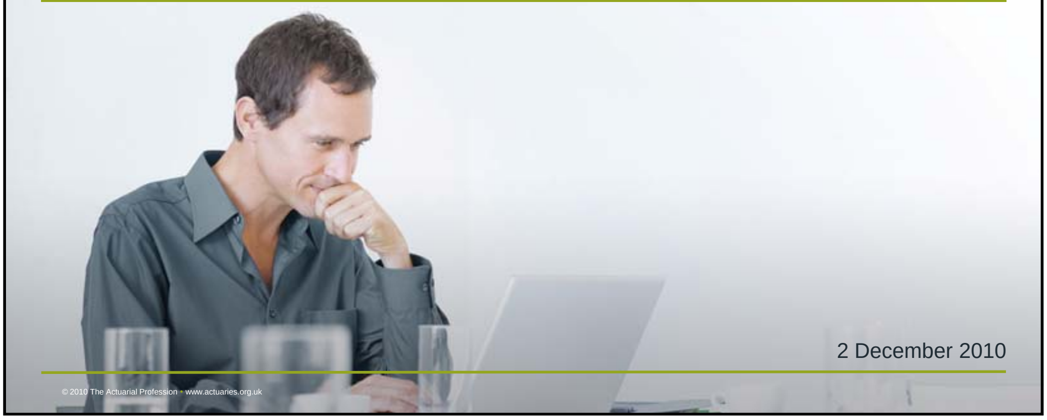
The Actuarial Profession
making financial sense of the future

Transferring schemes to the PPF where the employer remains solvent
Steven Hull: Ashurst LLP Tel: 0207 859 1257 E: steven.hull@ashurst.com



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What is the PPF?

- The PPF is a statutory fund established under the Pensions Act 2004
- The main function of the PPF is:
  - to pay compensation to defined benefit scheme members
  - when there is a qualifying insolvency event in relation to the employer
  - where there are insufficient assets in the pensions scheme to cover the PPF level of compensation

Which pension schemes?

- "Defined benefit" (or "final salary") schemes only
- 7,400 in U.K. and most are in deficit
- Not defined contribution schemes (including group personal pension/stakeholder plans)

Why transfer the pension scheme into the PPF where the employer remains solvent?

- Substantial deficit in the pension scheme
- Company cannot sustain/fund existing level of scheme debt
- Lender will not provide any further lending unless the pension scheme is accepted into the PPF
- Damage to trading entity in insolvency process (i.e. reputation and relationship with suppliers, trade creditors, etc)
- Can be used in debt for equity swaps
- But overseas parent?

How is the transfer of a scheme to the PPF achieved when there is a solvent employer?

- By regulated apportionment arrangement (RAA) (Reg 7A Occupational Pension Schemes (Employer Debt) Regulations 2005 as amended by the Occupational Pension Schemes (Employer Debt and Miscellaneous Amendment) Regulations 2008).
- RAAs allow the employer to survive and continue to trade free of its pensions liabilities

When can an RAA be used?

- Where the trustees consider:
  - reasonable likelihood the scheme will enter a PPF assessment period in next 12 months; or
  - where an assessment period has started but not ended
- Where TPR persuaded:
  - insolvency is “inevitable”; and
  - no grounds for it to consider using its moral hazard powers
- Where the potential recovery to the PPF is greater than the employer entering into insolvency

What is an RAA?

- A reduced amount of the employer debt is apportioned so as to avoid employer insolvency
- The employer pays a regulated apportionment arrangement share and not the employer’s liability share
- All/part of the difference between the RAA share and the employer’s liability share is apportioned to one/more of the remaining employers (“suicide company”)
- For single employer schemes a new “suicide company” will need to be created to take over the scheme
- “Suicide company” suffers an insolvency event (usually a CVA) triggering the PPF assessment period

Statement by TPR on RAAs and employer insolvency (August 2010)

- Where the sponsoring employer is at serious risk of insolvency, employers/trustees/advisers must engage in discussion at an early stage on all options including outcomes other than insolvency
- Engage with TPR at an early stage
- RAAs extremely uncommon
- RAAs must be approved by TPR

Statement by TPR on RAAs and employer insolvency (August 2010) (continued…)

- PPF confirmation that they do not object to the RAA
- Expectation that RAA applications will be accompanied by clearance applications
- Submit relevant information to TPR in draft clearance application and RAA including proposed level of mitigation
- Proposal should have been discussed in detail with the trustees
- Trustees/advisers need to consider all relevant factors, possible alternatives to RAA and whether insolvency is inevitable

Statement by TPR on RAAs and employer insolvency (August 2010) (continued…)

