

BT: combining contingent funding solutions to provide an attractive outcome for all stakeholders

The BT Pension Scheme is one of the UK's largest defined benefit pension schemes with assets of £57bn at its most recent actuarial valuation. LCP has recently supported BT in connection with the Scheme's 2020 valuation in which a suite of contingent funding mechanisms have been put in place. These mechanisms provide benefits for both the Scheme and the Company. For the Scheme there is significant value provided over the next three years, and increased security as it progresses towards full funding and a low risk long term investment strategy. For the Company, it is able to spread some cash payments over a longer term than the recovery plan by providing security, which helps to free up resources so that it can invest in its business. There is also some protection against the risk of over-funding the Scheme.

£2bn Asset Backed Funding arrangement ("ABF")

£2bn cash contributions

£4bn BT option to use co-investment vehicle

A D E

- Provides annual cash payments of £180m to the Scheme over 13 years, secured against the EE business
- Spreads payments over a longer period than the recovery plan
- Upfront deficit reduction
- Switch-off mechanism to reduce over-funding risks: annual payments will stop if the deficit is eliminated earlier than expected
- Favourable tax treatment as upfront tax relief on full value of recovery plan can be claimed (with adjustment for 'switch-off')
- Underlying asset is a loan note from the company that owns the EE business
- Covenant enhancing for Scheme as provides access to EE through security over EE's shares (EE is part of the BT Group, but was not part of the Scheme's direct covenant)

Co-investment vehicle

- Contributions from 2023 can be paid to a co-investment vehicle at BT's option, or directly into the Scheme if preferred at the time to maximise tax flexibility
- Funds will be paid into the Scheme if required at the end of the journey plan in 2034, and the vehicle provides the Scheme with security for these funds over the intervening period
- Otherwise, provides potential for funds to be returned to BT if not required, thus reducing over-funding / "trapped surplus" risks
- Structured as a Scottish Limited Partnership (as ABFs typically are) and assets held in the vehicle can be included in the assets of the Scheme
- The Company gets tax relief at the end of the journey plan (2034) to the extent funds are actually paid into the Scheme
- Flexibility on investments that can be held, and funds will be invested as if part of the overall Scheme investment strategy

Contingent contributions

Contingent contributions and covenant protections

- Pre-agreed contingent contributions based on funding tests each year (but with a buffer to reduce impacts of market volatility) to keep the journey plan on track for 2034
- Increases certainty on how future deficits can be funded on acceptable terms
- Provides added protection for Scheme if future deficits emerge (with overpayment risk to BT reduced through co-investment vehicle)
- Pre-agreed contingent contributions also arise based on covenant tests (see below),
 which reflect regulatory direction of travel and support overall agreement

Also in place are a number of covenant-based contingent funding mechanisms similar to those agreed as part of previous valuation discussions:

- There is a dividend link in place whereby additional contributions are paid to the Scheme if dividend growth exceeds a 10% annual threshold and the Company has also committed to consulting with the Trustee before any special dividends are paid
- Extra contributions to the Scheme are triggered if business disposal proceeds net of aquisitions are above a certain threshold, and BT has committed to consulting with the Trustee in connection with material acquisitions or any other corporate event that could have a material impact on the covenant
- BT has also committed to a negative pledge that it will not provide other creditors with security that would sit ahead of the Scheme. There's a £0.5bn threshold for this to trigger and business as usual financing arrangements are exempt from the commitment

<u>Click here</u> to read BT's press release with further details



Click here to read our contingent funding handbook



Whilst the BT Pension Scheme is much larger than most, similar approaches to contingent funding can be easily put in place regardless of scheme size. For example, LCP's **Streamlined Escrow** can achieve similar economics to the co-investment vehicle and we regularly advise trustees and employers of all scheme sizes as to appropriate contingent contribution and covenant protection frameworks.

Want to find out more?

If you would like further information, please visit our **contingent funding handbook** or contact your usual LCP adviser or one of the people below.



Phil Cuddeford
Partner
+44 (0)20 7432 6676
phil.cuddeford@lcp.uk.com



Katie Peto
Partner
+44 (0)1962 872776
katie.peto@lcp.uk.com



Helen Abbott
Partner
+44 (0)20 3314 4997
helen.abbott@lcp@uk.com

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