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Carillion Pension Schemes

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1. Summary

Carillion has 13 UK defined benefit pension schemes with 27,000 members. Following the company's entering compulsory liquidation on 15 January 2018, most, or all of the schemes, were expected to enter a Pension Protection Fund assessment period.[1] By 21 May 2018, 12 had done so.[2]

In the report of their inquiry into this on 16 May 2018, the BEIS and Work and Pensions Committee called on the Government to carry out an 'ambitious and wide-ranging set of reforms' to 'reset our systems of corporate accountability.' [3] They said that a "system of internal checks and balances were support to prevent board failures of the degree evidence in Carillion" had failed. As regards the pension schemes:

> The key regulators, the Financial Reporting Council (FRC) and the Pensions Regulator (TPR), were united in their feebleness and timidity. The FRC identified concerns in the Carillion accounts in 2015 but failed to follow them up. TPR threatened on seven occasions to use a power to enforce pension contributions that it has never used. These were empty threats; the Carillion directors knew it and got their way.[4]

In response, Chief Executive Lesley Titcomb said TPR had made changes to strengthen its regulatory approach and would continue to do so:

> We are now a very different organisation; we are clearer about what we expect, quicker to intervene and tougher on those who do not act in the interest of members. We have reinforced our regulatory teams on the frontline and are embedding a new regulatory culture. We sought stronger and clearer powers on scheme funding from DWP and we are working with the Government on how to implement the changes in the white paper, alongside our wider changes to how we regulate. (Response to Report of the BEIS and Work and Pensions Select Committees, 16 May 2018).

For more on the background, see Library Briefing Paper CPB-8206 The collapse of Carillion (March 2018). This note takes story forward in relation to pensions.

1 PQ 129456, 28 February 2018
2 PQ 905457 21 May 2018
3 Work and Pensions and BEIS Committees publish report on Carillion, 16 May 2017
4 Work and Pensions and BEIS Committee, Carillion, HC 769, May 2018, Summary

1.1 What is the position of the pension schemes?

There are 27,000 members of the Carillion Group's defined benefit (DB) pension schemes.[5] There are 13 schemes. The three largest schemes are the Carillion Staff, Mowlem Staff and Alfred McAlpine Staff schemes.[6]

At the beginning of 2018, the schemes had an estimated deficit of £800 to £900 million on a PPF basis (i.e. compared to the premium that would have to be paid to an insurance company to take on payment of Pension Protection Fund levels of compensation).[7] Former pensions minister Steve Webb told the Guardian that "Carillion would be the biggest-ever hit on the PPF" but that the lifeboat would be able to "comfortably absorb" the Carillion scheme.[8]

Measures of pension scheme funding

Scheme assets re usually measured at market value. Liabilities are measured by "discounting" the promised future payments. This allows for the fact that money to pay for the liabilities will earn interest over the intervening period. The main differences between the different standards lines in the way liabilities are valued. From an economic perspective, the differences reflect the different degrees of certainty required in the payment of pensions. For more detail, see Library Briefing Paper SN-04877 Defined benefit pension scheme funding (October 2017). A discussion of the deficit in the Carillion pension schemes according to the different measures is in Library Briefing Paper CBP-8206 The collapse of Carillion (March 2018).

Price Waterhouse Coopers (PWC) (who had been appointed as special managers to the liquidation) said it was looking into the position of each of the pension schemes with Trustees and the PPF.[9]

The Pension Protection Fund

The Pension Protection Fund (PPF) was set up in 2005 under the *Pensions Act 2004* to pay compensation to members of pension schemes that wind up underfunded on the insolvency of the employer.

In general, those over scheme pension age at the time their scheme enters a PPF assessment period get compensation equal to 100 per cent of their pension initially; while members below that age at the date of insolvency get compensation equal to 90 per cent of their accrued pension, subject to an overall cap. PPF compensation is not index-linked on rights built up before 1997.

