

Advising on pension and related benefit issues in corporate transactions

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5 June 2008

Agenda

- The M&A market
- Section 75 debts
- Clearance
- Pricing pensions
- TUPE
- Examples

Experience of M&A advice

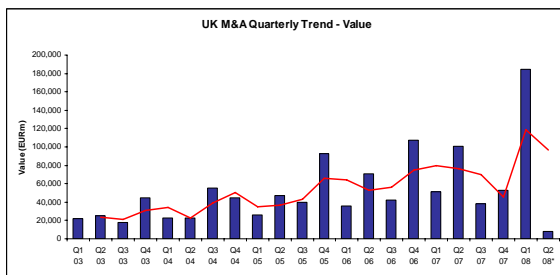
- Please choose one of the following categories that best describes advice you have provided on pension issues in corporate deals:-

Experience of M&A advice



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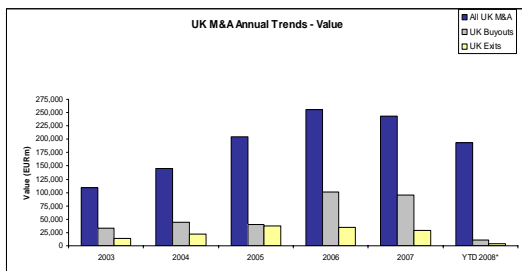
M&A activity - UK



Source - mergermarket

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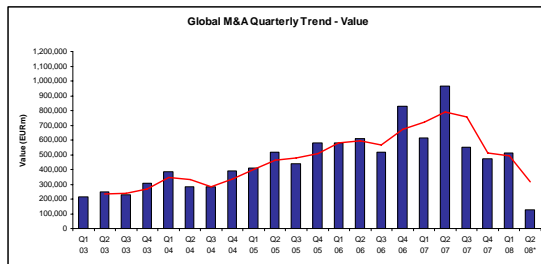
M&A activity - UK



Source - mergermarket

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M&A activity - Global



Source - mergemarket

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Types of deal

- Asset deal
 - Bricks and mortar, plus people
 - TUPE
- Share deal
 - Everything, unless carve out
 - General ongoing employment contracts

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Debt regulations

- September 2005
 - MFR....
 -to buy out
- Deal impact?
- No debts for an asset deal
 - Deal restructure?
- Examples
- But debts could be reduced/deferred
 - Approved withdrawal arrangements

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Approved withdrawal arrangement example – pre April 2008

- £30m section 75 debt triggered on sale of participating employer
- AWA proposed as part of a funding plan
 - £25m cash
 - A further £25m over 7 years
- Lengthy conversations with TPR
 - No approval
 - “more likely” test
- Final position
 - Debt paid in full
 - Balance of deficit funded over 10 years
 - Result – deficit paid off more slowly than under initial AWA proposal

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Revised debt regulations

- New definition of cessation of participation
 - No more active members when another employer still has active members
 - 12 month grace period
- Bulk transfers allowed with no AWA
- Orphans
 - Transfers in allocated to last employer
- No “more likely” test

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Revised debt regulations

- Default is liability share
- Alternatives:-
 - scheme apportionment arrangement
 - regulated apportionment arrangement
 - withdrawal arrangement
 - approved withdrawal arrangement
- Pragmatic
 - Trustee agreement still needed
 - Clearance?
- Funding test
 - For all except regulated apportionment

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Revised debt regulations

- Funding test
 - Remaining employers reasonably likely to fund technical provisions
- Scheme apportionment arrangement
 - No adverse effect on security of benefits
 - Covenant
 - Technical provisions
 - Recovery plan
- Clearance....

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Clearance

- Has always been and remains voluntary
- Requested by business, especially PE firms
- No Contribution Notices issued
- 1 Financial Support Direction issued
 - To a non UK business
 - in Chapter 11 bankruptcy
- No published price of clearance
 - FRS17 became the benchmark for many cases
 - ½ up front, ½ over 3-7 years

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Clearance

- May 2007 announcement
 - "significant" weakening of covenant
 - "materially" enhanced mitigation
- Revised guidance issued in March 2008
- Clearance "appropriate" where covenant materially reduced
 - but voluntary
- Trustee reporting?
 - TPR expects open dialogue between companies and trustees
- Funding tests for whether clearance is "appropriate":-
 - Accounting
 - PPF
 - Funding
 - Buy out, in limited cases
- No guidance on the price of clearance
 - "self sufficiency"?

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Clearance

- Is the protection worth the cost?
 - Each case should be considered on its own merits
 - Advice in this area is evolving rapidly
- What can be done if no clearance application
 - Trustees may want to "consider contacting the regulator"
 - TPR intervention – CN, FSD
 - Next funding valuation
- Reach to PE funds
 - US PBGC claim
 - 2004/05 UK Government comment
 - Grey area

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Clearance – April 2008

- New proposal out for consultation
 - Major concerns
 - Government
 - Risks
- Removal of powers
 - Focus on the regulator
- Wider definition for FSDs
- Clearance will provide comfort...but remains optional

"Regulator's extended powers may be unworkable without scrutiny"

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Issues for trustees

- Conflicts of interest
 - Independent trustee
- Negotiation
 - Trustee powers
 - Acceptable to the beneficiaries
 - Acceptable to TPR
 - Act like bankers
 - Opportunity for extra funding
- Impact on the deal itself

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Preparation as a seller

- Vendor due diligence
 - Get your house in order early
- Consider de-risking or buy out
- Emap
 - All risks buyout in advance of sale
 - 2 months to complete
- Rank
 - Press commentary around removal of takeover barrier

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Pricing pension liabilities



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Pricing pension liabilities

- Accounting liabilities
 - Invest in AA bonds
 - Duration mismatch
 - ASB proposals
- Credit spread impact
 - Short term blip?
 - Spread at exit
- Cash funding
 - Mortality
 - Covenant changes
 - Clearance costs
- Buy out
 - Maximum
- Negotiations will lead to differing results

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TUPE

- Only for asset deals, not share deals
- Non occupational pensions always included in the protection TUPE offers
- Occupational pensions were excluded
- Care over Beckmann and Martin type liabilities
- Occupational pensions now included
 - Minimum level of pension provision

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Examples and summary

Example 1

- Business value £3bn - refinancing
- Closed DB pension scheme
- Assets = liabilities = £500m
- Cash into the scheme
 - Only to cover new accrual
- No material change in covenant
 - Some leverage but not too high
- Outlook very good – cash and profit

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Example 1

- No accounting deficit in last disclosed accounts
- Updated figures:-
 - Accounting (no sal incs) - £50m surplus
 - PPF basis - £50m surplus
 - AAA bonds (no sal incs) - £25m surplus
 - Gilts - £100m deficit
 - Buy out - £200m deficit

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Example 1

- Clearance for small cash payment
 - Trustee agreement
- No TPR agreement
 - Self sufficiency

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Example 2

- UK PE firm
- UK business
 - DB pension scheme
 - Shortfall on funding and accounting measures
- Increase in debt
- Clearance recommended
- Trustee consultation

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Example 3

- US PE firm
- Multinational business, including UK subsid
- Increase in debt
 - None in UK business – covenant the same?
 - No upstream cash now or in future
- Funding deficit in pension scheme
- Clearance prudent
 - Cash accelerated
 - Consult with trustees
 - Depends on PE attitude to risk
- TPR views
- Trustee whistle blow

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Summary

- Section 75 debt regulations
 - More commercial than previously
- Clearance
 - More applications?
- Pricing pension liabilities
 - Consider business model

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