The Pensions Bill

New duties on trustees and employers with Defined Benefit Schemes will make restructuring more complex

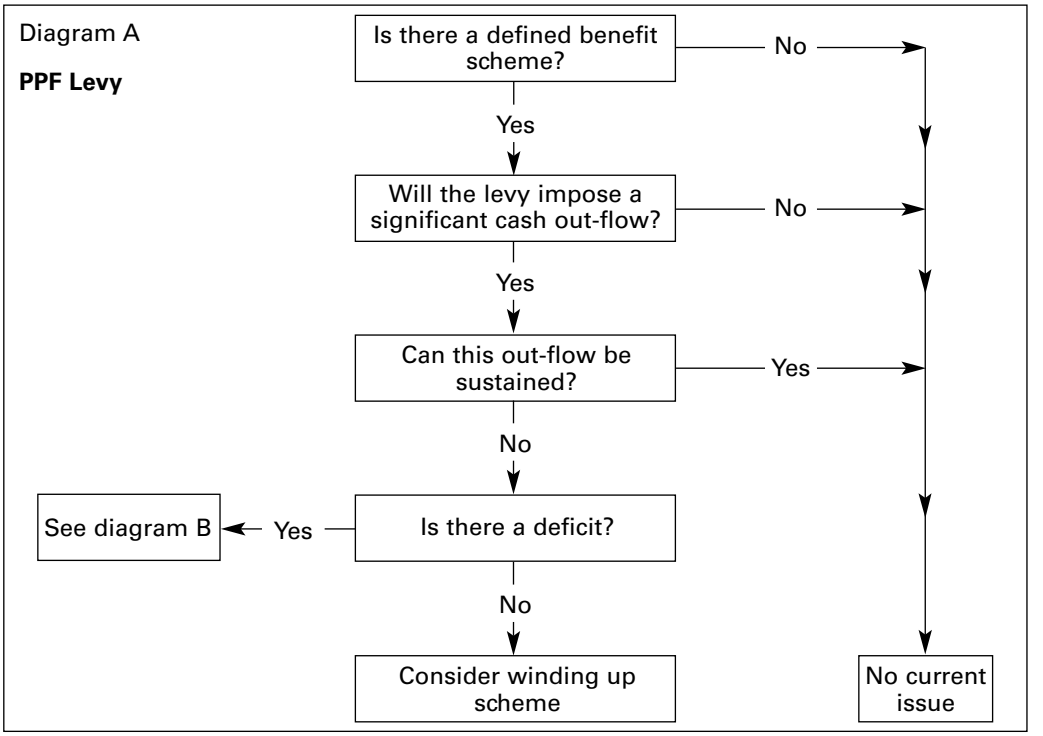
Key points for lenders in the recent Pensions Bill:

- Companies will have to contribute to the new Pensions Protection Fund ("PPF") levy, through their pension schemes, potentially placing further cash strains on troubled companies.
- Trustees, and/or the Pensions Regulator, will have new duties to take action where it appears that the employing company is unlikely to continue as a going concern.
- The PPF's Board will not automatically be bound by a S425 Companies Act Scheme of Arrangement ("Scheme") or by a Company Voluntary Arrangement ("CVA").
- In procedures other than a liquidation, the unsecured creditor for the deficit will now amount to the full cost of providing for all members' entitlements.

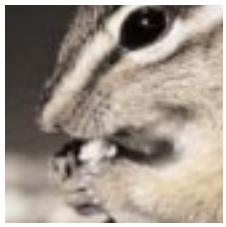
What should a lender worry about?

PPF levy

The levy has been widely trailed and is intended to fund a compensation scheme for employers who have become insolvent, leaving pension funds with a deficit. The levy may be either risk-based (size of deficit and risk of insolvency) or scheme-based (number of members, amount of earnings, amount of liabilities – not deficit) or both. At present it appears that in the first instance a simple scheme-based levy will be used. A decision tree for action is shown below.



The levy will add an extra burden to employers, and it is possible that a troubled company will be hit by the "double whammy" of increased contributions to the scheme to meet the deficit and a higher levy if the risk-based method is used. Both increase the likelihood that the troubled company might fail.

