Grant Thornton
An instinct for growth™

Pensions Advisory Services

Secure, Manage, Reduce

2017

Contents

"The Grant Thornton team were very professional and easy to work with. I felt it was particularly helpful that the team had a background knowledge and experience of tPR."

Tom Clark
Agfa Finance UK

Helping trustees, sponsors and other key stakeholders meet their objectives.

Uncertainties in the economic environment and the constant change in legislation can make it challenging for trustees of defined benefit (DB) schemes to align their conclusions on the level of support their sponsoring employers can provide. Employers also face challenges in understanding how their performance and position, as well as structural issues, can impact upon the support that is required of them, how they can manage costs and how they can efficiently deal with schemes in the longer term.

At Grant Thornton, we provide award-winning pension scheme advice to both trustees and employers, working collaboratively with all stakeholders and tailoring our services to their circumstances but specialising in simplifying complex issues around managing, reducing and removing pension scheme risk. We also offer the kind of depth of experience you would expect from a major consultancy firm of our size, one which is plugged into an unrivalled international network of member firms.

Since our team was formed in 2004, we have acted in over 450 triennial valuation and transaction-based assignments. We have made a point of working as closely as possible with both the Pensions Regulator (tPR) and the Pension Protection Fund (PPF), where we have on-going secondment programmes, which give us a unique insight into how those key bodies operate.

We have also acted as lead advisers in three very high-profile, pension-centric corporate restructurings. In these assignments – for the pension schemes of Kodak Limited, Uniq plc and UK Coal plc – we created and installed ground-breaking solutions to what seemed to be complex, and indeed intractable, scheme funding problems. In the coming years we look forward to using our experience and expertise to help our trustee and employer clients find innovative solutions that work for their DB pension schemes. We are delighted that we have been recognised by our peers in industry awards for our innovative client work.

Keith Hinds
Head of Pensions Advisory

Scheme funding advisory

The term ‘covenant’ broadly refers to the ability of an employer to support the liabilities of its DB scheme. The regulator regards covenant as being one of the cornerstones of the overall scheme risk spectrum that needs to considered and monitored.

Uncertainties in economic conditions have led to volatile and increasing deficits in recent years, which have made it even more important for there to be an understanding of the employer’s ability to provide support. The strength of the covenant can also change rapidly and therefore both the trustees and their employers will want to ensure they have mechanisms in place for the regular monitoring of the situation.

A completely independent analysis of the employer covenant

We provide bespoke assessments of covenant strength to support our client through triennial valuations. We also give real-world views on suitable recovery plans given the specific circumstances of the scheme and the employer. Such reviews take full account of guidance set out by tPR and its objective to ensure that scheme funding should not adversely impact upon the sustainable growth plans of employers.

We find that collaboration between trustees and employers is usually the most effective route to achieving the best outcomes for both sides. We can create innovative solutions to overcome seemingly insurmountable funding issues, including the use of contingent assets, the implementation of profit-sharing mechanisms and further forms of compromise between employers and trustees. We can also provide due diligence support, where trustees have received proposals to implement asset-backed contribution (ABC) structures and our experience of looking at a multitude of such arrangements provides real insight and value-add to our clients.

“In a difficult negotiation, Grant Thornton brought clarity and insight. I was impressed by the speed of response and commercial approach – an invaluable asset to the Trustees.”

