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Rt Hon Frank Field MP
Chair, Work and Pensions Committee
[redacted]
London
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12 March 2018

Dear Mr Field

Thank you for your letter dated 26 February requesting further clarification and information following my letter of 23 February. I set out answers to your queries below and have included an appendix providing the details that the joint committee requested at their hearing on February 22 on DB schemes subject to higher levels of scrutiny from TPR.

Answering each of the questions in turn:

The letter (Feb 23) states TPR "would be concerned if our regulatory approach was perceived as focussed too heavily on the length of the recovery plan, if this encouraged schemes and employers to target a lower funding objective." Schemes are required to meet the statutory funding objective and if they are not meeting that objective put a recovery plan in place. In what circumstances could a longer plan allow the trustees and employers to target a lower funding objective?

The statutory funding objective is defined in the Pensions Act 2004. Section 222 sets out that every scheme must have sufficient and appropriate assets to cover its technical provisions - the amount calculated on an actuarial basis to meet its liabilities. The calculation is scheme-specific involving a number of variables. If less prudent assumptions are made this can result in a lower figure for the scheme's liabilities.

The issue we were highlighting was not one of longer plans allowing trustees and employer to target a lower funding objective, rather the opposite. A longer recovery plan may be necessary in circumstances where trustees and employers are targeting a higher funding objective (i.e. higher liabilities), employing prudent assumptions. This can be better protection for members than a shorter recovery plan with a lower funding objective, calculated less prudently.

Hence, focusing in isolation on recovery plan length to identify risk can have the unintended consequence of trustees and sponsoring employers targeting a lower funding objective in order to manage down the recovery plan length. This is why an integrated approach to risk management is central to our code of practice on scheme funding and to our approach to the overall risk assessment of schemes.

More information is available in our funding regulatory enforcement policy which sets out in more detail our risk assessment approach and the indicators we employ:

http://www.thepensionsregulator.gov.uk/docs/db-funding-regulatory-enforcement-policy.pdf

The letter reports that Carillion's pension deficits would be repaired through 12 years of payments. The relevant Carillion scheme accounts, all published on our website, show that for both the 2011 and 2013 valuations, Carillion was due to make repair contributions from 2014 to 2029, a 16-year recovery period. Can you clarify where your figure of 12 years comes from?

The trustees and Carillion updated the recovery plans on 23 December 2014, following completion of the actuarial valuations at 31 December 2013. Their expectation was that these recovery plans would repair the deficits that existed as at 31 December 2013 by the end of October 2026, a period of less than 12 years from the date they were signed. These recovery plans were submitted to us in January 2015 and copies of these can be found in the appendices to the 2013 valuations. The expected date of recovery of October 2026 for the schemes is also set out on page 5 of that document. This is the 12 year period to which we referred in oral evidence and our subsequent letter. As part of the 31 December 2013 valuation, the trustee and employer agreed to leave the existing schedule of contributions in place (which ran to 2029), which would have provided improved protection for the schemes.

How many times you have used your s231 powers, when they were used and what were the circumstances for using them?

As confirmed in our oral evidence to the Committee, we have issued a Warning Notice commencing regulatory action under s231 of the Pensions Act 2004 on three occasions. In strict terms, TPR has not yet formally exercised this power as on two of these occasions an acceptable agreement was reached ahead of a hearing of TPR's Determinations Panel in relation to the Warning Notices and the third occasion remains an active case. We do stand ready to use the power as appropriate, and we believe that this has influenced the approach taken by trustees/employers in relation to their valuations numerous times. Indeed, it is the statutory underpinning for all our funding interventions and discussions. We also have several open cases where we are working towards formal use of these powers. Whether or not we ultimately do so will depend on whether the employer and trustees can, with our support, voluntarily come to a funding arrangement which is acceptable to all parties, including TPR.

How many times you have used your s71 powers, which allows the regulator to obtain a skilled person report on a scheme valuation and recovery plan? When were these powers used and what were the circumstances for using them?

We used our power under s71 Pensions Act 2004 for the first time in the Hoover case. You can find our case report via the following link:

http://www.thepensionsregulator.gov.uk/docs/regulatory-intervention-section-89-hoover.pdf.