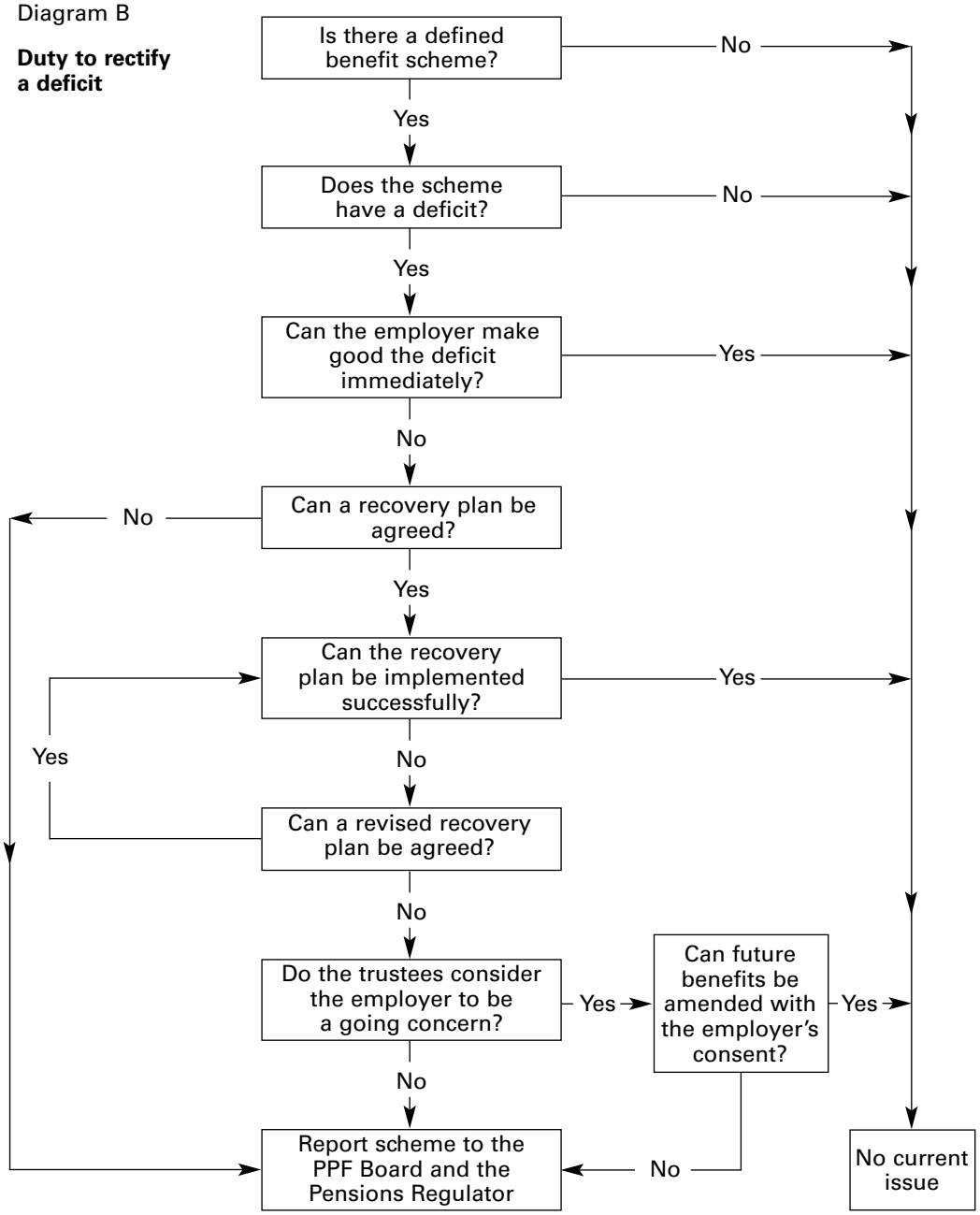


Duties of the trustee to rectify a deficit

A decision tree showing the steps which might be taken is below.

Diagram B

Duty to rectify a deficit



If, following an actuarial valuation, the scheme has a deficit, then the trustees have a duty to prepare a "recovery plan". This must show how, and in what timescale, the deficit will be made good, and must be appropriate having regard to the nature and circumstances of the pension scheme. The circumstances of the employer are not mentioned.

