BHS pension scheme – key questions

- Where were the distress flares: How and when should anyone have intervened on behalf of members?
- Why the gap between Project Thor being put on hold and the trustees being notified of the sale?
- Who should take responsibility for the scheme debt?
- What are the longer term implications for final salary pension schemes, sponsoring employers and their employees more generally?
- What is going wrong with final salary scheme investment strategies?
- Timeline of events for the BHS pension scheme

Where were the distress flares?

The employees and pension scheme members of BHS were depending on the scheme trustees and the Regulator to protect their interests, yet no one seems to have been able to prevent the pension scheme being steered full steam ahead onto the rocks. At crucial moments between 2013 and 2015, no one on the trustee body or the Pensions Regulator seemed able to send up the necessary distress flares to warn of impending disaster.

In spite of a 23 year recovery programme being accepted by the trustees in 2013, 18 months later in February 2015 the company and the attendant pension scheme liabilities were off-loaded by Arcadia onto Retail Acquisitions ltd without the deficit recovery having been resolved (and with the Regulator not yet having signed it off). Neither the trustees nor the Pensions Regulator were able to intervene in the sale of the business, in spite of only being given around one month’s notice of the impending sale and without having been given a meaningful opportunity to explore the implications of the sale for the scheme members.

- What could the trustees have done in 2013, when faced with an ultimatum of recovery funding of £10 million a year and a 23 year horizon? It appears that their only choices were to either accept the deal or resign; so what other measures should trustees be given to protect members’ interests.
- What could the trustees have done in 2015 when faced with a sale on which they had not had time to perform adequate due diligence? With no power to intervene, their only other option would have been to resign; what other powers or measures should have been available to them?

The Pensions Regulator’s powers exist in making a retrospective Contribution Notice or Financial Support Direction.

- Should the Regulator have explicitly informed Arcadia that they would be held liable for the scheme debts unless the trustees were given sufficient time to conduct due diligence on the strength of RAL’s covenant?
Mind the gap

Project Thor was put on hold in September 2014, to the dismay of the scheme trustees who saw it as a viable opportunity to safeguard members’ interests. Within weeks, in October 2014 Sir Philip Green was discussing the sale of BHS with Deloitte. However the Trustees and the Pension Regulator were only informed of the possible sale in February of 2015, just a few weeks before the sale to Retail Acquisitions Ltd was completed.

Should they have been notified earlier? This is a moot point, given that neither body had the power to block the transaction. They could however have had more time to explore the viability of the new purchaser and to satisfy themselves as to the strength of the covenant backing the scheme.

Who owns the debt?

As recently as 2008, the pension scheme was in surplus, so who should be liable for the debt when the company is sold 8 years later with a deficit of £571 million? The debt effectively passes to the new owners of the business, however as the Committee has learned, Retail Acquisitions Ltd seemed to have only a very superficial understanding of the scale of the debt they were taking on.

The BHS pension scheme members have been promised final salary pensions, which are legally defined as deferred pay. Their employer, the legal entity BHS is obliged to meet the cost of these promised pensions. The root cause of the liabilities, the years of service when the scheme members were accruing their entitlement to a final salary pension stretch decades back into the past. This matters not a jot however, when the liabilities can be off-loaded to anyone willing to take them on and without the trustees or the Regulator having any say in the matter at the time.

What are the possible implications for final salary schemes, sponsoring employers and their employees more generally?

For final salary scheme members their pension promises are a vital reassurance of financial security in retirement. However for many sponsoring employers and for their defined contribution scheme employees, the final salary schemes are more like an unwelcome drain on their precious resources which could otherwise be used for business growth, or to provide pension rewards for the next generation of young employees.

Employers spend in the region of £100 billion a year on workplace pensions in the UK. A large proportion of it goes on final salary schemes, in spite of the fact that these schemes have only a relatively small and dwindling population of predominantly older members.

According to the Pension Protection Fund, in March 2015 there were 10.97 million members of private sector final salary schemes but just 1.75 million active members.

The overall funding ratios for the 5,967 schemes of which they are members were 84% on a S.179 basis (PPF level benefits) and 62% for full buy out.

According to the ONS, in 2014 in the private sector, 1% of active members of occupational DC schemes had employer contribution rates of “15% and over”, whilst for occupational Defined Benefit (DB) the figure was 57%.

Final salary scheme investment strategies have become increasingly out of kilter with the conventional wisdom of long term investing. According to the PPF:
“Between 2006 and 2015, the equity share of total assets fell from 61.1 per cent to 33 per cent, the gilt and fixed interest share rose from 28.3 per cent to 47.7 per cent, and the ‘other investments’ share of total assets rose from 10.6 per cent to 19.3 per cent. The UK quoted share of total equities has almost halved, falling from 48 per cent to 25.6 per cent.”

It is worth noting that UK Gilt yields currently rest at record lows.

These current enquiries present a welcome opportunity to reconsider the balance between the members’ guarantees on the one hand, and on the other the economic and social consequences of persisting with a strategy of guaranteeing 100% of promised benefits.

- If benefits are still to be guaranteed at 100%, then how can those liabilities best be met?
- Is it possible to introduce risk sharing mechanisms which would permit more progressive investment strategies to be pursued?
- Should trustees and the Regulator have greater powers and responsibilities to intervene in the activities and finances of businesses?

Timeline (the following timeline is based entirely on written and oral evidence made to the Select Committees investigating BHS)

April 2010: 2009 valuation documents and recovery plan submitted to The Pensions Regulator (TPR)

June 2010: TPR opened a funding case to challenge trustees on (i) recovery plan length of 12.5 years and (ii) technical provisions assumptions

March 2011: In view of the improvements obtained by the trustees, TPR decided to close the case with comments for the trustees to focus on for the next valuation

January 2013: Chris Martin approached to act as new chair of Trustee board

June 2013: Trustees notified TPR the 2012 valuation and recovery plan would be filed late

September 2013: Valuation submitted with a 23 year recovery plan

January 2014: TPR requests more information relating to valuation and recovery programme

January – July 2014: TPR engages in dialogue with scheme trustees

February 2014: Chris Martin appointed as Chair of Trustee board

February 2014: Arcadia open discussion with trustees on project Thor

June 2014: TPR notified of a possible business reorganisation

July to September 2014: Project Thor developed and analysed by trustees

5 September 2014: Trustees notified project Thor to be put on hold until after Christmas trading period

24 September: Letter from Deloitte to TPR formally withdrawing Thor proposal, referenced desire to focus on Christmas trading period; no reference made to possible sale of business

14 October 2014: Sir Philip Green contacts Goldman Sachs concerning the possible sale of BHS by Arcadia
2 February 2015: Chris Martin first notified of possible sale of BHS by Arcadia. Subsequently engages KPMG to advise on implications of the sale

19 February: Chris Martin meets Retail Acquisitions Ltd. Trustees seek reassurance that purchasers have sufficient working capital

February 2015: TPR notified by Deloitte of intention to put business up for sale

25 February: Chair of trustees Chris Martin meets Sir Philip Green

3 March: TPR writes to Adam Goldman (Arcadia Group Company Secretary) setting out concerns about the sale

4 March: TPR meets with Sir Philip Green and Chris Martin, at this meeting TPR asked whether trustees had completed their due diligence and they said not

11 March 2015: Sale of BHS to RAL by Arcadia completed

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