



**The Actuarial Profession**

making financial sense of the future

# Pensions conference 2010

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**Non-cash funding for pension schemes**

**A legal look-see**

10 June 2010

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# Non-cash funding for pension schemes

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## Agenda

- Background
- Regulatory context
- Contingent assets
- Special purpose vehicles
- Questions

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# Non-cash funding for pension schemes

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## Background

- Fear of trapped surpluses
- Large deficits
- Sponsors under strain
- Market innovation

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# Non-cash funding for pension schemes

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## Regulatory context

- Scheme funding regime
- Code of Practice 3 : Funding Defined Benefits
- Affordability
- Regulatory Statement, June 2009:

“Contingent assets need to be approached with care... the company will want to ensure that terms do not hamper their ability to do business in future and trustees will want to ensure that terms enable them to crystallise the contingent asset should they have need.”

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# The Pensions Regulator's stance on contingent assets

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Contingent assets might support **technical provisions** by:

- allowing trustees to pursue a higher risk investment strategy
- allowing trustees to increase their assessment of investment returns
- providing security against falls in a scheme's future funding level

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# The Pensions Regulator's stance on contingent assets

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Contingent assets might support a **recovery plan** by providing:

- security against employer default
- security against actual investment returns being less than those assumed
- comfort to the trustees that the recovery plan may be differently structured

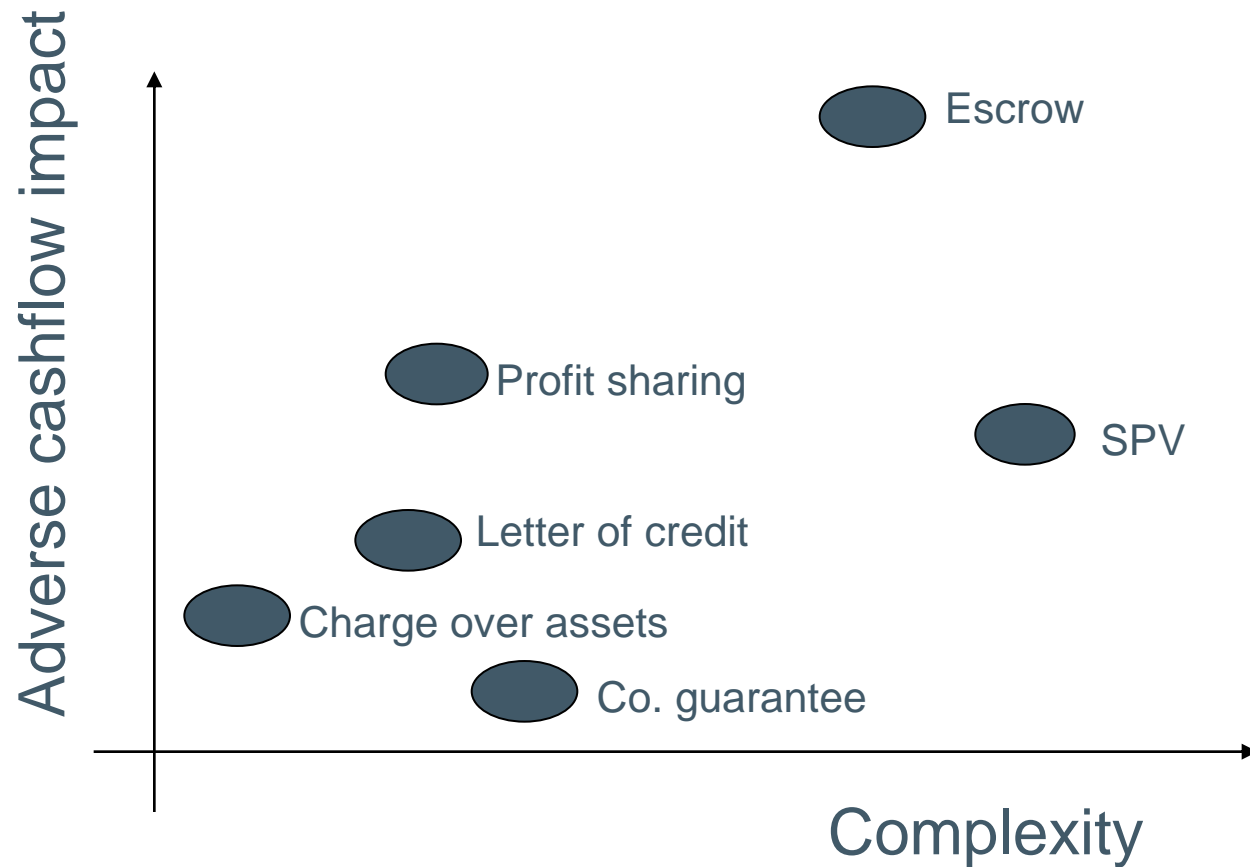
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# Types of non-cash funding

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- Examples:
  - Charging (preferably unsecured) assets
  - Letters of credit
  - Escrow accounts
  - Group company guarantees
  - Profit sharing
  - Income generating special purpose vehicles (SPVs)
- Assurance or *funding*?

