

Regulatory intervention report

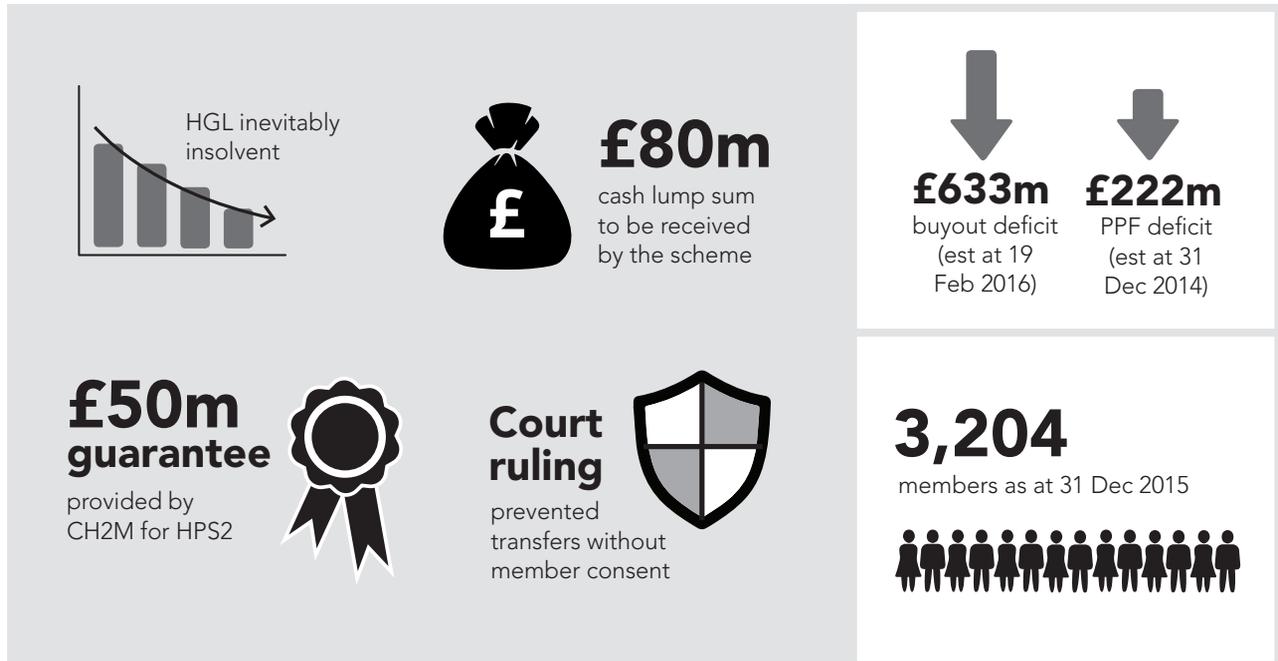
issued under s89 of the Pensions Act 2004 in relation
to Halcrow Pension Scheme

July 2016

The Pensions
Regulator

The Pensions Regulator (TPR) has recently approved a Regulated Apportionment Arrangement (RAA) in relation to the Halcrow Pension Scheme ('the scheme'). In our view, the RAA represents the best outcome for all parties in difficult circumstances.

Illustrated summary



Background

Halcrow Group Limited (HGL) is a consulting engineering business and the sponsoring employer of the scheme.

In 2011, HGL's parent was acquired by CH2M HILL (CH2M), a global engineering company based in Denver, Colorado. Both HGL and its parent company, Halcrow Holdings Limited, were loss-making when they were acquired by CH2M. At the time of the deal, both we and the trustees believed that the purchase improved the level of financial support available to the scheme. In this case, there was no legal obligation on CH2M to fund the scheme and it was highly likely that HGL would have become insolvent without investment from CH2M. Despite the trustees' request that CH2M enter into a legally binding promise to support the scheme at the time of the purchase, CH2M was not willing to do this, nor was it required to by law.

Following the purchase, CH2M provided significant help to HGL to turn its fortunes around. CH2M ensured that the UK business obtained from previous Halcrow relationships would continue to be contracted through the appropriate Halcrow entity where possible, which would maintain HGL's ability to support the scheme.

