THE RISE AND RISE OF CVAS

IMPACT ON PENSION SCHEMES

Mark Jenkins and Glen Flannery of CMS Cameron McKenna Nabarro Olswang LLP look at the effect of company voluntary arrangements on defined benefit pension schemes.

There has been a flurry of high-profile company voluntary arrangements (CVAs) in the last few years, particularly in the retail sector. High street shops have suffered from consumers tightening their purse strings and shifting towards online purchases. This has left many traditional bricks and mortar retailers with redundant or excess space in leased premises and needing to take action to reduce costs (*see feature article "Challenges in the consumer sector: adapting to the new reality", www.practicallaw.com/w-020-8428*). This has led to a series of high-profile CVAs in the retail sector, including Toys R Us, House of Fraser, Mothercare, Regis, Debenhams, Arcadia and, most recently, Monsoon Accessorize (*see News brief "The year of the CVA: is there a need for change?", www.practicallaw.com/w-015-3943*).

The principal focus of these particular CVAs has been on compromising property lease liabilities owed to landlords, while largely not seeking to compromise the position of other creditors, including defined benefit (DB) pension schemes. However, many companies proposing CVAs have final salary or DB pension schemes that may be affected either directly or indirectly by the CVA.

This article looks at:

- How to implement a CVA.
- The impact of a CVA on a DB pension scheme.
- The role of pension scheme trustees, the Pension Protection Fund (PPF) and the Pensions Regulator (the Regulator) during the CVA process.
- What pension scheme trustees can do to prepare for an insolvency event.

The article looks only at the position of occupational DB pension schemes. The impact of CVAs on other types of pension arrangement, including occupational defined contribution schemes and contract-based schemes such as group personal pension plans, is beyond the scope of this article.

THE CVA PROCESS

A CVA is a statutory tool that can be used by a debtor company to compromise creditors' claims or give effect to some other restructuring of the company's affairs (*see box "Overview of a CVA"*).

The advantage of a CVA is that if the CVA is approved by the requisite majorities of creditors, it binds all creditors, irrespective of whether or how they voted, subject to some exceptions and a creditor's right to challenge the CVA. This avoids the need to negotiate and reach agreement with each creditor individually.

To make a CVA proposal it is not a prerequisite that the company should be insolvent or unable to pay its debts. However, in practice, typically it is necessary to demonstrate in the proposal that the company is likely to fail if the proposal is not approved, in order to garner creditors' approval of the proposal.

The proposal

A CVA proposal is made by the company's directors (or an administrator or liquidator of the company) to the company and its creditors for a composition in satisfaction of the company's debts or a scheme of arrangement of its affairs (*section 1(1), Insolvency Act 1986*) (1986 Act).

The proposal must be endorsed by a licensed insolvency practitioner, who is known as a nominee of the CVA while the CVA is being proposed, and a supervisor of the CVA if it is approved and therefore needs to be implemented.

Overview of a CVA

A CVA is a statutory tool that can be used by a debtor company to compromise creditors' claims or give effect to some other restructuring of the company's affairs.

A CVA proposal is made by the company's directors (or an administrator or liquidator of the company) to the company and its creditors. The proposal must be endorsed by a licensed insolvency practitioner, who is known as a "nominee" of the CVA while the CVA is being proposed, and a "supervisor" of the CVA if it is approved and therefore needs to be implemented.

The company's shareholders and creditors vote on whether to approve the proposal. In general, this requires at least 75% by value of creditors who vote and more than 50% by value of shareholders who vote, to vote in favour of the proposal.

The advantage of a CVA is that if the proposal is approved by the requisite majorities of creditors, the proposal binds all creditors, irrespective of whether or how they voted, subject to some exceptions and a creditor's right to challenge the CVA. This avoids the need to negotiate and reach agreement with each creditor individually.

A CVA cannot compromise the rights of a secured creditor to enforce its security and certain preferential creditor rights without the concurrence of the affected creditor. A CVA can be challenged on grounds of material irregularity or unfair prejudice, or both.

The nominee must submit a report to court stating whether, in their opinion, the proposal:

- Has a reasonable prospect of being approved and implemented.
- Should be considered by a meeting of the company and by the company's creditors, and, if in the nominee's opinion it should, the proposed time and place for the company meeting to be held (*section 2(2), 1986 Act*) (section 2).

