Dear Mr Field,

BHS

Thank you for your letter of 1 June asking a number of additional questions regarding Project Thor and the sale of BHS. Please see our responses below.

Project Thor

1. When exactly did The Pensions Regulator (TPR) inform you of Project Thor?

TPR advised us of the existence of Project Thor in July 2014. The proposal considered, at a high level, the group’s preferred option of a solvent restructuring of the Thor business. TPR advised us that although they had reviewed this, there was lots of missing information. In addition, they indicated that they were waiting to hear back from the trustees in respect of their analysis and views on the proposal.

2. What further engagement did you have with TPR regarding Project Thor?

Nothing further was heard by us until October 2014 when TPR advised (by telephone and email) that the parties who had previously submitted the clearance application had told TPR that they had decided to put the application on hold until January 2015 as they wished to focus on the Christmas trading period. Further, TPR asked the applicants to formally withdraw the application.

3. You note in your letter “no approach was made to seek our view by any of the parties concerned”. Can you please confirm there was no contact from advisers to Taveta group companies or BHS pension trustees?

There was no contact with the PPF from Taveta or their advisers, or the pension scheme trustees, on or around the time Project Thor was advised to us by TPR.

4. When did you become aware that Project Thor had been paused, and how was this communicated to you?
See 2 above for details of when and how we were advised that Project Thor had been paused.

5. **At what stage in an RAA proposal process would you typically expect to be involved?**

We would normally expect to be involved in any discussions regarding a Regulated Apportionment Arrangement (RAA) at an early stage and be fully engaged in the negotiations between the employer/TPR/trustees, ideally when a proposal is sufficiently developed.

6. **Tony Clare of Deloitte referred in oral evidence to the Kodak and Uniq pension schemes going through “similar restructurings” to that proposed in Project Thor.**\(^1\) I would be grateful if you could provide a short note for each of those schemes setting out:

   a. **similarities with BHS/Thor;**
   b. **any notable differences;**
   c. **the eventual outcome;**
   d. **the timescales involved.**

As referenced in my previous letter, while we were notified by TPR of the existence of Project Thor, the PPF was not involved in the discussions about the outline proposal and we didn’t receive a formal RAA proposal to consider or express a view on. It never reached the stage where we were engaged to consider a substantive proposal. This in itself is a fundamental point of difference.

The cases were similar in that Kodak, Uniq and the discussion document we saw on Project Thor were all proposals to restructure an insolvent (or nearly insolvent) business to achieve a better outcome for the pension schemes than if the businesses had been simply left to fail. Details of the Kodak and Uniq restructurings can be found in the publicly-available reports issued by TPR under s89 of the Pensions Act 2004. It is though important to emphasise that each transaction is different and considered upon the specific circumstances of the scheme and its employer covenant, and cases are rarely directly comparable.

The outcome was that in the Kodak case, members representing over 94% of the scheme’s liabilities transferred to a new scheme, which provided members with benefits above those which they would have received from the PPF. It was agreed that the new scheme would be funded by the acquisition of fresh assets by the scheme as part of the restructuring. The PPF took on those members who, for whatever reason, did not transfer to the new scheme. This was a complex transaction which took around 16 months to finalise.

In Uniq, the scheme took a significant equity stake in the employer’s business as part of the restructuring. The outcome was that the business was sold and the proceeds helped

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the scheme become sufficiently well-funded so that it did not eventually transfer to the PPF. This restructuring took around five months to finalise.

The Kodak and Uniq transactions both met the principles outlined in our restructuring criteria and the Committee may find it helpful to have some further explanation about the PPF’s involvement in such restructurings.

Restructuring proposals usually assert that the PPF could do better to take on a pension scheme by way of a RAA (see note 4 of criteria below) enabling the company to trade more profitably without its pension liabilities. These proposals need to be carefully assessed in order to avoid potential “pension dumping”. We therefore only consider taking part in such transactions if our strict criteria are met. Our overriding duty is to protect members’ pensions and to ensure we have the funds to do so.

Our criteria when considering such restructuring proposals, which are publicly stated on our website, are also designed to ensure that we are in a much better position than if an insolvency of the sponsoring employer had simply proceeded without such a restructuring.

1. Insolvency has to be inevitable – i.e. we will have to take on the pension debt whatever happens.

2. The pension scheme will receive money or assets which are significantly better than it would have received through the otherwise inevitable insolvency, given that every pound that we recover in this way is a pound less that we may have to charge to levy payers. The level of money/assets we receive in total also needs to be realistic in relation to the full pension buy-out deficit.

3. What is offered to the pension scheme in the restructuring is fair compared to what other creditors and shareholders will receive as part of the transaction proposed.

4. The pension scheme will be given a minimum of 10 per cent equity in the ongoing business if a new stakeholder becomes involved (e.g. to inject new capital), or a minimum of 33 per cent if the existing stakeholders remain involved. This is termed “anti-embarrassment equity” – and is taken to cover the eventuality of the business going on to be profitable in the future without having to support the pension scheme. The provision of such equity enables the scheme/PPF to share the benefits of any future improvement in the company’s financial position. (By way of clarity, it should be noted that a RAA often forms part of the restructuring. This normally entails the pension scheme liability being transferred to a newly formed company, which temporarily becomes the employer ahead of an insolvency event which leads to PPF entry, leaving the hitherto sponsoring employer company free of its pension deficit).