Susan Andrews
Independent Trustee

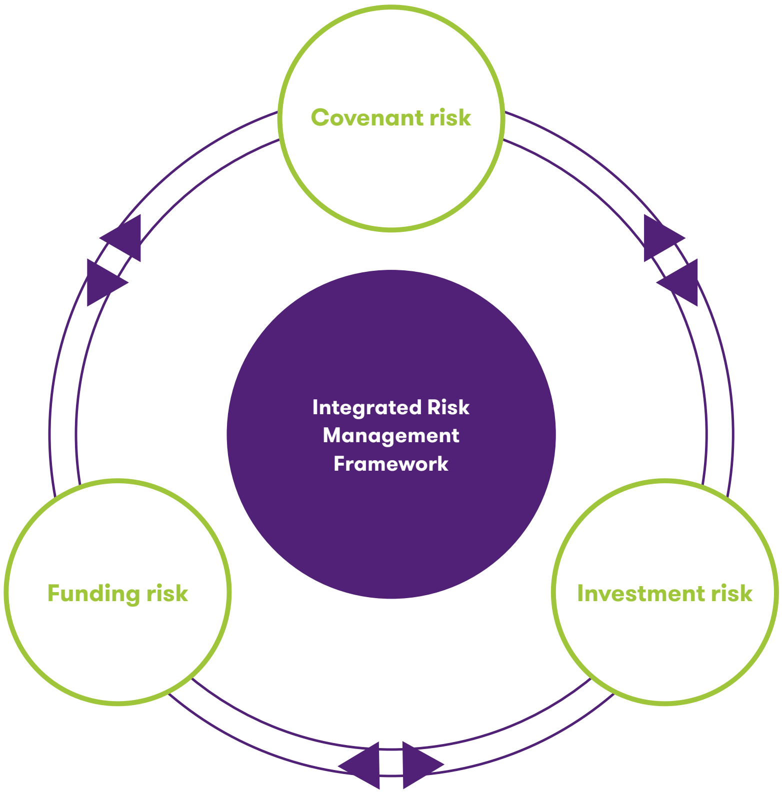
Our services for trustees:

- Independent covenant assessment
- Advice on recovery plans
- Non-cash funding solutions
- Negotiation assistance
- On-going covenant monitoring
- Advice on scheme amendment (including closure to accrual) and merger
- Due diligence on ABCs and valuation of ABC instruments
- Advice on PPF guarantee certification

Overview of services for employers and other stakeholders:

- Proactive assessments, presenting an initial view of covenant for trustee consideration
- Advice in affordability discussions with trustees
- Non-cash funding solutions
- Negotiation assistance
- Advice on scheme amendment (including closure to accrual) and merger

Integrated covenant advice



We adopt the integrated approach when providing covenant advice regarding scheme funding, as advocated by tPR. We help employers and trustees to understand the updated regulatory environment. We work closely with your other advisers to ensure a holistic approach is taken in the assessment and management of employer covenant, investment and funding risks. A robust covenant assessment is important as ultimately the employer covenant underwrites investment risks and funding risk held within the scheme.

Pension scheme restructuring

In certain circumstances employers will no longer be able to deal with the burden of their final salary schemes, even if the underlying business is profitable and cash-generative. It therefore can be in the best interests of key stakeholders for some form of restructuring to occur.

In these situations, the options for dealing with the pension scheme must be considered in detail to ensure equitable treatment. It can also be crucial in certain circumstances to ensure restructuring proposals are acceptable to tPR and/or the PPF if clearance and PPF entry to be required to achieve optimal outcomes.

Outlining the options in situations of distress

We offer specialist advice to either employers or trustees. We have developed a number of innovative proposals ourselves, or have guided trustee clients through proposals drafted by their employer, giving our view on necessity (given the health of the employer) and feasibility.

In the case of insolvent restructurings, we advise trustees and employers on whether the underlying conditions have been met for the PPF and tPR to consider restructuring proposals. We establish, for example, whether the insolvency of the employer is inevitable and whether suitable levels of mitigation have been offered. We have built up a unique insight into the way both tPR and the PPF work from our close working relationships with them, having advised on many of such processes in the past and having an ongoing programme of secondments within both organisations.

"Grant Thornton worked seamlessly across service lines, combining practical deal advice with specialist knowledge, helping us to deliver a ground breaking international asset carve-out. They also helped us cut through the layers of complexity which included a completion deadline driven by the parent company's emergence from Chapter 11"

Stephen Ross
Kodak Pension Plan

We have significant experience of advising other financial stakeholders, particularly lenders, in the context of restructurings which involve pension schemes. For example, we can provide advice on optimal exit strategies or on the appropriate level of debt pricing given the risks present in schemes.