This is simply a procedural step; there is no court hearing. Typically, the court will not play an active role in the CVA unless a dispute arises or the court's directions are required. Once filed with the court, the nominee will summon a meeting of the company and seek a decision from the company's creditors as to whether they approve the proposal, with or without modifications (*section 3(1), 1986 Act*).

The creditors' decision can be sought by one of the qualifying decision-making procedures under the Insolvency (England and Wales) Rules 2016 (*SI 2016/1024*) (Insolvency Rules 2016) (*section 3(2), 1986 Act*). The qualifying decision procedures are correspondence, electronic voting, a virtual meeting or a physical meeting (*rule 15.3, Insolvency Rules 2016*). In the larger retail CVAs that have been proposed in recent years, it has remained common practice to convene a physical meeting of creditors. The minimum notice period for the decision date is 14 days from delivery of the notice requiring a decision (*rule 15.2(2), Insolvency Rules 2016*).

Voting

The approval of a CVA proposal requires votes in favour from:

- At least 75% by value of creditors who vote.
- More than 50% by value of shareholders who vote.

Even if the threshold for creditor approval is met, the proposal will not be treated as approved if more than half of the total value of the unconnected creditors (whose claims have been admitted for voting) vote against the proposal (*rule 15.34, Insolvency Rules 2016*). Accordingly, a DB pension scheme's voting leverage will be determined not just by the size of the pension scheme's claim against the company relative to other creditors' claims, but also whether or not the scheme trustees are connected to the company. A person is considered "connected" to a company if they are a director or shadow director of the company, or an associate of such a director or shadow director, or an associate of the company (*section 249, 1986 Act*). An "associate" includes a wide range of relationships, as set out at length in section 435 of the 1986 Act.

If the shareholders reach a different decision to the creditors, the creditors' decision will prevail and any shareholder may apply to court (*section 4A(2) and 4A(3), 1986 Act*). The chairman of the meeting of the company and the person who sought the creditors' decision must report the outcome of the meeting and the creditors' decision making to the court (*section 4, 1986 Act*).

Effect of approval

If the CVA proposal is approved by the requisite majorities, the CVA terms will automatically bind all creditors who were entitled to vote in the process or who would have been so entitled had they had notice of the process, subject to some exceptions and a creditor's right to challenge the CVA (*section 5, 1986 Act*).

Exceptions

A CVA cannot compromise the rights of a secured creditor to enforce their security or certain preferential creditor rights, without the concurrence of the affected creditor (*sections 4(3) and 4(4), 1986 Act*). Preferential creditors are creditors who by statute are afforded special priority in a formal insolvency of the debtor company (*sections 175 and*

386, and Schedule 6, 1986 Act). Normally, a debt owing to a DB pension scheme is not a preferential debt, but the trustees of the pension scheme may have security rights.

Pension scheme notifications

In the case of a CVA proposal for a company that is a DB pension scheme employer, when the nominee of the CVA files at court the initial report under section 2, this constitutes an "insolvency event" under pensions legislation (*section 121(3)(a), Pensions Act 2004*) (2004 Act).

The nominee must notify the Regulator, the PPF and the trustees of the pension scheme within 14 days of the occurrence of the insolvency event (*section 120(2), 2004 Act; regulation 4(1), Pension Protection Fund (Entry Rules) Regulations 2006 (SI 2006/590)*). In practice, this notice is often just a formality because the company has already been in discussions with all three stakeholders in the lead up to the CVA proposal being launched.

CHALLENGING A CVA

A CVA can be challenged on grounds of material irregularity or unfair prejudice, or both (*section 6, 1986 Act*). An application to court to challenge a CVA must be made within a 28-day period after the filing at court of the reports of the voting on the CVA proposal (*section 6(3)(a), 1986 Act*). If notice of the decision procedure to approve the CVA was not given to the relevant creditor, that creditor can apply to court to challenge the decision within a 28-day period after the creditor becomes aware of the approval of the CVA (*section 6(3)(b), 1986 Act*).

