Regulatory intervention report

issued under section 89 of the Pensions Act 2004
in relation to the BHS pension schemes

June 2017

The Pensions Regulator

Introduction

Reasons for publication

The Pensions Regulator (TPR) regularly publishes regulatory intervention reports[1], setting out our actions during a case, why we made certain decisions, and what happened as a result.

This report outlines the action we undertook and its background. We pay particular attention to the period of nearly four years from our engagement with the 2012 valuations, including the events leading up to the sale of BHS, its subsequent administration, our investigation and the Warning Notice we issued, and concluding with the settlement reached with Sir Philip Green, Taveta Investments Limited and Taveta Investments (No.2) Limited on 28 February 2017.

Our single investigation into BHS resulted in the issue of Warning Notices against a number of respondents. One of these Warning Notices involved a case brought against Sir Philip Green and associated companies (Taveta Investments Limited and Taveta Investments (No.2) Limited). This matter settled before any responses were made to our Warning Notice or the case was brought before our Determinations Panel[2]. As such, Sir Philip Green, Taveta Investments Limited and Taveta Investments (No.2) Limited have not responded to our findings as part of regulatory proceedings or our case as described in the Warning Notice. In addition, the settlement reached was expressly on the basis of no admission of liability on the part of Sir Philip Green or the associated Taveta companies.

We have also taken action separately against Dominic Chappell and Retail Acquisitions Limited (RAL). This report deliberately does not cover that matter, which is ongoing. As a result, this report omits details or information which could prejudice our case against Dominic Chappell or RAL. We expect to publish a further report on that matter when it concludes.

1
http://www.thepensionsregulator.gov.uk/doc-library/regulatory-intervention-reports.aspx

2
This is a TPR committee required to be set up under the Pensions Act 2004 which is separate from the investigative case teams. It determines what regulatory action, if any, is appropriate in relation to any cases referred to it. See further explanation of its role on page 6.

Purpose of this report

TPR's stated publication objectives[3] are:

Transparency

We recognise that it is in the public interest to ensure that everyone has a greater understanding of how we exercise our statutory functions. An important aim of publication is to increase understanding of how and when we have used our powers.

Education and guidance

To provide guidance to improve practices, behaviours and compliance with legal obligations which otherwise might lead to intervention, and to encourage higher standards by sharing good practice.

Deterrence

To deter unlawful or improper practices or behaviours, to increase awareness of such practices or behaviours, and to inform others who may be adversely affected by such practices or behaviours.

3 http://www.thepensionsregulator.gov.uk/docs/essential-guide-publish-information-cases.pdf

Contents

The BHS case included the use or potential use of a number of our powers and spanned a considerable period. This report is therefore arranged in the following sections:

Role of TPR

We have statutory powers to intervene in the running of pension schemes under certain circumstances. The key powers we considered or used during the time covered by this report are:

- Power to intervene in scheme funding[4]
- Power to approve a regulated apportionment arrangement (RAA)[5]
- Power to require the provision of information[6]
- Power to demand contributions where there has been avoidance of the 'employer debt' (this demand is usually referred to as a 'Contribution Notice' or 'CN')[7]
- Power to issue a direction for financial support (this is usually referred to as a 'Financial Support Direction' or 'FSD')[8] if an employer to a scheme is a service company or insufficiently resourced
- Power to issue a clearance statement in relation to a particular event[9]. A clearance statement is not an approval of a transaction or a scheme-related event but an assurance that, based on the information provided, we will not use our CN and/or FSD powers (often referred to as 'anti-avoidance' or 'moral hazard' powers).

4
Section 231,
Pensions Act 2004.

5
Regulation 7A(c), Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2008.

6
Section 72,
Pensions Act 2004.

7
Section 38,
Pensions Act 2004.

8
Section 43,
Pensions Act 2004.

9
Sections 42 and 46,
Pensions Act 2004.

The Determinations Panel

The Determinations Panel (DP) is a committee of TPR. It operates separately from other parts of the organisation, including TPR's case teams.

The DP has a separately appointed membership and legal support. This enables it to make independent and impartial decisions. The DP considers all the evidence before it and provides each party with reasonable opportunity to present their case. Members of the panel are not involved in the investigation process.

The DP consists of a chairman appointed by TPR and at least six other people who are nominated by the chair and appointed by TPR.

Key considerations when exercising our powers

When exercising our powers, we will have regard to our statutory objectives[10] as put in place by Parliament. Our statutory objectives are:

- to protect the pension benefits of members of occupational pension schemes
- to reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund (PPF)
- when using funding powers, to minimise any adverse impact on the sustainable growth of an employer, and
- to promote, and to improve understanding of, the good administration of work-based pension schemes

10
Section 5,
Pensions Act 2004.

Background

BHS – the company and its ownership[11]

BHS was a well known British high street retailer, employing 11,000 staff. The company, BHS Limited, was formerly part of the Storehouse Group before being acquired in May 2000 by Measuremarket Limited. The majority shareholder of Measuremarket Limited at the time of the acquisition was Global Textiles Investments Limited, which was ultimately owned by the Green family. Following its acquisition, Measuremarket Limited changed its name to BHS Group Limited. When we say 'BHS' in this report, we are referring to BHS Group Limited and its subsidiaries.

In 2009, as part of a plan to turn around a fall in its performance, BHS was acquired by Taveta Investments (No 2) Limited and became part of the Taveta group of companies, including Taveta Investments Limited, which is ultimately owned by Lady Cristina Green.

Taveta is also the ultimate parent company of Arcadia Group Limited, which operates other well known retail brands such as Topshop, Topman, Dorothy Perkins, Evans, Miss Selfridge and Burton. BHS was reporting losses by the time it joined the Taveta Group.

When we say 'Arcadia' in the remainder of this report we are referring to Arcadia Group Limited and its subsidiaries. Similarly, references to 'Taveta' include Taveta Investments Limited and its subsidiaries, including Arcadia.

The BHS schemes

There are two BHS pension schemes, the BHS Pension Scheme (the 'main scheme') and BHS Senior Management Scheme (the 'senior scheme') which, combined, currently have around 19,000 members. They are both defined benefit (DB) pension schemes and were established by way of transfers out of the Storehouse Group Pension Scheme and the Storehouse Senior Management Scheme when BHS was acquired by the Green family. For both schemes, the sole employer has been BHS Limited. The schemes' trustees are currently BHS Pension Trustees Ltd, MGL Corporate Services Ltd and Independent Trustee Services Ltd, which is represented by Chris Martin, who was appointed to act as Chair in 2014.

19,000
members in total

The schemes are both closed to future accrual. As at 2 March 2016, the main scheme had a total of 19,082 members, made up of 13,115 deferred members and 5,967 pensioner members, and assets of £421 million. The senior scheme had a total of 222 members, made up of 81 deferred members and 141 pensioner members, and assets of £95 million.

11
See corporate structure and ownership charts on pages 43-44.

Scheme funding

The law gives us powers to intervene to ensure that DB schemes, such as the two BHS schemes, are run properly and lawfully. It also places a requirement on trustees, subject to limited exemptions, to complete a triennial valuation of their assets and liabilities.

Schemes have up to 15 months from the effective date of their triennial valuation to complete the valuation and, if the scheme is in deficit, submit a recovery plan to TPR.

Our role is not to agree recovery plans – this is for the trustee and employer to agree – but we will conduct a risk assessment based on criteria that include strength of the employer covenant, length of the recovery plan, and the size and funding level of the scheme. This helps us understand the amount of risk to members' benefits in the recovery plan. We will open a funding case to raise issues with the trustee and employer where we have concerns or wish to better understand the agreed recovery plan. We have the power to impose a schedule of contributions (including recovery plan payments) if the trustee and employer cannot come to an appropriate agreement. When we are satisfied with a recovery plan we will ordinarily confirm that we do not intend to exercise our funding powers[12] in respect of it.

Pre-sale

Summary of funding position since 2000

A summary of the schemes' funding positions (surplus/(deficit) figures) from March 2000 until March 2015 is presented in the table overleaf. A description of the different bases shown is provided after the table.

'The law gives us powers to intervene to ensure that DB schemes are run properly and lawfully'

12
Using section 231 of the Pensions Act 2004.

Year[13]	Scheme	PPF basis		Ongoing basis		Buy-out basis	
		Surplus/ (Deficit) (£m)	Funding level	Surplus/ (Deficit) (£m)	Funding level	Surplus/ (Deficit) (£m)	Funding level
2000	Main:	N/A[14]		26	113%	(47)	83%
	Senior:	N/A		17	145%	8	116%
	Combined surplus/deficit:	N/A		43.0		(39)	
2003	Main:	N/A		12.0	105%	(234.2)	49%
	Senior:	N/A		16.3	133%	(27.7)	65%
	Combined surplus/deficit:	N/A		28.3		(261.9)	
2006	Main:	(76.1)	82%	(18.6)	95%	(261.1)	57%
	Senior:	23.7	138%	11.3	115%	(20.5)	81%
	Combined surplus/deficit:	(52.4)		(7.3)		(281.6)	
2009	Main:	(214)	56%	(147.7)	65%	(354.2)	44%
	Senior:	(12)	84%	(18.2)	78%	(47.7)	58%
	Combined surplus/deficit:	(226)		(165.9)		(401.9)	
2012	Main:	(249.7)	58%	(210.5)	62%	(452.1)	43%
	Senior:	(3.5)	96%	(22)	80%	(62.4)	58%
	Combined surplus/deficit:	(253.2)		(232.5)		(514.5)	
2015[15]	Main:	(296)	60%	(231)-(300)	59-65%	(516)	46%
	Senior:	(1)	99%	(20)-(32)	77-84%	(55)	65%
	Combined surplus/deficit:	(297)		(251)-(332)		(571)	

13 As at 31 March.

14 The schemes' first PPF valuations were as at 31 March 2006.

15 The 31 March 2015 valuations were never finalised, so the ongoing basis range shown refers to indicative figures provided when the preliminary results of the valuations were being discussed and were not agreed.

