Burges Salmon Pensions Law Summary

Asset Backed Funding

Scope and Summary

This note provides a practical summary of some key aspects relating to Asset Backed Funding (ABF) for pensions schemes as at July 2021.

ABFs can be attractive options to help address a pension scheme deficit, where an employer has available assets to pledge to the ABF (during the period required under its terms), without needing to commit that asset outright to the scheme. Trustees may also benefit from the security provided by the ABF structure.

Key features include:

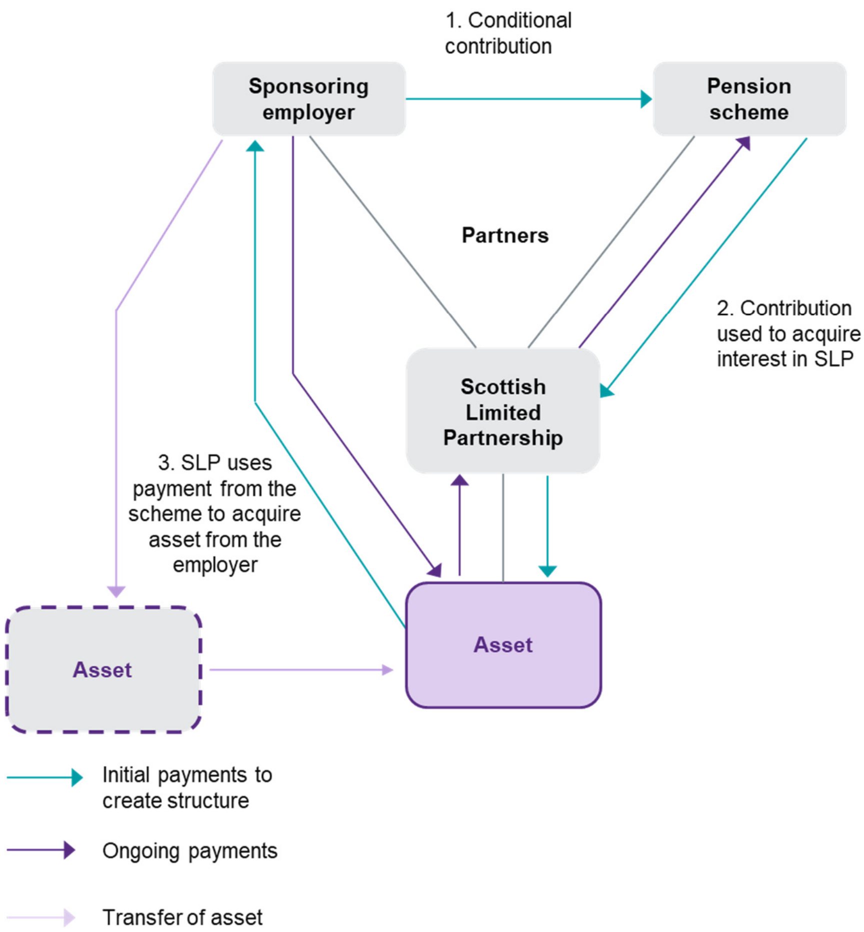
- asset backed funding arrangements are designed to make available a non-cash asset towards the funding of a pension scheme;
- when structured appropriately, ABFs can help to successfully balance the needs of the trustee in respect of increased certainty of funding and of the employer in relation to the level of payments into a scheme;
- a key feature for employers is that an ABF can be structured such that all or part of the asset may be returned to the employer on agreed triggers;
- as the ABF structure can have the effect of immediately reducing the scheme deficit, this can reduce the level of cash contributions that would be required otherwise under a recovery plan;
- for trustees, potential benefits may include greater access to security and the prospect of a new income stream (from the secured asset) to help fund benefits compared to the position absent an ABF;
- trustees will need to consider whether an ABF is better in terms of the combination of security and payments to their scheme compared to reliance otherwise on the level of cash payments under a recovery plan;
- ABFs require legal review and documentation to ensure that their terms address the requirements of both employers and trustees. This includes the ability to ensure that there is effective security for the trustees and clear provisions for return of the asset to the employer on the agreed triggers.

Example Structure of ABF

The structure of an ABF requires a number of elements within it including to allow for the joint interest in the LLP between the employer and the trustees and also for the return of the asset to the employer on set triggers. Under statute this involves a Scottish LLP that generally sits within an English law structure.

The asset is acquired from the employer by the LLP (using the one-off contribution which the employer pays to the trustee and the trustee uses to invest in the LLP) and then leased back to the employer by the LLP in return for a regular income stream which is paid to the trustee.

An example of an ABF structure from the [Pensions Regulator's (TPR) guidance] is as follows:



The Guidance provides that "*The regulator recognises that innovative funding mechanisms such as AB[F]s may help employers meet their obligations to schemes and can, in certain circumstances, improve a scheme's security by providing access to valuable assets which were previously out of reach*".

Some key considerations

Theme	Impact of ABT	Employer Considerations	Trustee Considerations	Legal and Regulatory
Employer assets not being held within scheme on an outright basis	The structure can allow full or partial return of the secured assets prior to buy out on agreed triggers. Contrast this with regular assets held by a scheme which are generally held outright, at least until buy out, where any repayment of surplus funds must await that point (and may be dependent on the scheme rules).	The ability to provide for return of an asset prior to scheme buy out can be a key attraction.	Trustees will wish to consider the value and effectiveness of the security, and whether this is a good alternative to other funding options available to the scheme.	Full review of the legal terms for return of the asset are key from an Employer, Trustee and Regulatory perspective.

Security provided to the scheme	Depending on its terms, the security provided by the ABF may provide greater member certainty rather than otherwise relying on the prospect of future cash payments under the recovery plan.	As above.	As above.	TPR highlights investigation of the reliability of the security in the event of insolvency.
Reduction in deficit and potential reduction in employer contribution levels	The value of the LLP which holds the underlying asset can give rise to an immediate reduction in the scheme deficit.	Determination of the amount of the deficit reduction (which may be lower than the value of the LLP's underlying asset).	Covenant and legal review are essential.	TPR has stressed the importance of trustees carrying out due diligence to determine the value of the LLP interest and that this value should not be double counted.

In Summary

ABFs can provide successful outcomes for employers and schemes. As their application and effectiveness are determined by the ABFs legal structure and the nature of the underlying asset, this is an area where detailed advice is key.

We have worked on numerous ABF projects including for Milford Haven Docks, QinetiQ, a department of a leading university and a national medical services supplier. The legal structure of ABFs under statute are part English and part Scottish law and we provide a seamless solution for this through our Bristol, London and Edinburgh offices. Our experience in this area means that we can offer ABF structures to schemes of all sizes on a cost effective basis.

Please do contact us if you would like any further information or advice on anything in this note.

This practical summary is not intended to be a full statement of the law on this topic and is not legal advice. It does not take account of any developments since it was written or last updated."

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