

Pension schemes and asset-backed special purpose vehicles

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“So, show me - what’s the real value to the pension scheme?” That is the make-or-break question the Pensions Regulator (TPR) will ask of any asset-backed special purpose vehicle (SPV) designed to put a non-cash asset towards funding.

Whether a proposed SPV structure is legally effective will be a matter for the trustees, the employer and their advisers. TPR is interested in the benefit it delivers to the scheme; in the substance, not the form.

Stephen Soper, Executive Director of Defined Benefit Funding, outlined TPR’s views recently at the Institute and Faculty of Actuaries annual seminar, *Actuaries and the Law*.

TPR’s position highlights the need for robust due diligence on the legal and commercial terms behind the income stream from an SPV and on the reliability of the security in the event of default or insolvency.

Real estate partner Euan Bremner works with Clive Pugh and others in our pensions team on SPV projects.

Euan comments:

The benefits of Scottish limited partnerships to plug pension deficits are well known. The income stream has been backed by things like whisky (Diageo) and trademarks (GKN) but real estate is the asset most commonly used.

It’s attractive for a number of reasons, not least that many employers have it readily available. Examples include Marks & Spencer, John Lewis and Sainsbury’s. It provides a relatively secure income through rental payments under a lease and a high degree of security through a legal charge over a valuable freehold asset.

The commercial mortgage-backed securities (CMBS) market I’ve worked in for over a decade has lessons for the pensions industry and illustrates why the Regulator is interested in substance. The CMBS market failed in part because of concerns over the strength of the income stream (valuation)

and the security over the asset (underpin).

The ratings agencies had difficulties valuing the securitised bonds because the strength of the tenant covenants under the leases on which the real estate was valued was unclear. Secondly, on default there was no recourse to the underlying real estate but only to an ailing insurance product that couldn’t support the bond.

If we apply lessons from CMBS we will go some way to satisfying the Regulator on substance:

- *would an arm’s length third party accept the structure?*
- *does the underlying asset have a value independent of the employer’s covenant?*
- *is any leaseback is on open market terms (many lease terms, not just rent, affect value)?*
- *have the income stream and the asset been valued on open market terms? how would the employer’s insolvency affect the valuation?*
- *does the SPV have a firm hold on the real estate, preferably through a legal charge?*
- *does the legal documentation give the trustees the protections they need against the SPV and the employer?*

Pensions at Burges Salmon

We have a market-leading pensions team with skills recognised by short-listings for three major industry awards in 2011. The team has exceptional and broad experience in all pensions matters.

We bring together UK pensions lawyers and solicitors qualified in Scotland to advise on innovative funding arrangements using Scottish limited partnerships and other vehicles. The team has worked with real estate and various other asset classes.

Our unique ability to deal with real estate in all UK jurisdictions (including Scotland and Northern Ireland) coupled with our in-depth knowledge of the regulatory regime has led to us being

recognised as a firm that *"maintains its position at the top of the market due to its ability to handle the most complex pensions issues and the sheer number of high-value schemes it advises,*

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