- TPR needs sufficient information to allow an initial assessment
- TPR will undertake due diligence to decide whether a RAA is appropriate
- TPR will consider circumstances such as:
  - whether employer insolvency is inevitable or are there other solutions including funding options for the scheme
  - whether the scheme might receive more from an insolvency
  - whether a better outcome might be obtained for the scheme by other ways (i.e. use of "moral hazard" powers)
  - the position of the rest of the employer group
  - the outcome of the proposals for other creditors

Statement by TPR on RAAs and employer insolvency (August 2010) (continued…)

- RAA approval will only be considered in circumstances where the scheme will enter a PPF assessment period in any case, irrespective of whether TPR approves the arrangement
- Approval notice can only be issued (at earliest!) 28 days after TPR determines to approve an arrangement

Deal usually agreed with PPF and TPR

- Cash payment – best negotiable above liquidation outcome
- 33% “anti-embarrassment equity stake in the U.K. employer if already connected to business
- 10% if not
- PPF very tough negotiators

Our experience of RAAs

Example: ABC PLC

- Bank required debt for equity swap and PPF entry or support withdrawn and put into administration
- Bank exposure above £50m and likely recovery on insolvency circa £6m
- RAA only means of achieving solvent restructuring
- Process and conditions for RAA
  - Trustees confirmed satisfaction re entry into PPF inevitable
  - Package of mitigating measures agreed with PPF – cash and equity
  - Cash equalled 10% of PPF deficit (not benchmark)
  - Agreement of PPF, TPR and trustees to "deal"
  - PPF confirmed non-objection to RAA
  - TPR issued notice of approval and cleared restructuring
- Timescale – circa 6 months

Example: DEF Ltd

- Parent entered Chapter 11 insolvency proceedings in US
- UK subsidiary loss-making with substantial pension scheme deficit but projected to return small profit if trade free of pension liability
- Parent would not support UK subsidiary with scheme deficit intact and agreed mitigation with trustees and PPF on basis that without deal insolvency of UK subsidiary inevitable
- TPR failed to confirm it would approve RAA and clear restructuring and shortly before parent's emergence from Chapter 11 in the US confirm it would only agree to a deal on buy-out basis
- Emergence from Chapter 11 delayed and UK subsidiary goes into administration
- What next?

Example: GHI Ltd

- Overseas parent of UK topco with UK sub which had substantial pension scheme deficit
- No history of value extraction from UK entity by parent
- Parent committed substantial loans to topco which it eventually remitted in debt for equity swap
- UK entity projected to be profitable without scheme liability but without parental support insolvency inevitable if no deal on pension scheme deficit
- Offer from overseas parent of c.1.5% of buy-out deficit plus 33% equity stake in topco accepted by trustees but rejected by PPF/TPR

Example: GHI Ltd (continued)

- UK entity sold to unconnected third party:
  - mitigation payment to schemes of c6% of buy-out deficit
  - PPF took 10% stake
  - overseas parent repaid 75% of its RCF provided to topco
- Deal struck with TPR, PPF and trustees fair in light of outcome for all parties – minimal return for overseas parent
- TPR/PPF will maximise value through competitive sales process if necessary in return for agreeing to RAA

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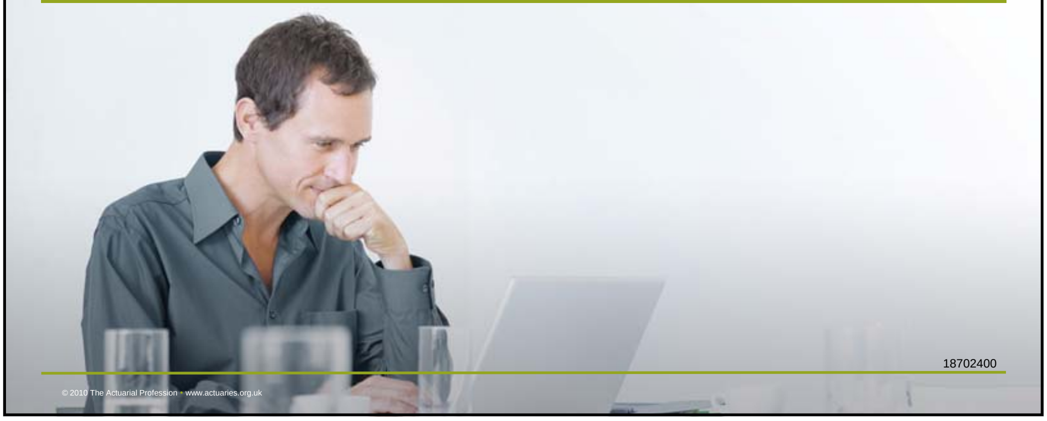

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