5. We need to ensure that the pension scheme would not have been better off by TPR issuing a contribution notice or financial support direction. Most restructuring transactions need the approval of TPR by way of the clearance process.

6. Where the transaction involves a refinancing, the fees charged by the bank(s)/other finance providers involved are reasonable.

7. The other party meets any legal fees incurred by the PPF and the scheme trustees as part of the transaction.
It should be reiterated that in the case of Project Thor, the proposals did not advance to a stage where we were asked to consider these criteria.

Sale of BHS

7. When and how did you become aware of the possibility of a sale of BHS?

TPR confirmed the possibility of a sale at our monthly meeting at the end of January 2015, which coincided with speculation in the press of a potential transaction.

8. When and how did you become aware that Swiss Rock/Retail Acquisitions Ltd was the preferred or likely buyer?

TPR advised us in early March 2015 that they had met with the employer and had been told that a purchaser of the business had been identified. We understand that TPR was not advised of the identity of the buyer at that time and we did not know exactly who the buyer was until 12 March 2015 from press reports following the sale.

9. When and how did you become aware that BHS was likely to seek a Company Voluntary Arrangement, and what action did you take?

We were first advised about the possibility of a CVA being undertaken on 22 January 2016. This resulted in several meetings – for further details, please see answer 14 below.

10. What engagement did you have with TPR before and after the sale?

See 8 above for details of discussions with TPR ahead of the sale. After the sale, we expressed our concerns to TPR several times about the impact of the sale on the pension scheme and the intentions of the buyers as we were mindful that there was a substantial pension deficit. We were told that TPR was to meet with the new owners, but TPR did not consider that the PPF should be in attendance.

11. What engagement did you have with (a) Taveta group companies and (b) their advisers in advance of the sale?

We had no engagement with Taveta group companies or their advisers in advance of the sale.

12. What engagement did you have with (a) Retail Acquisitions Ltd and (b) its advisers before and after the sale?

We had no engagement with Retail Acquisitions Ltd or its advisers before or at the time of the sale. We first met with representatives from RAL on 26 January 2016 in connection with the proposed CVA.

13. What engagement did you have with (a) the BHS pension scheme trustees and (b) their advisers, before and after the sale?
We had no engagement with the trustees in advance of the sale. After the sale, however, and in an attempt to consider our risk (of the scheme entering PPF assessment) we sought details from them regarding the scheme’s investment de-risking measures that TPR had told us that the trustees were implementing. Thereafter, we undertook discussions with the trustees regarding payment of the PPF levy and sought updates from them regarding the general position of the covenant.

14. What discussions did you have with TPR about BHS, between March 2015 (when BHS was sold) and March 2016 (when BHS obtained a Company Voluntary Arrangement)?

See 10 above in respect of our initial discussions with TPR. Thereafter, we had numerous discussions with TPR (see below) and were advised that TPR had commenced its own moral hazard investigations into the sale of the business.

In August 2015, TPR shared a proposal from BHS with us for a pension scheme restructuring. TPR’s view of this was that not enough information had been provided to the trustees to reach a conclusion and it was apparent that the PPF’s criteria for restructuring, incorporating a RAA, were not met. We agreed with this view. In the meantime, and from then until January 2016, we were advised that TPR’s investigations remained ongoing.

From 22 January 2016 until the CVA in early March, we had engagement on numerous occasions with the relevant parties. This included meeting with TPR and the company/its advisors and trustees, on 26 January, 9 February and 29 February. We also had several telephone conversations with the company’s representatives. On the 29 February, separate to the meeting with the company on the same date, we met with Arcadia, again with TPR in attendance. During this period, no offers were proposed which met our published principles.

15. You note “where a restructuring offer is made that both meets our principles and is acceptable to the Pensions Regulator, we can reach an agreement in principle in a matter of days, and have done so in past cases”. I would be grateful if you could provide a short note with examples of such cases.

Below are two examples of past cases which illustrate that we have been able to reach agreements in principle in a short timeframe. We have anonymised the examples to avoid the risk of disclosing Restricted Information.

Project Y

Day 1 – we advised the company that their RAA proposal was unacceptable. We therefore agreed to meet with all interested stakeholders as a matter of urgency in view of the company’s parlous financial position.

Day 3 – at the meeting, we negotiated an increased the offer from the company and in principle agreement was reached late that evening which satisfied our restructuring guidelines.

Project Z

Day 1 – following a meeting with the company, we received a formal RAA proposal in writing which represented an increase on the offer made at the meeting.
Day 7 - we responded with small suggested amendments to the terms.

Day 21 – agreement was formally reached with all parties following further negotiations by telephone.

I trust the above is helpful. Please do not hesitate to contact me or colleagues if I can be of any further assistance.

Yours sincerely,

David Taylor
General Counsel

CC: Iain Wright MP, Chairman of the Business, Innovation and Skills Select Committee