

The Actuarial Profession

making financial sense of the future

It's as easy
as ABC

Open Forum on Asset Backed Funding

What is Asset Backed Funding?

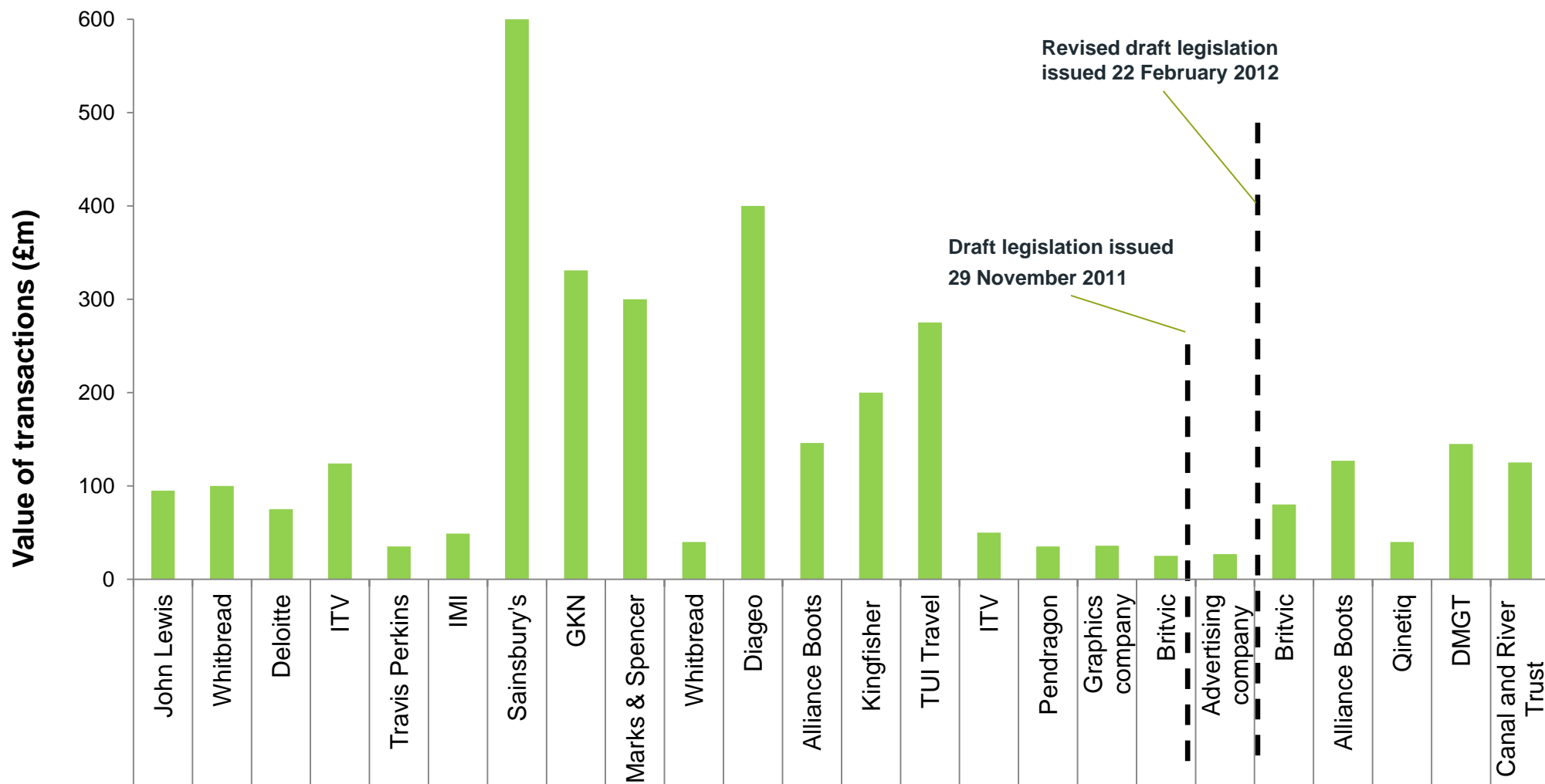
Employer

Pension
Scheme

Special
Purpose
Vehicle

Property

Timeline of ABCs



Benefits for Employer

- ✓ Efficient
- ✓ Immediate reduction in scheme deficit
- ✓ No impact on balance sheet / income statement
- ✓ Complements de-risking
- ✓ Operational flexibility retained

Asset Considerations

- ☐ What assets can be used?
- ☐ Accessing value in a default
- ☐ Valuing the assets
- ☐ Banking restrictions
- ☐ Transfer to structure

Initial cashflows

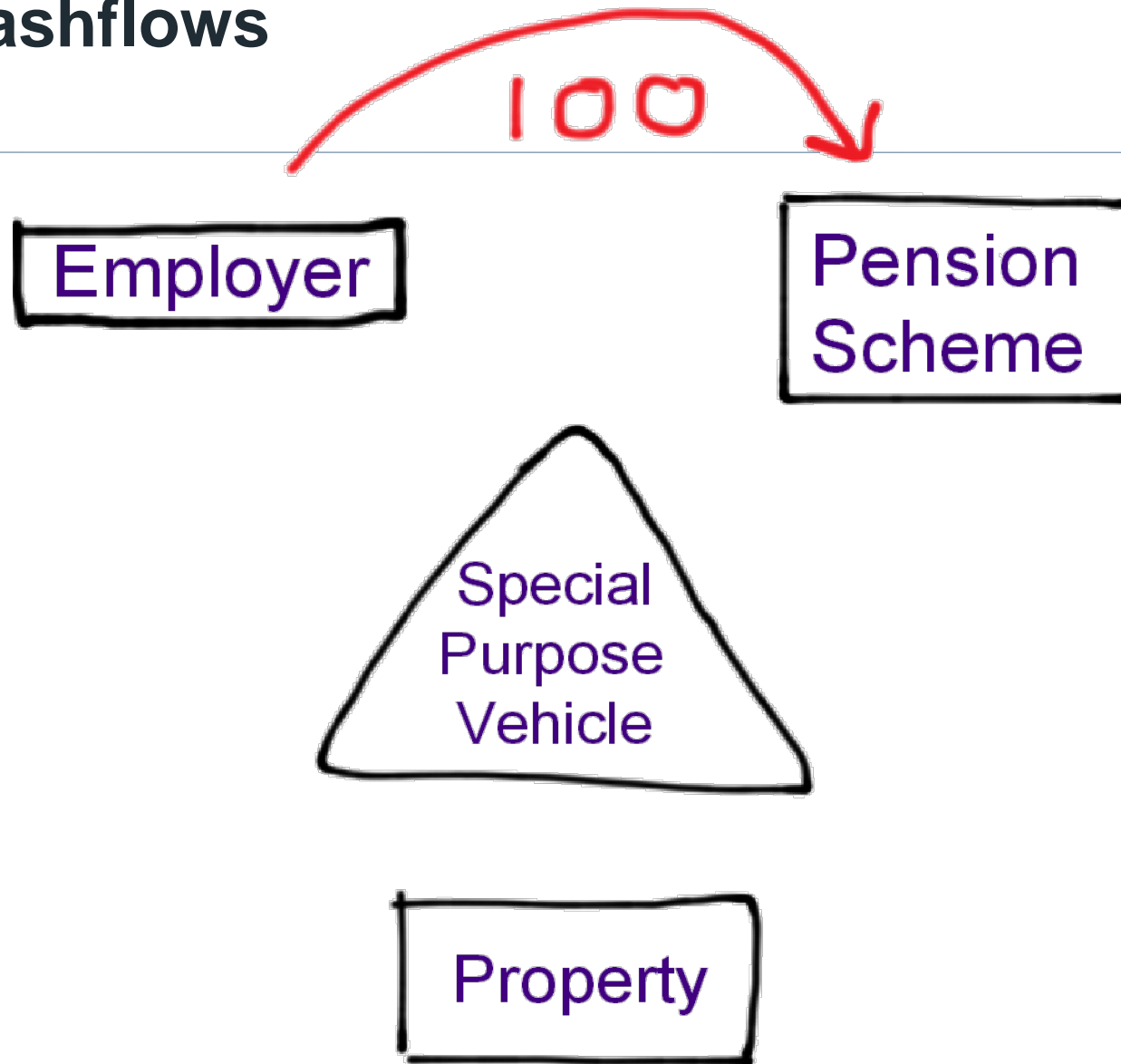
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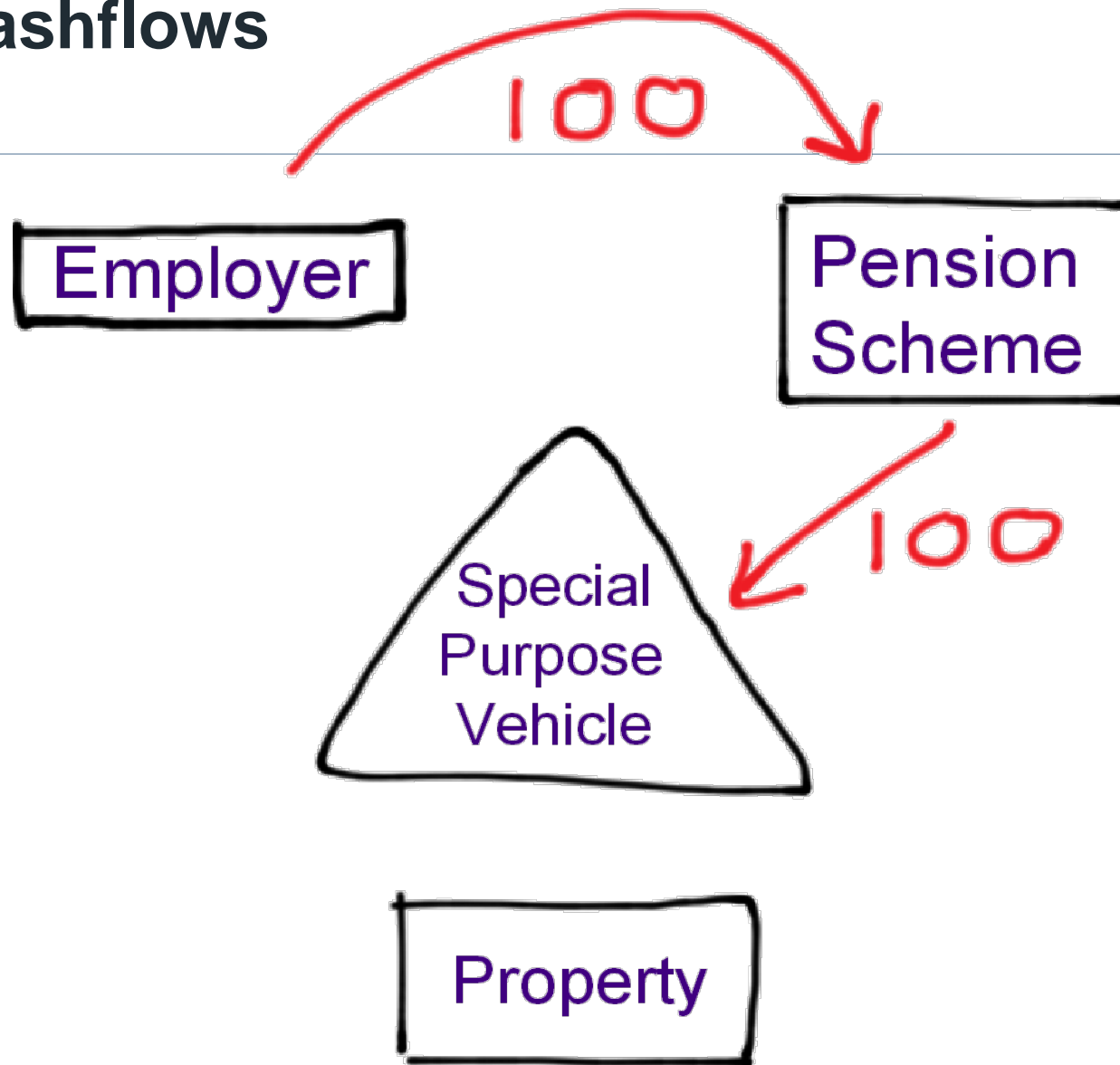
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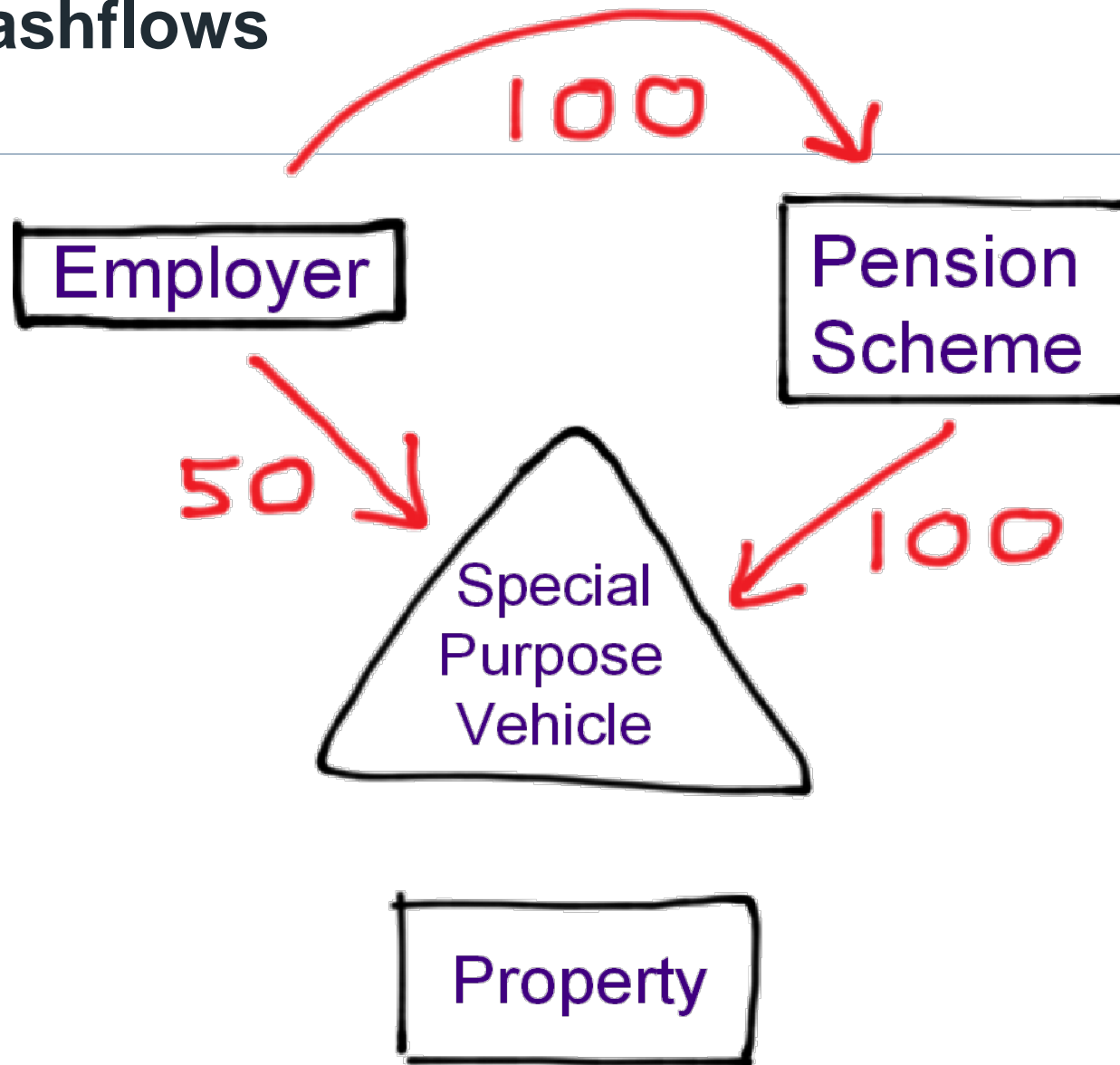
Initial cashflows