The different types of bases shown in the previous table can be summarised as follows:

- **PPF basis:** Based on the PPF's prescribed methodology[16]. Valuation is of the benefits that members would be entitled to receive in the PPF.
- **Ongoing basis:** A set of assumptions used to determine a scheme's accrued liabilities assuming the scheme continues on an ongoing basis. For the 2006 valuation onwards, the scheme-specific funding provisions of Part 3 of the Pensions Act 2004 applied.
- **Buy-out basis:** A set of assumptions used to estimate the cost of securing a scheme's pension benefits in full by purchasing annuities with an insurance company.

2006 valuations

The schemes each conducted a valuation assessing their assets and liabilities as at 31 March 2006. Pension schemes have 15 months to complete valuations which must be submitted to us, along with a recovery plan when the scheme is in deficit. The scheme valuations as at 31 March 2006 were the first to fall within our remit. In respect of the main scheme, we asked the trustees to explain their position regarding:

- their assessment of the covenant – ie BHS's legal obligation and financial ability to support the scheme now and in the future – including whether they had taken independent advice.
- their view of the appropriateness of the agreed levels of contributions of £2.5m a year being paid by BHS to remove the deficit over a ten year recovery plan, and whether contributions could be increased.
- some of the assumptions used to calculate the scheme's funding target (known as its technical provisions).

After meeting with the trustees, we wrote to them in February 2008 with recommendations on what to focus on for the next valuation, including assumptions on members' mortality rates, the affordability of deficit contributions to the employer and the length of a future recovery plan.

'Pension schemes have 15 months to complete valuations, along with a recovery plan when the scheme is in deficit'

16
In accordance with Section 179 of the Pensions Act 2004.

2009 valuations

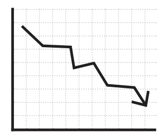
Between 31 March 2006 and 31 March 2009 the funding position of the schemes deteriorated significantly. The majority of UK DB pension schemes also saw deficits emerge or increase over this period. This was due to changes in economic conditions, particularly a significant fall in the values of equities across the world following the credit crisis.

In June 2010 in respect of the 2009 valuations, we again asked the trustees to explain their position regarding the lengthened 12.5 year recovery plan and the assumptions that had been used to calculate the schemes' funding targets, which we considered to be weak.

The trustees explained that they had negotiated with the employer to increase contributions and reduce the employer's proposed 20 year recovery plan to the 12.5 year recovery plan as submitted. They confirmed that the company had declined to provide security or guarantees to the schemes but that, in their view, this had been somewhat alleviated by the company's agreement to pay increased annual contributions. In March 2011, we acknowledged that the trustees had negotiated increased contributions and a reduction to the company's proposed recovery plan length. Given the proximity of the next valuation we took a pragmatic approach and asked the trustees to focus on three issues for the March 2012 valuation. These were:

- setting the funding target to reflect the strength of the employer covenant
- the length of the recovery plan and
- obtaining additional security when negotiating a back end-loaded recovery plan (ie a recovery plan where greater contributions are due later in the plan)

The independent Chair of trustees at that time confirmed the trustees would take our guidance and specific recommendations for the 2012 valuations into account, and so we closed our funding case based on their reassurances.



FTSE 100
The majority of UK DB pension schemes saw deficits emerge between March 2006 and March 2009 due to changes in economic conditions

2012 valuations

The 2012 valuations should have been completed by 30 June 2013. However, in June 2013, the trustees told us that the valuations would be late. They assured us that, despite the delay, discussions with the employer were progressing, so we considered it reasonable to give them a short extension. We therefore confirmed that we would take no action if they submitted the valuations by the end of September 2013, which they did.

This was in line with our usual practice that, if we receive advance notification that trustees are unlikely to complete their valuation within the statutory 15 month timeframe, we will consider not taking action and allow sufficient time for the trustees to conclude their negotiations with the company. We will only consider this option if we are satisfied there is a realistic likelihood of the parties reaching an appropriate agreement in the near future.

We assessed the 2012 valuations in October 2013 using a set of risk-based criteria that included the size of the scheme, strength of the employer covenant and length of the recovery plan agreed between the employer and the trustees. This assessment raised several concerns, which included:

- the length of the recovery plan (23 years)
- the reduction in the value of deficit recovery contributions compared to the 2009 valuations, which the trustees had agreed to after receiving professional advice on what the employer could afford
- the strength of the employer covenant, as the employer had experienced a downturn in sales and profitability and
- the level of risk in the investment strategy

In January 2014, we asked the trustees to give us further information so we could better understand the schemes' situation and how the trustees and employer had reached the agreed position on the valuations.

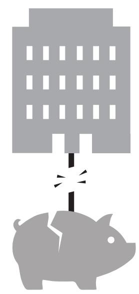
We considered the additional information provided by the trustees and conducted our own financial and actuarial reviews, which were completed by April 2014. Our concerns remained, so in May 2014, we requested a meeting with the trustees to explore possible ways to mitigate the risks. The trustees and their advisers told us they were unable to meet with us until July 2014. However, before a meeting could be held the trustees notified us in June 2014 of a proposal from the company for a business reorganisation, known as Project Thor.

While our internal reviews were an essential step to consider what we understood to be the current situation for the schemes, we acknowledge that we could have been quicker and more proactive by engaging with the trustees without waiting for all internal reviews to be completed given the significant weakening of covenant and the very long recovery plan that was submitted.

The implications for the employer and the schemes from this proposed reorganisation meant that the trustees and employer would not be discussing the valuations to address our concerns. Their focus was now on the new proposal and the likely impact to the schemes. In light of this, our discussions with the trustees and employer also changed focus although our concerns about these particular schemes' valuations and recovery plans remained. We did not confirm that no action would be taken, or that our investigation into the schemes' valuations had concluded. The schemes continued to receive contributions from the employer according to the Schedule of Contributions.

Project Thor

Taveta proposed a solvent business restructuring of BHS in order to avoid the company entering an insolvency process. This proposal involved a Regulated Apportionment Arrangement (RAA), the purpose of which was to separate BHS as the employer from the schemes so that it had no ongoing liability for the schemes. Instead, it would become liable for a new scheme, which would provide benefits lower than under the schemes, but in excess of PPF compensation.



The purpose of the RAA was to separate BHS as the employer from the schemes

With the schemes being dealt with as Phase 1, the scope of Project Thor also included resolution of the company's obligations to landlords and suppliers. Taveta claimed that this, together with the RAA, would help restore the business to financial stability.

The trustees provided us with a summary of Taveta's proposal on 3 July 2014. The key proposals in relation to the schemes were:

- A new scheme would be set up with benefits lower than under the schemes but in excess of PPF compensation. The new scheme would offer the same headline benefits as the schemes but with reduced increases. All members who agreed to accept reduced benefits would be transferred to this new scheme, which would continue with BHS as its employer.
- Eligible members (ie those with benefits of up to £18,000 in value) would be offered a winding up lump sum (WULS).
- The remaining members who did not agree to transfer to the new scheme would remain in the schemes, which would enter the PPF via a RAA[17].

17 **http://www.thepensionsregulator.gov.uk/docs/regulated-apportionment-arrangements-statement-august-2010.pdf**

- A lump sum would be paid into the new scheme that would be equivalent to what the schemes would have received in the event of BHS's insolvency. This lump sum was intended to fund the new scheme to a level that would enable it to continue on a low-risk ongoing basis with no further contributions expected to be required from the employer.

We engaged with the trustees, Taveta and their respective advisers, and on 17 July 2014 a draft clearance and RAA application was submitted to us by Taveta and other parties within the Taveta group of companies. We notified the PPF of this proposal due to the potential implications for them. In the event of us approving the application, the PPF would need to consider whether to provide its non-objection to the RAA.

For a restructuring of this kind, we would expect some sort of mitigation to be paid to the schemes. A range of amounts between £54 million to £80 million was discussed between Taveta and the trustees as a lump sum to be paid into the new scheme. There was no offer of any equity in BHS as we would usually require as part of any RAA.

