Pension Protection Fund

Guidance on the PPF's approach to Employer Restructuring

December 2018

Contents

An introduction from the Director of Restructuring & Insolvency

When an employer becomes insolvent and it has a pension scheme which 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.

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

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.

These arrangements can sometimes be controversial, so we feel it is important that people have a better understanding about our approach to them. This guidance is designed to assist employers, trustees and their advisors in formulating proposals and managing expectations of possible outcomes.

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

Malcolm Weir
Director of Restructuring & Insolvency
Pension Protection Fund
December 2018

"This guidance is designed to assist employers, trustees and their advisors in formulating proposals and managing expectations of possible outcomes."

Section 2

Background

We typically participate in two or three restructurings a year.

Each year we are involved in a very small number of restructuring or rescue transactions affecting employers which otherwise face certain insolvency. The negotiations that take place to agree these transactions are, by their very nature, complex and confidential because of their commercial sensitivity.

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

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

"The negotiations that take place are, by their very nature, complex and confidential because of their commercial sensitivity."

Restructuring and rescues

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

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).

This could be considered to be ‘pensions dumping’, which would be contrary to the Pensions Act 2004, but that is not the case. 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. These principles are designed to make sure that we only consider restructurings for pension schemes that will come to the PPF in any event and the scheme will be in a much better position than it would have been if we had done nothing. Most negotiations will take place alongside The Pensions Regulator (TPR), which also needs to provide clearance for the transaction before any restructuring can be concluded.

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 *PPF Restructuring & Insolvency Team – Guidance Note 5*.

Further guidance is available on our website for situations arising where the restructuring proposal involves a new or successor scheme (https://www.ppf.co.uk/further-guidance-and-support).

Restructuring principles

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.

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.

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. The proposal also needs to be considered by the PPF to be realistic compared to the pension buy-out deficit. This is the debt that would be due under s75 of the Pensions Act 1995.

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.

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.

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.

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.

Restructuring principles
continued

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.

"The party seeking the restructuring must pay the costs incurred by both the PPF and the trustees in delivering the restructuring."

Case study

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

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.

The employer has a £100 million bank debt which will be just about irrecoverable on insolvency. The bank will not advance any new money to the company in the current circumstances.

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

The employer puts forward a rescue proposal which 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.

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

The company is clearly insolvent and has a large deficit in its pension scheme.

This means the company cannot afford to pay for wages or vital supplies. Insolvency is, therefore, inevitable.

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.

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

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

Case study
continued

them agreeing to convert a substantial proportion of their 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.

If we did not agree to the transaction, the pension scheme and, ultimately, the PPF, would have received virtually nothing from the inevitable insolvency that would have followed – and our levy payers would have to fund the deficit. However before any transaction could be agreed the PPF principles must demonstrably be met. Accordingly proposals will be rejected if they do not satisfy PPF principles and cannot be revised to meet those criteria.

"Restructuring proposals will be rejected if the PPF's restructuring principles are not met."

Section 6

Restructuring & Insolvency Team contact details

Malcolm Weir
Director of Restructuring & Insolvency
malcolm.weir@ppf.gsi.gov.uk
020 8633 4940

Mark Allen
Case Manager
mark.allen@ppf.gsi.gov.uk
020 8633 5823

Mark Stonestreet
Case Advisor
mark.stonestreet@ppf.gsi.gov.uk
020 8633 5941

Address for all correspondence:

The Pension Protection Fund
Renaissance
12 Dingwall Road
Croydon Surrey CR0 2NA

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 and The Pensions Regulator on our respective websites, not a substitute. We encourage restructuring and insolvency practitioners and trustees to seek appropriate specific case guidance.

See **www.ppf.co.uk** and www.thepensionsregulator.gov.uk for further information.