Throughout 2012, the trustees were in the process of completing the scheme's 2011 valuation. It became clear that the pension obligations were significant when compared to the financial strength of HGL, the company who, together with Halcrow Water Services Limited, had legal responsibility for funding the scheme. Despite lengthy discussions, the terms of the 2011 valuation could not be agreed between the trustees and HGL management. An independent trustee was appointed by HGL to work alongside existing trustees in January 2013.

Efforts had been made to reduce costs and improve the business and these began to bear fruit during 2013. HGL recorded a profit before tax of £691,000 in that year (following losses totalling £78 million for the previous two years), but despite this, the business remained under pressure.

Negotiations between the trustees and HGL on the 2011 valuation continued, but the contributions that HGL could afford were still well below the amount needed to fund the scheme appropriately. As such, the March 2013 deadline to complete the 2011 valuation passed and the valuation was not agreed. Despite this deadlock, CH2M provided substantial financial support to ensure that all contributions were made, even though it had no legal obligation to do so.

In late 2012 we began further discussions with the trustees and HGL due to their failure to complete the 2011 valuation, and considered whether it was appropriate to use our powers¹ to impose a recovery plan on the scheme. However, it was clear that HGL would not be able to afford to make payments under an appropriate recovery plan due to its difficult financial circumstances. We took into account the fact that it continued to make contributions of approximately £13 million per year in accordance with the recovery plan agreed in 2008. As a result, we concluded that using our funding powers would not improve the situation. Instead, we allowed additional time for the trustees and HGL to consider what other options were open to them and were in the best interests of members.

Between August and October 2014, CH2M and HGL considered changing the benefits that the scheme was set up to pay. They considered this to be preferential to the insolvency of HGL and the scheme entering the PPF. A proposal, which would see the bulk transfer of all members (without their consent) to a new scheme with reduced benefits, was put to the trustees in November 2014. By April 2015 the trustees had agreed in principle to the proposal but were only prepared to implement it if a court approved that it would be a proper use of the trustees' powers.

¹ Under s231 of the Pensions Act 2004.

Legal proceedings

In April 2015, the trustees informed us that they intended to begin legal proceedings in the High Court of Justice with regards to the proposal. The PPF was joined as a party to the proceedings to confirm that the benefit redesign did not affect the new scheme's eligibility for PPF compensation (should that ever be required). The trustees also asked a scheme member to act as a 'representative beneficiary' – someone who is appointed when it is not practical for all beneficiaries who might be affected by the issues to participate in the proceedings. In this case, the representative beneficiary was given the role of putting forward arguments in opposition to the benefit redesign.

We were not initially a party but we subsequently applied to the Court to join as we disagreed with the trustees' interpretation and considered that the Court would benefit from our industry-wide perspective. The proposal relied on an interpretation of the legislation that the scheme actuary was able to take the security of scheme benefits into account and allow members to be transferred without their consent. The judge ruled in our favour, so the benefit redesign could not go ahead without member consent.

At the request of HGL, the proceedings and the judgment were subject to a court confidentiality order until 29 April 2016. Although the granting of such orders is unusual, the Court ordered that the judgment remain confidential during this time in light of its commercial sensitivity and in order to allow time for the trustees, CH2M and HGL to develop an alternative proposal. The judgment refers to the financial strength of HGL and, if that were to have been made public, it could have had serious implications for the business and consequently the scheme. In light of these commercial issues, we did not object to the confidentiality order and were bound to comply with it.

The Court's judgment can be found at <http://bit.ly/29jcbqs>.

Regulatory action

The financial position of HGL and the scheme remained precarious in light of the Court's decision and an alternative solution was needed. The trustees, HGL and CH2M explored alternative options for providing members with benefits that were greater than PPF compensation. CH2M had no legal responsibility to fund the scheme but agreed to continue to provide funding to allow time to pursue a consensual solvent solution. The alternative was for CH2M to withdraw support from HGL which would have led to an insolvency event, loss of jobs and the scheme entering the PPF in late 2015.

The trustees, HGL and CH2M met with us and the PPF in December 2015 and the companies presented their proposals. Over the next three months these parties negotiated the terms of a proposal that would involve similar changes to member benefits but on a consensual basis. This would involve:

- ▶ offering members the chance to transfer to a new scheme – HPS2 – that provided benefits above PPF but lower than the benefits members would have received under the scheme. HPS2 would still be backed by HGL but with a guarantee from CH2M
- ▶ non-consenting members remaining in the scheme and transferring to the PPF
- ▶ a cash payment to the scheme from CH2M, together with an equity stake in HGL in view of the loss of employer support through the use of an RAA²

RAAs are extremely uncommon and the continuation of a scheme following the conclusion of an RAA is even rarer. The trustees supported the proposal as they were of the view that this presented the best outcome for members in the circumstances and the PPF, after the negotiations we and the PPF had with HGL and CH2M, was able to provide its non-objection as required.