In relation to a challenge that a CVA unfairly prejudices the interests of a creditor, member or contributory of the company, it is generally accepted that there is no universal test for judging unfairness. Case law establishes that it is necessary to consider all the circumstances, including the alternatives available and the practical consequences of a decision to confirm or reject the arrangement (*In re A Debtor (No 101 of 199) [2001] 1 BCLC 54; SISU Capital Fund Ltd and others v Tucker and others [2005] EWHC 2170*).

In assessing the question of unfairness, a number of techniques may be used, including what have become known as the "vertical" and "horizontal" comparisons (*Prudential Assurance Co Ltd v PRG Powerhouse Ltd [2007] EWHC 1002, see News brief "Powerhouse: is your CVA fair?", www.practicallaw.com/0-364-6016; Mourant & Co Trustees Ltd v Sixty UK Ltd (In Administration) [2010] EWHC 1890, www.practicallaw.com/3-503-1599*).

Vertical comparison

The vertical comparison compares the position that the creditor has under the CVA with the position that they would be in if the company were simply to be liquidated. Case law suggests that fairness requires creditors to be offered more than they would receive in a hypothetical liquidation of the company but there is no absolute rule to this effect; all of the circumstances must be taken into account (*In re English, Scottish and Australian Chartered Bank [1893] 3 Ch 385; Prudential Assurance; Mourant & Co*).

Horizontal comparison

The horizontal comparison compares the position that the creditor has under the CVA with the position of other creditors or classes of creditors. The fact that a CVA treats certain creditors differently will not necessarily result in a finding of unfair prejudice. In some cases, differential treatment may be required to secure the continuation of the company's business, which underpins the company's ability to perform the CVA (*Inland Revenue Commissioners v Wimbledon Football Club Ltd [2004] EWCA Civ 655; SISU Capital Fund*). For example, business critical suppliers that have greater commercial leverage may need to be paid in full to avoid undue business disruption.

Recent challenges

Although the bar for successfully challenging a CVA is high and formal challenges to CVAs have been rare compared to the number of CVA proposals, in recent years there has been a spike in formal challenges (*see box "Recent challenges to CVAs"*).

Many of these recent high-profile retail CVAs have focused on compromising property lease obligations while not seeking to compromise other liabilities, including the CVA company's pension scheme obligations. This has led to increasing disquiet from affected landlords who, among other things, consider that other creditors and stakeholders should be sharing more of the burden of the restructuring.

In the challenge to the Debenhams CVA, one of the grounds of challenge is that landlords have been treated differently to other unsecured creditors, without objective justification for the differential (*see News brief "Debenhams CVA challenge: landlord's objections", this issue*). The applicants have argued that Debenhams could have differentiated between critical and non-critical trade suppliers, and compromised the latter group to avoid landlords having to bear all of the burden of the CVA. It will be interesting to see whether the court concurs with this argument.

Although the challenges to the House of Fraser and Arcadia CVAs were settled before substantive court hearings, the Regis, Debenhams and Monsoon Accessorize challenges are progressing. It remains to be seen whether the outcomes will influence the approach taken in relation to pension schemes.

IMPACT ON DB SCHEMES

Even if the pension scheme is not the primary target of a CVA, the CVA will generally have some impact on the scheme.

Single employer scheme

The position of a single employer pension scheme is the most straightforward. When a nominee files at court their initial report under section 2, this constitutes an "insolvency event" under pensions legislation (*section 121(3)(a), 2004 Act*) (*see "The proposal" above*). If the scheme is underfunded, this will also automatically trigger both:

- A potential employer debt under section 75 of the Pensions Act 1995 (section 75 debt), although that debt remains contingent unless the nominee later files a scheme failure notice.

- A PPF assessment period, if the insolvency event is a "qualifying" insolvency event under section 127(3) of the 2004 Act, which will generally be the case for a single employer scheme.

Assessing the section 75 debt. The section 75 debt will be based on the scheme's deficit on a buy-out basis. This is the most prudent basis for calculating the debt, which can give rise to a significant claim. This explains why the pension scheme can often have one of the largest votes by value in the CVA.

From a practical perspective, the scheme actuary is likely to estimate the amount of the debt for the purposes of the CVA, not least because the certification of the section 75 debt usually involves audited accounts for the scheme being prepared and there is no time to prepare a more definitive calculation. There is generally a degree of dialogue between the trustees, the PPF, the actuary and the nominee in the run-up to the CVA vote to agree the basis on which the actuary is assessing the section 75 debt for these purposes.