Clearly, there is scope for considerable conflict here between the scheme and the employer. Should the recovery plan be too aggressive, the employer may not be able to meet it without breaching its facilities; should it be too weak, then the trustees face criticism and possible penalties. There will be a particular conflict where the trustees are also the directors of the employer.

It will be important for trustees, employers and lenders that any recovery plans are based on robust and realistic forecasts, enabling the employer to survive whilst rectifying the deficit as swiftly as possible.

Lenders will need to take particular care that the recovery plan is robust. Otherwise, they run the risk of lending money which will go straight to the pension fund and pensions levy, without producing income or assets for the company.

There is an issue as to whether failure on the employer's part to meet such a plan would give the trustees grounds to think that the employer is no longer a going concern, with the consequences outlined below.

If a plan is agreed by the employer, but not then fully met, the trustees must report this to the Pensions Regulator.

New duties on the trustee to investigate the financial health of the employer

The Bill imposes a duty on trustees of an eligible scheme (which is not a money purchase scheme) to request the PPF Board to take responsibility for the scheme where it appears to them that the employer is unlikely to continue as a going concern. The PPF Board must then investigate whether a "scheme rescue" is possible.

This raises a number of interesting points for lenders:

- At what point might a trustee consider the employer unlikely to continue as a going concern? The duties of a trustee are onerous and they may be inclined to "play safe" – by leaning towards an early intervention.
- How will a trustee decide on the going concern status of an employer? They might instruct investigating accountants to review the company following a failure to pay contributions, or some other warning sign. They might, however, simply rely on (outdated) statutory accounts showing a deficit under FRS17 valuations.
- Does this trigger a default under any facility – and if not, should it? If the trustees are appointing an investigating accountant, should the lender try to become involved or take protective steps of its own?
- What is a scheme rescue? The term is not defined in the Bill.
- How will the PPF Board decide if a scheme rescue is possible? Almost anything can be "rescued" if sufficient new money is provided, and/or liabilities are sufficiently reduced, but where from? Again, lenders will need to be involved in the process to become comfortable that the proposed solution is robust and achievable.

Compromises

CVAs and Schemes have become relatively common methods of allowing a company to restructure its liabilities. The arrangement will normally involve most or all creditors agreeing to some form of debt reduction.

In an insolvency of the employer, the PPF will meet the deficit on the scheme, on a limited benefit basis, and will then be a contingent creditor in respect of the deficit. However, a CVA or Scheme will not, it appears, bind the PPF Board unless it consents. If it does not consent, the PPF Board will not be subject to the terms of the compromise.
This may mean that:

- it is free to pursue its own remedies – which may include petitioning for insolvency of the company if its claim is not met; and/or
- it will need to be involved in separate negotiations to obtain its consent, in addition to the normal processes of seeking approval to a CVA or Scheme; and/or
- it may drive a very hard bargain for its consent, thus effectively gaining priority over other creditors. This is inconsistent with a pari passu treatment of creditors.

The effect of these provisions, if they remain unchanged, will be to introduce further complexity and expense into the restructuring process. It is unlikely to assist in saving companies, as one, often substantial, creditor will be outside the process and can take its own enforcement steps.

Conclusions

The Bill makes it likely that there will be more financial demands on employers who maintain a defined benefit scheme. Any deficit will need to be addressed much earlier and is likely to be higher than previous methods of calculation, in particular the Minimum Funding Requirement basis, have indicated. This will place further stress on the cash position of troubled companies and lenders may be asked to make further facilities available to meet the claims of the pension scheme and pensions levy.

Trustees may need to take action earlier to force employers to remedy pension scheme deficits. Lenders will need to be aware of trustees' proposed actions in order to ensure that they are not "shut out" of a process which will have a significant effect on the debtor's cash position.

It is even possible that trustees of a Defined Benefit Scheme may precipitate an insolvency, in order to take advantage of the PPF "safety net", which might produce higher returns for members.

Lenders should review their clients to identify those with Defined Benefit Schemes and seriously consider the implications if there is a deficit.

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