'For a restructuring of this kind, we would expect mitigation to be paid to the schemes'

Regulated apportionment arrangements

While the best security for a DB pension scheme is a strong, ongoing sponsoring employer, we recognise that in some situations this support may no longer be available, if an employer is at serious risk of insolvency. Where this is the case, it is important for employers, trustees and their respective advisers to explore the available options for the pension scheme.

One such option, which offers an outcome other than insolvency for the employer, is a Regulated Apportionment Arrangement (RAA).[18] In the Project Thor proposal, members would be given the opportunity to transfer to a new scheme with the existing schemes going into the PPF, while allowing the sponsoring employer to continue in business and to support the new scheme.

RAAs are rare and must be approved by TPR. The PPF must also confirm it does not object. The continuation of a scheme (whether the existing scheme or a new scheme) following a RAA is even less common.

We carefully consider RAAs and we will only approve a proposal where it is reasonable to do so and criteria are met, including:

- whether insolvency of the employer would be otherwise inevitable or whether there could be alternative solutions which would prevent it
- whether the scheme might demonstrably receive more from an insolvency dividend than the mitigation on offer
- whether a better outcome for the scheme might be obtained by other means, including using our anti-avoidance powers where relevant
- the position of the remainder of the employer group
- the outcome of the proposals for other creditors.

A clearance application would normally be submitted alongside an application for the approval of a RAA. Both are company-led, voluntary processes.

18 http://www.thepensionsregulator.gov.uk/docs/regulated-apportionment-arrangements-statement-august-2010.pdf

Moral hazard assessment

When considering whether a better outcome for the scheme might be obtained by means other than a RAA, we will examine whether any of our other powers could be used. For example, we have power under the Pensions Act 2004 to issue either a CN or FSD[19], which are often referred to as our ‘avoidance’ or ‘moral hazard’ powers. We ask the trustees to conduct their own moral hazard assessment to consider whether, in their view, our avoidance powers could be used.

Anti-embarrassment assessment

The PPF has its own criteria for assessing whether it would object to a RAA proposal, which includes the PPF being given an equity stake in the surviving restructured company. This is a form of ‘anti-embarrassment’ protection to make sure that, where the PPF has taken on a scheme from a company with a large pension liability, the PPF won’t lose out if the restructured company goes on to become profitable as a result of being released from its pension obligations.

The PPF will generally seek at least 10% equity in the restructured company for the scheme if the future shareholders are not currently involved with the company. It will seek at least 33% if the future shareholders are parties currently involved with the business.

Our consideration of the Project Thor application

We engaged with Taveta and the trustees to investigate whether the Project Thor proposal would meet our criteria for approving a RAA. The estimated return to the schemes on an insolvency of BHS and the level of mitigation to be provided to the schemes were not included in the draft application, so we were unable to conclude whether the Thor proposal would meet our criteria for approving a RAA. However, from the information that was provided, our initial view was that there was insufficient evidence to demonstrate that BHS was inevitably insolvent – ie would become insolvent within the next 12 months.

Taveta explained that BHS had been loss-making for a number of years and was being supported by the wider Taveta group through an inter-company loan from Arcadia Group Limited. Without the proposed restructure, Taveta, as group holding company, stated that it was no longer willing for Arcadia to provide BHS with further financial support. Furthermore, Taveta was of the view that if a demand was made for the loan to be repaid, BHS would be unable to repay it and insolvency was therefore inevitable.

19
See further explanation on our CN and FSD powers at pages 22-23.

Given the significant interconnected nature of trading and operational relationships between the Arcadia and BHS groups at the time, we did not accept that further financial support from Arcadia would be withdrawn or that a demand for the repayment of the inter-company loan would be made against BHS. This position was later confirmed in Arcadia Group Limited board minutes, dated 4 March 2015, that were submitted to the Work and Pensions Select Committee. These stated that ongoing support for BHS by Arcadia would have been provided, although it would only be done so with the benefit of a fixed charge over BHS assets.

The trustees were also not given sufficient information to complete their 'moral hazard assessment' as to whether there could be a better outcome to the schemes if we used our anti-avoidance powers. This assessment would typically involve a detailed legal and business covenant review of the employer and the wider corporate group. The areas we expected the trustees to investigate and obtain independent advice on as part of this analysis included, but were not limited to, dividend payments, prior corporate restructurings, related party transactions, property transactions, financing arrangements and group tax arrangements. The advice trustees receive from independent professional advisers and the trustees' conclusion is a fundamental part of our consideration of any RAA application.

'The advice trustees receive from independent professional advisers and the trustees' conclusion is a fundamental part of our consideration of any RAA application'

At the end of August 2014 we had a conference call with the trustees, who told us they had instructed advisers in February 2014 but were still waiting for further information from Taveta's advisers to fully assess the RAA application. We stressed the importance of the trustees completing their independent moral hazard assessment to establish whether there could be a better outcome for the schemes if we were to use our moral hazard powers.

We also spoke with Taveta, BHS and their advisers about the draft application. We went through the relevant considerations and identified where further detailed information was required, eg the estimated return to the schemes on an insolvency of BHS.

On 4 September 2014, we sent the trustees a detailed letter which acknowledged that, although the trustees' covenant adviser had indicated in its report that it did not consider that there would be grounds for us to use our moral hazard powers "based on the information provided and discussions held", we believed there were additional areas which needed further analysis. We identified various areas where we considered further analysis was required in order to fully complete a moral hazard assessment.

On 24 September 2014, Taveta's advisers emailed us to say that Taveta wished to "pause" the draft application so it could focus on the critical Christmas trading period, and reconsider options for the business in the New Year.

The draft application was formally withdrawn at the beginning of October 2014 at our request. We considered that BHS's circumstances were likely to change, in which case a new application would be required. Not only would over six months have passed since the draft application was made in July but, as the reason behind the pause was to focus on Christmas trading, this would almost certainly have meant that at least some of the facts relevant to the RAA application would have changed.

We made it clear that any new application made in the New Year would be considered in the usual way. Taveta stated that it was happy to withdraw the application on the basis that this would not cause any delays if there was then a new application in January 2015.

RAAs and information disclosure

RAAs are initiated by the applicant. As a result, given that this is something that they are asking us to consider, we expect them to provide the necessary information. We would not typically look to use a statutory notice[20] to compel the disclosure of information in these circumstances.

It is important for trustees to be fully engaged in such applications and we will actively seek the views of the trustees as part of our consideration.

20
Section 72,
Pensions Act 2004.

Run-up to the sale of BHS

After the RAA application was withdrawn, our case team decided that further work on the outstanding valuation would remain on hold until the beginning of 2015, as we expected to receive a new proposal at that time. On 8 January 2015 we contacted the trustees requesting an update in relation to Project Thor, and were informed that Taveta's advisers would be in touch. Taveta's advisers called us on 14 January to discuss Project Thor and, after some preliminary discussion, we told them that we were unable to give a formal view as we had not yet received an updated application.

On 26 January 2015, we became aware of media reports of a possible sale of BHS and were contacted by the trustees, who we asked for more information.

On 28 January 2015, the trustees advised us that they had still not received all of the outstanding information requested from the company necessary to complete their moral hazard analysis.

On 6 February 2015, Taveta's advisers contacted us to inform us about Taveta's decision to sell BHS. The trustees were also contacted by Taveta about the potential sale, and they had a meeting with Taveta and the prospective purchaser on 19 February 2015.

Where there is a potential sale of a sponsoring employer, we expect the employers to provide trustees with all the information they need to make an assessment of the likely impact of the sale on the employer covenant. However, in this case, despite concerted efforts by the trustees and their advisers, they were not given enough information to fully assess the impact of the sale on the employer covenant and, therefore, on the schemes.

Following media speculation about the sale of BHS, we requested an urgent meeting with Taveta

On 3 March 2015, following further media speculation about the sale of BHS, we requested an urgent meeting with Taveta. The meeting was held on the following day, when we discussed the proposed share sale of BHS by Taveta (due to complete on 9 March 2015) and the potential for the purchaser, identified only as 'Swiss Rock', to execute a modified version of Project Thor.

We sought to understand what the impact of the proposed sale would be on the employer covenant and the schemes. At the meeting with Taveta, we raised the prospect of, and requirements for, a RAA along the lines of Project Thor. We highlighted that if the sale was a solvent sale, it would be difficult for us to understand how Taveta had demonstrated that insolvency could then be assumed to be inevitable. During our discussions, we made it clear that we could not give comfort that a RAA would be agreed and that Taveta should not represent to the buyer that there was any agreement to this by TPR.

On 5 March 2015, we sent a detailed letter to Taveta setting out the information it needed to provide to us so that we could properly consider a RAA on an urgent basis. However, no further information was provided. Neither we nor the trustees were therefore able to assess the merits of a potential application, or understand the impact of the sale on the employer covenant and the schemes. We had no further contact with Taveta before the sale of BHS concluded on 11 March 2015.

The sale and TPR's investigation

The sale of BHS to Retail Acquisitions Limited (RAL) completed on 11 March 2015. Despite repeated attempts by us, the trustees and their advisers to obtain information from Taveta about the potential sale, (including at the meeting only the week before and in our letter of 5 March), we only learned that the sale had actually concluded when it was publically announced on 12 March 2015. We were not given any details about the terms of the sale or confirmation of the buyer before this announcement.