²
Further information about RAAs can be found in our regulatory guidance on multi-employer schemes and employer departures on our website at www.tpr.gov.uk/multi-employer

Our approval was needed for the RAA to be implemented and we will only give this if we believe it is reasonable and that certain tests are met.³ In this case, the following applied:

RAA test	How it was met
Whether insolvency of the employer would be inevitable or whether other solutions would prevent this	The trustees sought independent financial advice which confirmed that insolvency was inevitable. We were satisfied by this conclusion
Whether the scheme might receive more from an insolvency	The trustees sought independent financial advice on the scheme's estimated outcome on insolvency. This confirmed that the £80 million negotiated was more than the scheme would have received in an insolvency of HGL
Whether a better outcome might be arrived at by other means (eg use of our other powers)	We concluded that the RAA was the best outcome in the circumstances and that it would not be reasonable to use our other powers
The circumstances of the rest of the employer group	The trustees sought independent advice as to the circumstances of the purchase of HGL by CH2M and we have seen a copy of this advice
The outcome of the proposal for other creditors	HGL's only other creditor was CH2M who will provide the £80 million and with whom we negotiated a package that meant that contributions to HPS2 would be prioritised over any CH2M and HGL inter-company loan payments for up to eight years

In the specific circumstances of this case, we concluded that an RAA and the ability for members to choose to transfer to HPS2 was an appropriate and reasonable course of action. Furthermore, we ensured that the level of risk being proposed for HPS2's funding strategy was at an acceptable level and steps were going to be taken to manage future risks and ensure that HPS2 remained viable.

³ Further information about how we deal with RAAs can be found within our statement entitled 'Regulated apportionment arrangements (RAAs) and employer insolvency' on our website at www.tpr.gov.uk/apportion

Our anti-avoidance powers

We have certain powers available to us to require contributions or other financial support to be paid to a scheme in order to protect the benefits of scheme members and to ensure that pension liabilities are not avoided or unsupported. These powers are often referred to as our anti-avoidance powers.⁴