The purpose of an assessment period is to determine whether the PPF should accept responsibility for the scheme. To answer this, it will look to establish answers to two key questions: can the scheme be rescued and can it afford to secure benefits at least equal to PPF compensation levels.[10]

On 24 January 2018, the Government said some of the Carillion schemes had already entered a PPF assessment period:

> At present, seven Carillon schemes, covering 6,000 members, have moved to the Pension Protection Fund assessment period, which occurs automatically when a sponsoring employer becomes insolvent. The remaining 21,000 members are in

5 PWC, Carillion/Pensions; Financial results for the 6 months ended 30 June 2017, 29 September 2017;
6 Carillion Annual Report 2016, Financial Statements, Note 30; Carillion,
7 Letter from Carillion DB Pension Trustee to chair of the Work and Pensions Select Committee, 26 January 2018 ; Recriminations fly after Carillion collapse, Financial Times, 15 January 2018
8 After Carillion, how many firms can the pensions lifeboat rescue? *The Guardian*, 16 January 2018
9 PWC, Carillion/Pensions
10 Library Briefing Paper SN-03917 – Overview of the Pension Protection Fund, (July 2018).

> schemes that have at least one sponsor not in insolvency and are therefore not in the PPF.[11]

On 28 February, Pensions Minister Guy Opperman said that most or all would do so and by 21 May 2018, 12 of the 13 had done so.[12]

There is a list of schemes in assessment on the PPF website.[13]

Payments not covered by the PPF

The trade union Prospect has raised the position of a group of former civil servants, who on transfer from the civil service, retained rights to the same redundancy compensation that would have been payable if they had been made redundant by a civil service employer. This included the right to an annual compensation payment ("ACP") between the date of redundancy (if made redundant over the age of 50) and age 60 as well as smaller ACPs from age 60 when pension became payable.

When this group were first transferred out of the civil service, an undertaking was included in the contract that required their private sector employer to secure the ACPs through a pension fund or insurance company at the point of redundancy to ensure the payments would not be threatened if the company subsequently ran into financial difficulties. Unfortunately, this did not happen and their ACPs have now stopped. Prospect understands that there are about 40 ex civil servants who were being paid ACPs by Carillion Group companies. As ACPs can represent the entire income of someone who has been made redundant, the average sums involved are very high and may be about £20,000 per annum.[14]

1.2 What factors contributed to this?

The regulatory framework

In an urgent question on 22 January 2018, the then Shadow Work and Pensions Secretary Debbie Abrahams asked what action the Government proposed to take to "stop private sector pension abuse":

> Between the end of 2015 and last year's interim results, the difference between Carillion's assets and liabilities almost doubled, from £317 million to £587 million. We know that profit warnings started to be issued in the summer of 2017. Given the severity of the financial problems facing Carillion, why did the Government not act then, rather than attempting to close the stable door after the horse had bolted?[15]

Work and Pensions Secretary Esther McVey said the Government had asked for views on measures to strengthen the powers of the Pensions Regulator in its February 2017 Green Paper and that it its manifesto for the 2017 election, the Conservative Party had proposed

11 HC Deb 24 January 2018 c349; PQ129456 28 February 2018

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13 **April 2018:** Carillion Public Sector Pension Scheme – Carillion Professional Services Ltd; Carillion Staff Pension Scheme – Carillion Professional Services Ltd; Carillion Staff Pension Scheme – Carillion Property Services Ltd; **March 2018:** Carillion Group Section of the Electricity Supply Pension Scheme – Carillion Services ltd; Mowlem Staff Pension and Life Assurance Scheme – Carillion JM Ltd; **February 2018**: Bower Group Retirement Benefits Scheme- PME Technical Services Limited; Carillion B Pension Scheme - Carillion Construction Limited; Carillion B Pension Scheme - Carillion plc; Carillion Integrated Services Limited Section of the Prudential Platinum Pension Scheme - Carillion Integrated Services Limited; Carillion Rail (Centrac) Shared Cost Section of the Railways Pension Scheme - Carillion Construction Limited; Carillion Rail (GTRM) Shared Cost Section of the Railways Pension Scheme - Carillion Construction Limited; Mowlem (1993) Pension Scheme – Sovereign Hospital Services Ltd; Permarock Products Pension Scheme – Carillion Construction Ltd; Planned Maintenance Engineering Ltd Staff Pension And Assurance Scheme – Planned Maintenance Engineering Ltd

14 Source: Prospect; You and Yours, BBC Radio 4, Friday 29 June 2018

15 HC Deb 22 January 2018 c28

giving TPR power to "impose punitive fines alongside contribution notices so that pension scheme members are fully protected." It also intended to make "certain corporate transactions subject to mandatory clearance" by TPR, while taking care to ensure such measures did "not have an adverse effect on legitimate business activity and the wider economy."[16]