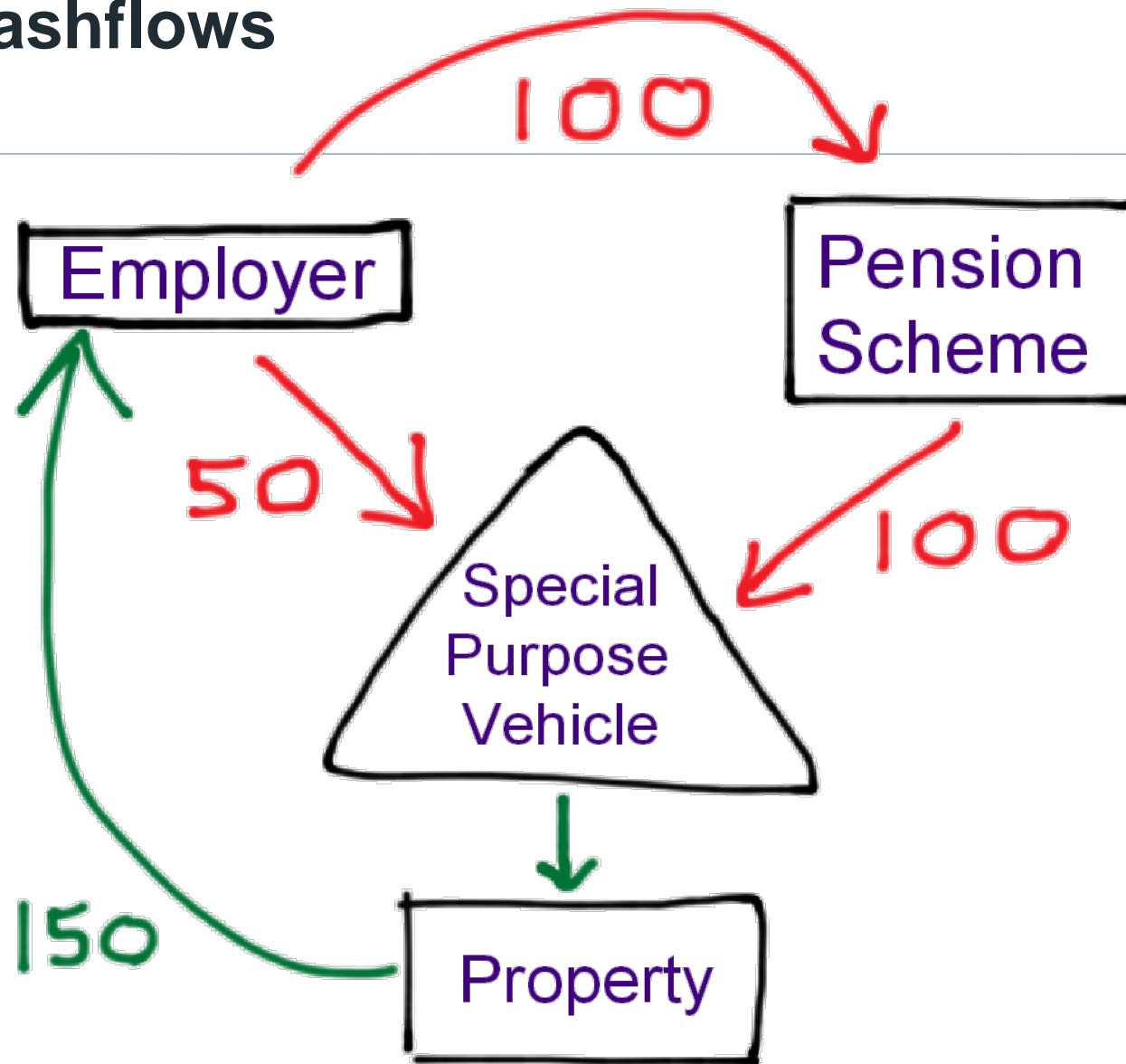
Initial cashflows



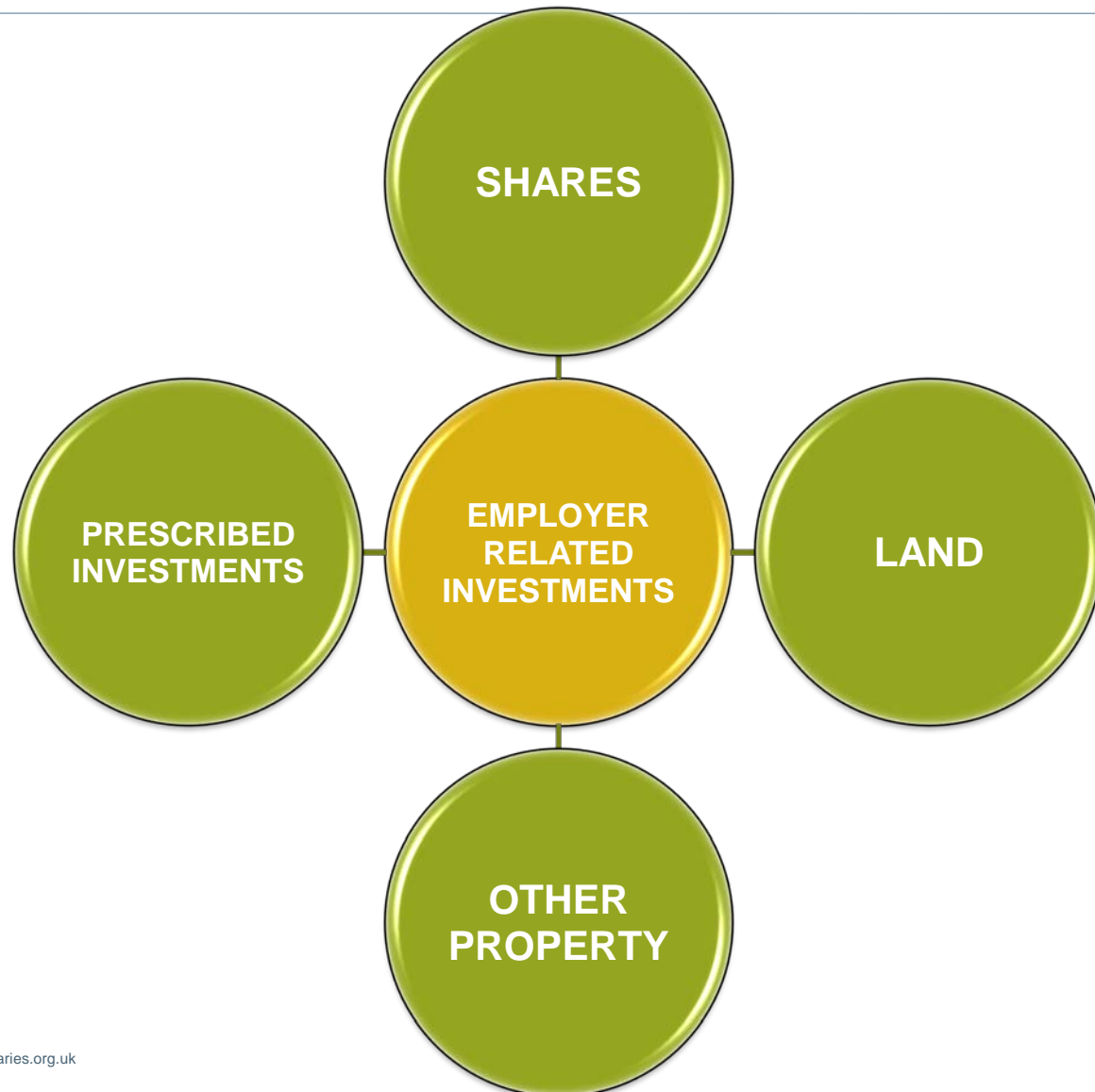
Initial cashflows



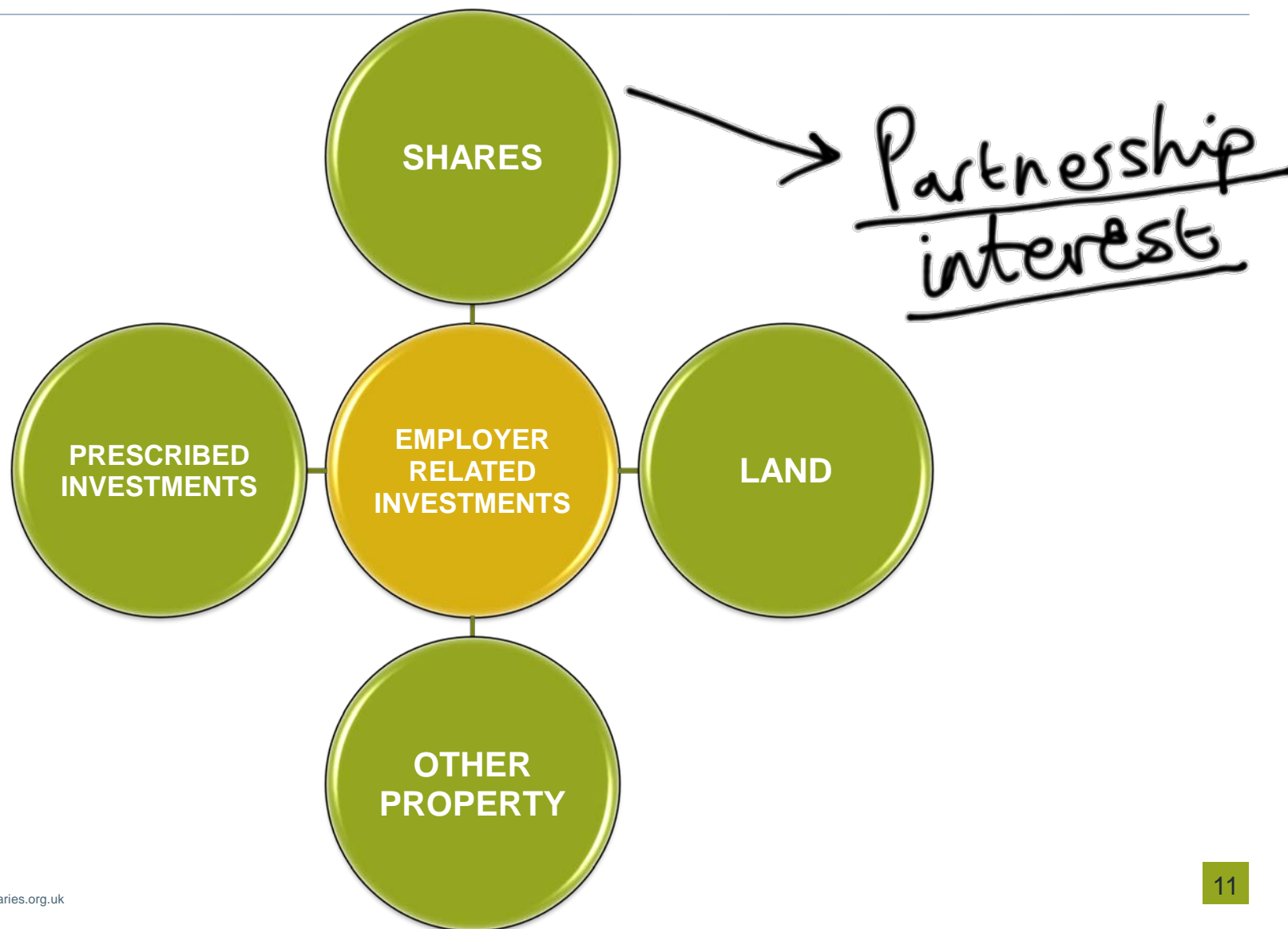
Initial cashflows



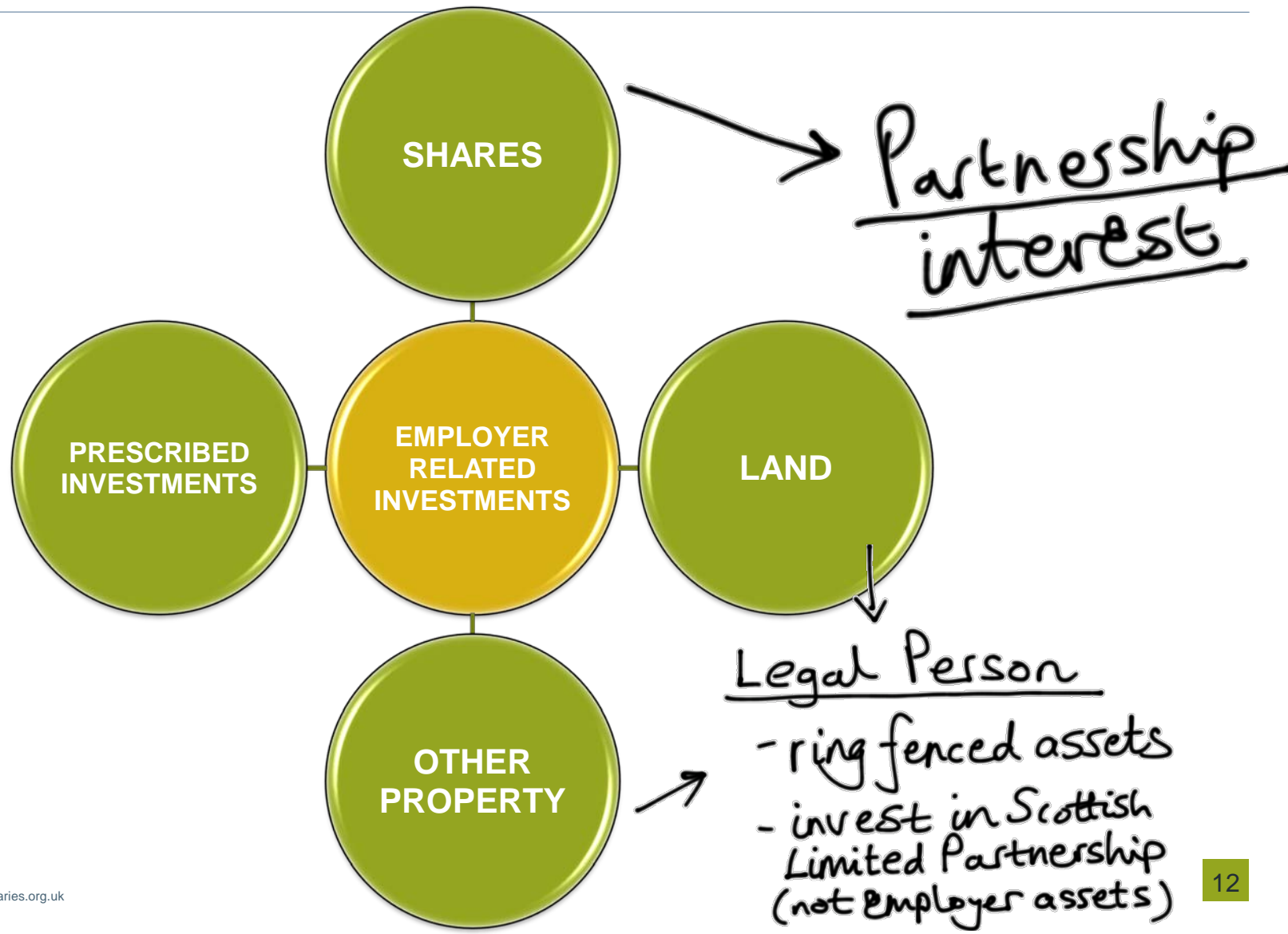