The debt will remain contingent unless the nominee serves a scheme failure notice on the trustees, the PPF and the Regulator. This would be done only if the nominee confirms that a scheme rescue is not possible. Essentially, in that situation the nominee will confirm that:

- The employer is not continuing as a going concern.
- No other person has assumed responsibility for meeting the employer's liabilities under the scheme.
- The nominee is of the opinion that the employer's pension liabilities will not be assumed by another person.

PPF assessment period. Provided that the pension scheme is an eligible scheme for PPF entry purposes, the nominee filing at court their initial report under section 2 will generally trigger the start of a PPF assessment period (*section 132, 2004 Act*). Once the assessment period begins, the trustees' powers become subject to certain statutory restrictions. Significantly, the PPF takes over the rights and powers of the trustees or managers of the scheme in relation to any debt (including any contingent debt) due to them by the employer (*section 137, 2004 Act*). The effect of this is that the PPF is empowered to exercise the trustees' vote on the CVA proposal to the exclusion of the trustees.

Recent challenges to CVAs

A number of recent company voluntary arrangements (CVAs) have been challenged by affected parties.

House of Fraser

In July 2018, certain landlords challenged the House of Fraser CVA on the basis of unfair prejudice (*see News brief "The year of the CVA: is there a need for change?", www.practicallaw.com/w-015-3943*). Little is known about the legal challenge because it was settled on confidential terms outside of court.

Regis

In December 2018, a group of landlords launched a challenge to rent cuts proposed by the Regis CVA. The CVA proposes rent reductions of between 25% and 100% at 110 out of 223 of the hair salon chain's sites. The CVA has been challenged on the basis that it is "substantively unfair" for reasons including wide-ranging changes to the terms of leases. The outcome of the challenge is still awaited.

Debenhams

In May 2019, the Debenhams CVA was approved. A group of landlords known as the Combined Property Control Group has mounted a challenge to the CVA and the High Court has heard this on an expedited basis (*see News brief "Debenhams CVA challenge: landlord's objections", this issue*). The challenging landlords advanced the following five grounds of challenge:

- Landlords should not be treated as creditors with respect to future rent.
- Landlords should be paid full contractual rent during the company's beneficial occupation of their premises.
- A CVA cannot compel a landlord to waive its right to forfeit a lease.
- The CVA treats landlords less favourably than other unsecured creditors without objective justification.
- There was a material irregularity in the CVA proposal because it failed to inform creditors of circumstances giving rise to potential clawback claims.

The trial finished on 6 September 2019 and judgment is expected shortly.

Arcadia

In July 2019, Arcadia received challenges from US property group Vornado in respect of two of its seven CVAs (*see News brief "Arcadia Group CVAs: given the green light", www.practicallaw.com/w-020-9326*). On 27 August 2019, Arcadia confirmed that Vornado had agreed to drop its challenges following "significant and constructive" dialogue. It is unclear what, if anything, was agreed with Vornado to persuade it to drop its challenges.

Monsoon Accessorize

In July 2019, the Monsoon CVA was approved. A landlord of five Monsoon stores is challenging the CVA. The landlord is reported to object to various elements of the CVA proposals, including the structure of the new funding provided by the retailer's owner, Mr Peter Simon.

Multi-employer schemes

Where there is more than one employer in the pension scheme, a PPF assessment period may not arise unless all the scheme employers become subject to a qualifying insolvency event. Whether or not it does will depend on the structure of the scheme and whether there is a partial wind-up rule.

Partial wind-up rule. Some schemes contain a requirement to segregate the scheme into different sections: one for the departing (insolvent) employer, and one for the remaining employer(s). If this is the case, the departing section will be treated in the same manner as for a single employer scheme, that is:

- An assessment period is triggered in relation to that section.
- A (contingent) section 75 debt arises in relation to that section. The section 75 debt in this situation will generally be limited to the CVA company's liability share; that is, the liabilities attributable

to employment with that company as a proportion of the overall liabilities, plus its share of any orphan liabilities.

