



Compromise under the PPF

Compromise of member benefits is sometimes advanced as an illustration of PPF involvement in corporate finance and offered as a counter-factual to our assertion that Government sponsored entities are poorly positioned to engage in this activity.

The PPF may compromise members' benefits prior to the insolvency of a sponsor. The offer made to the Trustees and PPF under such a compromise must be materially more than would be available to the scheme under insolvency. In order to achieve such a compromise, it is usual for the sponsor to have to give up an interest in the rescued company – this is sometimes referred to as an “anti-embarrassment” stake.

In terms of the corporate finance, this is actually rather ugly. There is an immediate need for the sponsor group to find additional resources for the scheme, which of course increases the likelihood of insolvency for the Group. It is not obvious why other companies within the Group would wish to do this, or even that it is a legal action on their part.

If this funding comes from the sponsor company itself, which is unlikely as the sponsor is in financial distress and close to insolvency, then clearly the likelihood of its insolvency is increased by this action. In the event that the sponsor subsequently fails it would not be surprising if an administrator, receiver or liquidator were then to challenge the validity of any payments made in such an arrangement as inequitable to other creditors.

The scheme members will receive either benefits under the PPF rules, some 83% of the entitlement perhaps, if the level of funding is below the S179 value, or annuities may be purchased commercially offering some lesser reduction of scheme benefits, where funding is above the S179 value but below full annuitisation funding.

With funding at 100% of the FRS17 value – the amount that may be considered equitable to other creditors – a scheme would not usually be able to improve in the commercial annuity markets upon PPF benefits for members.

The question then arises as to the true ownership of the “anti-embarrassment” interest in the reorganised sponsor company, which is an asset of the PPF. In the situation, where the scheme has entered the PPF, and the sponsor company subsequently prospers, this interest benefits other schemes by lowering future levy claims upon them. But as the PPF cannot pay greater benefits than its rules allow, there is no potential for enhancement of the surviving members' benefits. Members have unequivocally lost. In



the event that PPF-relative enhanced benefits were acquired commercially, there appears no intent to further improve these as the value of the anti-embarrassment becomes evident – a process of potential future “top-up”.

This raises another issue – the question of schemes which fail with more funds than are necessary for achievement of the S179 PPF benefits level but insufficient to acquire commercially enhanced benefits. These surplus assets become the property of the PPF and lower future levy demands on other member schemes. The fact that these surplus assets are not available for member benefits is inequitable to them.

The optimal corporate finance position in times of distress is, in fact, to under-fund the scheme, to the greatest extent possible, given the pensions regulator’s powers with respect to contributions, in order to maximise the value of its put option on the PPF.

There are also further, more involved potential complications, but these points alone should serve to illustrate some of the inadequacies of a Government sponsored enterprise in matters of corporate finance.