Employer Related Investments



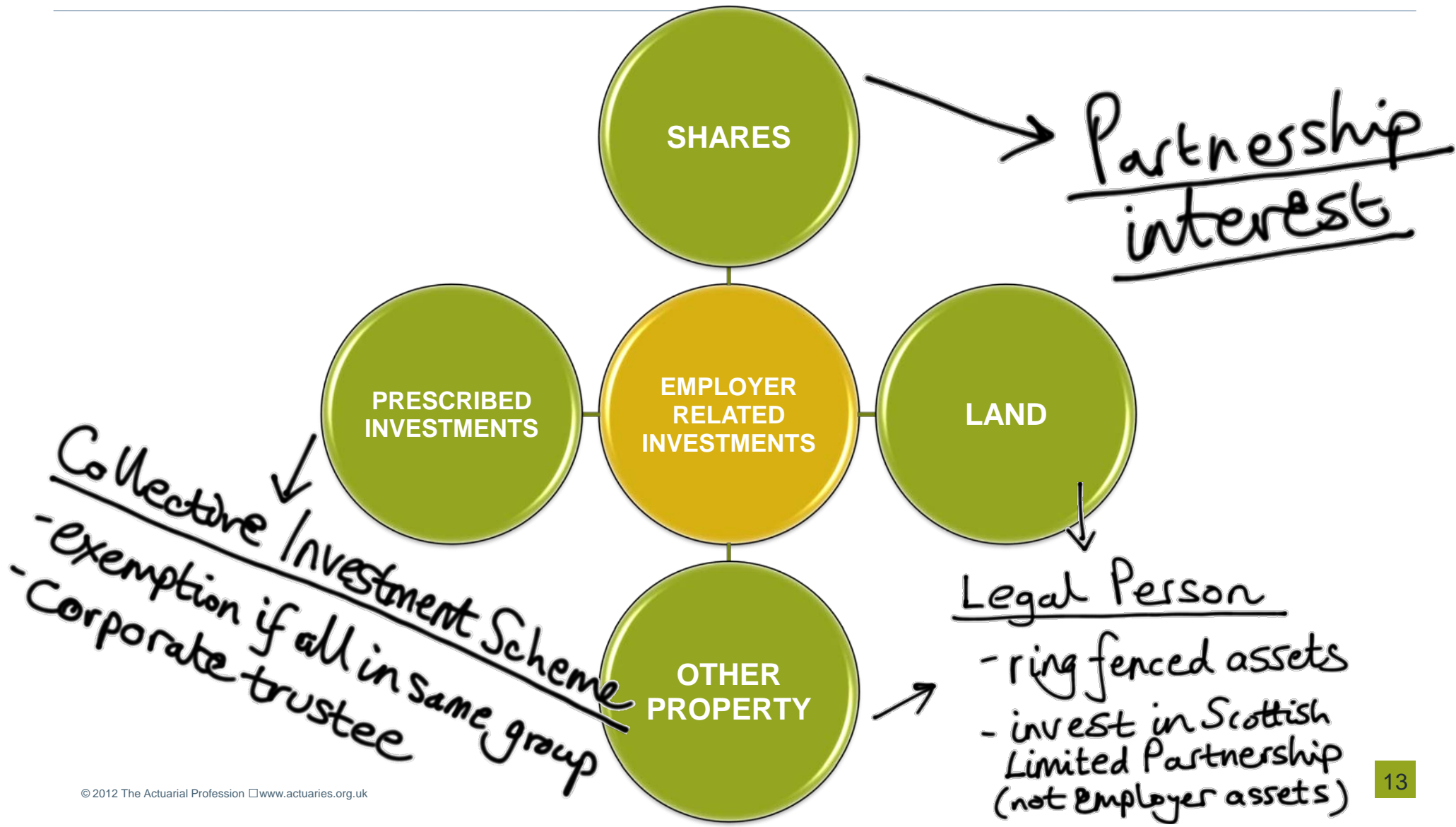
Employer Related Investments - Solution



Employer Related Investments - Solution



Employer Related Investments - Solution



Income stream

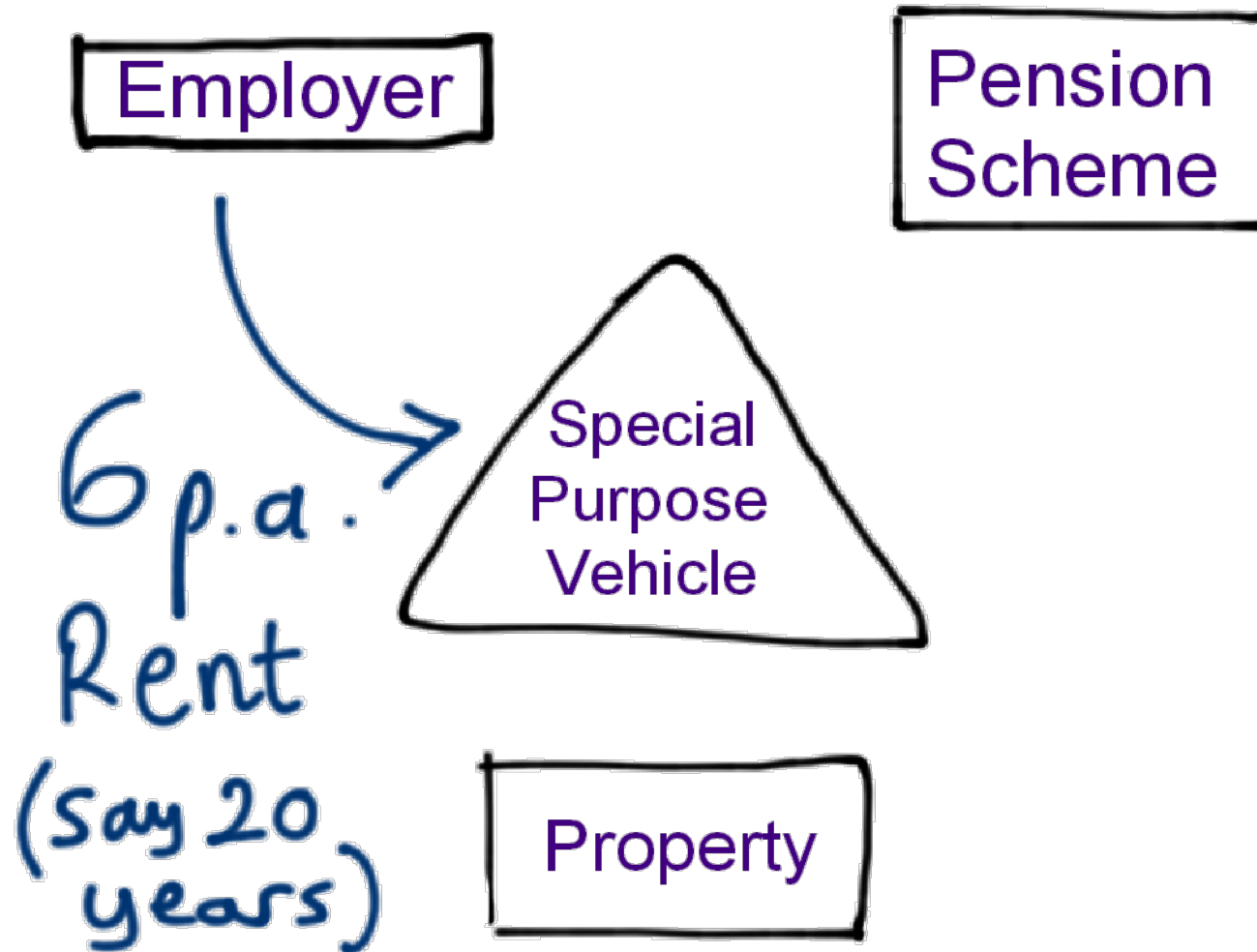