The announcement itself did not provide us with any clarity so we immediately contacted the trustees, who told us they had been unable to obtain any meaningful information. This only increased our concerns that the position in relation to the schemes may not have been appropriately addressed.

Immediately after the sale was announced on 12 March 2015, we made contact with Taveta and BHS (under new ownership, but still with responsibility for the schemes) to confirm that we were considering the impact of the sale on the schemes. In our letters, we noted that we were engaging with the employer and the buyer to understand the impact of the transaction on the schemes, and that we might need further information from Arcadia in due course. The letters also requested that no records relating to BHS be destroyed.

As part of the sale, Arcadia wrote off £216m of a £256m inter-company debt balance which we were informed was owed by BHS to Arcadia. In addition, it was agreed that Arcadia would be granted fixed and floating security over BHS in respect of the £40m which remained outstanding. The benefit of the secured outstanding amount was initially proposed by Arcadia to be provided to the schemes as part mitigation in any potential future compromise – however, the benefit of this security was never assigned to the schemes.

Certain property transactions also took place as part of the sale, including the acquisition by BHS Properties Limited of Carmen Properties Limited and its subsidiaries (the Green family vehicle that previously acquired properties from BHS in 2001) for £1 from a further Green family company based outside the UK. While £30m of its debt was discharged by the Green family as part of the terms of the sale agreement, Carmen Properties Limited was itself still subject to a significant debt burden of £70m when sold to BHS Properties Limited.

We were informed that, on completion of the sale, BHS would be left in a position of having £63.5m cash and the potential of £119.1m of unencumbered properties (a total of £182.6m), with Arcadia guaranteeing the continuation of further loan facilities to the value of £110m.

Taveta also committed to pay pension contributions of £5m per annum into the schemes for the next three years, with matching amounts to be paid by BHS. These amounts combined would meet the amounts due under the 2012 valuation recovery plans for those three years, although the 2015 recovery plan had still not been agreed.

'We immediately opened an investigation to establish whether we should use our anti-avoidance powers'

The anti-avoidance investigation and consideration of our CN/FSD powers

When we learned that BHS had been sold, we immediately opened an investigation, with a view to establishing whether we should use our anti-avoidance powers.

Our investigation sought to establish whether it was appropriate to exercise our anti-avoidance powers to seek a CN and/or a FSD in respect of the schemes. We therefore needed to examine the long and complex history of BHS, ascertain the circumstances surrounding its sale, and establish the impact of events on the schemes, both before and after the sale.

The investigation at that stage broadly focused on the following areas:

- the history of how BHS and the schemes were run
- the events leading up to the sale
- the impact of the sale on BHS and the schemes, and
- the impact of post-sale events on BHS and the schemes

Anti-avoidance powers

We have power under the Pensions Act 2004 to issue a CN under sections 38 and 47 and/or a FSD under section 43, which are often referred to as our anti-avoidance or moral hazard powers.

Contribution notice

A CN requires a cash payment to be made to a scheme (or, in some circumstances, to the PPF by the respondent(s), which might be the scheme's sponsoring employer or a person(s) connected to or associated with the employer (including individuals).

A CN creates a debt due from the respondent(s) to the trustees or managers of the scheme, payment of which can be enforced by those trustees or managers (or the PPF, where the scheme is in PPF assessment). Alternatively we may enforce on their behalf.

In order for a CN to be issued under section 38 of the Pensions Act 2004, we must be of the opinion that the respondent(s) was party to an act, or failure to act, which either meets the 'main purpose' test or the 'material detriment' test.

- The 'main purpose' test is that one of the main purposes of the act (or failure to act) was either (a) to prevent the recovery of all or part of a debt due to the scheme under section 75 of the Pensions Act 1995, or (b) to prevent such a debt from becoming due, or reduce or compromise that debt.
- The 'material detriment' test is met where we are of the opinion that the act or failure has detrimentally affected in a material way the likelihood of accrued scheme benefits being received by or in respect of members.

We must also be of the opinion that it is reasonable to require the respondent(s) to pay the sum specified in the contribution notice. This will include, where relevant, consideration of issues such as the degree of involvement of the respondent(s) in the act or failure to act; the relationship the respondent(s) had with the employer; and the value of benefits which the respondent(s) receives or is entitled to receive from the employer.

We can initiate our Warning Notice procedure seeking a CN up to six years after the act in question occurred.

A CN may also be issued under section 47 of the Pensions Act 2004 following non-compliance with a FSD.

Financial support direction

A FSD requires financial support for a scheme to be put in place by the respondent(s).

If a FSD is issued by the DP, the form and amount of any financial support will then need to be proposed by the respondent(s) concerned and approved by us. If we do not approve the financial support offered, then the law allows us to take further action to impose a CN under section 47 of the Pensions Act 2004 to require specified support to be put in place.

As with CNs, the respondent(s) can be the scheme's sponsoring employer or a person(s) connected to or associated with the employer. In contrast to CNs, FSDs can only be issued to individuals in specific limited circumstances.

In order for a FSD to be issued, we must be of the opinion that the scheme's employer was either (a) a service company or (b) 'insufficiently resourced', at a time chosen by TPR (referred to as the 'relevant time').

Being 'insufficiently resourced' requires that an employer's resources are valued at less than 50% of its estimated section 75 debt[21] to the scheme at the 'relevant time', and that there is an associated or connected entity (or entities) that have sufficient value to make up the difference. The respondent(s) must have been either an employer in relation to the scheme or a person connected to or associated with the employer as at the relevant time.

We must also be of the opinion that it is reasonable to require the respondent(s) to provide financial support. This requires, where relevant, consideration of similar matters as noted above in relation to contribution notices.

We can initiate its procedure seeking a FSD up to two years after the 'relevant time'.

Information-gathering

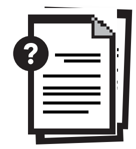
In all investigations it is essential that any information and documentation which may be pertinent to the investigation is preserved. Therefore, on opening our anti-avoidance investigation, we immediately wrote to everyone whom we considered at that stage was, or may have been, in possession or control of relevant documentation and information, alerting them to our investigation and asking them to keep, preserve and not destroy anything in their possession or control which we may have required.

21
The section 75 debt is the amount of money estimated by the scheme actuary to be required to secure the scheme's liabilities by purchasing life assurance annuities for each member of the scheme to pay their benefits in full.

Section 72 information-gathering power

Section 72 of the Pensions Act 2004 gives TPR a wide-reaching power to require the disclosure of information and/or documents which are relevant to the exercise of our functions. A request can be issued to anyone who appears to us to be in possession or control of any such information/documents. Failure to comply with a Section 72 request is a criminal offence.

Over the course of the entire BHS investigation, we issued 123 formal notices requiring information using our statutory s72 information-gathering power. These notices were not only issued against the main parties involved with BHS but also to their professional advisers, connected parties and to banking and financial entities and individuals.



123
s72 notices issued using our information-gathering power

Use of the section 72 power was important in this case. In the early stages it allowed us to gather considerable information which provided an understanding of the events that had taken place. As the investigation continued we were able to be more targeted in the information we requested and this allowed us to focus on the central areas that would form our case, as well as discard areas of investigation that we had originally considered might be pertinent.

Our information-gathering powers

The focus of a s72 notice needs to balance competing factors:

- a wide-ranging s72 notice gathers a correspondingly wide response, in terms of information and documents. This helps us understand the wider context but takes longer to review.
- a narrow, targeted, s72 notice can be issued with a shorter timeframe for response and may be quicker to review, but generally results in a greater number of notices being required to obtain all the information/documents that might be needed.

We encourage the recipient of a s72 notice to engage with us early if they have any questions relating to:

- the scope or terms of the notice.
- the search process to be undertaken or underway and the manner or timing of production of documents.

We welcome active co-operation from parties issued with a section 72 notice and expect them to be willing to discuss any issues in an open and transparent manner, so as not to impede our investigation.

Tactics that we suspect are being used to delay or impede an investigation will be dealt with robustly.

Our approach is to actively take action to address what we believe to be non-compliance with s72 notices, which may include seeking a criminal sanction.

Information-gathering was a wide ranging and complex part of the investigation and, from the perspective of the number of parties that we approached for assistance and information, the scale of the exercise was unprecedented in terms of any we had carried out before. This included demands for access to, and subsequent review of, almost 100,000 documents, as well as meetings with various parties and stakeholders. We used specialist technology to help us review the large volume of documents we received and to analyse the responses for any gaps in the information we had received, and/or to identify additional areas of investigation.

100,000
documents reviewed
during our investigation

We sought expert advice where necessary to inform our developing case and to test any emerging assumptions. This provided us with an independent view and was extremely helpful in focusing certain aspects of the investigation.

Challenges faced during the investigation

This complex investigation required us to interact with a large number of different individuals and corporate entities, many of whom were required to provide information and documentation, or assistance to us.

On the whole, our s72 notices were generally complied with but, as with any investigation, recipients often sought extensions or raised specific issues with us if they found the timeframe or any other aspect of the notice challenging.

