THE CIPFA PENSIONS NETWORK WORKSHOPS

PRACTICAL IMPLICATIONS OF PENSIONS REFORM

Approaches to managing Employer risks

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Employer Risk

Prevention and cure

- Active Management
  - Risk management
  - Employer covenant assessment
  - Good practice

- Disaster Management
  - Administration
  - Company Voluntary Arrangements ("CVA")
  - Liquidation

Disaster Management - Administration

The basics

- A procedure where a company may be rescued or reorganised or where its assets may be realised under the protection of a statutory moratorium.

- Statutory defined purpose(s) – a sliding scale:
  - To rescue company as a going concern;
  - To achieve a better result, for creditors as a whole, than on a winding up; and
  - To realise property to make a distribution to one or more secured or preferential creditors.

- Administrator appointed to take custody and control of the company's business and assets. Appointment automatically ends after one year.

- Administrator carries out his functions in the interests of creditors as a whole.

Disaster Management - Administration

Creditors' rights

- Initial creditors' meeting to vote on administrator's proposals.
- Creditors vote – one vote per £1 of unsecured debt.
- Proposals may be approved with or without modifications or otherwise rejected.
- Proposals approved if >50% (in value) of all creditors vote in favour but invalid if >50% (in value) of unconnected creditors vote against.
- If approved, the proposals will set out how the administrator intends to manage the affairs of the company and his entitlement to draw fees and expenses.
- Creditors then receive updates by way of biannual progress reports.

Disaster Management - Administration

Creditors' rights

- Influencing the administrator's actions, for example by:
  - forming a committee of creditors (para 57); and/or
  - summoning further creditors' meetings (para 56).

- Taking action against the administrator, for example, if the administrator:
  - acts/intends to act in a way that unfairly harms the interests of the creditor (para 74(1));
  - has not acted quickly or efficiently (para 74(2));
  - has breached his duties, for example, if misapplying or retaining the company's money/other property (para 75);
  - claims excessive remuneration (rule 2.109); or
  - was improperly appointed (para 81).

Disaster Management - Administration

In practice – Employer administration

- Employer enters administration.
- Fund not involved. First indication of problems when notified of administration.
- Employer assets sold – pre-pack.
- Concern over pre and post appointment fees of administrator and advisors and level of progress/engagement.
- Resolutions passed to replace administrators and control fees.

Disaster Management - CVAs

The basics

- A procedure where the company and its creditors come to an agreement which is implemented and supervised by an insolvency practitioner.
- Purpose – to allow the company to settle its debts by only paying a proportion of the debts due.
- Requires creditor approval of 75% (in value).
- Once approved binds all creditors who were entitled to receive notice of the proposal – whether known or unknown and even those who voted against the proposal.
- Not binding on secured or preferential creditors.
- No statutory moratorium.

Disaster Management - CVAs

Creditors' rights

- Depending on the value of a creditor's debt they may have an influencing or blocking vote (if they hold more than 25% (in value) of the debt) affecting whether the proposals are passed.

- A CVA can be challenged in court on the grounds of unfair prejudice or material irregularity.

Disaster Management - Administration

In practice – Employer in a CVA

- Received a call from Nominee re proposed CVA.
- Creditor held more than 75% of unsecured vote.
- Able to force through our own agenda.
- Ensure voting rights are triggered – convert contingent debt to an actual one.

Disaster Management - Liquidation

The basics

- An alternative to rescue mechanisms.
- Purpose – to realise assets and distribute to creditors.
- A terminal process – the liquidator takes control of the company's assets and all employees are automatically dismissed.
- Either compulsory (via a winding-up petition) or voluntary (creditors voluntary liquidation if company insolvent or members voluntary liquidation if solvent).
- Liquidator appointed to collect in assets and distribute them in a prescribed order.

Disaster Management - Liquidation

Creditors' rights

- CVL - both the creditors and the members can nominate a person to be liquidator at their respective meetings. Creditors' choice prevails.

- CVL – creditors may raise questions of the directors and the proposed liquidator at the creditors meeting.

- Compulsory liquidation - Official Receiver (the "OR") acts as the liquidator in the first instance. Creditors can influence the appointment and identity of an external liquidator to replace the OR.

Disaster Management - Liquidation

Creditors' rights – post appointment

- Request the liquidator to summon further meetings at which they could (with a 50% majority):
  - remove the liquidator from office; and/or
  - form a liquidation committee.

- Challenge a liquidator's excessive remuneration.

  - Apply to court if they suspect there has been a breach by the liquidator of his duties, for example, if he has misapplied or retained the company's money/other property (section 212). Under section 212 a liquidator can also look back at the actions of an administrator.

Disaster Management - Administration

In practice – Employer in liquidation

- Employer insolvent.
- Cash at Bank the only asset.
- Majority creditor so able to influence proposal and identity of Liquidator.
- Voting at creditors' meeting.
- Continue to monitor Liquidator's actions and fees.

Active Management

A banker in disguise

- "Trustee should learn from the way a banker with a large unsecured loan would act and negotiate" – Pension Regulator

- Employer obligation – to fund the pension scheme now and in the future.

- Trustee obligation –
  - to understand the Employer's liability; and
  - maintain prudent technical provisions, funding principles, recovery plans and contributions.

- Risk management – Employer covenant assessment

Active Management

Employer covenant assessment – what

- Understanding the pension arrangements:
  - participating employees;
  - funding; and
  - scheme claims/priority.

- Understanding the company's financial performance:
  - company structure;
  - assets and liabilities;
  - cash flow/liquidity; and
  - performance against forecasts/trends.

Active Management

Employer covenant assessment – what

- Understanding the business:
  - market conditions;
  - historical/industry context; and
  - management.

- Assessing risks to the pension scheme:
  - credibility of assumptions;
  - affordability of current and future contributions/deficit catch up payments (deficit reduction vs employer viability); and
  - value of claim on employer insolvency.

Active Management

Employer covenant assessment - when

- When there is a problem?

- Regular intervals – at each valuation when contributions/funding are agreed

- Key events
  - change in ownership/control;
  - change in creditor priority;
  - significant increase in debt; and/or
  - payment of dividends/other stakeholder distribution.

- Ongoing monitoring – if the Trustees have concerns.

- Frequency and level of detail of assessment proportionate to size of the deficit.

Active Management

Employer covenant assessment - how

- Statutory/Management accounts.
- Non-executive directorship/observer.
- Monitoring – Companies House/D&B Scores/CCJs/winding up petitions/administration petitions/intentions to dissolve/sector review.
- Employer engagement – formal plan which may include:
  - granting specific contingent assets;
  - key performance indicators;
  - positive obligations which increase funding on certain events e.g. if profitability improves; and/or
  - negative obligations – e.g. not to act without trustees agreement in certain circumstances.

Active Management

Good Practice - Summary

- Ensure regular monitoring of Employer covenant strength – company viability can change quickly.
- Consider agreeing a formal plan with Employer to specify how the covenant will be monitored.
- Include monitoring of covenant as a standing agenda item.
- Balance risk and degree/frequency of monitoring - consider scale of deficit and financial strength of Employer.

Questions & Answers

Any questions?

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