We have also used this power in a defined contribution case concerning Now: Pensions. Our media statement can be read via the following link:

http://www.thepensionsregulator.gov.uk/press/tpr-fines-trustee-of-now-pensions-and-sets-deadline-by-which-problems-must-be-fixed.aspx

The Warning Notice issued in the Docklands Light Railway case (also mentioned in this letter in relation to our s231 powers) requested that TPR's Determination Panel order two skilled person reports to be produced. This case was settled without TPR needing to formerly exercise our powers after the trustees and employer reached an agreement.

We have a number of open cases where we are considering use of our s71 power, in relation to scheme funding matters and others. Again, whether or not we do so will largely depend on whether the employer and trustees can reach a satisfactory agreement.

How many times have you issued s231 warning notices, when were they issued and what were the circumstances for issuing them?

As mentioned above, we have reached the stage of issuing a Warning Notice on three occasions. One was issued in 2017 and remains an active case, where we are seeking to address apparent inequitable treatment of the scheme relative to dividends.

The other cases were Docklands Light Railway and EMI. More information is available via these web links:

http://www.thepensionsregulator.gov.uk/docs/section-89-report-docklands-light-railway.pdf

http://webarchive.nationalarchives.gov.uk/20110709110653/http://www.thepensionsregulator.gov.uk/press/pn10-18.aspx

How many times did you threaten Carillion with use of your s231 powers in relation to the 2008 and 2011 valuations?

During our involvement in the 2011 valuation, the potential for use of our powers was set out in correspondence on seven occasions:

- 27 June 2013 - letter to employer & trustees
- 17 July 2013 - meeting with employer & trustees
- 22 July 2013 - letter to employer & trustees
- 4 September 2013 - letter to employer
- 8 November 2013 - letter to employer
- 29 November 2013 - letter to employer
- 19 March 2014 - letter to employer & trustees.

We did not refer to the potential use of our powers during our involvement in the 2008 valuation.

As part of the 200 valuations that you are currently proactively engaging with, how often have you threatened use of your s231 powers?

We currently have 191 active cases relating to defined benefit pension schemes. A breakdown of these cases and an explanation of each type is set out in the appendix to this letter.

All cases relating to submitted or overdue scheme funding valuations are considered by us in the context of s231 Pensions Act 2004. As s231 is the basis of our involvement, all parties will be in no doubt that the power is available and we will have recourse to it if an acceptable outcome is not reached. We do not therefore track how frequently an explicit threat is made.

What proportion of scheme valuations in each of the previous 10 years have not been agreed within the 15-month timescale allowed?

Information in relation to the last five tranches of triennial valuations is shown below. Information in relation to earlier years is not retrievable without significant further work.

If the trustees and employer fail to agree their valuation within the statutory timescales, they are required to report this breach of law to us. As part of our focus on compliance with the basic legal requirements that apply to all schemes, we have been taking a tougher stance since April 2017 and in that time have issued 4 Improvement Notices in respect of these breaches, all resulting in compliance without the need for further regulatory action. We have also achieved high levels of compliance from schemes without the need for an Improvement Notice. However, as indicated above, it is more important that trustees and employers reach the right agreement, rather than reaching one at any cost, so we do allow a small number to submit late without action being taken to enable robust negotiations to continue.

Year	Not agreed within statutory 15-month period	Proportion of schemes within valuation period
2012	251	11%
2013	287	12%
2014	310	14%
2015	274	13%
2016	230	12%

How many schemes in the last 10 years assessed as having a 'tending to strong' covenant have failed to agree a valuation within the 15-month timescale?
Of the 1,352 instances recorded between 2012 and 2016 where the recovery plan was not agreed within the statutory 15-month period, there are 495 schemes that we consider have a covenant grade rating of 'tending to strong' using the most up to date information available to us.

I hope the joint committee find this information helpful.