No partial wind-up rule. If there is no partial wind-up rule, that is, the scheme is a "last man standing" scheme, a PPF assessment period will begin only when the last remaining employer (the "last man") undergoes a qualifying insolvency event. This means that if there is a CVA proposal for a participating employer but the other employers do not also suffer a formal insolvency event:

- An insolvency event will have occurred, giving rise to a contingent section 75 debt. The amount of the section 75 debt will usually be the CVA company's liability share.

- The insolvency event is not a qualifying insolvency event. Therefore, a PPF assessment period will not commence in respect of the scheme. This is because regulation 64 of the Pension Protection Fund (Multi-employer Schemes) (Modification) Regulations 2005 (*SI 2005/441*) modifies the 2004 Act to the effect that an assessment period does not occur until all employers have suffered a formal insolvency event.

Because a PPF assessment period is not commenced, section 137 of the 2004 Act does not apply. Therefore, the PPF does not assume the rights and powers of the trustees or managers of the scheme in relation to any debt (including any contingent debt) due to them by the employer. In this scenario, the scheme trustees retain power to exercise the pension scheme's vote in the CVA.

The PPF's general restructuring principles

The Pension Protection Fund (PPF) will apply the following general principles when faced with a restructuring proposal that will result in a defined benefit pension scheme not being rescued and being likely to enter the PPF:

- The insolvency of the employer must be inevitable. This means that, absent the restructuring, the pension scheme will enter a PPF assessment period.

- In the restructuring, the pension scheme must receive money or other assets of a significantly higher value than it would have otherwise received through the insolvency of the employer. This must be realistic when compared to the debt under section 75 of the Pensions Act 1995 that would otherwise arise.

- What is offered to the pension scheme in the restructuring must be fair compared to what other creditors and stakeholders receive. Other creditors should not be in a better position than the pension scheme following a pension liability reduction restructuring.

- The PPF will seek at least 33% of the equity in the restructured company for the scheme. This is generally referred to as an "anti-embarrassment" stake, enabling the scheme to realise the value in any future success of the restructured company. The percentage sought may be reduced to 10% if the future stakeholders in the company are not connected to the employer before the restructuring.

- The PPF must be satisfied that the pension scheme would not be better off if the Pensions Regulator had used its moral hazard powers to issue a contribution notice or financial support direction instead of agreeing to the restructuring. In the context of a company voluntary arrangement, it remains open to the Pensions Regulator to use those powers in the future. The PPF expects trustees with their professional advisers to have fully analysed the circumstances surrounding the scheme and the employer to ascertain if moral hazard powers could be used.

- The PPF will consider the overall viability of the employer's restructuring proposal. The PPF's view is that the pension deficit is rarely the sole cause of the employer's difficulties and, where this is the case, the PPF will wish to ensure that the proposals have a reasonable chance of success. This is particularly important if any mitigation provided by the employer is reliant on the business going forward.

- The party seeking the restructuring must pay the costs incurred by both the PPF and the trustees in delivering the restructuring. In addition, the PPF must deem any refinancing fees to be reasonable.

VOTING ON A CVA PROPOSAL

A CVA proposal will become binding on creditors only when the company's creditors have voted on and approved the proposal (*see "The CVA process" above*). Interestingly, a key feature of the CVA process is that every creditor of the CVA company can vote in respect of any unsecured debt owed to them by the CVA company at the time of the voting. This is taken to include any debt owed to the pension scheme, even if the CVA proposal does not intend to compromise that debt.

Valuing a contingent section 75 debt

When the nominee of a CVA files their initial report at court under section 2, a contingent section 75 debt normally arises (*see "Impact on DB schemes" above*). While the actuary will have estimated the amount of the section 75 debt due from the employer, the nominee still needs to decide the amount of the section 75 debt to be allowed when valuing the scheme's claim for voting purposes in the CVA.

If a debt is unliquidated or unascertained, it should be valued at £1 for the purpose of voting, unless the convener or chair decides to put a higher value on it (*rule 15.31(3), Insolvency Rules 2016*). Typically, for a contingent debt, a nominee will seek to value the debt for voting purposes by reference to the likelihood of the contingency occurring. For example, if there is a very high likelihood of the contingency occurring, the nominee may place full or close to full value on the debt for voting purposes; whereas if there is little prospect of the contingency occurring, they may apply a very large discount.