Our services for trustees:

- Viability review and assessment of inevitability of insolvency
- Entity priority and insolvency modelling
- Restructuring feasibility studies
- Advice on Regulated Apportionment Arrangements (RAAs)
- Scenario and options planning, including risk analysis and asset/liability modelling
- Moral Hazard investigations
- Negotiation support between all parties, their advisers and the relevant regulatory bodies

Overview of services for employers and other stakeholders:

- Solvent and insolvent restructuring proposal development
- Entity priority modelling and insolvency analysis
- Project management of restructuring plans
- Scenario and options planning, including risk analysis and asset/liability modelling
- Exit option planning for creditors
- Negotiation support between all parties, their advisers and the relevant regulatory bodies

Case study

Kodak Pension Plan (KPP)

Background

The Eastman Kodak Company (EKC), the UK employer's US parent company, agreed to guarantee payments to the KPP so that it would be fully funded by the 2022 valuation. However, in January 2012 it filed for Chapter 11 bankruptcy protection.

Our role

Post-Chapter 11, we continued to advise the KPP trustees in their discussions with both EKC and the UK employer to agree a strategy that would secure members' benefits at a reduced level, albeit higher than that which would have been received with entry to the PPF.

As part of this, we reviewed whether we might obtain a better outcome for the members from a negotiated on-going funding solution with the wider group rather than from an insolvency of the UK employer and subsequent 'Moral Hazard' recoveries. In April 2013, we unveiled an innovative solution where the KPP acquired Kodak's Personalized Imaging and Document Imaging businesses as consideration for releasing its $2.8 billion claim against both EKC and the employer.

The long-term income stream from these two businesses, with expected annual revenues of $1.3 billion, will be used to fund the KPP going forwards. However, the trustees concluded that the existing deficit was so large that the scheme could not continue in its current form so scheme members were offered the chance to transfer to a new scheme, with reduced benefits but at a higher level than would have been on offer from the PPF, which was the only alternative. An overwhelming majority of members voted for this transfer. The deal was approved in September 2013 and EKC was able to exit from Chapter 11.

Pension scheme transaction advisory

M&A transactions usually make perfect commercial sense for the primary parties involved. However, in our experience we often find that issues relating to pension schemes can often be overlooked, when actually they can frequently be the largest liability involved in the deal.

We are able to assist trustees in making sense of what such transactions mean for the covenant and how any downside risks can be mitigated. For employers and other stakeholders, we advise on likely trustee reactions and negotiating levers and, crucially, we also provide scheme due diligence advice to make sense of the scale, volatility and risk of the scheme liabilities being bought or sold.

Trusted advice on the impact of corporate activity

In the case of a corporate transaction, trustees and employers need to understand whether it could be considered a 'Type A' event, defined by tPR as one which might result in 'material detriment' to the scheme. In such a situation, trustees will need assistance in identifying and negotiating appropriate mitigation with the employer.

Our team of specialist advisers includes professionals with extensive experience of assessing the covenant impact of such transactions. We have a proven track record in negotiations, between trustees, employers, lenders, tPR and the PPF.

We also have qualified actuaries in the team who specialise in providing scheme specific due diligence for both vendors or purchasers. Through such work and subsequent advice on negotiating strategies, we can assist in the protection of value or suitable pricing reductions in deals.

> "Grant Thornton have a very clear grasp of this whole subject area and their experience at the Pensions Regulator was invaluable in adding kudos to the Trustees' position in the negotiations."