We recognise that the cost and resources required to comply with a s72 notice can be an issue for some, but we need to ensure compliance in order to regulate effectively.

In parallel with our continuing investigations we held discussions and negotiations about the schemes with the trustees, the employer, Sir Philip Green and his advisers, and representatives of Taveta Investments Limited and Taveta Investments (No.2) Limited. We also continued liaising with other stakeholders, in particular the PPF and the Department for Work and Pensions (DWP).

Our approach to investigations

At the early stages of any investigation, we will be robust in requiring the trustees and/or the employer to provide information, documents or analysis as requested.

We will approach any other parties we consider relevant where their assistance is seen as necessary or desirable to assist our investigation.

Where appropriate we will use specialist technology to manage and review large volumes of documents received.

We will also use independent experts to assist the case team in both informing the direction of the case and speeding up progress to reach the conclusion of the investigation.

Post-sale events

Immediately after the sale we met with the buyer, RAL, and the trustees and their respective advisers to understand the impact on the schemes. We continued in discussion with them over the months following the sale, which included meetings with the BHS directors appointed by RAL, and also with Arcadia.

Arcadia was still involved with the BHS business after the sale. This was due to:

- ongoing central 'shared services' with BHS in accordance with the terms of the Transitional Services Agreement
- its position as a secured creditor
- the presence of some Arcadia-brand concessions in BHS stores from the period of Taveta's ownership of BHS, which continued after formal concession agreements were entered into with RAL.

During this time, the trustees were also having discussions with BHS about the 2015 scheme funding valuation.

CVA and administration of BHS

On 3 March 2016, almost a year after the sale, the first formal steps were taken by the BHS directors to launch a Company Voluntary Arrangement (CVA)[22] in respect of BHS. The CVA imposed rent reductions on landlords of some BHS stores to address lease costs that were negatively impacting the business, to improve the financial position of BHS, and attempt to fulfil the 'turnaround strategy' for the business, enabling BHS to trade itself out of difficulties.

It was noted on the face of the CVA documents that addressing the costs of the property leases was only one of a number of steps needed to achieve this turnaround – the other key steps were a resolution of the pension liabilities, securing additional financing for the business, and further reduction of BHS's costs. As a consequence of the launch of the CVA the schemes automatically entered into a PPF-assessment period[23] as this is a qualifying insolvency event. We met regularly with the then BHS directors and the trustees, as well as continuing our ongoing work with the PPF, to pursue a resolution for the schemes.

22
A CVA is an insolvency process under Part 1 of the Insolvency Act 1986 by which a company can compromise or reschedule some or all of its unsecured debts. It is generally used to allow companies an opportunity to trade out of their financial difficulties.

23
An assessment period is the period after a qualifying insolvency event has occurred in relation to an employer of an eligible scheme, during which the PPF will assess whether or not it must assume responsibility for the scheme. See s132 of the Pensions Act 2004.

The Pension Protection Fund (PPF)

The PPF is a public corporation created by the Pensions Act 2004, whose main function is to provide compensation to members of eligible DB pension schemes when there is a qualifying insolvency event in relation to the employer, and where there are insufficient assets in the pension scheme to cover PPF levels of compensation.

The PPF is funded by compulsory annual levies on eligible schemes.

Although the CVA was launched, with the landlords unanimously voting for a reduction in the future rents payable to them by BHS, the BHS directors filed for administration on 25 April 2016 by reason of insolvency. Despite the successful launch of the CVA, the board of BHS Limited failed to secure adequate additional finance to fund the turnaround and, after discussions with Arcadia as a secured creditor of BHS, agreed to put BHS Limited into administration.

Philip Duffy of Duff & Phelps was suggested as the insolvency practitioner, and he and his colleague Benjamin Wiles were appointed joint administrators of certain companies in the BHS Group by the directors on 25 April 2016. They took over from the BHS directors in managing BHS's affairs, which included responsibilities as the employer to the schemes.

'We remained available to review any proposals that might be forthcoming from a potential buyer'

The conclusion of our Warning Notice investigation

By the time BHS filed for administration in April 2016, we were reaching the closing stages of our investigation for the purposes of preparing Warning Notices, but still had certain avenues to explore. Those aspects became all the more critical as a result of the insolvency.

The investigation, crucial as it was, also had to take account of all attempts by the administrators to try to secure an alternative outcome for the employer (and consequently the schemes), which included attempts to achieve a sale of the business as a going concern. We remained available to review any proposals that might be forthcoming from a potential buyer, who might also be seeking clearance as part of the terms of the deal.

Ultimately, despite the attempts of administrators to secure a sale of BHS as a going concern, and of the various parties to achieve a different outcome, BHS ceased trading in August 2016. Given the funding position of the schemes and without an ongoing employer or the prospect of one, our investigation continued to seek to secure a better outcome for the BHS members than the schemes transferring to the PPF at the end of the assessment period. Our investigation resulted in Warning Notices being issued on 2 November 2016.

The Warning Notices

Our approach to CNs and FSDs

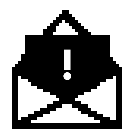
If we conclude that the use of the CN or FSD powers may be appropriate, our case team will draft a Warning Notice, setting out our case, and issue it to the potential respondent(s) of the action. The Warning Notice will also be served on any other entity or person we believe is a 'directly affected party', for example the employer and the scheme's trustees.

After we issue the Warning Notice, the respondents and directly affected parties can respond, and the case team may investigate further and decide whether to refer the case to the Determinations Panel, who will then decide whether or not it is appropriate to issue a CN and/or FSD. After the Determinations Panel has issued its determination notice in the case, its decision can be referred to the Upper Tribunal for a re-hearing. Any appeals thereafter on points of law will be heard first by the Court of Appeal, and then by the Supreme Court.

The respondents

It was our view that we had sufficient documentary and expert evidence to issue Warning Notices to various respondents, seeking both CNs and FSDs.

The respondents to the CN case were individuals or companies who we believed were parties to an 'act' that had caused material detriment and/or the main purpose of which was to avoid liability to the schemes. Consequently, we issued Warning Notices stating our case to Sir Philip Green, Taveta Investments Limited and Taveta Investments (No. 2) Limited, as well as to Dominic Chappell and Retail Acquisitions Limited, as buyers of BHS.



We had sufficient documentary and expert evidence to issue Warning Notices

As noted at the outset of this report, because settlement was reached, Sir Philip Green, Taveta Investments Limited and Taveta Investments (No. 2) Limited have not responded to our findings or to the allegations in the Warning Notice. In addition, the settlement reached was expressly on the basis of no admission of liability on the part of Sir Philip Green or the associated Taveta companies.

Our case was that Sir Philip Green, a director of the BHS group companies until 11 March 2015, was a key decision-maker in relation to its financial and business affairs from the time of its acquisition by the Green family in 2000. We also alleged that the Taveta group was, at all material times, majority owned by the Green family, with Sir Philip Green also a key decision-maker in relation to its financial and business affairs and those of each of its subsidiaries and that, when Taveta purchased BHS in 2009, this brought BHS into the wider Green family's Taveta group.

Taveta also owns Arcadia, and the purchase of BHS was intended to turn around BHS as a loss-making business, and provide savings for BHS and Arcadia through a shared management structure, with central services provided by Arcadia and re-charged to BHS. It was also intended to increase profitability, primarily from the introduction of Arcadia-brand concessions into BHS stores. BHS's store portfolio had significant floor space and the insertion of Arcadia concessions was intended to increase customer footfall and turnover.

Accordingly, our case was that Taveta, Arcadia, and the Green family as owner, were instrumental at all material times in the progress of the BHS business, and at all key stages in its reorganisation and integration into the Taveta group.

Our Warning Notice alleged that, after the sale in March 2015, Arcadia and its parent Taveta (and, by extension, the Green family and Sir Philip Green) still benefited from BHS and key elements of the relationship established during the period of Taveta's ownership and control. We alleged that this was both through continued provision of Arcadia's central 'shared services' arrangements and the continued presence of Arcadia concessions in BHS stores. It was also alleged that after the sale, Sir Philip Green, Taveta and Arcadia continued to have involvement in the management of BHS, and both sought and were given updates as to the implementation of the 'turnaround strategy' and developing business plan for BHS. We argued that this was further highlighted by their continued involvement with the pension schemes, which eventually culminated in Sir Philip Green's public expression of a desire to achieve a voluntary solution for the schemes and a satisfactory outcome for the members, made on 9 September 2016.

'We recognise that the increase in the size of the deficit of the schemes was in part due to economic and demographic factors'

Our Warning Notice also alleged that this involvement in the BHS business had also historically extended to involvement with the schemes and, over the first nine years from the acquisition of BHS by Green family companies, Sir Philip Green had taken an active interest in both schemes' funding. Our position was that this continued after BHS transferred to Taveta, and included oversight of the negotiations with the schemes' trustees over employer contributions.

Our case was that from having a surplus on an ongoing basis at the time of acquisition in 2000 until the 2006 valuations, the schemes' funding levels dropped to their positions of significant deficits at the time of the sale. As already acknowledged, we recognise that the emergence and increase in the size of the deficit of the schemes was in part due to economic and demographic factors which have affected nearly all DB schemes.