This can lead to some interesting debates about the value that should be applied to contingent section 75 debts for voting purposes. In practice, in cases where the debtor company is considered likely to enter into administration or liquidation and be wound up insolvently if the CVA proposal is not approved, nominees may accept the contingent section 75 debt at its full estimated value for voting purposes.

Casting the scheme's vote

If a PPF assessment period has commenced in respect of the scheme, the PPF will exercise the pension scheme's vote in the CVA (*see "Impact on DB schemes" above*). If a PPF assessment period has not commenced, the pension scheme's vote in the CVA will be exercised by the trustees.

This is the case even if the PPF is not expecting to assume responsibility for the scheme because the scheme is above 100% funded on the basis set out in section 179 of the 2004 Act. This is the basis used for calculating the annual PPF levy, which is a figure that forms part of the mandatory triennial actuarial valuation in respect of any DB pension scheme and therefore should be readily available. If a scheme is 100% funded on this basis, it is expected to be at least 100% funded on the basis set out in section 143 of the 2004 Act. This is the basis for the valuation that is required to be completed during a PPF assessment period in order to determine whether the scheme has sufficient assets to provide benefits to members at a level that is at least equal to the level that members would receive if PPF compensation was to be paid.

THE TRUSTEES' APPROACH

In a single employer pension scheme where a PPF assessment period has commenced, the PPF will have power to exercise the trustees' vote to the exclusion of the trustees (*see "The PPF's approach" below*).

The fact that the PPF has the power to exercise the vote does not mean that the trustees are not involved in the process leading up to the vote. On the contrary, there is normally a lot to do in a short space of time and the trustees, the PPF, and the Regulator will collaborate to prepare for the vote. The PPF and the Regulator will often ask the trustees to provide information and procure advice that will be relevant to their decision making.

In a multi-employer scheme, where no PPF assessment period has commenced, the trustees will exercise the vote in the CVA. In assessing how to exercise their vote, the trustees will be guided by their fiduciary duties to the pension scheme's members; in particular, their duty to act in the best interests of the scheme's beneficiaries. If the CVA is expected to extend the life of the scheme outside of the PPF, typically trustees are motivated to vote in favour of the CVA. This is because it allows for more deficit repair contributions to be received, more investment returns and an increased likelihood of more members receiving their benefits in full.

This can result in a tension between the interests of the trustees on the one hand and the objectives of the PPF on the other. One of the PPF's principal considerations is "PPF drift". PPF drift is the increase in the PPF's potential exposure as a result of a delay in a pension scheme entering a PPF assessment period. Essentially, this arises as a result of more members reaching their normal retirement date under the scheme and receiving their benefits in full from the PPF (that is, they are not subject to the PPF's compensation cap) and because each time a pension increase date is reached, members "bank" those increases.

In practice, the trustees, the PPF and the Regulator will try to reach a consensus on how the vote should be exercised and any terms that may need to be agreed between the employer company and the trustees to achieve this; for example, any additional deficit repair contributions that should be made to the scheme to cover the PPF drift for a period of time.

The trustees will also consider whether any de-risking of investments is required in light of the employers' weakened covenant strength.

The Pensions Regulator's restructuring criteria

When considering whether or not to approve a pensions restructuring, the Pensions Regulator will consider:

- Whether the employer's insolvency would otherwise be inevitable or whether there may be other solutions that avoid insolvency.
- Whether the scheme might receive more from an insolvency.
- Whether a better outcome might be attained for the scheme by other means, including the use of the Pensions Regulator's powers, for example its moral hazard powers.
- Where there is an employer group, the position of the remainder of the employer group.
- Whether the scheme is being treated equitably compared to other creditors.

THE PPF'S APPROACH

The PPF is the "lifeboat" fund that was established to pay compensation to members of eligible DB pension schemes following the insolvency of the pension scheme's employer where the scheme's assets are insufficient to provide benefits of at least the amount of compensation the PPF would provide. The PPF is funded by an annual levy on all eligible schemes, the assets of the pension schemes that enter the PPF and investment returns.

General restructuring principles

The PPF has published detailed restructuring guidance (*https://ppf.co.uk/sites/default/files/2019-01/guidance_on_the_ppfs_approach_to_employer_restructuring.pdf*). This guidance incorporates principles that the PPF will seek to apply when faced with a restructuring proposal that will result in a DB pension scheme not being rescued and being likely to enter the PPF (PPF restructuring principles) (*see box "The PPF's general restructuring principles"*).

