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Pensions: Asset Backed Contributions (ABCs)

Using corporate assets to provide efficient funding to pension schemes

The issue

For many UK Defined Benefit pension schemes, an increased deficit will be an unavoidable outcome of their next funding valuation. Additionally, with new pensions funding legislation and guidance on the horizon, the Pensions Regulator ("tPR") is directing trustees and companies to agree long-term funding targets ("LTFT"). A LTFT is not prescribed, but we anticipate that many trustees will seek a LTFT that assumes a scheme will move to a low risk investment strategy (i.e. self-sufficiency) or will secure benefits with an insurer (i.e. buy-out) within an agreed timeframe.

As a result, many companies will be facing increased demands from pension scheme trustees for cash or other forms of funding/protection to meet these increased deficits and/or help achieve these long-term targets.

The latest Deloitte CFO survey* shows these increased demands will come at a time when more companies are prioritising cost reduction than in late 2009, when the economy was emerging from recession.

Asset Backed Contributions (ABCs) utilise group assets (e.g. property, brand, loan notes, receivables, stock) and can provide a means of immediately funding a significant amount of pension deficit, whilst preserving corporate cashflow and reducing the risk of overfunding the pension scheme.

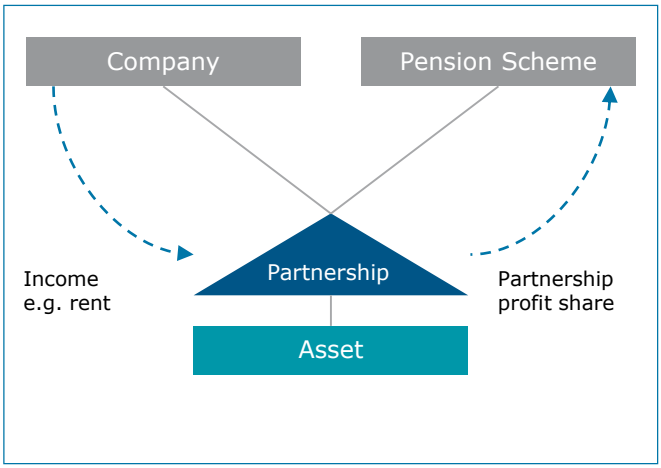
What is an ABC?

ABCs typically work by the company and the pension scheme establishing a Partnership into which group assets (e.g. property, brand, loan notes, receivables, stock) are transferred. These assets will be leased or licensed back to the company, to generate an income stream to provide annual cash distributions to the pension scheme.

The pension scheme holds an interest in the partnership of an agreed value, which immediately reduces the deficit. The interest typically delivers a profit share to the pension scheme over a 15-25 year period and is collateralised by assets which have value independent of the corporate and are ring-fenced for the benefit of the scheme.

The key benefits of using an ABC are set out below. They can also be used to facilitate other objectives, such as pension scheme merger, changes to investment strategy or liability management exercises.

An illustrative ABC



Why use an ABC?

Cash preservation
ABCs enable cashflows to be spread over a longer period than a typical recovery plan. Upfront tax relief may also be available

Immediate deficit reduction
ABCs enable an immediate improvement to the cash funding position of the pension scheme

Overfunding protection
ABCs can be designed to reduce the risk of paying more cash into a pension scheme than is actually required

Security of member benefits
Scheme trustees gain access to a valuable corporate asset, with a value independent of the employer's circumstances

Control of assets
The company maintains operational control of the underlying corporate assets

* http://www2.deloitte.com/uk/en/pages/finance/articles/deloitte-cfo-survey.html

Contact us

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