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Pension
Scheme

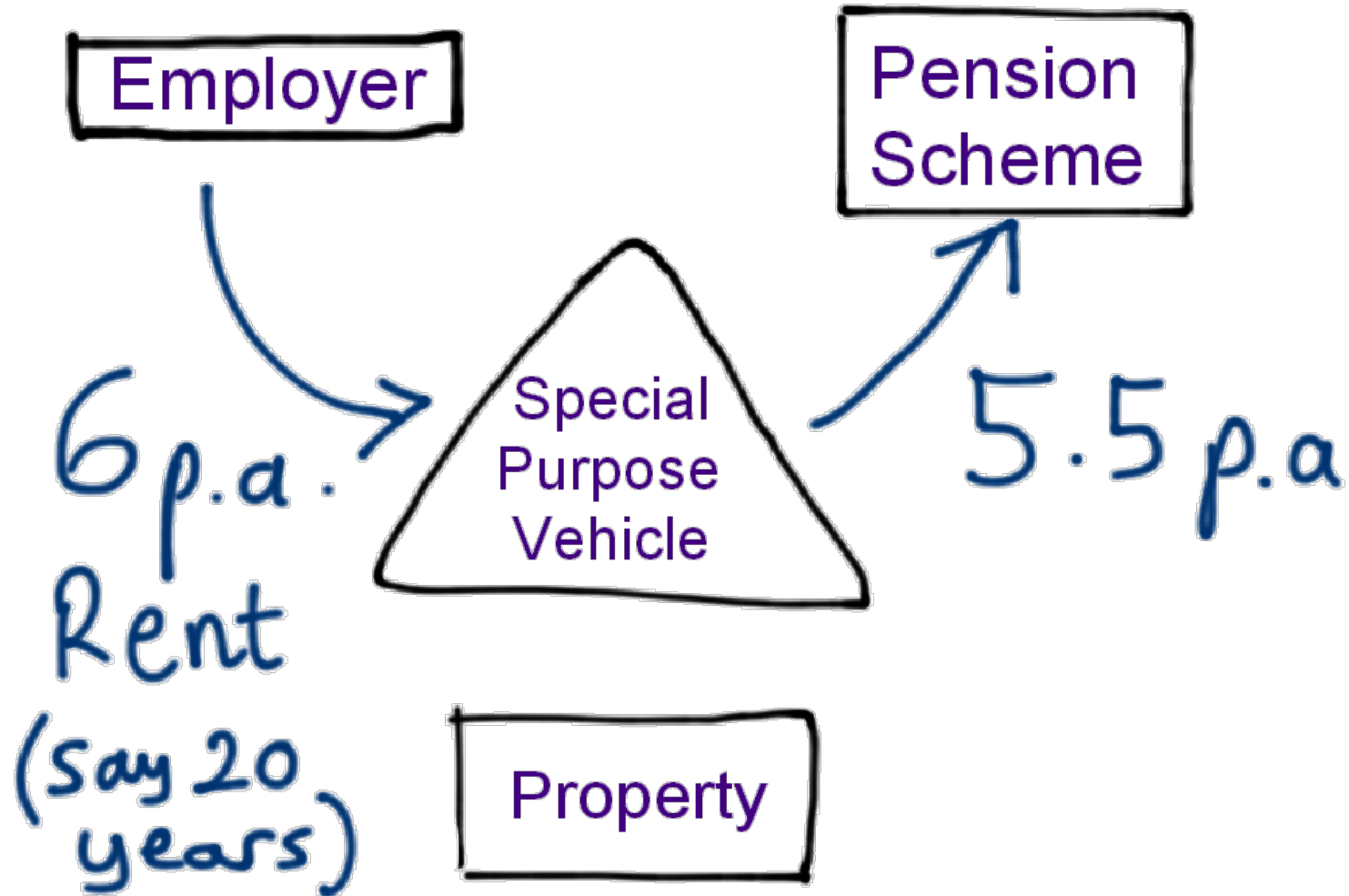
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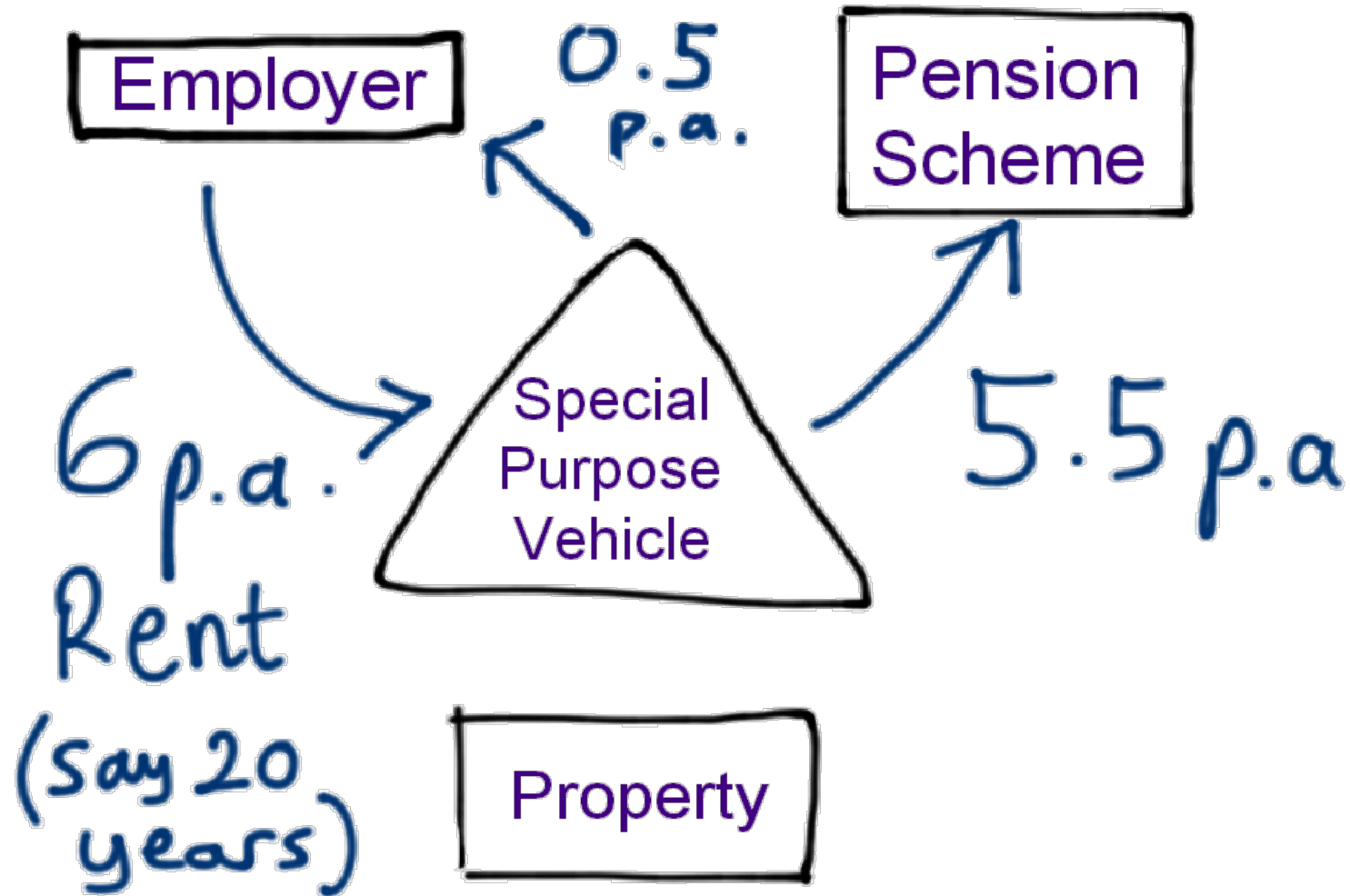
Income stream



