



Regulatory intervention report

Issued in relation to the GKN PLC Pension Schemes

March 2019

Case summary

We saw a number of high profile mergers and acquisitions in 2018, one of which was the takeover of GKN by Melrose. The purpose of this regulatory intervention report is to highlight to trustees, employers and advisers how we expect to work with parties where there is a takeover or acquisition and a defined benefit pension (DB) scheme involved.

Illustrated summary



Background

GKN PLC (GKN) is a global engineering group which was, at the time of the takeover bid, listed on the London Stock Exchange. GKN has various divisions, including GKN Aerospace, GKN Driveline and GKN Powder Metallurgy.

GKN has two UK-based DB pension schemes – GKN Group Pension Scheme 2012 and GKN Group Pension Scheme 2016. The schemes have a combined membership of over 32,000 members. The schemes' combined deficit was around £1.4bn based on a gilts flat basis¹ and £2.2bn on a solvency basis².

Melrose Industries PLC (Melrose) is a company also listed on the London Stock Exchange. Melrose aims to create significant gains by buying companies and increasing the value of the businesses that it owns through substantial investment. Its stated strategy is “Buy, Improve, Sell”.

In January 2018, Melrose offered to buy each existing GKN share for a cash payment of 81p and 1.49 shares in Melrose (equating to £7.4bn at 17 January 2018 prices). The share portion of this offer was subsequently increased from 1.49 shares to 1.69 shares on 13 March 2018 – valuing GKN at £8.1bn. The cash part of the bid would largely be financed by increasing debt, resulting in GKN having potential liability for materially more debt after the takeover. The bid included a proposal to make an initial payment of £150m to the GKN pension schemes.

The bid was not recommended by the existing GKN management and so went ahead on a hostile basis. GKN management sought to prevent the hostile takeover and presented its plans for the GKN group to shareholders on 14 February 2018. A subsequent proposal was announced in early March to merge its Driveline business with Dana Incorporated, a US-based business. Alongside these announcements, GKN management agreed with the trustees a package of support for the schemes which would apply if the Melrose takeover bid was unsuccessful.

Shortly after the announcement of Melrose's takeover bid on 12 January 2018, the trustees of the two schemes acted promptly and made a joint statement to the market. This highlighted their aggregate funding level and noted that any change to the corporate and capital structure of GKN would lead the trustees to reassess the strength of covenant and funding requirements.

We consider that this statement was a positive factor in ensuring that the trustees were able to agree a funding package with both GKN and Melrose.

Ahead of the final GKN shareholder vote on Melrose's takeover proposal, Melrose's management agreed a package of future support for the schemes. This included agreement to fund the schemes more prudently. Melrose agreed cash contributions of up to £1bn to fully fund the schemes on the revised funding basis, including one off contributions to be paid when businesses within the group are sold.

1 A gilts flat basis is a measure of the funding required to pay benefits in full which aims to limit reliance on the continuing support of the sponsoring employer.

2 All GKN deficit numbers are quoted excluding the GKN Investments LLP asset of £0.3bn, in order to be consistent with the Melrose basis of calculating the deficit and the total cash contributions required.

Regulatory action

The hostile bid and the defence plan by the existing GKN management meant that either Melrose would acquire GKN or changes would be implemented by the existing ownership. Both would have a significant impact on the position of the scheme. We were very clear that in either scenario, mitigation to manage the possible impact on the security of members' benefits would be needed.

As soon as we became aware of the possible takeover of GKN by Melrose, we contacted the management of both companies setting out our concerns about the potential impact on the schemes, and subsequently met with representatives of both companies and with the trustees of both schemes.

Given the importance of the pension schemes as financial stakeholders and the public nature of the takeover battle, our involvement quickly became public.

We continued to communicate with the trustees as well as both Melrose and GKN's management separately before plans for the schemes were agreed between each company (separately) and the schemes' trustees. We wanted to understand how the schemes could be affected depending on whether the hostile takeover succeeded or not, and to ensure that any material detriment to the schemes would be appropriately mitigated.