Our Warning Notice alleged that, during this time, Sir Philip Green was personally involved with the schemes, including investment issues, the 2012 valuation and recovery plan negotiations, and the appointment of new trustees and advisers. We also alleged that this extended to Sir Philip Green being the driving force behind Project Thor (and the decision to pause it) as well as behind the sale of BHS itself which, we alleged, was completed without having provided appropriate mitigation for the schemes.

Based on our investigations, we considered who it would be reasonable to pursue for a CN and/or FSD. We were of the view that Sir Philip Green, and the Taveta group companies owned by the Green family, had the most influence over BHS and the schemes, and had been the key decision-makers in relation to BHS.

We issued the Warning Notices on 2 November 2016. Given the protracted history and complex issues in the case, each Warning Notice was over 300 pages long and set out the background, specific evidence and legal arguments as to why we considered it reasonable for the respondents to have to support the schemes. The Warning Notices were also accompanied by a bundle of supporting evidence and expert reports amounting to approximately 13,000 documents in total.

Warning Notices issued on 2 November 2016

We gave careful consideration to the support we should seek for the schemes and we sought a CN from Sir Philip Green and Taveta Investments (No 2) Limited. In the Warning Notice, we argued that the statutory tests for a CN were met for each of them in relation to the 'act' of the sale of BHS. We argued that the main purpose of the sale was to postpone BHS' insolvency to prevent a liability to the schemes falling due while it was part of the Taveta group of companies ultimately owned by the Green family, and/or that the effect of the sale was materially detrimental to the schemes. We argued that it was reasonable in all the circumstances of the case to impose a CN, given the overall history of control and involvement with the BHS business and with the Schemes.

We also sought a FSD from Taveta Investments Limited and Taveta Investments (No. 2) Limited. In the Warning Notice, we argued that the statutory tests for a FSD were met for the former parent companies to provide financial support to the schemes. When deciding on the reasonableness of a FSD, we considered the history of control and involvement with the BHS business and with the schemes, the benefits secured during the period of ownership of BHS and their significant resources.

Settlement discussions and outcome

Throughout the course of our investigation we continued to engage with Sir Philip Green, representatives for Taveta Investments Limited and Taveta Investments (No.2 Limited), the trustees, the employer and the PPF regarding potential settlement. Our case team conducted these discussions on a 'without prejudice' basis and without interruption to the investigation. Settlement discussions were conducted with involvement from senior management and oversight was provided by our Executive Committee. All parties made considerable efforts to reach an outcome that would be better for members without the delay, cost and inherent risks of protracted regulatory proceedings.

Before the Warning Notices

Arcadia proposed three offers in February and March 2016, as a way of supporting the aims of the CVA and to help BHS avoid a subsequent insolvency.

We rejected the first two offers because we considered that the amounts offered were insufficient. We also made clear, and continued to make clear throughout the discussions, what we required in order to reach a settlement. We received a further offer in March 2016 which built on the work that had been undertaken during Project Thor and involved a new pension scheme being established to which the members of the schemes could transfer. However, we rejected this offer as we considered that it lacked sufficient detail and, more fundamentally, was insufficient to ensure that the new scheme could continue on an ongoing basis with little or no supporting covenant.

Discussions continued about what an appropriate solution would be. We were clear that any settlement must provide a good outcome for members and protect the PPF. Therefore, we worked closely with the schemes' trustees and the PPF throughout.

While a further offer was made at the end of October 2016, and even though we recognised that efforts had previously been made by Sir Philip Green, Taveta and their advisers to reach a settlement, we concluded that we had not received a sufficiently comprehensive proposal in respect of the schemes. We had unresolved concerns about the ongoing risk that the structure of the proposed new scheme would represent to the PPF. Despite these concerns, we concluded that the proposal represented an opportunity to continue constructive dialogue with a view to reaching a settlement, and discussions continued.

'We had not received a sufficiently comprehensive proposal in respect of the schemes'

Throughout the discussions, we maintained a parallel track of pursuing our ongoing investigation into the use of our powers. While we may in appropriate circumstances be willing to enter into discussions to resolve the problem without the use of formal enforcement, we will not let these discussions deter us from establishing our case or allow them to erode time and resources to the detriment of our case. In this case we felt that it was appropriate to issue the Warning Notices even though settlement discussions were also taking place.

Key message

We are open to consider offers of settlement but we will not be distracted or deterred from continuing our investigations.

After the Warning Notices

A key goal throughout was to pursue our investigation in tandem with any settlement discussions, to demonstrate that we would not be deterred from pursuing regulatory action while we remained open to an appropriate settlement. Issuing the Warning Notices was a critical step in support of these parallel aims.

Discussions continued with Sir Philip Green, his advisers and all relevant parties, and we reached agreement on 28 February 2017 that led us to stop the regulatory action against Sir Philip Green, Taveta Investments Limited and Taveta 2 Limited.

The settlement – headlines

£343m has been placed in a fully independent escrow account to fund a new scheme. An additional amount of up to £20m is being held in other accounts to cover expenses and the costs of implementing the voluntary member options and the new scheme.

Existing members of the schemes now have three options:

- to transfer to the proposed new pension scheme
- to opt for a lump sum payment if eligible
- to remain in their current scheme (which is expected to eventually transfer to the PPF)

The lump sum payment option will be available to members with small pots of up to £18,000 in total value. Those who choose not to take a lump sum and opt to transfer to the new scheme will be entitled to the same benefit structure as all other members. The new scheme will also be eligible for the PPF.

The starting pension (on transfer to the proposed new scheme) will be the same as with the original BHS schemes. Members under 60 who transfer to the proposed new scheme will therefore not be subject to the 10% reduction in their starting pension that applies to members in the PPF. Benefits payable in retirement and built up before April 1997 will increase at 1.8% per year. This compares to nil increases for pre-1997 benefits provided within the PPF.

Each member will be notified by the BHS schemes' trustees about the options available to them. In order to support members facing potentially difficult financial decisions, we insisted on a free helpline offering members support with their options

If the proposed new scheme structure cannot be implemented within 15 months, £343m will be transferred to the original BHS schemes. This amount is expected to be sufficient for the trustees to purchase annuities for all members at a level in excess of the PPF compensation.

Unusually in this case, we granted clearance and entered into a settlement deed with all the relevant parties involved in the settlement discussions. The deed included details about the implementation and structure of the new scheme that will be set up. The reason the structure was included was because it was a key part of applying the settlement monies in such a way as to ensure that members would receive the best possible outcome in terms of their benefits, while also being consistent with the overall settlement objectives that are set out in the following section. It was therefore key that the ongoing structure was understood and agreed to by all parties.

On average, the new scheme will offer members benefits of around 88% of the value of their full BHS scheme benefits. How much individuals receive will vary according to their particular circumstances including their age, their length of service with the scheme, and when that service occurred. For the vast majority of members (more than 99%), the value of benefits offered in the new scheme will be 80% or more of the value of their full BHS scheme benefits. The benefits that the vast majority of transferring members are expected to receive are above PPF level.

Once the £343m, along with any additional amount in respect of member options, is paid into the new scheme, the scheme is expected to be well-funded[24]:

- with a surplus of around £100m on an low-risk ongoing basis[25]
- with a surplus of around £80m to £90m on a PPF basis[26] (depending on the number of eligible members who chose to take a lump sum payment).

Our objectives for a settlement

In concluding that the settlement was sufficiently strong to allow us to cease our regulatory action, we were focused on two of our statutory objectives – to protect members' benefits and to protect the PPF. Therefore we ensured that:

- the new scheme would offer benefits that were higher than those provided for by PPF compensation and as close as possible to those promised under the BHS schemes
- the new scheme would be PPF eligible
- the new scheme would be funded in excess of the level required to meet PPF compensation[27]
- the new scheme would be sufficiently well funded on a 'low risk' funding basis to ensure that it had an extremely high chance of being able to meet all the members' new scheme benefits in full
- the new scheme would have robust governance and controls in place with three independent trustees

24
These calculations are as at 19 December 2016, the 'strike date' at which the levels of members' benefits in the new scheme were set.

25
The low-risk basis includes an allowance for future investment returns in line with gilt yields plus 0.5% p.a. along with prudent assumptions for inflation and mortality.

26
Using assumptions for a valuation in accordance with Section 179 of the Pensions Act 2004.

27
Section 179, Pensions Act 2004.

During the settlement discussions, one of our objectives was to ensure members' benefits were as close as possible to the benefits they could have expected from the schemes. We treated all classes of members equally in this regard and consequently, we did not consider it appropriate to cap benefits in the new scheme by reference to the levels of compensation offered by the PPF. The impact of this is that those members who would have been subject to the PPF compensation cap will receive a higher proportion of benefits in the new scheme compared with the compensation they would have received from the PPF.

The trustees of the schemes and the PPF worked with TPR in support of the settlement that was reached. The trustees continue to work with us and the PPF to implement the new scheme.