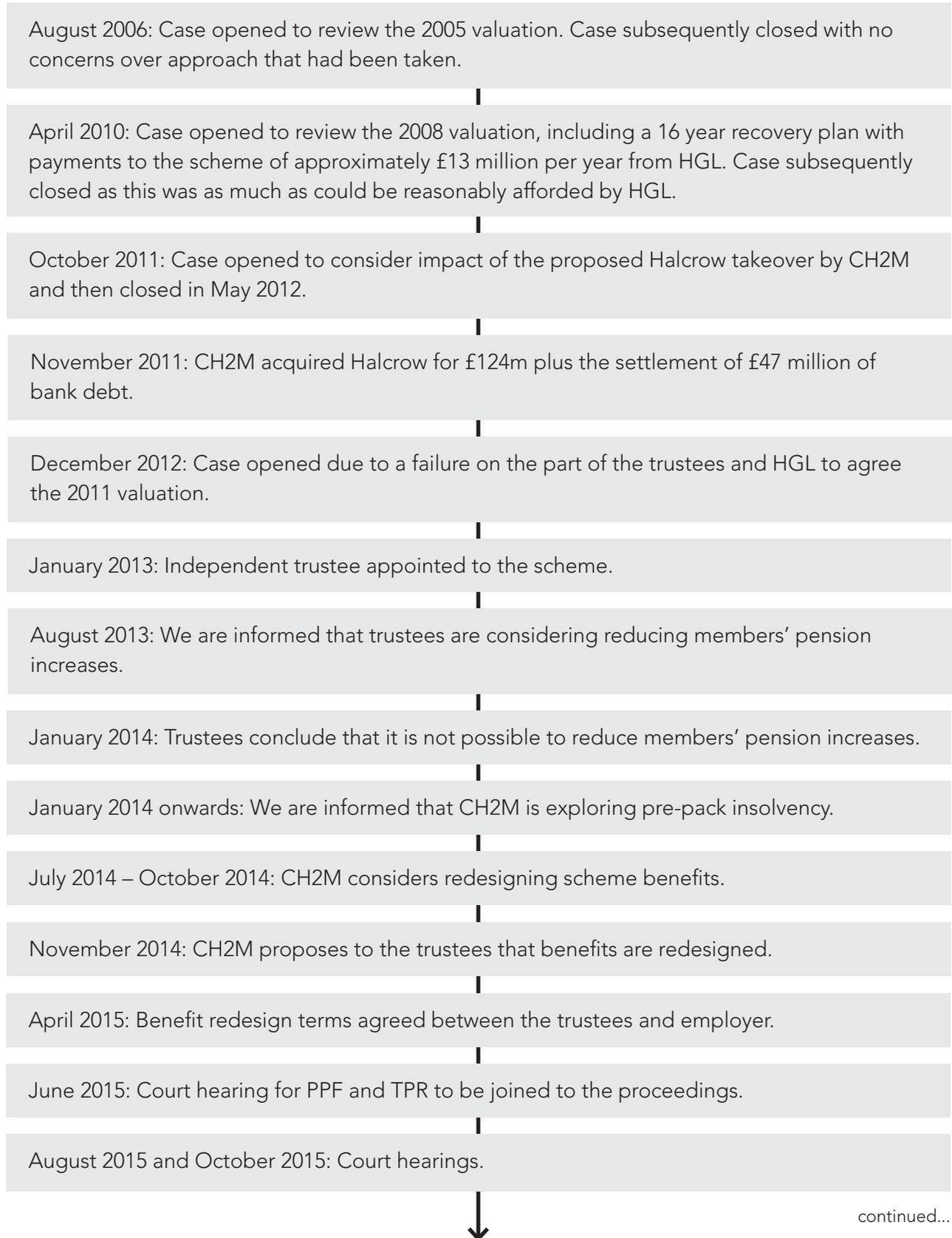
Buyers of pension scheme sponsors are not automatically responsible for funding or making contributions to that pension scheme. However, our anti-avoidance powers enable us to impose such a responsibility if we think it is reasonable to do so and the legal criteria have been met.

At the time of the takeover in 2011, we explored whether it would be reasonable to use our powers and concluded that it would not. We viewed the takeover as normal commercial activity which had improved HGL's ability to support the scheme.

We continued to consider throughout our engagement, and in particular in connection with the RAA proposal, whether it would be reasonable to use our anti-avoidance powers and were satisfied that it would not. In considering this we took into account the fact that CH2M provided significant financial support to HGL and continued to fund the contributions due to the scheme under the 2008 valuation.

4
Further information about these powers can be found in Appendix B to our Clearance Guidance, which is available on our website at www.tpr.gov.uk/clearance

Timeline of events



October 2015: Court decides that transferring without member consent is not legally possible. The decision was handed down in December 2015.

November 2015: Trustees write to CH2M expressing support for exploring alternative options for providing members with benefits that are better than PPF compensation.

December 2015: The trustees, CH2M and the employer meet the PPF and us to discuss the companies' alternative proposal.

January 2016 to April 2016: Proposal, including RAA, negotiated.

28 April 2016: CH2M submits final clearance application. Warning Notices are sent to the directly affected parties (DAPs) giving notice of our intention to grant clearance and approve the RAA.

29 April 2016: Determination Notices and Clearance Statement issued.

28 May 2016: RAA approval notice issued following 28 day statutory referral period to Upper Tribunal.

31 May 2016: Employer and trustees issue letters to members explaining their options.

May 2016 to August 2016: Period for members to make their decision.

Outcome

From late 2012 we began discussions with the trustees and HGL as a result of their failure to complete the 2011 valuation and tried to find a solution to the funding risks presented by HGL's weak financial position.

This led to challenging negotiations where we agreed a proposal with the trustees, HGL, CH2M and the PPF which, in view of the circumstances, was in the best interests of both the scheme members and the PPF. Clearance was sought by HGL and CH2M in respect of the proposal. In considering the proposal we looked at the level of ongoing risk in HPS2 and whether our RAA principles were met. We and the PPF worked closely together to make sure that the protections around HPS2 were sufficient.