In its White Paper on 19 March 2018, the Government outlined plans to strengthen the regulatory framework:

> 1. Give the Regulator powers to punish those who deliberately put their pension scheme at risk by introducing punitive fines;
> 2. Legislate to introduce a criminal offence to punish those found to have committed wilful or grossly reckless behaviour in relation to a pension scheme and, build on the existing process to support the disqualification of company directors; and
> 3. Work with the Regulator to strengthen the existing notifiable events framework and voluntary clearance regime so that employers have appropriate regard to pension considerations in any relevant corporate transactions. This includes improving the effectiveness and efficiency of the Regulator's existing anti-avoidance powers. We will work with relevant parties to ensure that these measures do not have an adverse effect on legitimate business activity and the wider economy.
> 4. Legislate to have the Regulator some of the information-gathering powers already in place for automatic enrolment and Master Trusts to its Defined Benefit and Defined Contribution functions, including the power to compel any person to submit to an interview, the power to issue civil sanctions for non-compliance and an inspection power. (Cm 9591, chapter 1).

On 11 April, the Work and Pensions Committee announced an inquiry with a view to influencing and informing debate on the White Paper. It asked for views on a range of questions, including the extent to which improving TPR's effectiveness was a matter of greater powers, better use of resources or cultural change in the organisation.[17] In its report on Carillion, it said it had become "ever more apparent that, while some new powers are required, the problems in DB pensions regulation are primarily about the regulatory approach."[18]

In Work and Pensions questions on 21 May 2018, Shadow Pensions Minister Jack Dromey asked how the Government would respond. Pensions Minister, Guy Opperman said there were lessons to be learned from this and other high-profile cases:

> **Jack Dromey (Birmingham, Erdington) (Lab):** The Secretary of State has said that the pensions regulator had concerns about Carillion pension scheme deficits in 2014 but failed to act. The Government went on letting contracts to Carillion, despite repeated profit warnings, and failed to act. Do the Government recognise that the consequences of their failure to act include the biggest-ever hit on the Pension Protection Fund—£800 million—and many thousands of pensioners losing out on their pensions?
>
> **The Parliamentary Under Secretary of State for Work and Pensions (Guy Opperman):** It was a Labour Government who created the Pensions Regulator in 2004, and I think we can all agree that there are lessons to be learned from Carillion and other recent high-profile cases. However, there are two options. We either try to discredit an organisation and run it down or—this is my choice—support the regulator, give it the further powers that we set out in detail in the defined benefit

16 Ibid c25-6
17 Work and Pensions Select Committee, Defined benefit pension schemes: the future, 11 April 2018
18 HC Deb 21 May 2018 c558-9

> pension schemes White Paper and stress that the vast majority of employers do right by their employees.
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> **Jack Dromey:** The DB White Paper proposes criminal charges for directors who neglect their duties. Would Carillion's directors go to jail under the proposed changes to the law? If not, why not?
>
> **Guy Opperman:** I look forward to working with the hon. Gentleman as we steer the DB White Paper into legislation, but the legislation is looking at the future—it is not necessarily retrospective.

The role of the trustees

The Trustee of the Carillion pension schemes has explained that, in coming to a judgment as to what level of contributions could be afforded, it took account of the Carillion's debt position. It was unable to secure the level of contributions that it wanted:

> Carillion made it clear, repeatedly, to the Trustee in valuation discussions (e.g. in correspondence shared with TPR for the 2011 and 2013 valuations, the Trustee sought to agree higher contributions for the schemes (taking into account the covenant advice they had received).
>
> For both the 2008 and 2011 valuations, the Trustee and Company were not able to reach agreement on the valuations by the due date under the Pensions Act 2004. This was essentially due to the Trustee seeking to take a more prudent approach to funding than the Company considered it could afford. The Trustee (and the former trustees of the schemes in the case of the 2008 valuations) reported this to tPR and tPR became involved in the discussions.
>
> Ultimately, for all three valuations TPR decided not to exercise its powers.[19]

In August 2017, the trustees were approached by Carillion with a request to defer contributions for a period. They agreed to defer eight months of contributions on the basis that failure to agree would have led to the banks not lending new money and the Carillion Group becoming insolvent. The contribution deferral agreement fell away with Carillion going into compulsory liquidation and the trustees informed the official receiver that the deferred contributions were now due to the schemes.[20]