Our considerations for settlement in anti-avoidance cases

Our high level objective for any settlement will be that it must offer a fair outcome for members and the PPF, consistent with our assessment of the merits of the case.

If long term support for a scheme is required (rather than a single cash contribution), any settlement proposal should be viable and sustainable in the long term.

When a solution is offered by the respondents of regulatory action, we have to decide whether it is strong enough to justify stopping our action on the case.

We have to balance the proposed settlement outcome against what we might achieve by pursuing action, with the risk of a prolonged period of legal challenge in the courts, and the delay and uncertainty that this would bring to members.

In undertaking this necessary 'balancing exercise', each case will offer its own unique challenges and circumstances. Therefore an acceptable settlement for one case may be very different for another case, even if the same regulatory power is being used.

In general, we will take into account the factors detailed in the table below. However no one factor is determinative and we will make our decision taking all relevant factors of an individual case into account.

For us to be able to properly understand and assess the merits of a settlement proposal it has to be sufficiently detailed and supported with evidence and analysis. It may require actuarial or investment modelling, legal analysis and, depending on complexity, a detailed project plan. We may require the trustees and/or the respondents to produce any necessary evidence that supports the proposal.

Factor	Our view
Protection of member benefits	We will consider the position of the members following the proposed settlement against the position that might be achieved following regulatory action.
Protection of the PPF	We will consider the position of the PPF following the proposed settlement against the position that might be achieved following regulatory action.
The nature and strength of our case	In considering a proposal for settlement we will take into account what we believe could realistically be achieved if regulatory action was pursued.
The possible duration of regulatory action	A case may take years to reach a conclusion, especially if subject to appeal. We take the view that it is not in any stakeholder's interests to engage in protracted regulatory action when a more immediate and appropriate solution is available.
The ongoing sustainability of the solution	Where the respondent presents a solution involving an ongoing scheme, we would expect that proposal to demonstrate that this is viable and sustainable in the long term. This includes: ▸ that the ongoing scheme will be supported by a suitable employer covenant. If no meaningful covenant is available then the structure will need to be carefully considered to ensure that appropriate protections are in place. ▸ that the scheme will not be exposed to any unnecessary investment risk.
Long term prospects of the proposal	Where there is an ongoing scheme, we will examine the long term impact of a settlement proposal and its effect on member benefits/PPF. Where possible, a solution that can achieve buy-out[28] for the ongoing scheme in the short term is most desirable.

28
Where an insurance company takes over responsibility for paying all the members' benefits of a scheme for one-off payment.

Settlement – conclusion

Above all, while the settlement reached in this case was concluded in relation to the specific facts and circumstances for the schemes, it raised a number of unique and exceptional points of principle, and required the full involvement and support of the whole organisation to ensure that we secured an appropriate outcome, not just 'right now' but in the longer term. This also included detailed consideration of all the wider implications that this settlement might have for our regulatory functions in the future and to ensure that we had taken into account any potential 'unintended' consequences.

TPR senior management and its Executive Committee were fully involved at all stages of the process. In particular, they conducted a full and detailed appraisal of all the proposals put forward. We had to be assured and satisfied that the settlement met our statutory objectives to protect the benefits of members and protect the PPF, as well as ensuring that it would not result in negative consequences for our wider operations, in the near and longer term.

The achievement of successfully securing the settlement in this case, and the protections and benefits which it will deliver for members and the PPF, reflect the culmination of nearly three years of significant work and commitment from all parts of our organisation.

'Securing the settlement reflects the culmination of nearly three years of work and commitment from all parts of our organisation'

Doing things differently

BHS has been a highly significant case which has placed the activities of TPR, the parties involved, and the regulatory and legislative framework for DB pensions under the microscope. We are committed to continuous improvement and to learning from each of the phases of our engagement.

The events surrounding the sale of BHS and our subsequent investigation into the impact on the BHS pension schemes came at a point when we were already evaluating our experience of regulation over the past decade: reflecting on how the key challenges and issues we face and requirements of our role have changed; assessing what has worked well; and what could be changed or improved for the future.

The case, and wider public interest surrounding it, have provided a further opportunity to reflect on our approach to regulation. In this section we identify a number of lessons learned from this particular case, and from the operation of the DB framework and our broader casework experience in recent years. A key regulatory tool for us is publishing reports on our case interventions in order to provide greater clarity to our stakeholders and the regulated community on what they can expect from us now and in the future.

Scheme funding and valuations

We are continuously refining our approach to regulating the funding of defined benefit schemes and recognise the importance of being upfront in our expectations of pension trustees and sponsoring employers. Since 2012, we have published an annual funding statement setting out our key messages to those schemes completing their triennial valuation. We have also engaged with schemes that we believe present the greatest risk before they submit their valuations. This helps us influence their approach and address any challenges and issues at an early stage. We also published a revised DB funding code and associated documents in 2014, further clarifying our regulatory approach to DB scheme funding.

Having reviewed our engagement with BHS and with other schemes over a number of valuation cycles, key areas where we recognise that we could have performed better are the timeliness of our engagement and the clarity of our communications. In particular, we recognise the importance of setting out clearly and robustly our expectations to pension trustees and sponsoring employers in cases where the affordability of deficit repair contributions is an issue for the employer. We have reduced the time it takes to conclude funding cases, and our 2016-2017 perceptions survey shows we have improved the rating of TPR being clear on our reasons for opening recovery plan cases (from 59% to 78%), with satisfaction with management of such cases remaining high (78%).

We are committed to further improvements and have taken steps to:

- Secure additional funding from DWP to address challenges across a number of areas including increasing our frontline resources to undertake higher volumes of casework more quickly and proactively (as set out in our Corporate Plan 2017-2020).
- Review our internal processes and ways of working, implementing a range of internal and externally published KPIs to ensure we continue to work more efficiently, are more outcome-focused, and that we communicate more clearly and effectively.
- Increase the number of proactive funding cases in order to influence the outcome in advance of valuations being agreed and submitted to us.
- Recruit additional staff to our case teams in support of this proactive casework approach.

We are also pursuing a number of very advanced investigations under s231 of the Pensions Act 2004 to challenge imprudent technical provisions and/or inappropriate recovery plans. In such cases, the prospect of TPR exercising its funding powers may be sufficient to bring about a suitable resolution but we are committed to making greater use of our s231 powers and, where necessary, bringing cases before the Determinations Panel.

Avoidance investigations

Avoidance activity by employers is rare, but where it occurs it can result in members receiving a lower pension, increased calls on the PPF, and undermine confidence in pension saving. We take potential avoidance activity very seriously and recognise the importance of our intervention as a deterrent and to seek redress for members and the PPF.

In light of our experiences from the BHS case and other anti-avoidance investigations, we would highlight:

- We will not hesitate to investigate, where appropriate, when we suspect that action has been taken to weaken the position of a DB pension scheme.
- We are committed to using our statutory powers more often where we believe there is avoidance activity, and our new DB enforcement KPI has been introduced to support this.
- We will be smart in the use of our resources and technology, focused in our use of investigatory powers, and will obtain external expert assistance where appropriate.

Our approach to settlement in avoidance cases

The settlement with Sir Philip Green for the BHS schemes is the largest of its kind TPR has reached to date. In total, we have secured more than £1 billion for pension schemes through the use of settlement in avoidance cases. It is an important part of our regulatory toolkit and allows us, in appropriate circumstances, to obtain financial support for schemes more quickly than if we were to continue pursuing our anti-avoidance powers through the Determinations Panel, the Upper Tribunal and the higher courts. This brings certainty for members and removes the risk of a prolonged period of legal challenge through the courts.

We detailed earlier in this report our settlement objectives and factors we took into consideration in this case. Additionally, we would highlight to those we regulate:

- Our door is always open to reasonable offers that represent a genuine alternative to the use of our anti-avoidance powers, but we expect offers to include fully worked out proposals.
- We will not suspend or cease our investigations while considering settlement offers.
- Our principal consideration is not simply the financial sum involved but whether the proposal overall would secure good outcomes for members of pension schemes and the PPF, and mean it would be inappropriate for us to continue our investigation and use of our powers.

TPR Future

During the last decade the pensions system has undergone momentous change, our role and responsibilities have increased significantly, and the economic environment has been hugely challenging. We have completed the initial phase of a programme of work called TPR Future, which underlines our commitment to adapt and change, through which we will develop sustainable approaches to regulation for the next five to ten years. This covers our full regulatory remit, not merely DB regulation. We will provide more information about this in coming months.