CVA guidance

The PPF has also published specific guidance on its approach to CVAs (*www.ppf.co.uk/sites/default/files/2019-07/company_voluntary_arrangements_ri_guidance_note_5.pdf*). This guidance makes clear that:

- The PPF will assess each case on its own merits and will normally exercise its vote in favour of or against a CVA proposal, rather than abstain from voting.
- For CVA proposals that will result in the scheme not being rescued and entering

into the PPF, the PPF will apply the PPF's general restructuring principles.

- Even if the CVA proposal is intended to result in the pension scheme being kept whole and a scheme rescue (as has been the intention in most of the recent high-profile retail CVA proposals), there are a large number of issues that the PPF expects the company and its advisers to have dealt with to the PPF's satisfaction in order for the PPF to vote in favour of the CVA. The PPF considers that the scheme will still be affected by the CVA because the employer covenant will inevitably be weaker, at least in the short term compared to the last valuation. As a result, it considers that deficit repair contributions are likely to be too low.

In summary, the PPF expects the following issues to be addressed, even if the CVA proposal does not purport to compromise the employer's obligations to the pension scheme:

- The viability of the restructuring plan and the business. This will include considering whether: the proposal has a reasonable prospect of being successful, taking into account current market and industry circumstances; appropriate sensitivities have been applied to the plan; any downside can be absorbed; and there will be a viable business capable of supporting the scheme.

- The management team, including whether it has the right level of experience, expertise and independence to deliver the plan.

- Working capital and restructuring finance, including whether there are sufficient committed working capital facilities and funding or equity to deliver the restructuring proposals.

- Bank financing; for example, whether the lenders are receiving any acceleration in repayment of their debts or substantive increase in margin and, if secured debt is being repaid or reduced, whether there is scope for the pension scheme to obtain second ranking security as it becomes available.

- Deficit reduction contributions. This might include considering what risks the CVA poses to the contributions and how those can be mitigated, and whether the trustees should seek a new valuation and schedule of contributions.

- Employer dividends, including whether any dividends are envisaged and, if so, what steps are proposed to ensure that the scheme receives comparable amounts.

- The quantum of the PPF drift and what mitigation is being proposed in addition to deficit repair contributions to protect against this.

- The anticipated PPF levy during the period of the CVA proposal and any proposals that are included to ensure that the scheme is not exposed to levy payment contributions during this period.

- The level of risk in the scheme's investment strategy and what steps are being taken to de-risk the scheme to reflect the additional risk posed by the CVA process (*see feature article "De-risking pension schemes: an employer's perspective", this issue*).

- Exit route protection for the pension scheme; for example, how it is envisaged that finance or equity providers will exit the company and what protections exist to ensure that the current level of recovery for the scheme and ranking in the repayment waterfall are at least preserved.

- The preservation of contributions before the scheme rescue notice becomes binding. Once a PPF assessment period

Practical steps for trustees

In anticipation of an employer insolvency event, defined benefit pension scheme trustees may find it helpful to:

- Consider and carefully manage any conflicts of interest that exist or are likely to arise for trustees who have duties to the employer company as a result of being officers or employees as well as trustees of the scheme.

- Consider whether it would be beneficial to appoint an independent professional trustee who is experienced in such matters to the board of trustees.

- Collate all governing documents for the scheme and store these somewhere that can be accessed even if the employer's systems become unavailable in the event of insolvency. Trustees should also determine whether there are any missing documents that can be obtained from the employer or advisers.

- Ensure that they have access to payroll information and a way of paying pensioners that does not depend on the employer. Trustees could consider setting up a separate bank account that contains funds covering three months of payroll, so that pensioners can continue to be paid even if the employer's systems become unavailable or disrupted as a result of an insolvency event.

- Identify all the employers in the scheme, including those who are the statutory employers responsible for funding the scheme's liabilities. If the scheme is a multi-employer scheme, trustees should know whether it is a "last man standing" scheme or if there is a partial wind-up rule.

- Engage with the Pensions Regulator (the Regulator) and the Pension Protection Fund (PPF). They are experienced in these situations and can help trustees to plan for an insolvency situation. They can also help in negotiations with the employer company.