The Trustees were also attempting to gradually 'de-risk' the schemes investments. Following the company's profit warning in July 2017, the Trustee took steps to "increase allocations to defensive assets and to draw up a contingency plan." The objective was to "put in place the mechanics to allow the Trustee to materially and quickly reduce investment risk should it become appropriate."[21]

In a report published on 16 May 2018, the Work and Pension and BEIS Select Committees concluded that the trustees had been "outgunned" in the negotiations:

> 131.Trustees invest the assets of a pension scheme and are responsible for ensuring it is run properly and that members' benefits are secure. In this role, trustees negotiate with the sponsoring employer on behalf of the scheme members. As we noted earlier in this report, a single trustee board (the Trustee) represented the large majority of Carillion's DB scheme members.
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> 132.Gazelle, who acted as covenant advisors to the Trustee, told us that Carillion may have set out to "manage" the Trustee so that it "did not present an effective negotiating counterparty" to the company. This was done in part through the "dominating influence" of Carillion employees, who faced an inherent conflict of interest, on the Trustee board. Robin Ellison, the Trustee Chair, disagreed stating that

19 Letter from chair of Carillion DB Pension Trustee Ltd to chair of the Work and Pensions Committee, 24 January 2018
20 Ibid
21 Ibid

"all the directors of the trust company were independently-minded." Gazelle also cited Carillion's budgetary control over the Trustee that "may have limited the ability of the Trustee to itself obtain detailed advice on more complex issues", and pressure exerted on the scheme actuary by Carillion at trustee meetings.

133.Despite these limitations, and as we considered earlier in this report, the Trustee pushed Carillion hard to secure additional contributions to fund the pension deficits. They also consistently acted on advice from The Pensions Regulator on their approach to dealing with company. Both the 2008 and 2011 valuations were agreed well outside the statutory 15-month deadline as the Trustee sought to obtain a better deal. Although agreements were eventually signed by the Trustee and Carillion on these valuations, Robin Ellison argued that they were effectively "imposed". As Mr Ellison noted, "the powers of pension fund trustees are limited and we cannot enforce a demand for money". TPR does have a power to impose contributions, and the Trustee wrote to TPR requesting "formal intervention" on behalf of scheme members with regard to the 2013 valuation and recovery plan.

134.**The pension trustees were outgunned in negotiations with directors intent on paying as little as possible into the pension schemes. Largely powerless, they took a conciliatory approach with a sponsor who was their only hope of additional money and, for some of them, their own employer. When it was clear that the company was refusing to budge an inch, they turned to the Pensions Regulator to intervene.**[22]

The role of the Pensions Regulator

In evidence to the Committee, the Regulator said it had been engaged with the Trustee and had considered using its powers before receiving an improved proposal.[23]

The Committee concluded that TPR's intervention had "only served to highlight" how unequal the contest would continue to be:

> 142.The Pensions Regulator's feeble response to the underfunding of Carillion's pension schemes was a threat to impose a contribution schedule, a power it had never—and has still never—used. The Regulator congratulated itself on a final agreement which was exactly what the company asked for the first few years and only incorporated a small uptick in recovery plan contributions after the next negotiation was due. In reality, this intervention only served to highlight to both sides quite how unequal the contest would continue to be.
>
> 143.The Pensions Regulator failed in all its objectives regarding the Carillion pension scheme. Scheme members will receive reduced pensions. The Pension Protection Fund and its levy payers will pick up their biggest bill ever. Any growth in the company that resulted from scrimping on pension contributions can hardly be described as sustainable. Carillion was run so irresponsibly that its pension schemes may well have ended up in the PPF regardless, but the Regulator should not be spared blame for allowing years of underfunding by the company. Carillion collapsed with net pension liabilities of around £2.6 billion and little prospect of anything being salvaged from the wreckage to offset them. Without any sense of irony, the Regulator chose this moment to launch an investigation to see if Carillion should contribute more money to its schemes. No action now by TPR will in any way protect pensioners from being consigned to the PPF.