BHS: Timeline of events

Funding case

Avoidance case

Settlement discussions

2013

March: Trustees notify TPR that 2012 valuation will be late

September: Trustees submit 2012 valuation

October-May 14: TPR opens a recovery plan case and conducts internal review and requests additional information from the trustees

2014

June: Trustees notify TPR of a BHS re-organisation and restructuring proposal

July: Taveta submits Project Thor draft clearance and RAA application to TPR

August: TPR requests moral hazard analysis from trustees

September: Taveta pauses Project Thor to allow BHS to focus on Christmas trading

2015

January: TPR contacts trustees for an update

Press story about a possible BHS sale – TPR asks trustees for more information

February: Taveta notifies TPR of intention to sell BHS

March: TPR meets Taveta to discuss impact of a sale on the schemes

BHS sold to RAL

BHS sale announced – TPR begins anti-avoidance investigation

2016

February: TPR receives two settlement offers which are rejected

March: BHS CVA launched – schemes enter PPF assessment period

March: TPR receives a further settlement offer, also rejected

April: BHS files for administration

June: Sir Philip Green commits to resolve pensions situation at Work and Pensions Select Committee

August: BHS ceases trading

September: Sir Philip Green publicly expresses desire to achieve voluntary solution for schemes

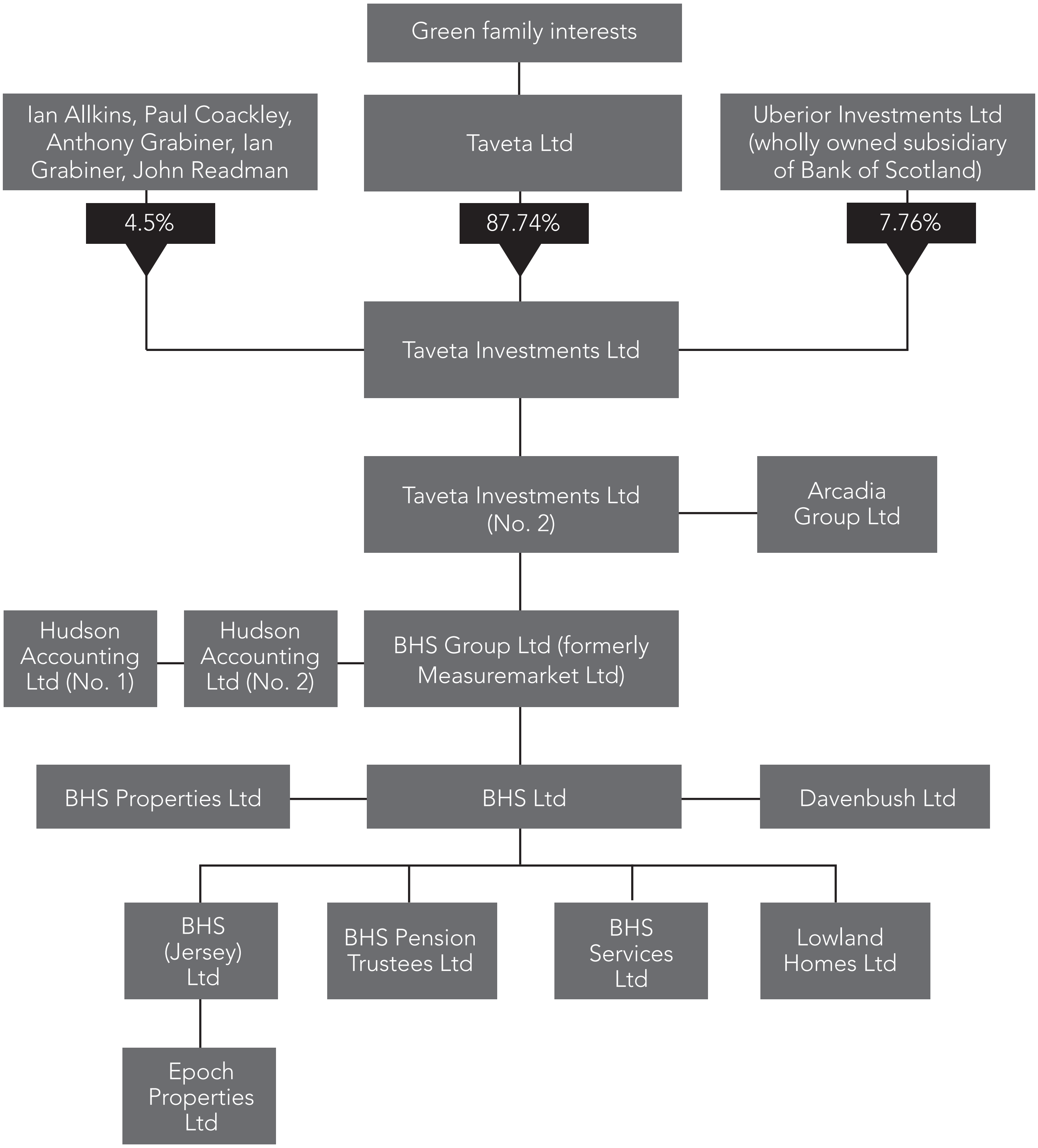
October: TPR receives a further offer, again rejected

November: TPR issues Warning Notices

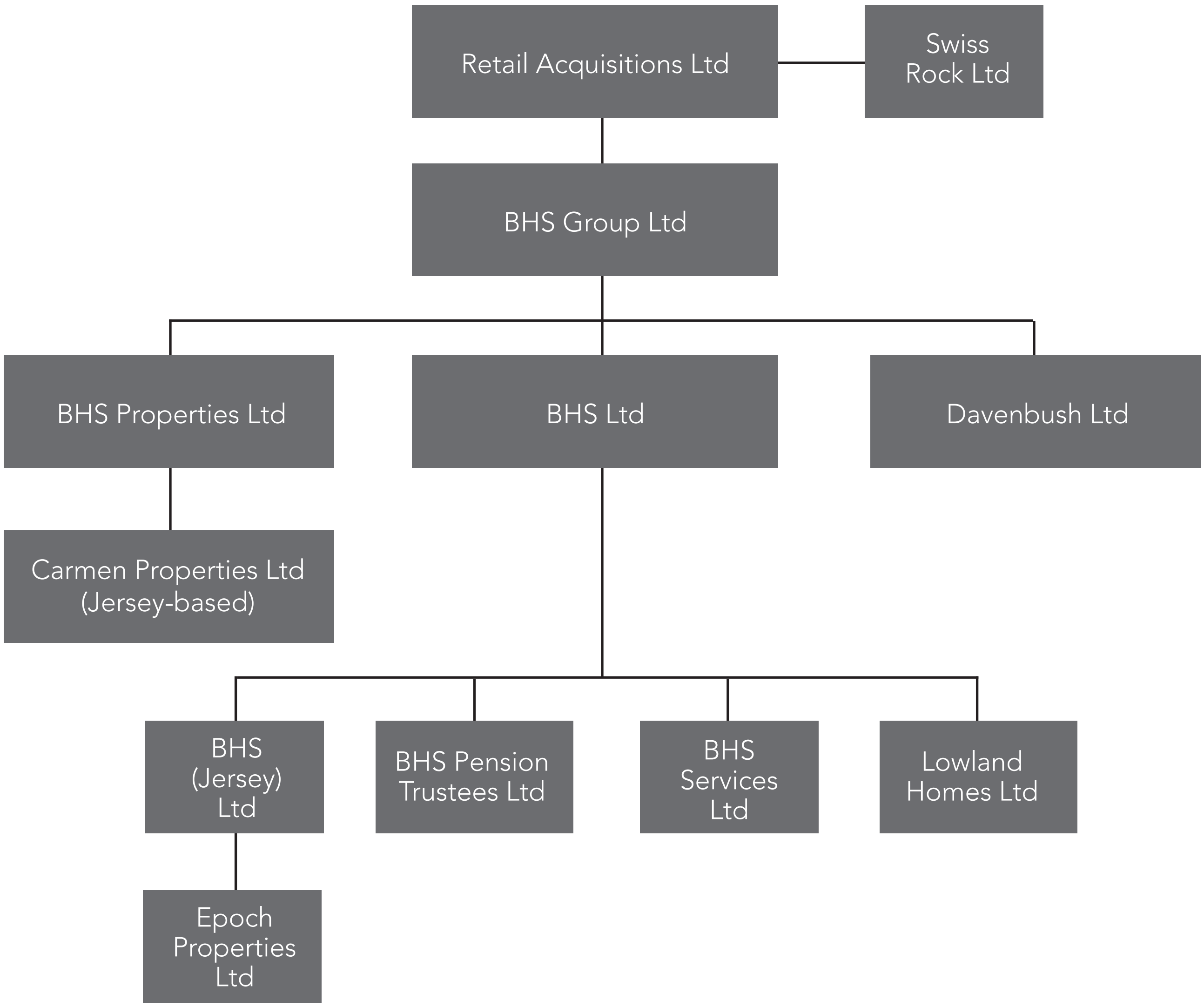
2017

February: £363m settlement agreed

Corporate structure of BHS before sale to RAL



Corporate structure of BHS after sale to RAL



The regulator's consideration and approach to individual cases is informed by the specific circumstances presented by a case, not all of which are referred to or set out in this summary report.

This summary report must be read in conjunction with the relevant legislation. It does not provide a definitive interpretation of the law. The exercise of the regulator's powers in any particular case will depend upon the relevant facts and the outcome set out in this report may not be appropriate in other cases. This statement should not be read as limiting the regulator's discretion in any particular case to take such action as is appropriate. Employers and other parties should, where appropriate, seek legal advice on the facts of their particular case.

Regulatory intervention report
BHS

The Pensions Regulator