May 2001; Oct 2004).

On occasion IMA and Margaret Hannell (MMH) (Secretary to the Trustees) updated the BHS Board on investments, funding and other matters and to seek endorsement of other proposals (20 May 2003; 11 June 2003; 9 July 2003)

18. The Trustees considered/endorsed various proposals from the Company – for instance:
a. August 2001: entry to the Bhs Pension Scheme to be by member application, rather than 'auto enrolment', which had always been the case before;
b. Feb 2003: a more from final salary to career average – although the Company never progressed this ...
c. June 2004: the Trustees proposed – and the BHS Board agreed – to cost-neutral early retirement factors for future service
d. June 2005: closing the Schemes to new joiners from July 2005
e. June 2005: for future service – introducing an 80ths accrual option; capping pension increases at 2.5% a year/RPI ; operating cost-neutral early retirement terms
f. March 2009: ceasing future DB accrual – implemented Aug 2009 – DC was the replacement
g. June 2009: integration into Arcadia/purchase by Taveta No 2 – which was advocated as putting BHS in a far stronger position, having Arcadia standing behind and supporting it;
h. July 2010: supported a Company enhanced transfer value (ETV) exercise; the Company did not pursue its proposed pension increase exchange (PIE) exercise for pensioners.
i. March 2011: supporting the Davenbush guarantee, enabling BHS to save [c.£1m+] in PPF levies
j. July 2012: dialogue/meetings with Goldman Sachs (GSAM) who had been appointed by the Company to advise on pension funding and investment matters;
k. Oct 2012: meeting with Company advisers to consider a PIE exercise – subsequently abandoned because the Bhs Schemes’ generous retirement terms could have triggered more people taking ER from the Schemes – with consequent detriment impact on funding – rather than taking a TV – which was a practice mirrored in the previous year’s ETV exercises] – wholesale PIE was not progressed by the Company except
l. Aug 2013: those up to a year from age 60/Pension Age were made aware of PIE option;
m. Oct 2012: meeting with SPG and others plus GSAM to discuss investment strategy.


20. SPG was given the opportunity to meet prospective new appointees/managers and, at SPG’s suggestion, trustee nominees met him/his associates: Terry Goddard and Malcolm Dalgleish (mid-2002); SPG and Fletcher King (Oct 2002); IMA and MMH with Chris Coles (BHS NED from Barclays Capital) (April 2003); then with reps from Barclays Global Investors (May 2003); SPG and GSAM/GLOBAL Tactical Asset Allocation managers (May 2006); Arthur Walford, new independent trustee (Nov 2007). Nov 2013 SPG and Paul Budge met Chris Martin and the other person short-listed to take on the chairmanship with MD retired at end 2013.

21. SPG/PC expressed strong views on affordability/providing security:
    a. June 2002: saying the then Company contribution input of £3m a year was “the maximum sum they would wish to contribute to the Scheme in the future”;
b. May 2006: security; guarantees; funds in escrow – were deemed to be constraints on the Company’s trading activities;

c. Nov 2006: on being asked to increase its contributions to eliminate the increased deficit of £18.6m in the main Scheme, PC expressed the view “the Company could do better by investing the additional money in the business ... which should give the Trustees greater comfort about the strength of the Company’s covenant.”

d. Feb 2007 Trustees’ meeting: PC said the Company was unwilling to accelerate the funding of the Scheme beyond the ten years it had committed to.

e. May 2009: PC said the Company could pay no more than £6.5m to the Schemes – inclusive of DC costs – so £4m a year net of DC costs;

f. Oct 2012: meeting with SPG, he emphasized his commitment to BHS and to funding contributions over the long-term – referencing 20+ years or as long as the Schemes need funding – but also stressed the Company’s budget for pension contributions will not stretch beyond £10m a year.

g. Baker Tilly’s ongoing financial reporting confirmed BHS’s continually weakening covenant – and by July 2013, Baker Tilly described BHS as “bleeding cash” and pretty much totally reliant on the wider Taveta Group and that Group is the source of the contributions being paid to the Bhs Schemes ....

22. The Trustees were very keen to de-risk the Schemes: at a meeting on 10 June 2002 with SPG and PC, significant switches out of equities into corporate bonds and property were proposed and the Trustees were informed that the BHS Board had approved this its 11 June 2002 meeting; SPG subsequently requested (Sept 2002) that the former be put on hold due to equity falls and reduced bond yields – but the increase in property weighting s was endorsed – the Trustees progressed;

23. From 2008 requests to BHS to provide security; collateral; guarantees; negative pledges – these were many and continued and PC’s repeated response was the Company could not accede or comply and this was not warranted – or it would be considered as part of 2012 valuation discussions. When asked in Nov 2009, PC said he did not think it would be acceptable, but would refer the Trustees’ latest request to the BHS Board. 2009 – PC raised ceasing future accrual and installing a replacement DC; Trustees requested collateral; PC said this would not find favour with the Company’s bankers and he would prefer not to pursue this.

24. Valuation discussions: became increasingly challenging post-2006 as BHS’s financial difficulties increased and affordability became a growing issue – coupled with which, the Company would not countenance providing any guarantees/security. Baker Tilly’s covenant assessments bore out the Company’s worsening position – the Trustees correspondingly strengthened valuation assumptions – which had the effect of increasing the Schemes’ deficits – although the recovery plans did build-in scope for some investment out-performance. There was increased engagement/intervention by the Pensions Regulator in relation to the 2009 and 2012 valuations. 2009 valuation paperwork was submitted within 12 months, but 2012 took 18 months (TPR agreed a three-month extension). In assumption-setting, the Trustees had regard for TPR issued guidance and market factors: 2012 reflecting further severe reductions in gilt and bond yields – and the expectation these would endure – return assumptions were reduced from pre-ret 6% to 4.78%; post-ret 5% to 3.8% whilst the latest forecasts for increases in longevity were also reflected. Given the Company’s worsening position, the Trustees continued their push for the receipt of security – in any form ....
25. **Investments**: consumed a considerable amount of Trustee time – a sub-committee was set up that met on average five/six times a year – but considerably more in some years. Overall performance was good versus benchmark: reported in June 2012 Trustees’ meeting, for the period July 2001 [when assets had been w/d from SPIF] annualized returns versus benchmark were: Scheme 5.6% v 5.0%; SMS 5.8% x 5.0% - but this good performance was swamped by the need to strengthen valuation return assumptions to reflect market trends and increasing longevity; it should be acknowledged that contribution input falling behind required levels had also been a factor in the past]. However, inevitably a few unsatisfactory appointments were made that had to be removed [add return stats] De-risking …. Re-balancing …. New investments: infrastructure; high yield bonds …

26. **July 2013** – MD announced her plans to retire “by the end of 2013” once a suitable replacement had been appointed; in the event, MD retired with effect from 31 December 2013.