Pension Protection Fund

PPF Restructuring and Insolvency Team
Guidance on the PPF's approach to Employer Restructuring

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1. Background

1.1. When an employer becomes insolvent and it has a pension scheme that we protect, we exercise creditor rights on behalf of the scheme and will seek to maximise recoveries from the employer to reduce the pension deficit.

1.2. Occasionally, an employer with a pension scheme in deficit faces insolvency and will propose a restructuring package to allow it to continue trading, while the Pension Protection Fund (PPF) takes on the pension scheme.

1.3. Such situations are rare and we do not agree to them lightly. We will only support such proposals once we are satisfied that insolvency is inevitable in the foreseeable future and they provide a significantly better return for the pension scheme than it would receive through the normal insolvency process.

1.4. The negotiations that take place to agree these transactions are, by their very nature, complex and confidential because of their commercial sensitivity.

1.5. This guidance is designed to assist employers, trustees and their advisors in formulating their proposals so that they have a better understanding about our approach and thus manage their expectations of possible outcomes.

1.6. High-profile restructuring cases such as Arcadia, Debenhams and Hoover have meant that our role in restructuring has received greater scrutiny and analysis, some of which has been inaccurate and occasionally even potentially misleading.

1.7. This guidance illustrates why we might enter into these agreements and summarises the principles we use to make our decisions. The example we use is based on a simplified set of facts and serves only to explain the points. Real world facts may well result in a different outcome.

1.8. It is important to note that this is general guidance and we may vary our approach or requirements depending on the individual circumstances presented. We consider each case

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on its own facts. However, we will always be focused on maximising the return in respect of the creditor rights we hold.

2. Restructuring and rescues

2.1. If our principles are met, we may take part in the restructuring or rescue of an otherwise insolvent business.

2.2. The restructuring will mean that the employer's pension scheme will be better off than if the business had been simply left to fail. It usually involves removing the pension debt from the employer company, allowing it to continue to trade with a positive cash flow and potentially make a profit. It is usually achieved through either a Regulated Apportionment Arrangement (RAA) or through a company voluntary arrangement (CVA), which has become a popular tool to compromise different types of unsecured creditor.

2.3. This could be considered to be "pensions dumping", which would be contrary to the Pensions Act 2004, but that is not the case.

2.4. We will only take part in a restructuring if our principles are met. These principles apply to the consideration of all proposals to ensure there is no selective advantage. The principles are designed to make sure that we only consider restructurings for pension schemes that are going to commence a PPF assessment period due to the insolvency of their employer, but as a result of a restructure, the scheme (and potentially the PPF) will be in a much better position than it would if we had done nothing.

2.5. Most negotiations will take place alongside The Pensions Regulator (TPR), which also needs to provide clearance for any RAA transaction before any restructuring can be concluded.

2.6. Where CVAs are proposed that do not involve the pension scheme being compromised, the PPF has some different considerations which are set out in our Guidance Note 5 - Company Voluntary Arrangements.

2.7. Further guidance is available on our website for situations arising where the restructuring proposal involves a new or successor scheme.

3. Restructuring principles

3.1. We judge every proposal that is put to us on the specific facts relating to the case. We apply these principles in all situations no matter what type of restructuring or rescue is involved.

3.1.1. Insolvency has to be inevitable – this means that the pension scheme will be entering a PPF assessment period whatever happens. This is the "gateway" test and we will not consider any proposal that does not meet it.

3.1.2. The pension scheme will receive money (or in rare circumstances assets) which are of a significantly higher value than it would have otherwise received through the insolvency of the employer. Importantly, the money received needs to be considered by the PPF to be proportionate to the pension buyout deficit. This is the debt that would be due under s75 of the Pensions Act 1995 (s75).

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3.1.3. What is offered to the pension scheme in the restructuring is fair compared to what other creditors and stakeholders receive as part of the transaction. We expect all creditors that would face a shortfall in an insolvency to take part in the restructuring and not to be in a better position than the pension scheme following a pension liability reduction restructuring.

3.1.4. The PPF will seek at least 33 per cent of the equity in the restructured company for the scheme. This is often called anti-embarrassment protection and is to make sure that in exercising creditor rights, the scheme/PPF can obtain the best return in respect of those rights, not only in respect of immediate cash realisations but also realising the value in any future success the restructured company enjoys. Should the future stakeholders (such as shareholders/owners/debt providers) be entirely unconnected or involved with the company prior to restructuring we may agree to receive a smaller percentage but this will never be less than 10 per cent. For the avoidance of doubt, the acquisition of an existing share or debt obligation will be considered as making the party connected.