- Agree with the employer, the Regulator and the PPF a strategy for communicating with members and the media.

- Ensure that they have the right advisers in place, including in relation to covenant, financial and legal issues.

begins, no further contributions to the scheme are permitted, including deficit repair contributions. If the intention is for the scheme to continue following completion of the CVA, the PPF considers that it is important for deficit repair contributions to continue to be made available to the scheme, whether or not the CVA is approved. This may require bespoke documents.

In the authors' experience, the PPF is particularly focused on: the viability of the restructuring plan and the business; and the amount of PPF drift and whether the PPF's exposure to this can be mitigated by additional funding from the employer. The PPF wishes to avoid situations in which the employer is simply "kicking the can down the road", while in the meantime, the pension scheme deficit is growing, increasing the liabilities that the PPF may ultimately inherit. In this regard, the PPF's approach is necessarily longer term than the trustees', for whom even a short period of the scheme continuing could benefit members significantly.

To assuage its concerns, the PPF will often seek concessions and assurances from the CVA company. For example, in relation to the Mothercare CVA in May 2018, it was reported that in order to secure the PPF's support for the rescue plan, Mothercare agreed to accelerate existing deficit repair contributions by paying £4.6 million into the pension scheme. It also agreed an additional £5 million in deficit repair contributions to be paid over the following 30 months, payable at the trustees' discretion. Malcolm Weir, the director of restructuring and insolvency at the PPF, commented at the time that the PPF was able to support the Mothercare CVA proposal because it had received additional assurances about the position of the relevant pension schemes. It is therefore clear that the PPF will act to protect its position.

To enable it to make an informed decision on any CVA proposal, the PPF will typically require the CVA company to provide extensive information and forecasts in order to supplement the information that may be contained in the formal CVA proposal which is circulated to all creditors. The level of information is akin to the level of information that a secured creditor might expect to receive. The PPF will analyse this information with the assistance of professional advice, procured through the trustees or directly.

Related information

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THE REGULATOR'S APPROACH

The Regulator is the UK's regulator of workplace pension schemes. It has a number of statutory objectives, which include protecting people's savings in workplace pensions, reducing the risk of pension schemes ending up in the PPF and making sure that employers balance the needs of their DB pension scheme with growing their business.

The Regulator is not a direct counterparty in a CVA proposal, unless clearance of the transaction is requested. The PPF's guidance on CVAs states that it will discuss all CVA requests with the Regulator, which will then assess the proposal against its own Regulated Apportionment Arrangement (RAA) principles (even though a CVA proposal is not an RAA). There is overlap between the Regulator's RAA criteria and the PPF restructuring principles, although the latter are more expansive (*see box "The Pensions Regulator's restructuring criteria"*).

Whereas the PPF can, and does, act solely in its own interest, the Regulator has broader interests, dictated by its statutory objectives. As well as having an objective of reducing the risk of situations arising that may lead to PPF compensation needing to be paid, the Regulator has the objectives of protecting the benefits of members of occupational pension schemes and, in relation to scheme funding only, minimising any adverse impact on the sustainable growth of the employer. Therefore, there is scope for tension between the views of the PPF and the views of the Regulator in certain situations. However, in the authors' experience, there is typically constructive dialogue between the PPF and the Regulator, resulting in positions that strike the right balance between the interests of scheme members and the PPF.

PREPARING FOR INSOLVENCY EVENTS

Pension scheme trustees cannot control an employer company's financial performance. However, they can monitor this and take steps to prepare for any formal insolvency event (*see box "Practical steps for trustees"*). There are clear benefits of doing this for trustees of schemes with distressed employers, not least because it will provide a better experience for members. In April 2019, the PPF published a practical guidance note for trustees to assist with this contingency planning process (*www.ppf.co.uk/sites/default/files/file-2019-04/ppf_contingency_planning_doc_final.pdf*).

For trustees, a CVA or other insolvency event may be the first, and only, time they go through this sort of process. Having experienced advisers is fundamental to achieving a good outcome. As well as having the necessary technical expertise, they will understand the stakeholder dynamics and know what to expect. A core part of the trustees' planning should be ensuring that the member experience, during a time that will be very unsettling for them, is as smooth as possible.

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