CORPORATE PENSION SCHEME DUE DILIGENCE

Able Governance Ltd Newsletter **Spring 2017**

Pensions in Corporate Deals

Pension schemes—particularly defined benefits schemes—can hold up or even derail a corporate transaction. Even defined contribution schemes or other workplace pension arrangements can cause problems and cannot be ignored.

Due diligence into the pension arrangements of a company is essential in any M&A or corporate restructuring activities.

What issues should you look out for?

The questions that you need to ask are:

- What type of scheme is it?
- Who is responsible for governance and liaising with the company?
- What issues may arise that could hold up the progress of the transaction?

Some schemes present real challenges

Although increasingly rare, defined benefit schemes (also known as DB or final salary schemes) are the most difficult to handle. It is vital that you understand the issues and have a plan to prevent the scheme from derailing the transaction.

" When we receive the information we require from co-operative employers and scheme trustees, we can use the tools available to us as part of the regulatory framework to agree innovative restructuring solutions."

- The Pensions Regulator

Being held up can be frustrating

In This Issue

- Why scheme type matters
- Measures of funding
- TPR and the PPF
- Potential solutions
- Corporate Pensions HealthCheck report

Different flavours

Why scheme type matters

Occupational pension schemes come in a number of flavours, some with more potential impact on a corporate transaction than others.

Defined Benefit schemes (DB or Final Salary)

Pensions are calculated according to a formula based on earnings and length of service. As the benefit is defined, it is difficult to predict how much it will cost to provide in the future.

This uncertainty is the root cause of the pensions deficits that can present difficulties for a company. Even where the scheme is closed to further benefits, the employer is on the hook for any shortfall.

Defined Contribution (DC or Money Purchase)

As the name suggests, the contribution is defined, and the uncertainty relates to the amount of pension it will provide in retirement. This type of scheme won't cause unpredictable funding headaches for the employer, but the Pensions Regulator has raised the bar for trustee performance. This step change may cause some employers to seek to wind up the scheme.

Master Trusts such as NEST

Many companies use a Master Trust such as NEST or Peoples Pension to meet their workplace pension auto enrolment obligations. The company must ensure that contributions and notices to members are handled correctly, or face fines.

Stakeholder Plans and GPPPs

Group Personal Pension Plans (GPPPs) and Stakeholder plans are 'contract-based'. This means that the policy belongs to the employee, and the company's duty is simple to ensure that the contributions are deducted properly and paid promptly to the pension provider.

Measures of Funding

The funding level of a DB scheme is the extent to which the assets cover the pension liabilities.

The liabilities are measured differently in different circumstances:

FRS102 or the Accounting standard: appear in Employer's accounts

FRS17 or PPF level: measures liabilities on the lower PPF basis

Statutory Funding Objective: the 'on-going' basis—assumes liabilities are settled as they fall due

S75 or Buy out level: the 'wind up' basis—benefits are secured in full with insurance policies

Which measure is important?

TPR and PPF

The guard dog and the lifeboat! These two bodies have an intense interest in company pension schemes. Any corporate activity that may affect the security of members' pensions will attract their close attention.

The Regulator has powers to direct trustees to take actions, or to impose an independent trustee. It can also impose Financial Support Directives and Contribution Notices on anyone connected to a deal that threatens the security of the scheme.

When a company suffers an insolvency event the IP must notify the trustees , the TPR and the PPF under section 120 of the Pensions Act 2004.

The scheme will enter an 'assessment period' to see if it will go into the PPF.

The safety net provided by the PPF has helped to prevent the worst cases where some members lost all pension benefits, but the PPF is not a like-for-like replacement.

Senior employees can be particularly hard hit due to the capping of benefits.

Securing benefits above PPF level would be a good outcome for a struggling employer and the members of their DB scheme.

Create a strategy to achieve the best outcome

Potential Solutions

Defined benefit pension schemes virtually always run a deficit, especially when interest rates are low. Unless wind up is triggered, don't be put off by the headline buyout deficit. This section explores the options that may be available in the context of a corporate reconstructing or M&A situation.

In a corporate restructuring, care should be taken to avoid triggering wind up. A Flexible Apportionment Arrangement can be made to move responsibility for the pension promises from one company to another. This is a good way of freeing a company of its pension liabilities prior to sale or disposal.

If there is no other company to shoulder the burden and a clean break is required, the scheme must be wound up. If the assets can secure benefits above PPF level, but full buyout level would sink the company, it might be possible to negotiate a compromise where the scheme is wound up with reduced benefits. This is better for members than the reduced and capped PPF benefits from an insolvency position, but less expensive than full buy out.

In a distress situation the PPF will consider accepting a scheme where the sponsor is not yet insolvent, but where this appears to be inevitable. A 'PPF drop-in' may allow the company to continue in existence with new investment, without the millstone that the pension scheme represents.

It is vital that you don't accidently trigger scheme wind up during the course of a corporate re-organization. The Regulator has strong 'moral hazard' powers to pursue companies that accidently or deliberately 'abandon' a scheme.

Defined Contribution schemes don't have these funding issues, but must have good governance. Alternatively, wind it up and change to a Master Trust solution.

This is a specialized and highly technical subject, and appropriate professional advice is essential.

Corporate Pensions Healthcheck

You wouldn't advise a company on a corporate transaction without doing proper due diligence, but do you feel confident addressing the pension arrangements?

Able Governance is able to investigate the pension schemes and provide a report that identifies the issues that need to be addressed. If the scheme is likely to interfere with the corporate transaction, we can make suggestions to address the pensions angle.

This may include recommending that an independent trustee is appointed in order to help guide the trustees through a transaction or negotiation, and to resolve any conflicts of interest problems.

A fixed-fee diagnostic reporting service

Priced at just £495, this could be the most cost-effective piece of due diligence that you perform!

Able Governance—Experienced, affordable independent trustees

Contact Us

Give us a call for more information about our services:

Able Governance Ltd
Suite 625, 109 Vernon House, Friar Lane,
Nottingham, NG1 6DQ

info@able-governance.co.uk

Visit us on the web at
www.able-governance.co.uk

Able Governance Ltd
Suite 625
109 Vernon House
Friar Lane
Nottingham
NG1 6DQ