# Cashflow/complexity





# Non-cash funding – general trustee considerations

- Is there a training need for the trustees?
- What is stopping the employer from paying in cash?
- Lack of access to cash and cashflow effect on scheme
- How appropriate is the contingent asset for the risk?
- Monitoring employer covenant (ongoing)
- What about company insolvency?



# Questions for the lawyers...



- Enforceability?
- Encumberments?
- Does the body providing the charge have authority to do so?
- Can another party take an interest in the asset which is preferential to the scheme's interest?
- Do the trustees have sufficient understanding of the agreement and the benefits?
- If the charge were triggered, what steps would the trustees need to take, to realise the contingent asset and by when?

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# Group company guarantees

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- An arrangement under which another company in the sponsoring employer's group of companies agrees to make certain payments to the trustees if a specified trigger event occurs
- Typical triggers
  - Insolvency
  - Funding
  - Investment



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# Group company guarantee – case study

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- 15 year recovery plan
- Guarantee supports back-end loading
- Link to assumed funding levels year on year
- Guarantee applies where actual funding level 4% (or more) less than assumed funding level

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# Group company guarantees

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## Group company

- Low cash flow impact
- May need to share financial information with the trustees
- Check banking covenants

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# Group company guarantees

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## Trustees

- Covenant review of guarantor
- May look for extra security
- Beware of parent company and inter-dependency traps
- Beware of employer-related loans
- Enforceability

## Regulator

- Period covered by guarantee
- Guarantor should be located in an OECD country

# Special purpose vehicles (SPVs)

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John Lewis



MARKS &  
SPENCER

EAT SLEEP & DRINK  
WHITBREAD

J Sainsbury plc



# The M&S experience

This is not *just* a deal with the pension scheme... This is an £800m property donation set to generate £1.5 billion by 2031 and a whopping lump sum at the end!





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# Special purpose vehicles (SPVs)

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- Key ingredients
  - Shares ownership (sponsor/scheme) of SPV
  - Unencumbered income generating assets
  - Deal on contribution levels
  - Deal on sponsor failure/other key issues
- Complexity – not for the faint-hearted!

# Special purpose vehicles (SPVs) – what sort of assets?

- Property
- Intellectual property
- Debtor books
- PFI contracts
- Intra-group loans
- Other

## Check

- Financing documents
- Shareholders' agreements
- Contracts

## Valuing the assets:

- Relevant professional advice
- Scheme asset

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# Special purpose vehicles (SPVs) – “Case Study”

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- Sponsor group
  - UK domiciled international conglomerate
  - Turnover £billions
  - UK covenant good; Non-UK covenant better
- Scheme
  - £1 billion assets
  - £150 million SSF deficit
  - Corporate trustee
- Asset
  - £90m intra-group 15 year loan to sponsor's International Holding company

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# SPV Case Study – the essential construct

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- Group loans International £90m
  - fixed interest rates generates annual receivable of £5m
- Group sets up an SPV
  - Scottish Limited Partnership
  - general partner plus two limited partners (including the scheme trustee)
- Loan receivable transferred to SPV
- Scheme's interest in SPV is an asset
- Scheme gets £5m contributions per year

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# SPV Case Study – the legals

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- Group
  - no constitutional bar to SPV
  - due process
- Loan receivable
  - check banking and other finance documents
  - loan agreement
  - loan transfer agreement

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# SPV Case Study – the legals (2)

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- Trustee
  - valuing the asset
  - covenant assessment re International
  - scheme rules
  - investment advice
  - employer – related investment?
  - documenting the funding deal

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# SPV Case Study – The Partnership Deed

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- Defines rights and obligations of the partners (including scheme trustees)
- Reflects the funding deal
  - Duration
  - Link to funding test
- Early repayment
- Capital transfer triggers
  - Unremedied breach of loan
  - Insolvency
  - Others?

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# SPV Case Study – Investment

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- 2005 Investment Regulations apply
- Written investment advice
- Security, quality, liquidity and profitability of portfolio
- Non-traded assets kept to prudent level
- Reg 4(2) – best interests of members
- Amend SIP



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# SPV Case Study – Employer-related investments

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- Criminal sanctions for breach!
- Scottish Limited Partnership – separate legal personality
  - Avoids prohibition on investing in “loans to the employer”
- Trustee interest in SPV not a prohibited “share or other security”
- Group exemption from “collective investment scheme”

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# SPV Case Study – Tax

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- SPV income exempt from tax in scheme
- Transfer taxes : SD, SDRT, SDLT, VAT
- Direct taxes : Corporation tax, CGT
- Scottish Limited Partnership
  - Tax transparency
  - Outside tax exemption restrictions for property partnerships

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# SPV Case Study – miscellaneous

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- TPR
- Valuation documents
- Member communications
- PPF risk-based levy reduction
- Listed companies
- Trustee training!!

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# Questions?

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