Income stream



Income stream



At the end of the term

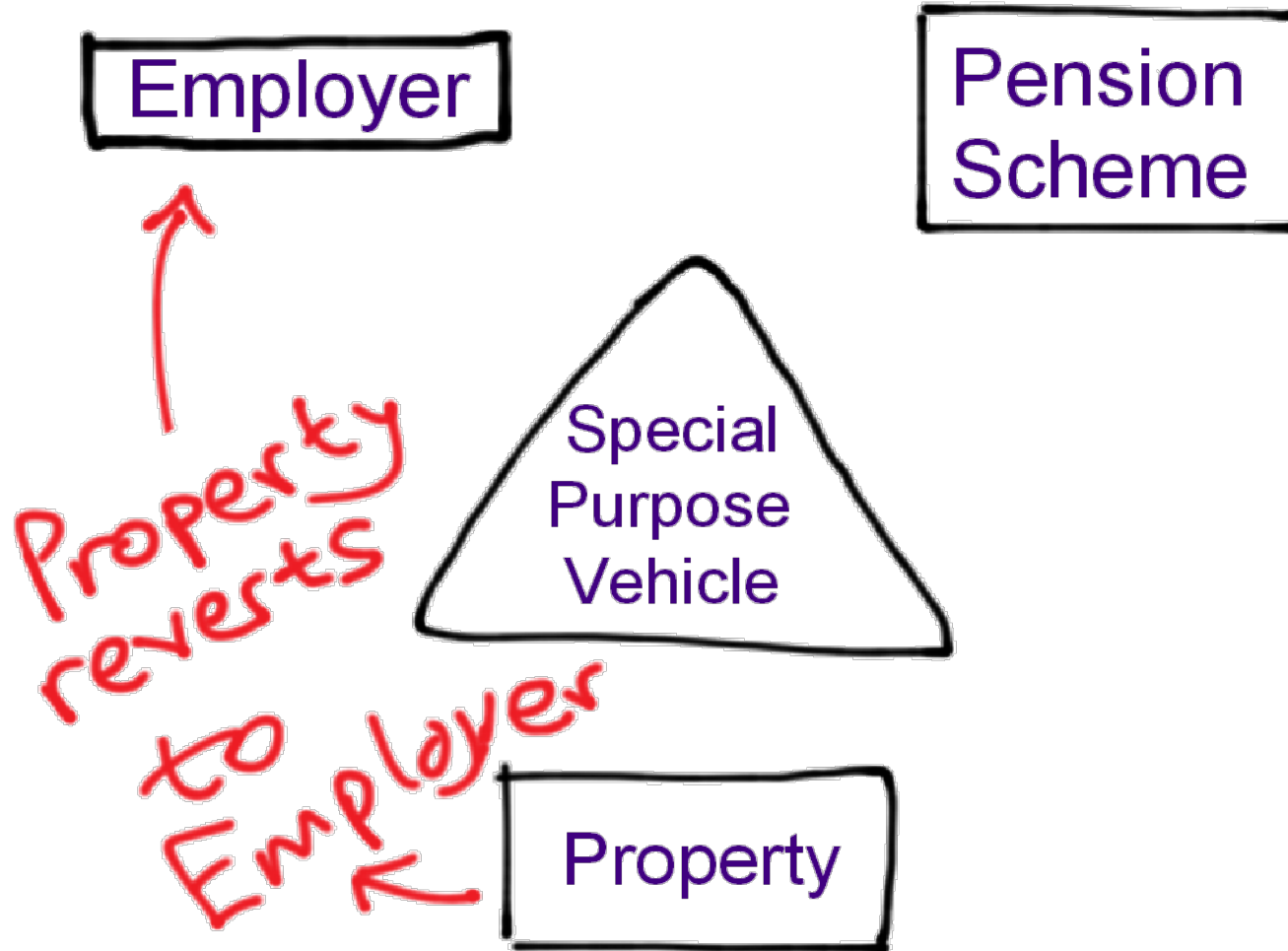
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At the end of the term



At the end of the term

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ABCs

Tax treatment of asset transfers

- ❑ Simple, **contingent type** arrangements such as parent guarantees or legal charges, may help trustees to accept longer but entirely cash funded recovery plans.

*Scheme does not recognise a plan asset – **no tax relief**.*

- ❑ **Direct asset funding structures**, on the other hand, do transfer real value to schemes. Property can be sold or transferred directly to a scheme and recognised as a plan asset.

***Tax relief on the value of the contribution**, just as it would do with a cash contribution asset.*

- ❑ **ABCs** transfer real value to schemes but allow the sponsor to retain operational flexibility and achieves an affordable cashflow profile.

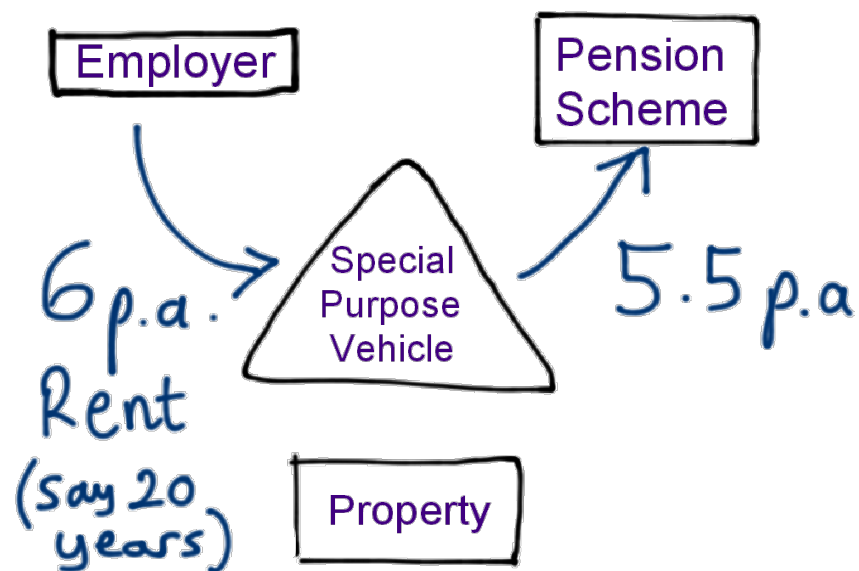
***Tax relief on the value of the contribution**, subject to HMRC's new ABC rules!*

ABCs

HMRC tax rules

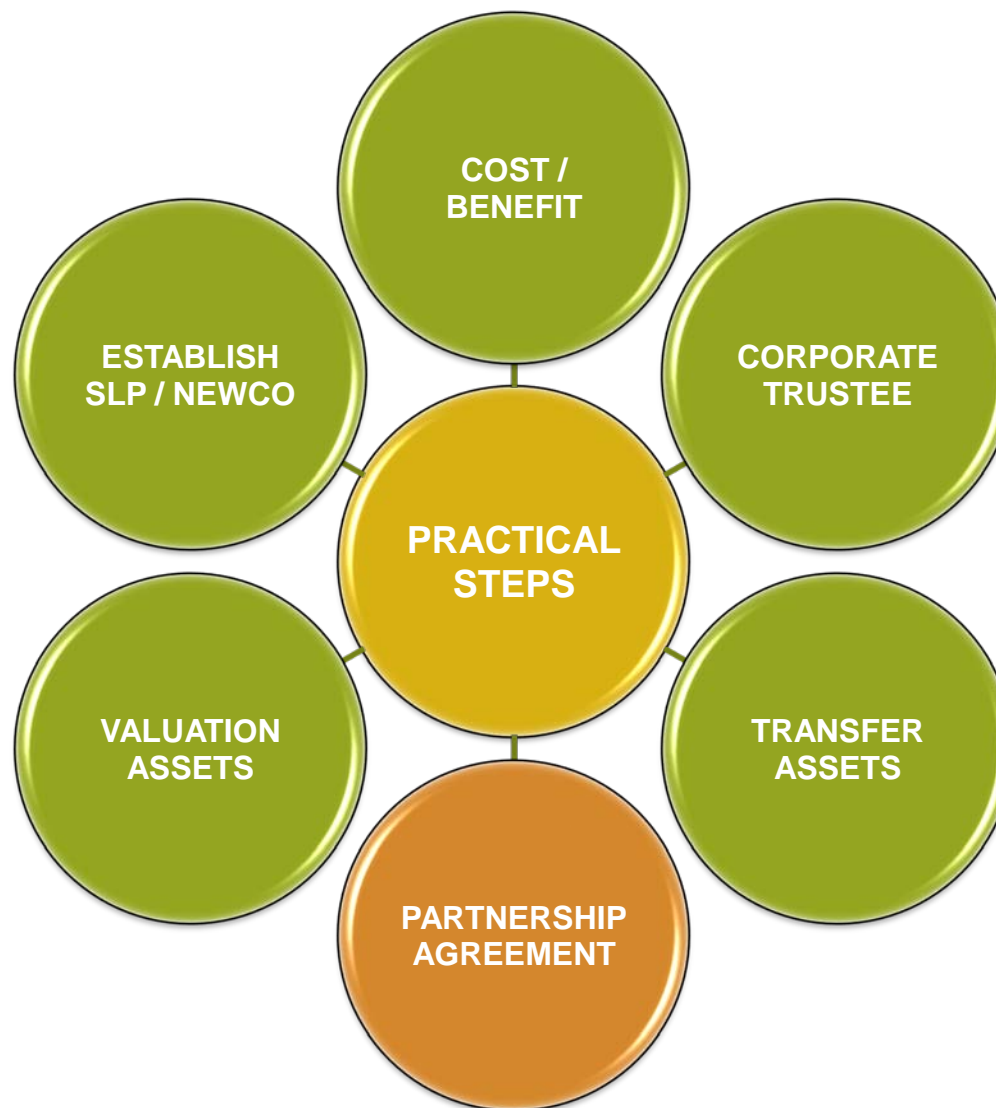
Changes announced in Finance Act 2012

- ☐ **For upfront tax relief to be available** for new ABC's, the structures must:
 1. Be an 'Acceptable Structured Finance Arrangement'.
 2. Recognise a financial liability that reduces to nil with regular, equal annual payments to the Scheme (i.e. a series of payments of a fixed amount, e.g. 5.5pa)
 3. No final bullet payment.
- ☐ **If upfront tax relief is not required, more flexibility on structuring.**