Yours sincerely

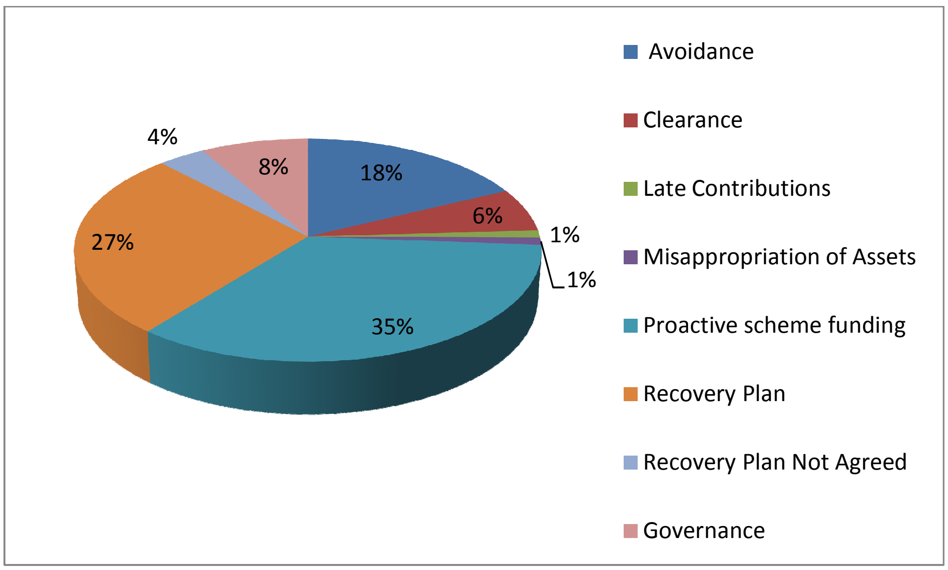
Lesley Titcomb

Lesley Titcomb
Chief Executive

APPENDIX - Defined Benefit (DB) Case Summary

The Pensions Regulator (TPR) was asked at the joint committee hearing on February 22 to provide information on the 200 highest priority DB cases (or *"red"* cases as it was put to us). This response provides an overview of 191 active cases, involving 190 separate DB schemes, currently being handled by our Case Management team. Such cases are frequently contentious, highly complex, raising novel issues and points of law and typically require multi-disciplinary teams to deal with them. DB is one part of TPR's remit and other teams within the Frontline Regulation directorate undertake casework in areas such as defined contribution, master trusts, scams and public service pensions.

The following analysis is undertaken with reference to the case type, which summarises the primary reason for opening a case. It should be noted that many cases have features and issues in common with other case types as well.



The table above sets out the proportion of each type of case within the 191 cases.

Case Type – Avoidance: enforcement
Number of Cases – 34

We open an avoidance case where we consider that an employer (or a party connected and associated to the employer):

- has acted in a way where one of the main purposes of their actions is to stop the triggering or recovery of all or part of a debt due to the scheme under section 75 of the Pensions Act 1995 (which could result in a Contribution Notice (CN) being issued); and/or
- the employer's actions have caused 'material detriment' to the scheme's ability to provide benefits (which could result in a CN being issued); and/or
- we require support to be put in place for a scheme where the employer has insufficient resources or is a service company (which could result in a Financial Support Direction (FSD) being issued).

Where there is sufficient evidence of avoidance activity and it is reasonable and proportionate to do so, we prepare a Warning Notice and refer the case to the Determinations Panel (a separate committee of the regulator that makes the formal decisions on the use of some of TPR's stronger powers) to consider whether to issue a CN and/or FSD. The 'Directly Affected Parties' have the opportunity to make representations. If we are successful, the parties may refer the matter to the Upper Tribunal. From there, the matter may be appealed to the Court of Appeal and Supreme Court (if permission to appeal is granted).

At any point within this process, it is possible for parties to settle. In deciding whether a settlement warrants the cessation of regulatory action, we must have regard to relevant factors, e.g. likely recovery for the scheme through use of our powers; our assessment of the prospects of success; the delay and uncertainty caused to members by drawn out litigation; and the views of the trustees and the PPF.

Case Type – Clearance
Number of Cases – 12

In circumstances where a corporate action is 'materially detrimental' to the scheme's ability to meet its liabilities, clearance provides statutory comfort to the applicant that TPR will not exercise its anti-avoidance powers. We expect employers to provide sufficient mitigation to cover any material detriment to the scheme. This can take many forms, including the provision of cash, guarantees and/or security being granted in favour of schemes.

Clearance case work can also include review and approval of Regulated Apportionment Arrangement (RAA) applications. An RAA severs the link between the sponsoring employer and the scheme, ordinarily resulting in the scheme going into the Pension Protection Fund (PPF). We will only agree RAAs in rare circumstances where a stringent set of criteria have been met and the PPF does not object to it.

Our clearance case work at present also includes banking reform, where banks are required under law to ring-fence their retail from their investment arms. If a bank takes the view that its ring-fencing arrangements are likely to cause material detriment to their scheme, they are required to come to TPR for clearance.

