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Pension Scheme Compromises in Corporate Restructuring

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Introduction

- Pre Pensions Act 2004
- What Has Changed?
- Implications for Restructurings
- Pension Law Issues Affecting Restructuring
- Case Study

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Pre Pensions Act 2004

- Restructurings led by employer or creditor group
- Pension scheme considerations secondary
- General approach adopted was “take it or leave it”
- No powers available to OPRA
- Cash settlements made unlikely to provide security for members benefits

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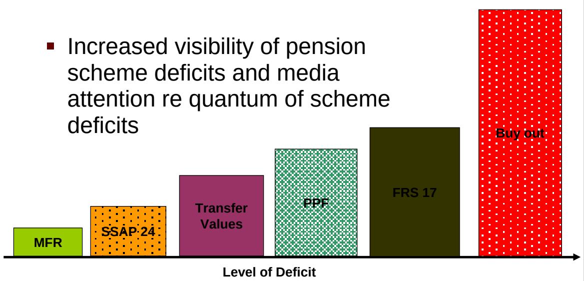
What Has Changed?

- Pensions Act 2004 – Far reaching impact, in particular moral hazard provisions
- New Pensions Regulator replacing OPRA
- Introduction of the Pension Protection Fund
- Amendments to Section 75 Pensions Act 1995 basis of debt on employer calculations

What Has Changed?

- Increased visibility of pension scheme deficits and media attention re quantum of scheme deficits



Implications for Restructurings

- Pension Schemes will increasingly be major stakeholders in restructurings
- Pensions Regulator involvement will be required
- Other parties to restructuring will be concerned to avoid Moral Hazard issues

Pension Law Issues Affecting Restructuring

- Revised Section 75 Pensions Act 1995 – crystallisation of debt on employer liability
- Sections 38–56 Pensions Act 2004 – anti-avoidance measures in relation to debt on employer liability (Moral Hazard)
- Clearance procedure
- Trustees desire to preserve entry to Pension Protection Fund PPF (on insolvency)

Section 75 Pensions Act Debt on Employer Liability

- Liability crystallises on the scheme going into winding up or on a participating employer when it leaves the scheme
- Calculated by reference to buy-out cost of all benefits under the scheme – very onerous
- Section 75 liability is much higher than PPF "protected liabilities" deficit
- Section 75 liability is an unsecured claim

Can a Section 75 Debt Be Avoided in Restructuring?

Anti avoidance provisions in PA 2004 include:

- Contribution notices
- Financial support directions
- Restoration orders

AVOIDANCE IS COURTING DISASTER!

Contribution Notice Liability

- Must be a party to an act or a deliberate failure to act where purpose was:-
  - to prevent recovery of whole/part of S.75 debt; or
  - otherwise than in good faith:
    - to prevent a S.75 debt becoming due;
    - to compromise or settle a S.75 debt; or
    - to reduce the amount of it.
- 6 year time limit

Financial Support Directions (FSD)

- Aimed at group companies to ensure they support pension liabilities of other group companies
- Pensions Regulator can make an FSD if:
  - Sponsoring employer of pension scheme is a service company; or
  - An employer in relation to the scheme is an "insufficiently resourced company"
- 12 month time limit from cessation of connection

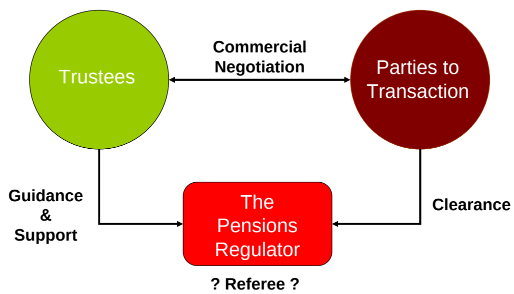
Clearance Procedure

- Businesses demanded a clearance procedure
- Objectives of Pensions regulator in offering transaction clearance:
  - Allow deal flow; and
  - Protect jobs
- Over-riding objectives still to ensure appropriate protection of pension benefits and avoid calls on PPF

Clearance Statements

- Pension Regulator confirmation that a transaction will not lead to a contribution notice or FSD
- Regulator has issued guidance it will follow and it expects parties seeking clearance statements to follow
- Each party seeking clearance must make a separate application but multiple applications based on same information are acceptable

Regulator's Role in Clearance



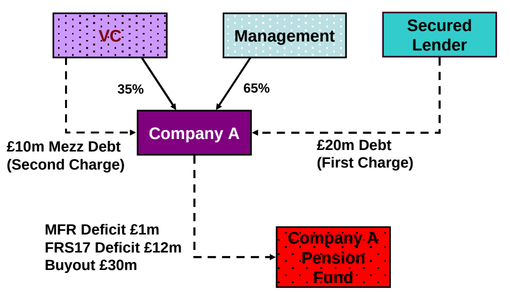
When Should Clearance be Obtained?

- All cases where a transaction is financially detrimental to the pension scheme as a creditor of the employer
- Scheme must be in deficit on FRS 17 basis
- If no FRS 17 measure or employer not continuing as a going concern must use s75 buy-out measure

Trustee Issues for Restructuring

- PPF fall back – provides bench mark against which any compromise can be assessed
- Compromise out of insolvency proceedings at below PPF benefits level may result in ineligibility for PPF
- Covenant assessment may be required for future business
- Encouragement from Pensions Regulator to act as an unsecured bank would

Case Study



Case Study

- Following operational restructuring - business profitable at an operating level but cannot service legacy debt
- In an insolvency situation the secured creditors would suffer a write of a large proportion of their debts - the unsecured creditors would get nothing
- The secured creditors are therefore considering a debt for equity swap but will not agree to this unless the pension scheme compromises at a level that will secure the company's viability
- The company has proposed a nominal payment compromise to the trustees - less than would be required to secure PPF level benefits. Cannot support pension scheme liabilities in restructured business

Implications for Stakeholders

Secured Creditor

- Key consideration will be on financial impact of transaction – might be better to allow failure than risk continued support
- May want to seek clearance to avoid suggestion that purpose of transaction was to avoid pension liability

Implications for Stakeholders

VC

- Consideration re financial implications – the right deal? Secured lender likely to control, but may require VC support
- Connected/Associated party – likely to want clearance from the Pensions Regulator (but clearance is always optional)

Implications for Stakeholders

Management

- May be conflict of interest issues between trustees and management
- May wish to seek clearance to protect against Contribution Notice

Implications for Stakeholders

Pension Scheme

- Key consideration for the trustees will be the protection of scheme members' interests
- Compromise level may result in ineligibility for PPF
- PPF entry requires insolvency event
- Regulator support and guidance may be sought
- Transaction may require "engineering" to enable PPF entry
- Regulator/PPF may consider stake in restructured business equity as condition of clearance

Conclusion

- Restructurings need to be planned carefully to avoid falling foul of Moral Hazard provisions
- Pension Schemes will be an additional substantial stakeholder to "buy-in" to process
- Member protection issues and PPF entry requirements may drive need to deal with restructuring by use of formal restructuring tools