While it accepted TPR had made changes and that there had been positive developments, it concluded that TPR needed to be "quicker, bolder and more proactive" and this would require "substantive cultural change":

> 187.**The case of Carillion emphasised that the answer to the failings of pensions regulation is not simply new powers. The Pensions Regulator, and ultimately pensioners, would benefit from far harsher sanctions on sponsors**

22 BEIS and Work and Pensions Select Committees, Carillion, HC 679, March 2018
23 Evidence to BEIS and Work and Pensions Committee, 22 February 2018, Q 678-9

> **who knowingly avoid their pension responsibilities through corporate transactions. But Carillion's pension schemes were not dumped as part of a sudden company sale; they were underfunded over an extended period in full view of TPR. TPR saw the wholly inadequate recovery plans and had the opportunity to impose a more appropriate schedule of contributions while the company was still solvent. Though it warned Carillion that it was prepared to do, it did not follow through with this ultimately hollow threat. TPR's bluff has been called too many times. It has said it will be quicker, bolder and more proactive. It certainly needs to be. But this will require substantial cultural change in an organisation where a tentative and apologetic approach is ingrained. We are far from convinced that TPR's current leadership is equipped to effect that change.** The Work and Pensions Committee will further consider TPR in its ongoing inquiry into the Defined Benefit Pensions White Paper.[24]

In response, Chief Executive Lesley Titcomb said TPR had made changes to strengthen its regulatory approach and would continue to do so:

> We actively seek to learn lessons to better protect members of pension schemes. In the past the balance between members and employers was not always right. The report underlines the significant changes already made at TPR but there is more work to do.
>
> We are now a very different organisation; we are clearer about what we expect, quicker to intervene and tougher on those who do not act in the interest of members. We have reinforced our regulatory teams on the frontline and are embedding a new regulatory culture. We sought stronger and clearer powers on scheme funding from DWP and we are working with the Government on how to implement the changes in the white paper, alongside our wider changes to how we regulate.[25]

TPR gave examples to show how it was changing:

> - Through our **TPR Future Programme** we have completed a wholesale review of our approach to regulation. In April, we started implementing a new regulatory model across TPR in order to drive up standards and tackle risks through proactive engagement with a larger proportion of the schemes and employers we regulate. We will do this by being clearer and more directive about what schemes must do; making better use of data to enable us to target the right schemes; and using a wider range of communications, oversight and enforcement tools, for example account-managed supervision or targeted directive campaigns.
> - We are piloting, testing and refining different approaches which are being incorporated into our day-to-day regulatory work. For example,
>   - we have undertaken **two thematic reviews** on compliance with late payment reporting and DC value for member requirements
>   - we have initiated a **new proactive approach** with a number of small DB schemes of their triennial funding valuations. This includes writing to trustees of small schemes setting out our expectations and setting out our view of the strength of the employer covenant supporting the scheme and asking them questions about key risk areas, including governance, covenant, investment and funding. Responses we receive will inform whether we open a funding case and we will provide clear, directive feedback to all small schemes we engage with. We ran sessions to get the views from 60 actuaries of over 1,000 small DB schemes around the country and received strong support for our new approach.
>   - we've **engaged with a range of schemes**, across the entire pensions landscape who we were concerned were at risk of contagion as a result

24 BEIS and Work and Pensions Select Committees, Carillion, HC 679, March 2018
25 TPR response to the report of the Work and Pensions Select Committee, 16 May 2018

of the collapse of Carillion. As part of this outreach, we looked at companies that participate in DB, DC and public service schemes. We made use of the intelligence available to us to target schemes for high, medium and low intensity engagement covering liabilities of £85.5bn and more than 800,000 members.

  – we have initiated **anti-avoidance action** by issuing a Warning Notice, achieving recoveries in excess of £1bn, often through the use of settlement thereby avoiding a costly litigation process.
  – we are **using our powers more often** and testing powers that we have not used previously. In the courts, we have seen 7 sucessful prosecution cases for failure to provide information, wilful noncompliance with automatic enrolment duties and recklessly providing false or misleading information to TPR.

- We will also improve how we work with our partners to ensure the pension saving system as a whole delivers the right outcomes for individuals. We are developing a **joint regulatory strategy with the FCA** which will clarify our remits and how we will work together in future. It will be published later in the year.
- We're supporting trustees through our 21st century trusteeship campaign so that they make the right decisions to help their pension schemes to thrive.[26]

For more on the background, see Library Briefing Paper SN-04368 The Pensions Regulator: powers to protect pension benefits (28 March 2018)

[26] Ibid