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CORPORATE RECOVERY

Pensions Act 2004

Pension Scheme Creditors - a force to be reckoned with

ADVISORY

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Where a pension creditor exists in a distressed situation, other creditors may have to get used to the pension trustees and / or their advisors becoming considerably more assertive. This situation will arise as trustees must ensure that they do not allow the pension scheme to have fewer assets than would support the benefits available to members under the new Pension Protection Fund regime ("the PPF").

The Pensions Regulator ("the Regulator") has issued guidance on what pension trustees should consider when corporate transactions, or a compromise of the pension creditor, are proposed. If they cannot secure the level of benefits available under the PPF, then their duties to their members may require them to force an insolvency procedure of the employer to obtain a better outcome for members through entry into the PPF.

What will the trustees consider in a distressed situation?

The Regulator's guidance suggests that trustees should seek to improve the position of their scheme in the same way as a lender holding a large unsecured balance would do, for example by:

- requesting higher contributions;
- requesting additional cash or other assets;
- requesting escrow accounts / cash deposits;
- requesting insurance of contributions;
- requesting information; or
- taking security (including negative pledges).

In a distressed situation, it is unusual for there to be sufficient free cash for any of the first three options to be implemented. Insuring against failure to pay contributions is theoretically possible, but in practice likely to be prohibitively expensive – money which might be better used to pay creditors. Requests for information should not be viewed as unreasonable and, if these can be aligned with the information already being provided to lenders, should not impose an unnecessary burden on a stretched management team – making this an easy concession to make in negotiations.

Security

In distressed situations, further security is usually granted in return for some consideration: for example, new money or continuation of facilities which could be withdrawn. It is possible that the pension creditor might argue that the security is being granted in return for it not enforcing its debt. However, any floating charge granted is at risk of being invalidated if an administrator or liquidator is appointed within 12 months of its execution as no new money will have been provided.

Compromising the Pension Creditor

If the likely outcome of a restructuring is that the pension creditor will receive, or remain funded at, less than the amount required to secure the benefits available from the PPF, then the trustees will achieve a better return for their members from the PPF. This does not give the trustees an incentive to agree to a restructuring following which the scheme remains unsecured. Indeed, it may give them a good reason to seek a formal insolvency where members' rights will be protected, wholly or partly, by the PPF. The insolvency may not be in the interests of other stakeholders or the company, but the trustees' duty is to protect their members. If an insolvency event occurs, or in certain circumstances before an insolvency event occurs, then the PPF will take over the rights, duties and obligations of the trustees, including their seat at the negotiating table. The PPF is unlikely to negotiate any less strongly than the trustees.

In addition, the PPF's guidance is clear that any compromise of the pension creditor to a level below that necessary to secure the level of benefits which the PPF would provide will make the scheme ineligible for the PPF. The obvious consequence of this is that trustees will be unwilling to compromise at a level which will not provide the pension fund with a share of the assets which gives it sufficient funds to secure at least the level of PPF benefits. This leaves trustees with a dilemma: do they force an insolvency or S425 Scheme to protect the compromise, with all the attendant loss of value in the business, or do they lose the protection for their members? Trustees will become very conscious of their personal liability if members feel that their rights have not been protected, and may become more risk-averse as a result.

As a result of both issues: the better outcome for members and the risk of losing protection for members in the future, trustees may consider insolvency an outcome with a limited downside.

Conclusions - so what should lenders consider?

The size of the unsecured pension creditor makes the trustee a significant player. The trustee not only has the power but also potentially a duty to force the company through an insolvency process to make the scheme eligible for entry into the PPF. Although the pension trustee is not providing new money, giving them security as part of a restructuring may be less damaging than going through an insolvency process. Lenders should take account of the level of compromise at which the trustee will prefer insolvency. If the level of funding proves too high for the company to support, lenders will need to consider a formal insolvency or S425 Scheme to effect the restructuring. The existence of the PPF is a double edged sword: potentially protecting pensions benefits at the cost of jobs.

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