Philip Sutton
The Trustee Corporation Limited

Our services for trustees:

- Assessment of the impact on the covenant of a corporate transaction, refinancing or reorganisation
- Entity priority modelling and insolvency analysis
- Negotiation assistance for mitigation
- Consideration of the covenant aspects of apportionment arrangements
- Moral Hazard investigations

Overview of services for employers and other stakeholders:

- Pension scheme due diligence for vendors or purchasers
- Advice on pricing strategy
- Advice on clearance applications
- Presenting transactions to trustees on behalf of employers
- Advising on regulatory impacts of transactions and trustee leverage
- Negotiation assistance

Case study

Project Diamond

Background

The employers were within a discreet manufacturing division under the ownership of a large multinational group. The group was in the process of selling the division and communicated to the trustees early on in the process that the buyer was likely to be a private equity house.

Our role

We were engaged to provide an assessment of the impact of the disposal on the covenant afforded to the scheme. As the transaction was to be a share sale the operational trading of the employers was not going to change, however, the impact of the new finance structure was likely to be significant. As a buyer had not been identified at the point we were engaged, the group provided us with a hypothetical debt structure so we could offer preliminary advice to the trustees.

Based on the amount of secured debt that would rank ahead of the scheme and the costs of servicing it we concluded that the transaction would be materially detrimental to the scheme, and recommended the level of mitigation the trustees should pursue in this regard. When a buyer was identified we summarised the variances in the debt structure from the hypothetical scenarios, which led us to slightly amend our conclusions and mitigation recommendations, which ultimately led to a significant lump sum payment being made to the scheme and the technical provisions being strengthened.

PPF Levy management

Every eligible scheme in the UK is obliged to pay an annual levy to support the PPF. It is essential that all employers and trustees understand their PPF levy, as the payments can be significant, are volatile year-onyear and cannot be recouped.

The PPF has introduced a number of changes to the way it calculates the levy it charges to all eligible DB schemes. These changes may have a material impact on the amount which schemes (and ultimately employers) will be liable to pay. The changes have created a number of winners and losers.

Manage your PPF levy

Every scheme's levy is different and is made up of a very complex individual calculation, based on a combination of the employer's perceived insolvency risk and the risk associated with the scheme. There is a system of scorecards to segregate different types of organisations based on their insolvency risk. The scorecards place each scheme into one of ten insolvency risk bands, with the lowest band paying the least and the highest the most.

"Grant Thornton took the time to explain any complex areas clearly and concisely, were readily available and furthermore, we felt that they constructively added real value."

Chair of Trustees
Hälfele Pension Scheme

Depending on the output of this calculation, the levy can vary from barely registering against scheme expenses to being the highest expense. For trustees, any payment towards a PPF levy is potentially deficit repair contributions (DRC) lost. For employers, even if levies are payable from scheme assets, this ultimately hits the employer in terms of extra cash requirements to reimburse the scheme. Therefore a lower PPF levy will result in a 'winwin' situation for the trustees and the employer. We have successfully advised a number of clients of all sizes, helping them to move to a lower insolvency band and saving the sponsors a considerable amount of money. We can help trustees and employers to proactively manage the PPF levy and minimise the levies payable.

Our PPF levy management services for trustees and employers:

- highlight how the insolvency and scheme risk may be improved, ultimately reducing the annual levy
- monitor your levy to allow you to address unfavourable movements quickly
- forecast your annual levy charge, using our modelling software to provide an estimate of your scheme's future levies
- assess the impact of business changes on your levy (ie the effect of a potential refinancing/ reorganisation or acquisitions and disposals)
- implement a suite of levy reduction options (mortgage exclusion certificates, PPF complaint guarantees, contingent assets, asset backed contributions, DRC certification etc)
- provide guidance on annual guarantee certification and ABC valuations.