Issues for Employer

Issues for Employer – Practical Steps



Issues for Employer – Partnership Agreement

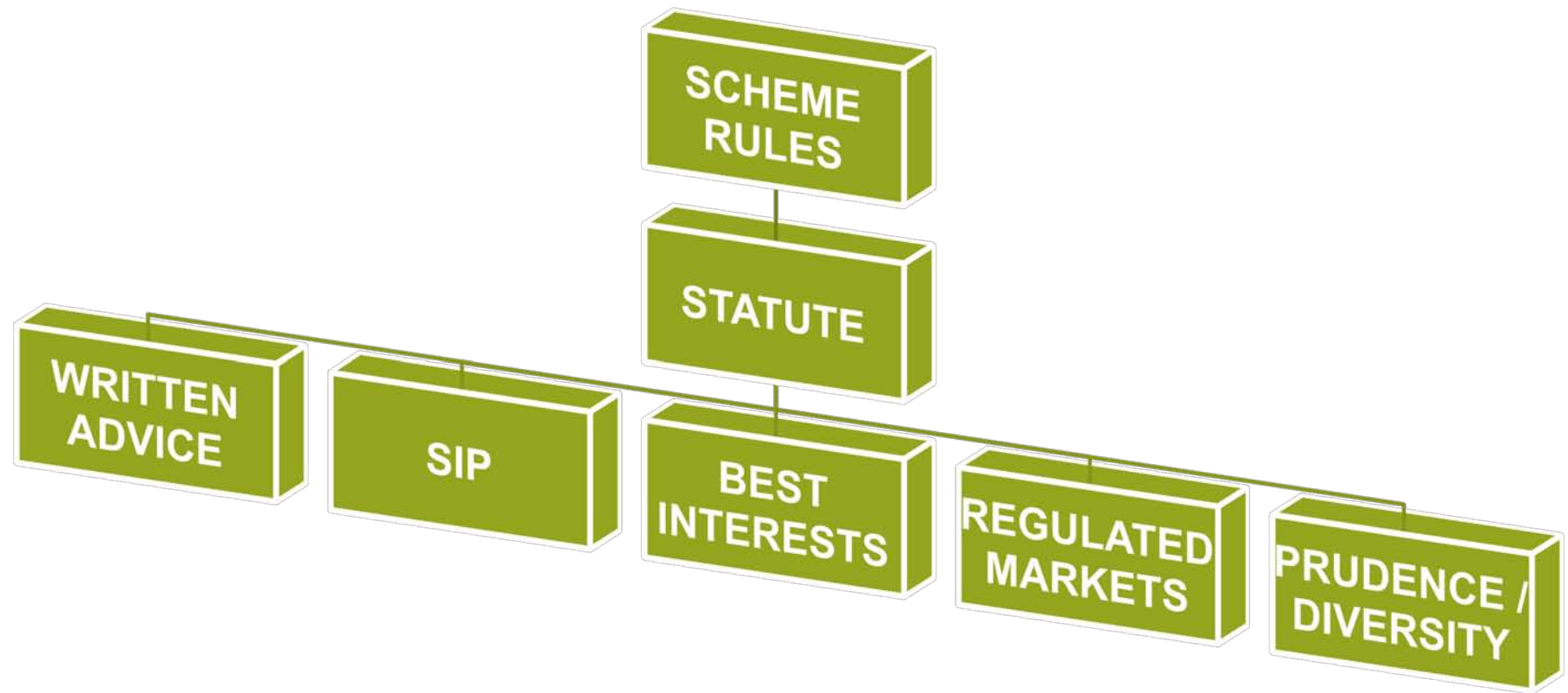


Benefits for Trustees

- ✓ Increased employer covenant strength
- ✓ Security
- ✓ Long term matching investment
- ✓ Attractive yield
- ✓ Guaranteed income stream

