# ALTERNATIVE FINANCING, INTELLECTUAL PROPERTY AND PENSION DEFICITS

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## Background - The Pension Deficit Epidemic

As reported the Pension Regulator says it has *"substantial concerns about the plan"* following BT's announced intention about how it will pay off its £9bn pension deficit.

> *"ITV cuts pension deficit £124m... an asset backing scheme makes rapid inroads into broadcaster's £550m pension deficit, which was seen as a takeover barrier".*
>
> *"GKN has unveiled a radical £400m plan to reduce its mounting pension deficit in the UK".*
>
> *"Cadbury pension deficit leaves a bitter taste for Kraft".*

Hardly a day passes without similar stories. The Pension's Regulator has significant and close interest in positive steps to address pension deficits through scheme funding and pension funding partnership schemes.

And the interest in Alternative Financing from both sponsors and trustees continues to increase. This is unsurprising given the current pensions environment:

- The Pensions Regulator (TPR) continues to look for legally enforceable contingency plans in circumstances where deficits are being significantly funded by excess investment returns.

- TPR has also issued its first warning notice under section 231 of the Pensions Act 2004.

- Forthcoming changes in the calculation of future PPF levies for bigger sponsors ought to push them review whether a PPF approved contingent asset (parent / group guarantee, security, third party insurance) may be appropriate in their circumstances.

- Well hedged pension plans may now be at / close to "trapped surplus" funding levels.
- IFRIC 14 (and capital reserving requirements) may mean that a pension plan accounting surplus cannot be recognised on a sponsor's balance sheet.

In addition, the PPF have recently introduced a new "scoring" system for assessing the strength of sponsors for PPF levy purposes that ignores the value of any intangibles on a sponsor's balance sheet (whilst maintaining the deduction for any amortisation of this value via P&L).

## Rationale for Intellectual Property in the Context of Alternative Financing and Pension Solutions

Despite the FTSE 350 running a combined pension deficit of about £80bn companies are concerned about committing cash contributions to their pension funds, even if they can afford to do it.

The credit crunch and recession has led to cash and credit restrictions for a large number of companies. Companies are reviewing balance sheets and trying to utilise assets for pension funding purposes that are undervalued or missing. Accounting is biased against intellectual property on corporate balance sheets.

As intellectual property is increasingly acknowledged as the dominant asset of most companies, it also becomes the primary collateral. Historically IP has rarely been used to maximum effect. IP is property just like any other asset but with more advantages, for example tax benefits following effective structuring. Commercial strategies with intellectual property have been commonplace in the area of off-shoring and IP management holding company structures.

As long ago as May 2011 Tui Travel Plc announced a measure to address the funding of its defined benefit schemes. Three schemes have been provided with a limited interest in a partnership which holds the Thomson and First Choice brands (trademarks and associated IP and intangible assets). This innovative 'pure IP' solution has been followed with Britvic and its brands and other large and small businesses.

## COMMENT

Whilst the market for alternative financing solutions for pension deficits is becoming more standardised with parent company guarantee, more specialised and innovative approaches have emerged. One particular and welcome development is the use of intellectual property to provide security to pension schemes. Trustees are increasingly willing to take patents, brands and trademarks as security against pension liabilities, thus reducing the cash contribution requirement and potentially improving overall balance sheet value.

In 2014 the Pension Protection Fund which pays compensation to members of final salary schemes if their employers become insolvent proposed a stricter approach to calculating the levy it imposes on employers that use Asset Backed Contribution structures. It had noticed that increasingly employers were using intangible assets such as trademarks and other IP to lower pension scheme deficits. Following considerable discussion within the industry and more widely it was agreed that in order to be able to recognise a range of assets including intangibles it was necessary that Regulators needed to require more from the Schemes in terms of how they certify to use the valuations on insolvency. In December 2014 Guidance in relation to Asset-Backed Contributions was published confirming that intangible assets and intellectual property were an acceptable ABC asset class, however with far more stringency and demand of the intangible asset valuer, for example Registered Expert status of those performing such valuations, the Expert's ability to be able to certify the value of the intangible asset in an insolvency situation and that the PPF can rely on that valuation as third party.

Given the above, there would appear to be continuing opportunities to use IP in a pension financing context:

- As a charge to support either an agreed level of liabilities or a longer recovery period of deficit contributions.

- Securitised via an asset backed funding arrangement.