3.1.5. We need to make sure the pension scheme would not be better off if TPR had used its moral hazard powers to issue a contribution notice or financial support direction instead of agreeing to the restructuring. In the case of a CVA, it remains open for TPR to use those powers in the future but it is likely that the clearance required for a RAA to take place will prevent the subsequent application of these powers. Accordingly, we expect scheme trustees, with the assistance of their professional advisors, to have fully analysed the circumstances surrounding the scheme and the employer to ascertain if the moral hazard powers could be used.

3.1.6. We will consider the overall viability of the employer's restructuring proposal. Rarely is the pension deficit the sole cause of the employer's distress and where this is the case, we will wish to ensure the proposals have a reasonable chance of success. This is particularly important if any of the mitigation provided by the employer is reliant on the business going forward. Additionally, where the restructuring involves a refinancing, the fees charged by the lenders must be deemed by the PPF to be reasonable in the context of the mainstream banking market. We are also focused on the overall return a lender may receive and how the anti-embarrassment equity is protected from expensive debt being introduced into the business as a means to dilute returns to equity.

3.1.7. The party seeking the restructuring must pay the costs incurred by both the PPF and the trustees in delivering the restructuring. These will include, but are not limited to, any fees for legal and financial advice and any other costs incurred by the PPF and trustees in considering the transaction and resulting from the transaction, such as TUPE liabilities relating to the staff costs of the pension scheme. These costs must be paid whether or not the restructuring is completed. We will request an undertaking to cover the costs and where appropriate, require funds to be placed in a designated client account at the start of the process if we consider there is a risk to them ultimately being paid.

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4. Case study

4.1. We assess every proposal that we receive on its unique set of facts and merits. Although every case is different, the following example helps demonstrate how the principles are applied in practice.

Background

4.2. The employer has fully utilised its working capital facilities following losses on the last contract in a business area that it no longer operates in.

4.3. The employer has a £100 million unsecured bank debt which is unlikely to be fully repaid on insolvency. The bank will not advance any new money to the company in the current circumstances.

4.4. Its pension scheme has a deficit of £100 million. The expected dividend through a normal insolvency process is zero.

4.5. The employer puts forward a rescue proposal that involves a management buy-out to allow the business to keep trading. It also proposes that the pension scheme enters the PPF assessment period and offers the pension scheme/PPF £1 million to eliminate the pension scheme so it can continue trading.

4.6. If the pension scheme is eliminated, the bank debt has a good chance of being fully recoverable and enough working capital will be made available.

No rescue

4.7. The company is clearly insolvent and has a large deficit in its pension scheme. The loss of the contract and the absence of new funding from the bank means the company cannot afford to pay for wages or vital supplies. Insolvency is, therefore, inevitable.

4.8. If the company enters insolvency, even the secured creditors (the bank) would only get a small proportion of what they are owed – and unsecured creditors, including the pension scheme, would get very little.

4.9. On insolvency the pension scheme would enter the PPF assessment period. The PPF would have to take on the deficit with very low recoveries to fund compensation paid to members.

Rescue

4.10 The proposal as it stands does not meet the PPF principles. We would enter into negotiations with the various stakeholders in the business to address the following points:

- A substantial cash payment to the scheme which is significantly better than the "going concern" insolvency outcome will be required. Although £1 million is better than the insolvency outcome, it is not proportionate when compared to the s75 buyout debt.
- An equity stake of at least 33 per cent in the company will be required as the new shareholders are the existing management team.
- Other creditors who would otherwise face a loss benefit disproportionately from the proposal. In particular, the bank will have the opportunity to recover significantly more of

its money over time. This means we would seek a more appropriate “price” from the bank, perhaps by it agreeing to convert a substantial proportion of its debt to equity.

- The company will have to cover any liability for staff employed to administer the pension scheme that might transfer to the PPF as a result of the rescue.
- The ongoing company will pay the costs and fees incurred by the trustees and PPF in completing the transaction.

4.11. If it was not possible to address these points and demonstrably comply with our principles, the proposal would be rejected. The employer would then enter insolvency and the pension scheme would receive virtually nothing in terms of recovery from the insolvency.

4.12. Alternatively, proposals that can be improved through negotiation to a point where they achieve demonstrable compliance with the PPF’s principles will result in an improved position for the scheme and in turn will also reduce the burden on our levy payers.

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Please note this leaflet seeks to assist stakeholders and insolvency professionals on our approach to restructuring and insolvency cases. It is an accompaniment to existing publications from the PPF published on our website, not a substitute. We encourage restructuring & insolvency practitioners and trustees to seek appropriate, specific case guidance.

See **www.ppf.co.uk** for further information.