Issues for Trustees

Issues for Trustees - Investment

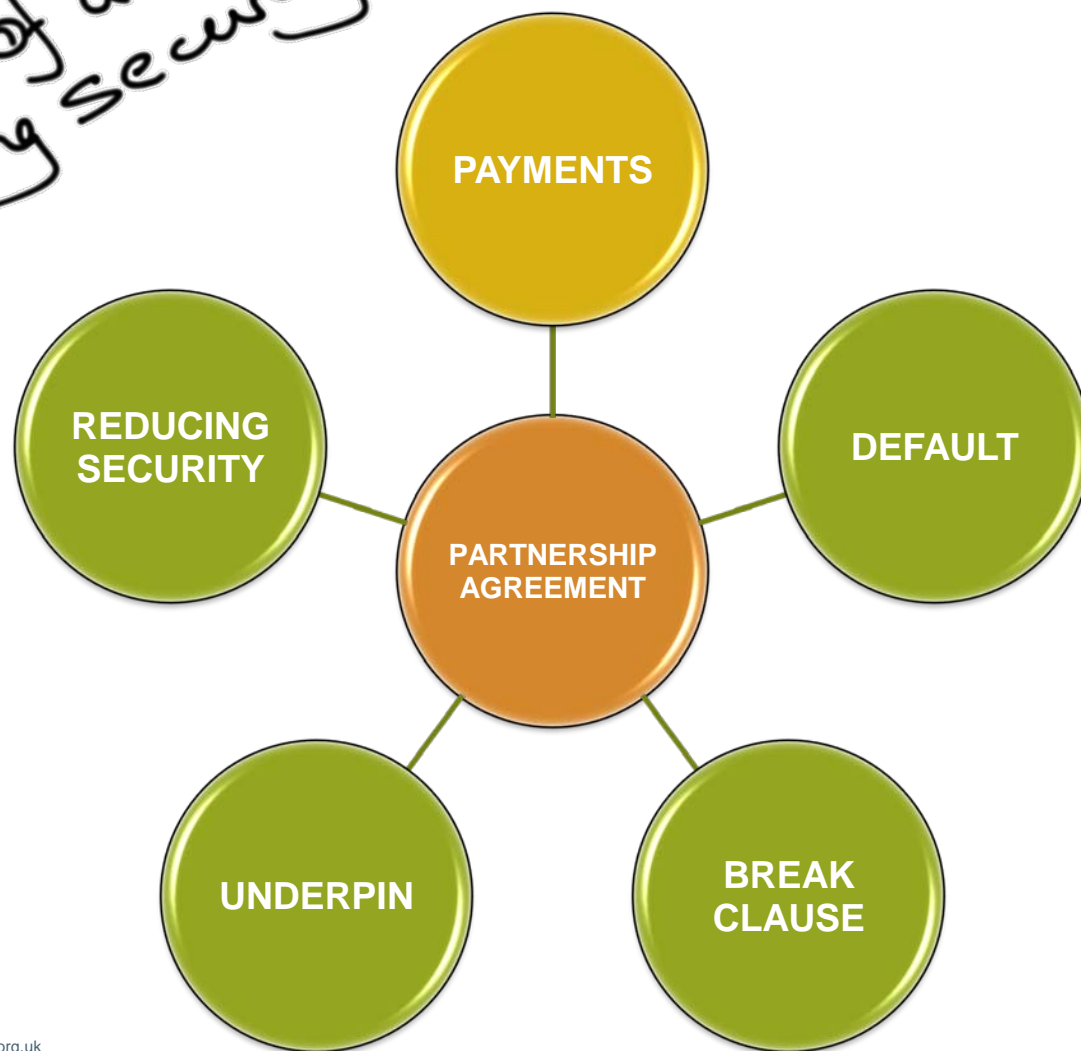


Issues for Trustees – Partnership Agreement

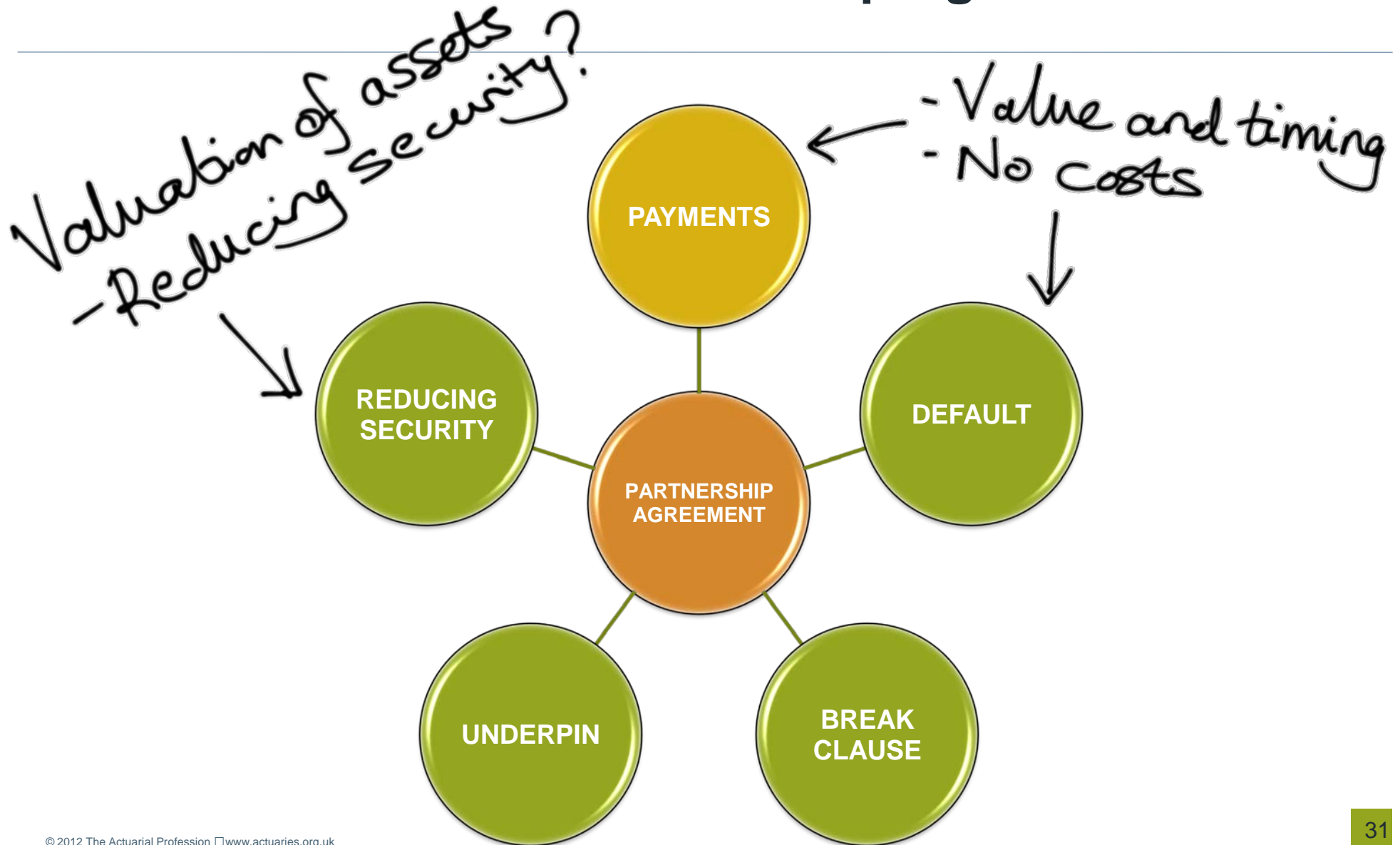


Issues for Trustees – Partnership Agreement

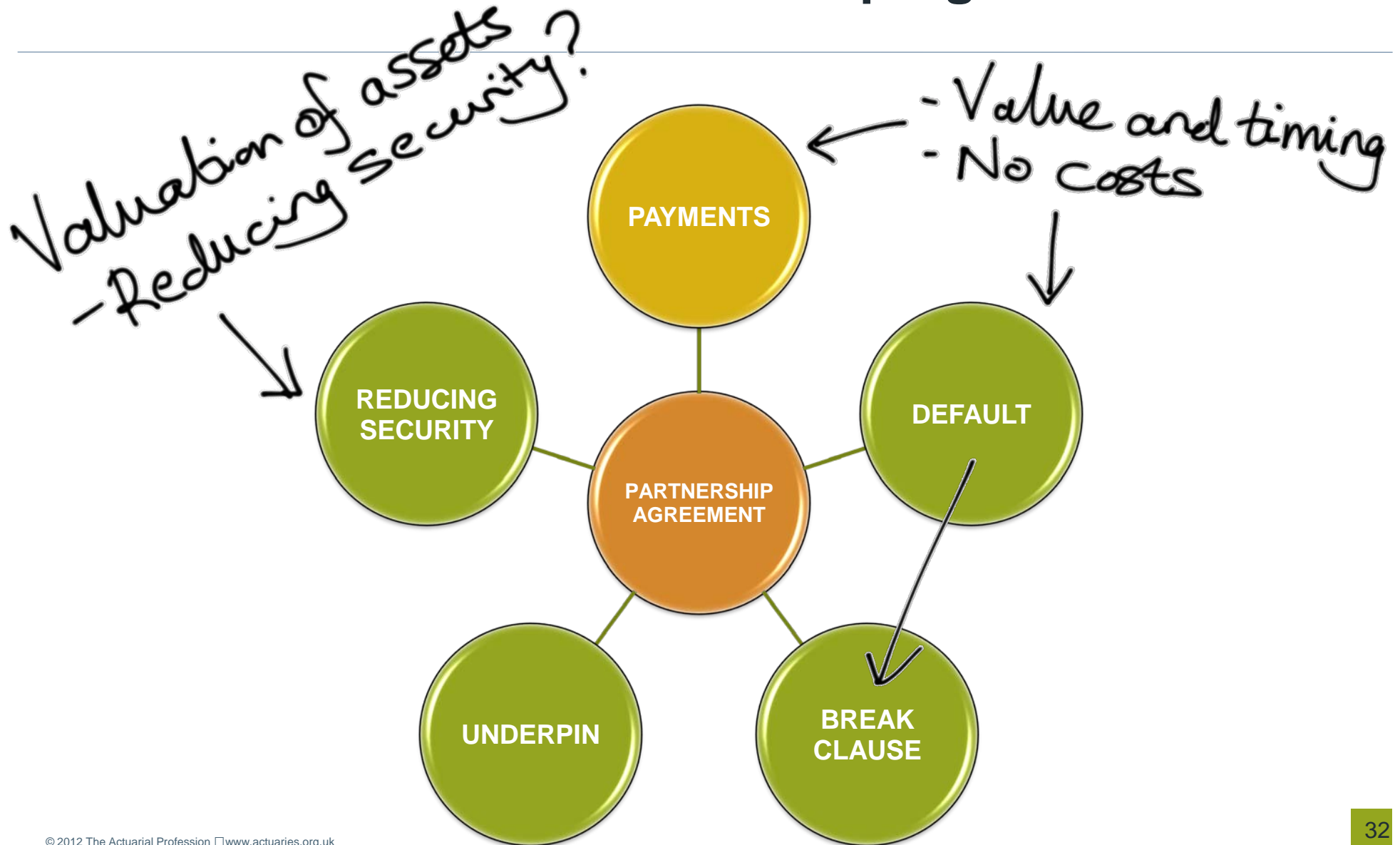
*Valuation of assets
- Reducing security?*



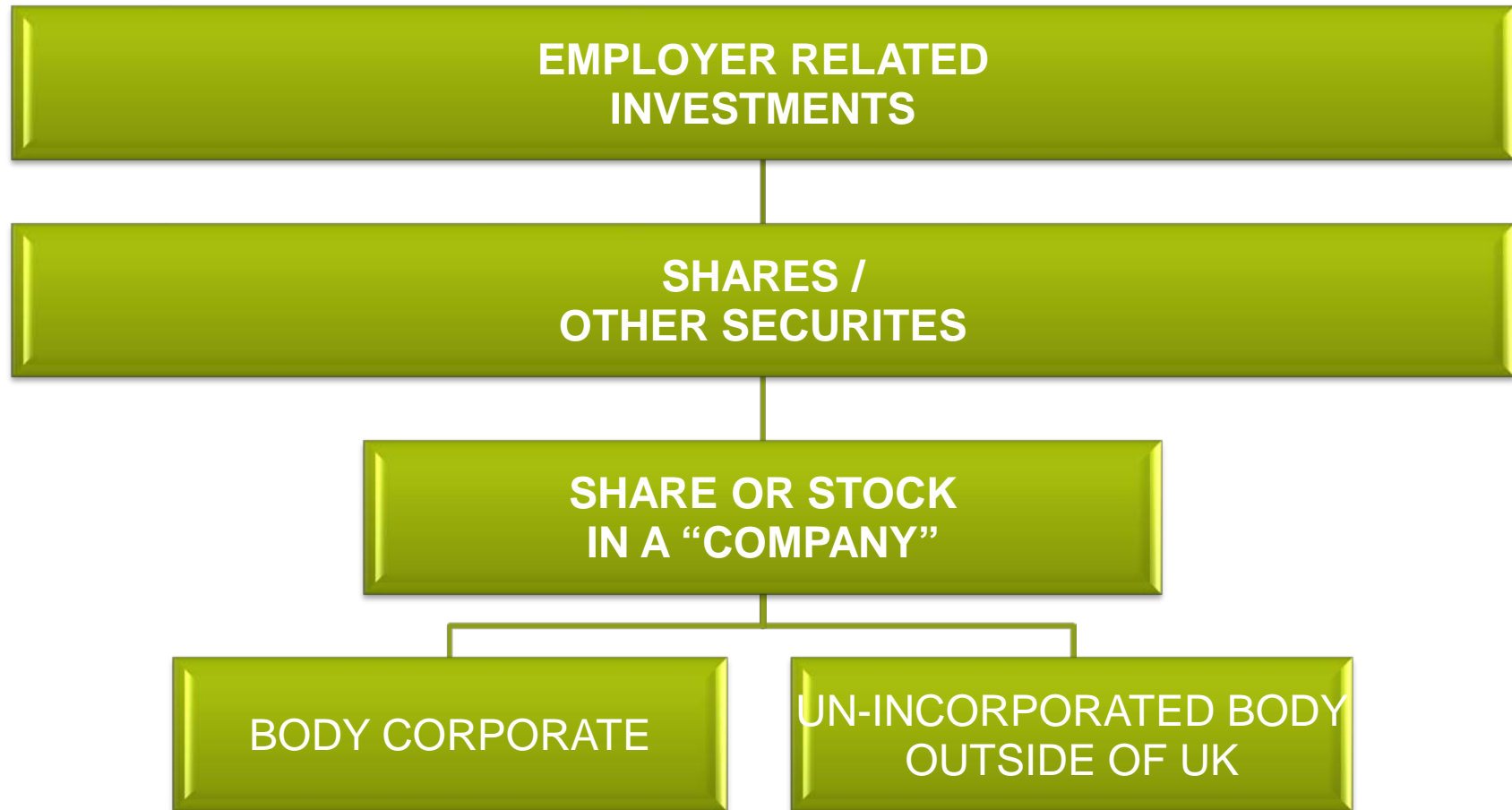
Issues for Trustees – Partnership Agreement



Issues for Trustees – Partnership Agreement



Scottish Independence



Deficit before and after

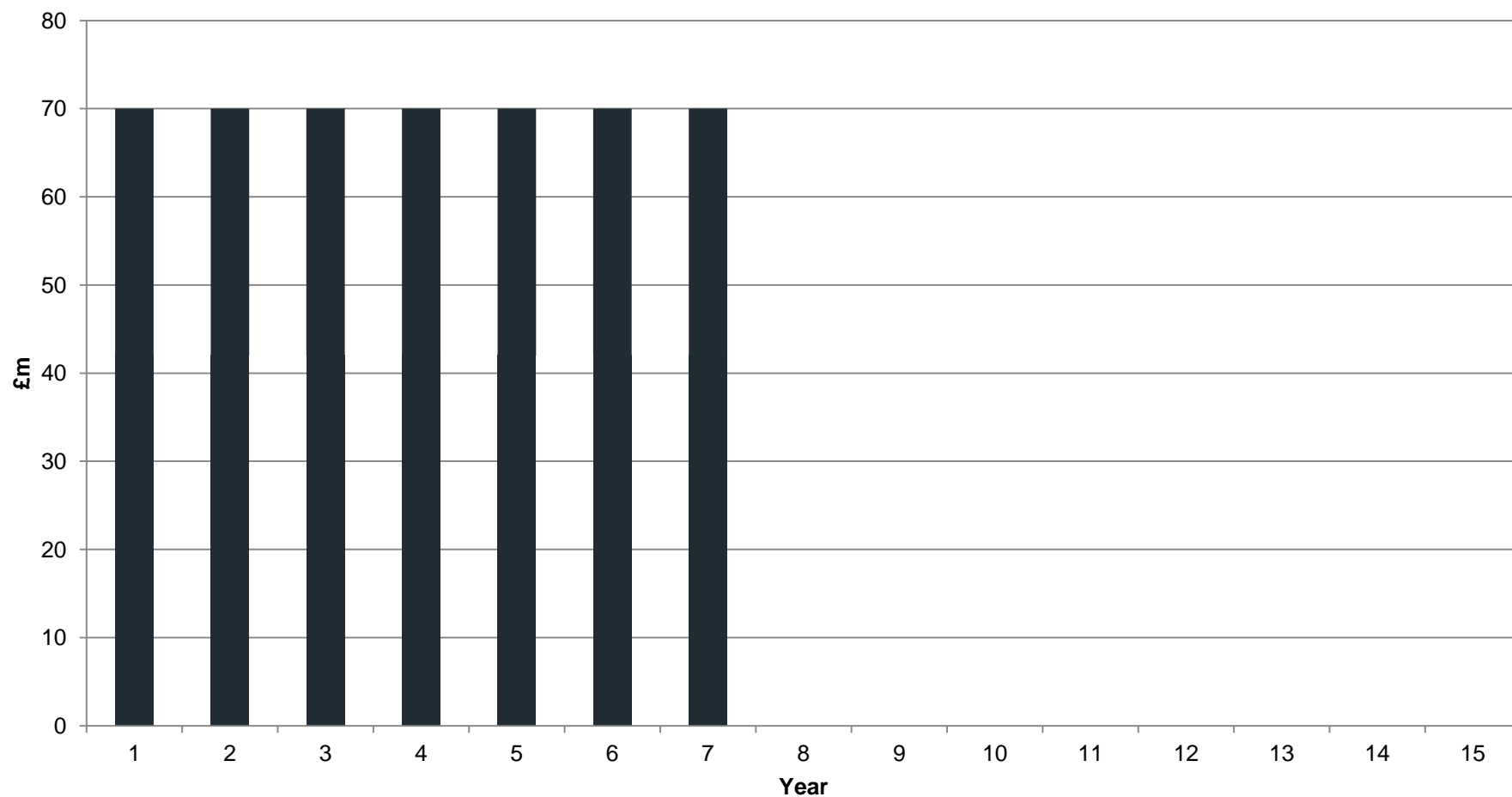
Deficit before funding vehicle	£400m
Value of funding vehicle (treated as an asset)	£250m
Deficit after funding vehicle	£150m