PPF levy timetable

The main filing deadline is 5pm on 31 March each year, although there a number of others

Action	Key dates
Monthly Experian* scores	Between 1 April and 31 March
Submission of data to Experian to impact on monthly Experian scores	One calendar month before the month end (excluding weekends and Bank Holidays) when an Experian score is taken
Submit scheme return on Exchange**	5pm, 31 March
Contingent asset certificates to be submitted on Exchange and, where necessary, hard copy documents to PPF	5pm, 31 March
Asset-backed contributions certificates to be sent to PPF	5pm, 31 March
Mortgage exclusion certificates and supporting evidence to be sent to Experian	5pm, 31 March
DRC certificates to be submitted on Exchange	5pm, 30 April
Confirm legal advice held on Last Man Standing (LMS) status to be sent to PPF	29 May
Certification of full block transfers to be completed on Exchange or (in limited circumstances) sent to PPF	5pm, 30 June
Invoicing starts	Autumn each year

* Experian is the PPF's insolvency risk information provider
** The Exchange is the Pensions Regulator's online service for submitting scheme information

Actuarial and scheme de-risking

The cost of operating a defined benefit pension scheme has become an increasingly important issue for companies and trustees. In the recent past, liabilities have rocketed as real interest rates have fallen to deeply negative levels.

Many companies and trustees received quite a wake-up call when updated on the latest funding position of their schemes.

In some instances the liabilities and obligations can threaten the very survival of sponsors. Escalating deficits and crippling contribution levels have made it harder for businesses to attract new investment, blocked M&A deals and impeded normal business restructurings.

Strategic business planning and tackling pension scheme risks

Without a strategy to reduce or remove the key risks within the scheme, employers will continue to face the possibility of increasing cash commitments to fund what must seem like a never ending obligation, whilst for trustees poorer funding places greater weight on the employer covenant to eliminate the deficit over time.

As more and more corporate sponsors and trustees are looking to remove or reduce the risks inherent in funding their schemes, we provide independent advice on practical and financially viable options to do this, either via investment strategy changes, annuity purchase or liability management.

We have deep experience on all forms of derisking and will understand the optimal route given your specific scheme circumstances, market conditions and current legislation.

We work on behalf of both trustees and employers on projects including annuity transactions, asset/liability modelling to quantify and remove individual risks and liability management in all its forms.

We can also provide a scheme actuarial service to trustees as we have many years of scheme actuary experience and appointments for many different sized schemes with varying characteristics.

Case study

Project Disraeli

Background

Our client, a leading provider of fire testing services, were looking to investigate the cost of ceasing contracting out in 2016 and the potential of ceasing future accrual, in order to reduce the impact of the pension scheme deficit on any potential sale price.

Our role

Working for the Employer, we provided advice on increasing employee contributions to allow for the cessation of contracting out and the large increase in future service contributions due to unfavourable market conditions. Our calculations showed that employee contributions would have to rise to unfeasible levels. Given this, we gained the agreement of the Trustees to cease accrual within the scheme after managing the communication exercise and employee presentations. The cessation of accrual led to a £1 million reduction in the Scheme deficit due to the breaking of final salary linkage. The Employer then looked for help in negotiations with potential buyers.

Outcome

After undertaking a stochastic modelling exercise to highlight the expected cost of funding the deficit to potential buyers and negotiating terms with the selected bidder, the Employer sold the business with the £15 million SSF deficit attached for a deduction of around £10 million to the sale price.

Our national dedicated Pensions Advisory leads

Keith Hinds
Head of Pensions Advisory

T +44 (0)20 7865 2716
M +44 (0)7802 306 831
E keith.hinds@uk.gt.com

Jamie MacKenzie
Director

T +44 (0)20 7865 2418
M +44 (0)79 6747 5469
E jamie.mackenzie@uk.gt.com

Kevin Hollister
Associate Director

T +44 (0)20 7184 4430
M +44 (0)7468 707 803
E kevin.m.hollister@uk.gt.com

Zoe O'Donnell
Associate Director

T +44 (0)20 7865 2773
M +44 (07825 053 463
E zoe.e.odonnell@uk.gt.com

Phil Green
Associate Director

T +44 (0)20 7865 2196
M +44 (0)7836 335 524
E phil.c.green@uk.gt.com

Paul Heeley
Associate Director

T +44 (0)161 953 6403
M +44 (0)7702 379 093
E paul.heeley@uk.gt.com

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grantthornton.co.uk

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