Case Type – Funding: "Proactive" engagement
Number of cases - 66

In proactive funding cases we seek to influence the outcome of a triennial valuation and any associated recovery plan prior to their formal submission to TPR. Trustees have a statutory period of 15 months from the effective date of their valuation to submit the valuation and recovery plan to us.

We will open a case where we are sufficiently concerned about risk to members of the scheme arising from the size, covenant strength, history of the scheme or other factors. We seek to influence the outcome so that the actuarial assumptions (technical provisions) are sufficiently prudent and that the recovery plan is appropriate. We will consider the risk of underfunding over the longer term and encourage effective contingency planning by the trustees and the employer. We expect trustees and sponsors to adopt an integrated approach to the management of these various risks and we challenge them where this is not in place.

Working with trustees and sponsors in this way enables us to influence discussions as they happen, rather than having to unpick valuations and recovery plans after the parties have reached agreement. Although this is a voluntary process, trustees and employers are usually happy to cooperate with our proactive casework as we provide support and information during the negotiation phase and we can indicate whether we think that the funding package is appropriate.

Case Type – Funding: Valuation & Recovery Plan
Number of Cases - 52
We open a funding case if the trustee and employer have agreed and submitted their valuation and recovery plan, and our initial assessment is that either the technical provisions are imprudent and/or the recovery plan is not appropriate. We liaise with the trustees and the employer to better understand how and why they agreed the funding package. The regime is scheme-specific so this more detailed due diligence is necessary. We have regard to factors including the strength of the employer covenant, the prudence of the assumptions used, the amount of investment risk and the amount of cash being paid to the scheme.

Where we are not satisfied that the funding package is appropriate, we seek to influence a voluntary amendment to the funding arrangements. If this does not result in an acceptable outcome, will we consider whether it is reasonable and proportionate to formally exercise our s231 funding powers and impose a schedule of contributions or recovery plan. We will warn the trustee and employer that this is what we propose to do. This often has the effect of bringing about a voluntary amendment to the funding plan. The decision to exercise these powers ultimately sits with TPR's Determinations Panel. The process is explained in more detail in relation to avoidance cases above.

Case Type – Funding: Valuation and/or Recovery Plan Not Agreed
Number of Cases - 7
When the trustee and employer have failed to agree and submit a valuation and recovery plan within 15 months of the effective date of the valuation, as required by the legislation, we examine the delay and work with both parties to reach an appropriate funding agreement. Initial review work is completed by a team within the Frontline Regulation directorate that deals with bulk enforcement and other transactional regulatory activities (e.g. compliance with requirements to send us completed chair's statements and scheme returns), with more serious and complex cases being escalated for further investigation by our Case Management team (the 7 mentioned here).

There are a range of powers available that we may use in order to address a failure to agree a valuation and/or recovery plan; these include issuing Improvement Notices, fines, skilled person's reports and our power under s231 Pensions Act 2004 to impose a valuation and recovery plan.

Case Type - Governance
Number of Cases - 16
In this type of case we consider using our powers to improve scheme governance and administration. Our concerns may relate to specific trustees' actions or behaviours, such as misuse of scheme assets or failure to comply with pensions legislation. Alternatively, we may

have more general concerns, such as trustee knowledge and understanding, management of conflicts of interest or administration issues.

Such cases usually require us to work closely with the trustees to ensure our concerns are addressed. If improvements do not come voluntarily, we have a range of powers available such as issuing Improvement Notices, fines, appointing a professional trustee or, in the most serious cases, prohibiting trustees.

Case Type - Late Contributions
Number of Cases - 2
In this case type, an employer has not made contributions to the scheme as required by law. In certain circumstances, these breaches must be notified to TPR. We risk-assess the late payments, looking at factors such as the overdue amount, the number of occasions that contributions have been late and whether the breach has been, or is expected to be, rectified.

We aim to get overdue sums paid as quickly as possible and get processes put in place to avoid late payments in future. Where necessary, we use our powers including fines for employers. We also examine whether the late contributions indicate that the sponsoring employer is struggling to support its DB pension scheme, requiring further involvement from TPR.

Case Type - Misappropriation of Assets
Number of Cases - 2
In this type of case we examine whether any person has been knowingly involved in the misuse and/or misappropriation of scheme assets. Where this is suspected, we investigate with a view to reaching a resolution (if appropriate). If necessary, we will have recourse to powers under the Pensions Act 2004. These include applications for injunctions and restitution orders. Where appropriate, we can also consider criminal prosecutions.