A nation of shopkeepers

Jennie Kreser considers the questions raised by the BHS pensions scheme, particularly regarding decisions made by trustees and The Pensions Regulator

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Napoleon famously described Britain in pejorative terms as 'a nation of shopkeepers', so perhaps it is no great surprise that the most interesting story from the world of occupational pensions in the last month or so concerns one of our most famous high-street names, BHS.

Acres of newsprint have already been written on the topic, but I want to explore some of the pension-specific questions that need to be asked about the collapse of this once, if not exactly giant, then at least familiar, household name.

First, a little history by way of background. When Sir Philip Green bought BHS in May 2000, the group's pension funds were in surplus. In the year to March 2001, accounts for BHS Group filed at Companies House indicated a surplus of at least £5m, and a year later that had risen to £12.2m.

Indeed, BHS's pension fund appeared well supported until 2008, the year of the financial crash. That year, the scheme had a surplus of £3.4m. One needs to exercise a little caution about these figures since, at the time, the way surplus and deficits were calculated in pension schemes was different to today. The funding standard was on something called the minimum funding requirement, which was less stringent than the current scheme funding regime.

The next thing to note is the scheme's investment strategy. It's highly likely that the scheme was heavily invested in equities – a 70 or even 80 per cent equity holding was not out of the ordinary at the time. But, gradually, the outlook for pension fund holdings of equity investments deteriorated, and the deficit went through the roof. By 2009 it stood at £137.9m and in 2012, after an actuarial valuation, the trustees set out a 23-year recovery plan to try to reduce the deficit.

Recovery plans

A little explanation might be helpful here. Every three years, a defined benefit pension scheme must be assessed by the scheme actuary to calculate the surplus or deficit which exists in the scheme. Essentially, the assets the scheme holds are compared with the benefit promises that the scheme has to provide and the difference will reveal how well the scheme can meet its liabilities. To paraphrase Mr Micawber, if the assets outweigh the liabilities, result happiness; if they do not, result misery. If a scheme valuation discloses a deficit, then the trustees and the employer must come up with a cunning plan to reduce this deficit over a reasonable period of time. This is called the recovery plan, and it has to be agreed between the trustees and the employer and sent to The Pensions Regulator (TPR), which, while it may not formally 'approve' the plan as such, should nevertheless review it to ensure that it is reasonable.

TPR has produced a scheme funding code of practice which sets out in general terms its approach to recovery plans and when it might ask additional questions. At the time of the problematical plan, TPR had certain 'trigger points' in place which would lead to a deeper scrutiny of plans. One of those 'triggers' was any plan that was longer than ten years. Hold that thought – I'll return to it in a minute.

When the BHS business went into administration, the deficit was understood to be in the region of £571m – eye-watering in anyone's mind. Much of the blame in the popular press and media has so far been laid at Sir Philip Green's door, and questions have already been raised in parliament, with calls for a public enquiry and – from some quarters at least – a public flogging, with a bit of hanging, drawing, and quartering on the side. Well, maybe just a removal of titles, to be

fair, but once the court of Twitter has spoken, what passes for 'justice' nowadays may play out its inevitable course.

While Green may indeed have some questions to answer, as far as the pension schemes go, I think the net needs to be cast a little bit wider than that.

Regulatory failings

First, let's consider that 23-year recovery plan again. What were the trustees and TPR thinking when they agreed to such a long plan? As a pension lawyer, I would have been advising my pension trustee clients at the time that they should be thinking very carefully about any plan over ten years, and certainly anything over 15 would be exceptional. The company should have been putting money in far quicker to get the deficit under control. Why did TPR not step in at that point to ask some searching questions and encourage the trustees to consider carefully the strength of the employer covenant (that is, the ability and willingness to support the schemes)? Did it in effect drop the ball on this one?

The regulator has announced, unsurprisingly: 'We can confirm we are undertaking an investigation into the BHS pensions scheme to determine whether it would be appropriate to use our anti-avoidance powers.' Forgive me if I think this is a bit like closing the stable door after the horse has bolted. And if TPR itself has questions to answer, should it really be conducting any kind of investigation where its own actions or inactions may be relevant?

Second, while it's true that many pension funds had suffered after the stock market crash in 2008, a question must be asked about the investment strategy adopted by the trustees in the years following the crash. As I have already noted, it seems likely that the scheme was too slow to react to the need to revisit its heavy reliance on equities – traditionally the best performing investment over time but volatile in times of financial stress – and instead adopt an approach that would better match its liabilities. It is possible the trustees were advised to 'watch and wait' – and this may all come out in the investigatory wash – but when you are in a hole, it's usually best to stop digging.

It is important to note that the current chair of the BHS trustees was not in post at the time of the events in question. However, one must assume that appropriate due diligence was undertaken at the time, and has been since, to monitor the employer covenant. As the deficit grew, there would (or at least should) have been regular reviews of the deficit position and annual actuarial reviews, which, as the situation grew steadily worse, would have led to the regulator being involved in ongoing discussions. This could have included raising the level of contributions being paid by the employer into the scheme over and above those initially agreed under the 23-year plan.

As a spokesperson for BHS's former owners said: 'There was an independent board of trustees who had sole control of the pension funds and they made the decisions. If a deal was agreed of £x to be paid that was the deal. They were free to do whatever they liked.' Well, exactly.

Pension Protection Fund

I am sure there is still a lot of information to come out on this story. The Pension Protection Fund (PPF) – the 'lifeboat' scheme that will pick up the majority of the responsibility for the payment of 'compensation', as they call it (the benefits under the schemes to ordinary mortals such as you and me) – seems to be willing to throw its colleagues at the regulator to the wolves somewhat by saying that it told TPR of its concerns several months ago but no action was taken.

There also seems to be some concern that – not to put too fine a point on it – the PPF may run out of money itself.

Finally, the Work and Pensions select committee has announced the scope of its new inquiry into pensions regulation, the PPF, and lessons from recent cases, including BHS.

The committee will consider the following points:

- The adequacy of defined benefit pension scheme regulation and regulatory powers, in general and specifically in relation to the pension schemes of complex and multi-national companies;
- Use of these powers by TPR in recent cases, including BHS;
- Resourcing and prioritisation of TPR supervisory work;
- Implications of the regulatory approach for company behaviour, including whether it mitigates or incentivises moral hazard;
- The sustainability of the PPF; and
- The fairness of the PPF levy system and its impact on businesses and scheme members.

Frank Field MP, the chair of the committee, said: 'We need as a committee to look at the [PPF] and how the receipt of pension liabilities of BHS will impact on the increases in the levy that will now be placed on all other eligible employers to finance the scheme. We will then need to judge whether the law is strong enough to protect future pensioners' contracts in occupational schemes.'

So, prepare for more legislation, folks – just what the simple world of occupational pension law needs. **SJ**

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