As a result of approving the RAA, the scheme will receive:

- ▶ £80 million as a cash lump sum (which is more than it would have received in the insolvency of HGL)
- ▶ a minimum 25%, and maximum 45%, equity stake in HGL

In practice, this will be split between HPS2 and the PPF, depending on the number of members who choose to transfer. The equity stake in particular is critical in ensuring that members and the PPF share in any benefit from the continued operation of the HGL business.

As part of the transaction the following protections were agreed in respect of HPS2:

- ▶ CH2M will provide a £50 million guarantee.
- ▶ The first recovery plan put in place will be no longer than eight years.
- ▶ Any CH2M and HGL inter-company loan payments will rank below contributions to HPS2 for up to eight years.

HPS2 is set up to be eligible for PPF entry, leaving the PPF exposed to the risk of HGL's future insolvency. However, we and the PPF were satisfied that this risk is being appropriately managed and represents the best solution available in the circumstances. CH2M, HGL and the trustees have contacted members about their options for transferring to HPS2 or the PPF.

Why did we agree to HPS2?

In most cases, there is no continuation of a scheme following an RAA because an ongoing or successor scheme would need to run an inappropriate level of risk. This would result in an unfair balance between the interests of the members and the PPF (and its levy payers).

In this case, we were satisfied because:

- ▶ Members have been given the option to transfer to HSP2. Although it offers lower benefits than the scheme, these HSP2 benefits will be worth £10 million more than the PPF compensation the members would have got under the scheme.
- ▶ HPS2 liabilities will still be lower than in the scheme. When combined with the cash lump sum and guarantee from CH2M, the PPF's future exposure is reduced.
- ▶ The trustees obtained advice on the risks for HPS2 and we were satisfied that these were manageable due to the ongoing financial support provided by HGL and the CH2M guarantee.
- ▶ We, the PPF and the trustees negotiated the protections outlined on page 10.
- ▶ There is a plan to de-risk HPS2's investment strategy over a reasonable timescale which will improve the security of member benefits and reduce the risk that the PPF will need to pay compensation in future.

The initial investment strategy to be implemented will depend on the profile of the members who transfer their benefits to HPS2, and therefore on the members' decisions. However, we have obtained assurances around the principles that underpin the investment and funding strategies, as well as any immediate de-risking measures.

Our approach

The best outcome for members and the PPF is generally a strong ongoing employer alongside an appropriate funding and investment strategy including, where necessary, a suitable recovery plan. However, we recognise that in some situations this support may no longer be possible. Where an employer is at serious risk of insolvency it is important for employers, trustees and their advisers to explore the available options for the pension scheme.

Where pension schemes and their sponsoring employers are in a precarious position, we work extensively, closely and creatively with them to try to deliver a solution that balances the interests of the members, PPF and employer.

RAAs will only be approved if they meet our stringent tests and if we believe it is reasonable to do so. We were satisfied that all of the tests were met in relation to this case. In the majority of cases where there are no new investors, we would only accept a minimum 33% equity stake. However, in this case, we were comfortable with the potentially lower equity stake as a result of the wider package we had negotiated, where inter-company loans would rank below contributions to HPS2 for up to eight years.

When considering approving an RAA, we must issue a Warning Notice to all DAPs so they can provide us with any comments before our decision is made. Those DAPs then also have the option to refer our decision to the Upper Tribunal. The trustees of pension schemes have a representative role for all their respective scheme members. They are, therefore, a DAP for these purposes and in this case, the trustees of the scheme were kept fully informed throughout the process.

In some exceptional cases we may consider it reasonable for a scheme (or successor scheme) to continue. This assessment is likely to require a considerable level of independent analysis to be obtained by the trustees. In the rare event that continuation is acceptable, such as with HGL, we will expect trustees to manage the residual risk to the PPF to ensure that a fair balance between members and PPF levy-payers is maintained. This may require restrictions over future behaviour or appropriate protections being put in place. It is also important that members are involved, are given a choice, and are not transferred without their consent.

The reduction of accrued benefits, via a transfer to a new scheme with member consent, is a step which trustees should approach with the utmost caution. We should be consulted before any such exercise is started and we will expect members to receive adequate information before being invited to make a decision. We would expect members and the PPF to be treated equitably with all other creditors and shareholders, which may include them compromising some or all of their rights.

For us to become involved in private Court proceedings is unusual. We will do so where we believe the issue being considered is likely to have a material industry-wide impact and, therefore, it is important for the Court to hear from us.

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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Halcrow Pension Scheme

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