

Pensions: Readers: Digest!

The Reader's Digest UK pension scheme is looking for someone to fill the £125m funding deficit in the face of the collapse of its sponsor and a Chapter 11 filing by its sponsor's US parent. This highlights the issues around pension deficits within international businesses.

Pensions Act, 2004

The Pensions Act of 2004 sought to close many loopholes that UK companies had exploited in order to diminish their pension deficits. Pensions have become a significant burden on companies. A friend of the BRAVE partners, who is a senior member of the HR department in a major international organisation, mentioned recently that when that company had originally set up their UK pension scheme, it expected retirees to live for two years post retirement.

Tricks of the trade

Some companies that were struggling under the burden of their pension liabilities would accumulate these in a specific subsidiary and then bankrupt that subsidiary. The concept of limited liability of a corporate would be enough to ring fence the rest of the company assets. The Pensions Act changed that by making former owners and parents liable for pension deficits.

The Pensions Act in action

The Pensions Act has worked well for the pension plans of UK companies. The attempted split and sale of Marconi is perhaps the best known example. Marconi is a UK institution. It was involved in the early days of telecommunications. The founder, Guglielmo Marconi, made the first radio transmission across

the Atlantic. Since those days the company had declined. As the UK economy has developed many, once great, UK engineering and manufacturing businesses have become small compared to their legacy pension liabilities. A plan was therefore made to split the company into two. One piece contained the viable business assets that was bought, including the name, by Ericsson. The remaining businesses and the pension liabilities remained with the former Marconi, which was renamed Telent. Half of the proceeds of the sale of assets to Ericsson went to the Telent shareholders and the other half was placed into an escrow account to support the pension. The deal worked well for the pension plan and there was considerable interest in buying Telent from a major hedge fund, Fortress. Ultimately the sale was blocked by another aggressive hedge fund, Polygon, that wanted a piece of the pie. Polygon managed to

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accumulate sufficient stock to block the vote on the sale to Fortress. Telent was acquired by the pensions buy out business, Pensions Corporation in November 2007.

Foreign owners

Even during the sale of Marconi, concerns were raised about a possible sale to Huawei, the largest telecoms equipment manufacturer in China. Whilst the Pension Act worked well for UK companies and extended to the EU, the Pensions Regulator had no real powers for non domestic or EU parents of UK companies.

The Pensions Regulator issue turned out to be theoretical for Marconi, it is now real for Reader's Digest. A proposal by Readers Digest to the Pensions Regulator was rejected, leading to the appointment of administrators at the company. The negotiation between Readers Digest and the Pensions Regulator centres around the amount of money that Readers Digest would need to put into the pension scheme in order for the Pensions Regulator to allow the company to transfer its pension liabilities to the Pension Protection Fund. Freed from these liabilities, Reader's Digest would have a chance at rebuilding a profitable business. The Pensions Regulator will only allow such a transfer in the event that it is certain that the company cannot fill the full deficit, and clearly, it is not certain in this case. The fact that the parent of Reader's Digest is an American company, and thus falls outside of the jurisdiction of the Pensions Regulator, will increase its need for absolute certainty on the parent company's ability to pay.

The value of illiquidity

The debate between the Pensions Regulator and Reader's Digest once again raises the issue facing long term investors, such as pension funds and life insurers as to the the value of illiquidity. In a market where asset values are driven down sharply by the lack of credit and other funds to purchase them, cash is King. There is an inherent value in just having cash to invest. This is not allowed for in the mark-to-market accounting that is currently prevalent. In some ways, life insurers and pensions funds have themselves to blame for the rigid adherence to market value accounting. For far too long, these investors hid behind their "buy-and-hold" strategy so as not to realise losses on clearly impaired assets. However, BRAVE Partners believes that the pendulum has swung too far. Pure mark-to-market accounting practices do not allow long term, cash rich investors to efficiently realise the value of their position. At a time when corporate sponsors are in financial difficulties; attention should be paid to assisting and allowing their pension funds to fully realise all the value that they can in order to support their members.

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BRAVE Partners Services

BRAVE Partners LLP can advise pension funds and life insurers on investment strategies and structures that will allow them to realise the value of their ability to take on illiquid asset positions.

Interaction

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- In a liquidity crisis, cash is valuable.
- BRAVE Partners believes that this value is not fully attributed to life insurers and pension funds.
- BRAVE Partners LLP can assist pension funds and life insurers to develop asset strategies that realise the value of their liquidity advantage in the current market.

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