There were calls from MPs, regulators and the press for Melrose to apply for formal clearance of the transaction, but it chose not to do so. Clearance is a voluntary process, and was included in the Pensions Act 2004 to provide comfort to companies engaging in corporate transactions which are likely to cause material detriment. It exists to address their concerns that our powers might otherwise deter companies from engaging in normal corporate activity. Although we encourage applications for clearance in these situations, it is for the parties involved to make that decision. The benefit of clearance is that, if we have been given full disclosure of all relevant facts, it provides certainty that we will not use our powers at a later date.

Outcome

The robust approach taken by the trustees of the GKN schemes, supported by prompt engagement by TPR with our expectations clearly set out, meant that both GKN and Melrose provided details of their plans and engaged with the trustees to agree mitigation for the changes in covenant resulting from the acquisition.

On 29 March, GKN shareholders voted in favour of Melrose's proposal – with the GKN companies now forming part of the enlarged Melrose group. Since the takeover took effect, we have continued to discuss the implementation of the agreed plans for the schemes with the trustees and with Melrose.

Our approach

In situations where a transaction is likely to have a significant impact on the employer's ability to support a DB pension scheme, we are likely to communicate with involved parties to ensure that appropriate steps are taken to understand and mitigate any material detriment to the schemes, with the aim of protecting members' benefits.

In the case of a transaction, we will consider the merits of investigating in detail whether the use of our anti-avoidance powers such as Contribution Notices or Financial Support Directions³ would be justified. We are likely to open an investigation if we are not satisfied that appropriate arrangements have been made to mitigate any potential material detriment caused by the transaction.

Where the parties to a transaction choose not to come to us for clearance (as was the case for the Melrose bid for GKN), we can open an investigation at a later stage if we consider it appropriate. If the companies want greater certainty about the use of our powers, they can apply for clearance where appropriate⁴.

We expect to be notified as soon as practicably possible about any potential transaction affecting a company or group that has a DB pension scheme attached. We routinely engage with confidential, price sensitive information and the sensitive nature of takeover discussions should not be a bar to discussing these situations with us. We are aware of the restrictions imposed by the takeover code for transactions which fall within the scope of that code, but would expect offerors to give careful consideration to whether the pension issues are sufficiently material to require early involvement of the pension trustees and the regulator.

Throughout the negotiation process, we may meet with stakeholders, including pension scheme trustees and management of companies involved, to ensure that they are taking appropriate advice and making a full assessment of any impact on their pension schemes.

3 For information about our anti-avoidance powers go to:
<https://www.tpr.gov.uk/en/about-us/how-we-regulate-and-enforce/anti-avoidance-powers>

4 For information about our clearance process go to:
<https://www.tpr.gov.uk/en/document-library/regulatory-guidance/clearance>

Timeline

12 January 2018: Media report of a hostile takeover bid of GKN by Melrose.

15 January 2018: TPR emails the trustees of both schemes.

16 January 2018: Trustees respond to TPR along with statement issued to the media.

22 January 2018: TPR requests meeting with trustees to discuss interaction between trustees and GKN as well as advice received and protections in place for the scheme.

30 January 2018 – March 2018: Regular meetings, calls and correspondence with trustees, companies and advisers about the proposals and setting out clearance process.

14 February 2018: GKN presents defence strategy to the market.

6 March 2018: Business, Energy and Industrial Strategy (BEIS) Committee Evidence Session.

9 March 2018: GKN announces plans for the schemes.

19 March 2018: Melrose announces plans for the scheme.

28 March 2018: TPR writes to Melrose setting out expected ways of working going forward if the bid is successful.

29 March 2018: Shareholders vote in favour of Melrose.

The regulator's consideration and approach to individual cases is informed by the specific circumstances presented by a case, not all of which are referred to or set out in this summary report.

This summary report must be read in conjunction with the relevant legislation. It does not provide a definitive interpretation of the law. The exercise of the regulator's powers in any particular case will depend upon the relevant facts and the outcome set out in this report may not be appropriate in other cases. This statement should not be read as limiting the regulator's discretion in any particular case to take such action as is appropriate. Employers and other parties should, where appropriate, seek legal advice on the facts of their particular case.



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