Case study.

Regulated apportionment arrangement (RAA)

Background.

The scheme:

A defined benefit (DB) scheme, closed to accrual some years before we were appointed as independent trustee.

The 2017 scheme funding update showed a buy out basis deficit of £18.8m and funding level of 33%.

The sponsor:

A partnership providing technical consultancy services. The sponsor's business was OK, with good clients and reasonable profitability. However, the size of the pension deficit:

- was disproportionate to the company's ability to generate cash to pay it down over a reasonable period; and
- had put off new partners joining.

The business was **feeling the effects of the recession** and downturn in the construction industry and, with the existing partners all over 55, it **wouldn't be sustainable without new blood**. To complicate matters, the current partners received legal advice that they were not the statutory employer responsible for funding the scheme. In consequence, they **ceased paying contributions in 2013**.

A lack of legal clarity – a partnership is not a legal entity.

We took counsel's opinion and identified the former partners at the time of cessation of accrual were liable. We engaged with them to progress valuation and deficit discussions. A flurry of additional legal advice on all sides followed and we reached the point where **the identity of the statutory employer was sufficiently unclear** to warrant going to Court. Draft claims were issued against all partners past and present.

Without the identity of the statutory employer being clear, the trustees were **unable to determine who, for example, is liable for the Section 75 debt**, is liable to contribute to under scheme specific funding legislation and needs to suffer an insolvency event for entry into a Pension Protection Fund (PPF) assessment period.

Discussions took place at an early stage with the PPF as to whether the current partners could (for the purposes of PPF entry only) accept they alone were the statutory employers, but the PPF was unable to accept that approach because of the genuine legal uncertainty.

Restructure proposal.

At this point the partners (past and present) engaged advisers to put together proposals to restructure the business and **seek an agreement** with their lenders, the pension scheme trustees, The Pensions Regulator (TPR) and the PPF **to transfer the pension liabilities to the PPF**.

Discussions with TPR and the PPF with a view to a regulated apportionment arrangement were held and, as part of the process, **the partnership incorporated to become a limited company (PCo)**. We were closely involved with the process, working with our advisers and the PPF's restructuring team.

In essence, the proposed RAA involved:

All scheme liabilities being transferred to 'Newco' – a new company established specifically for that purpose. Newco would be the sole statutory employer and its insolvency would trigger a PPF assessment.

In return, the scheme/PPF would receive:

- £1m upfront made up of individual payments from both the current and former partners
- £2m over 10 years secured by a debenture over the assets of PCo
- a 33% equity share in PCo

Why was the RAA the trustees' preferred approach?

Clearance papers were submitted in March 2019 and approved by The Pensions Regulator the following month. The scheme entered PPF assessment in May 2019.

The regulated apportionment arrangement would cause the scheme to suffer detriment; however:

Trying to resolve uncertainty over the statutory employer in Court would be protracted and expensive.

There was a risk some costs incurred by the current and/or former partners could be payable by the scheme.

Once resolved, the trustees may have needed to pursue liable partners to bankruptcy to generate an insolvency event. No meaningful recovery would be possible with this route – the maximum was estimated to be c£0.8m.

Without the RAA, the partnership could not continue trading and would not be able to support the scheme ongoing anyway.

Any litigation process would cause huge uncertainty and distress for scheme members, many of whom were still long serving employees.

The trustees felt, given the nature of the risks, the scheme's financial position and the range of possible outcomes, the RAA would be in the best interests of members.

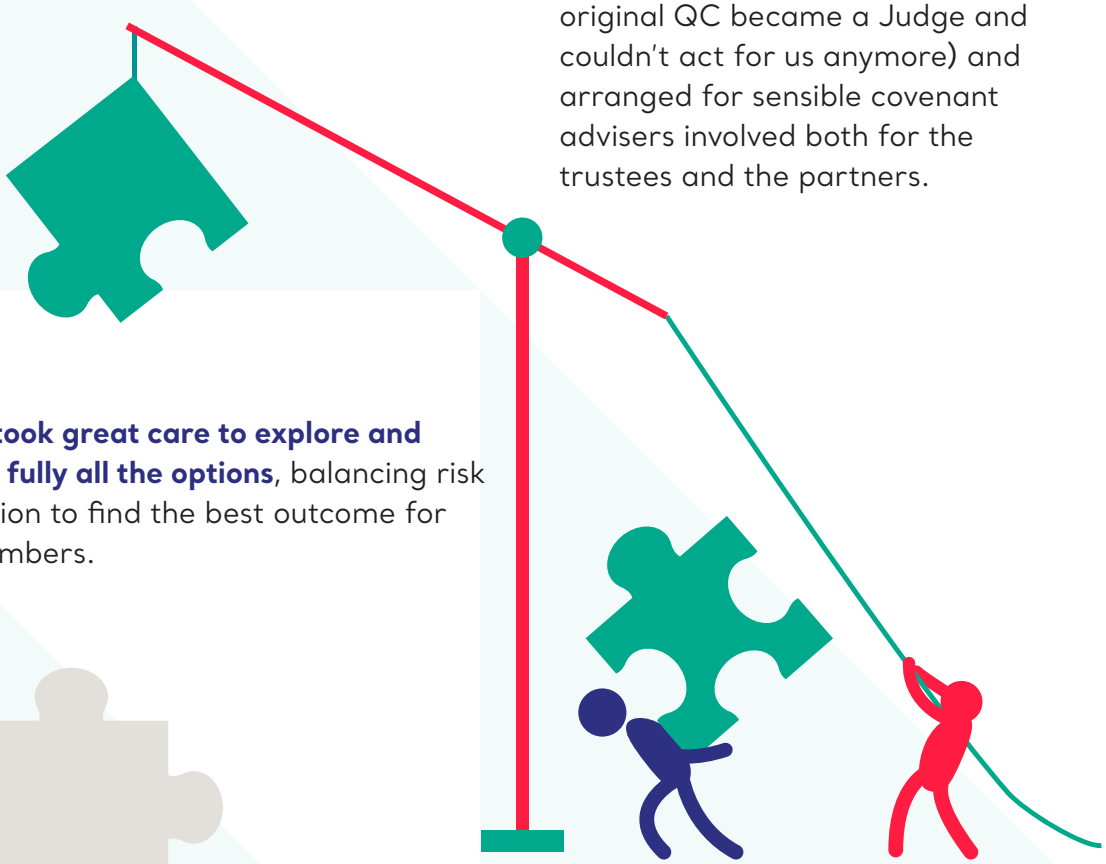
What PSGS did.

As professional trustee we **provided support for our co-trustee** through what was a very complex, sensitive and prolonged situation.

We managed the various scheme advisers, **trying to keep costs down**. Every scheme penny counted, even more so than normal.

We built a good relationship with the partnership and we were **patient, flexible and sympathetic** when the current partners originally requested a contribution holiday and then argued they were not the statutory employer – and always looked for a pragmatic way forward.

We were the conduit for TPR and the PPF, explaining to them the situation was far from straightforward. We **managed their expectations** over the six year period during which we had a change in QC (the trustees' original QC became a Judge and couldn't act for us anymore) and arranged for sensible covenant advisers involved both for the trustees and the partners.



Finally, we **took great care to explore and understand fully all the options**, balancing risk and mitigation to find the best outcome for scheme members.