Deficit before and after

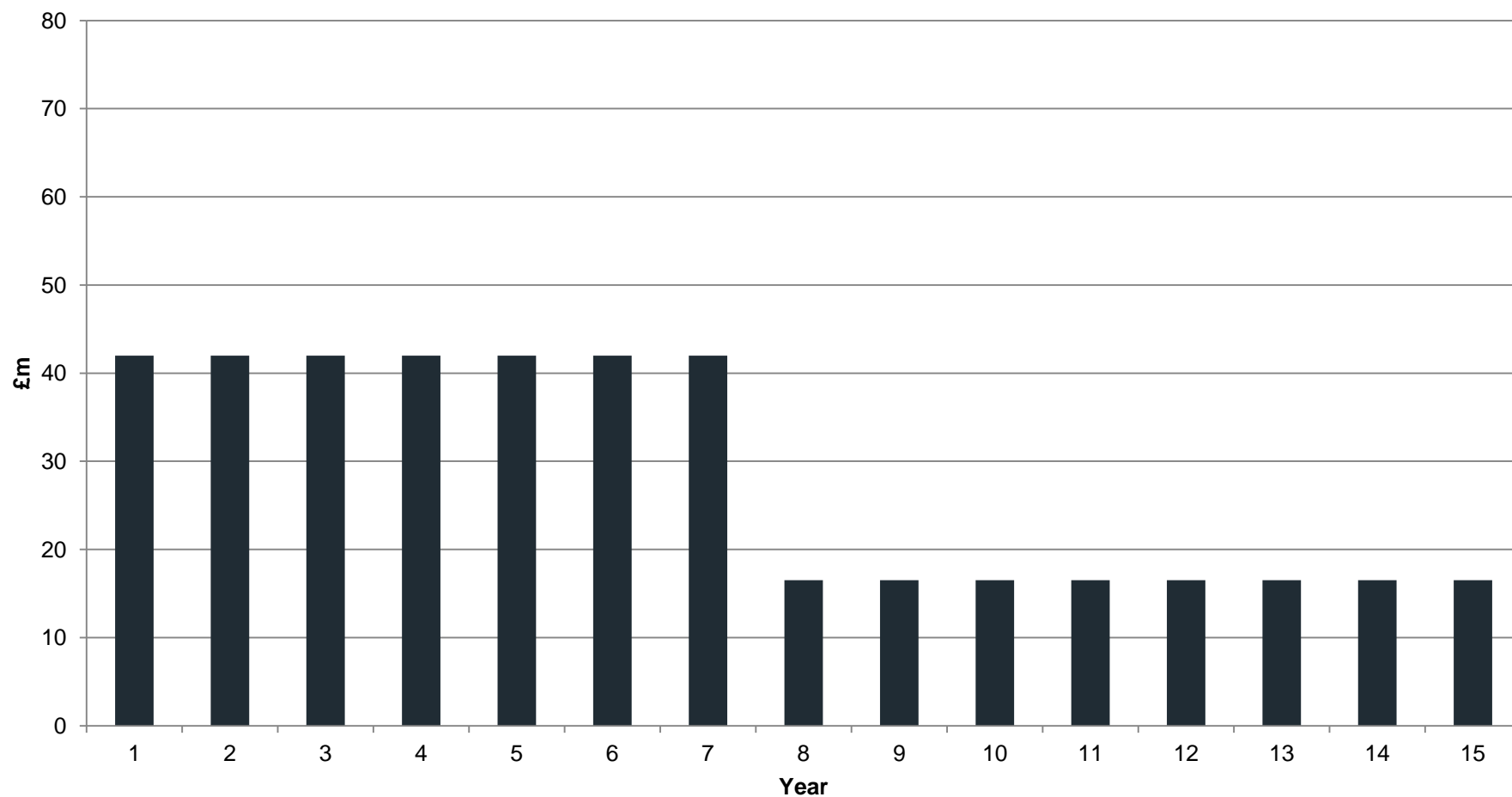
Deficit before funding vehicle	£400m
Value of funding vehicle (treated as an asset)	£250m
Deficit after funding vehicle	£150m

Looks as if a large proportion of the deficit has been paid off by this new asset

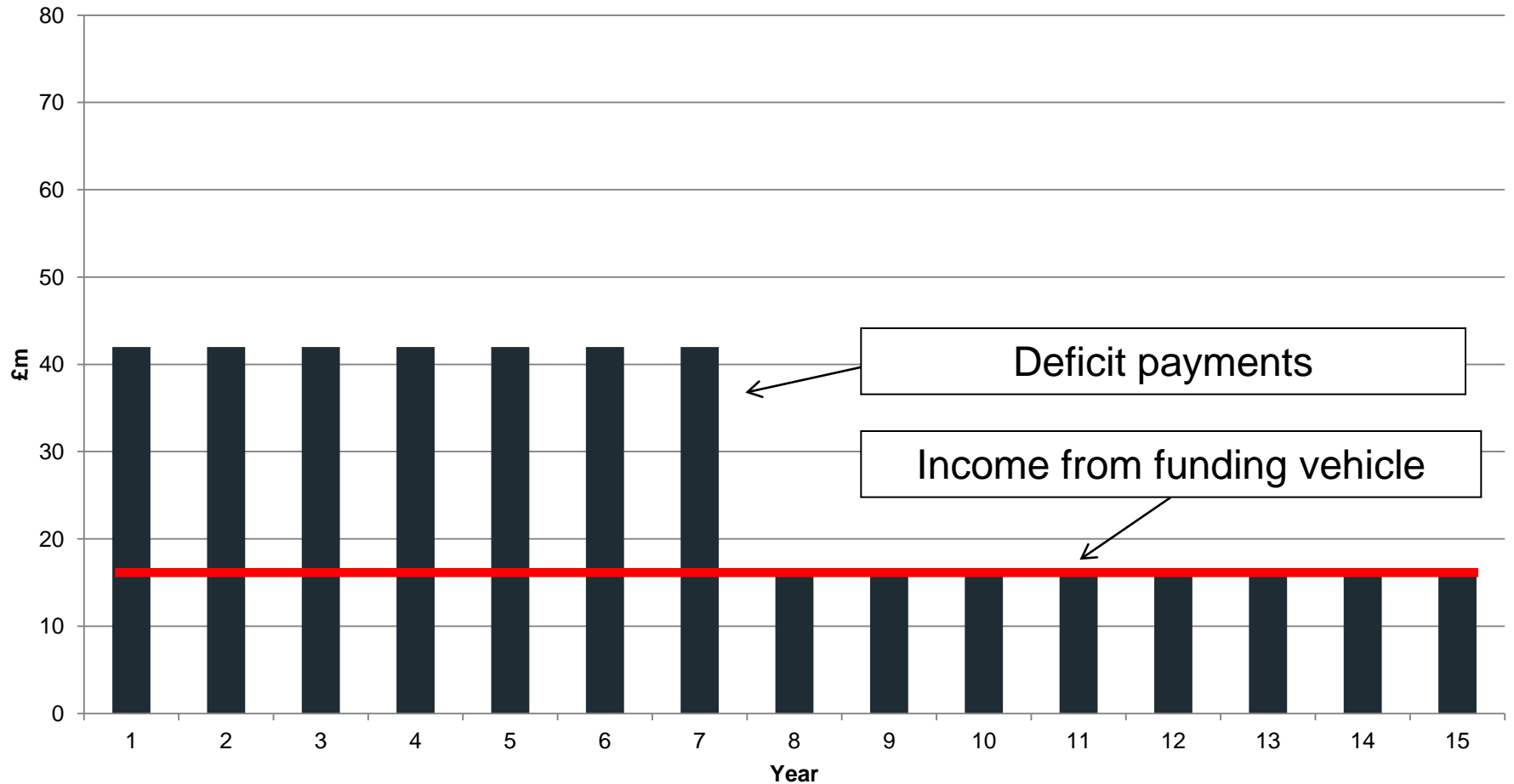
Recovery payments - before



Recovery payments - after

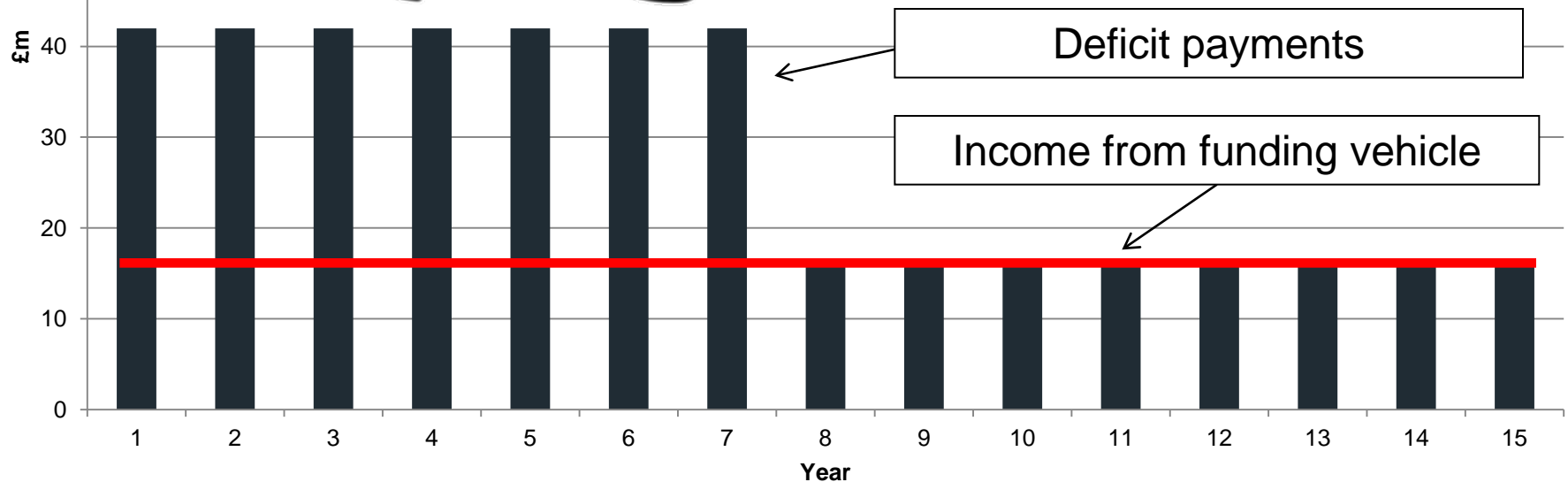


Recovery payments - after



Recovery payments - after


It's not an asset !!!
It's an extension to the
recovery period
(contingent asset)



Value of interest in funding vehicle

Deficit before funding vehicle	£400m
Value of funding vehicle (treated as an asset)	£250m
Deficit after funding vehicle	£150m

Discounted value of income affects the residual deficit payments



Options :

- Technical Provisions / Recovery Plan basis
- Negotiated
- Arm's length / Scheme Accounts value

Default risk :

- Not included
- Partial allowance
- Fully factored in

ABCs

Tax and accounting issues

1) Upfront contribution

- Is the ABC within the SFA legislation
- Is it an acceptable SFA?
- Is the investment by the Scheme at arm's length?

2) Tax treatment on establishing structure

- Capital gains
- Stamp Duty
- VAT

3) Ongoing taxation

- Is the structure an ABC?
- Deductibility of 'coupon' payments
- Underlying source of income

4) Accounting

- Treatment at group level – consolidate SPV?

Final thoughts

Thank you