

# MERCER

Eleanor Dowling  
Principal

Tower Place  
London EC3R 5BU  
Tel/Fax 020 7178 7186

eleanor.dowling@mercer.com  
www.mercer.com

The Secretary to the Code Committee  
The Takeover Panel  
10 Paternoster Square  
London EC4M 7DY

27 May 2011

Subject: Consultation regarding proposed amendments to the Takeover Code – PCP  
2011/1

Dear Sir

Mercer Limited is a global leader for HR and related financial advice and services. In the UK, our client base includes employers and trustees providing occupational pension schemes to employees in all sectors of industry. We provide pension advice and services to companies in the FTSE250, and we also have a large proportion of clients that are employers classed as “Small to Medium sized Enterprises”. A large proportion of our clients are the trustees of pension schemes with sponsoring employers in all of these classes. We will comment from the perspective of these groups.

We are responding because a large part of our expertise is in the context of occupational pension provision and human resources more widely. We have noted the Code Committee’s conclusion in Statement 2010/22 that the Code should be amended to recognise the interests of offeree company employees. We strongly support this conclusion and the proposed amendments to the Code, as we are aware that company takeovers often result in changes to employment contracts, including pension provision. They can also affect the company covenant available to occupational pension schemes which, in turn, affects benefit security and the way trustees of defined benefit (DB) schemes might choose to finance the scheme.

The principle aim of our response is to suggest that the amendments in the Code should be extended to give trustees of DB pension schemes sponsored by the offeree or offeror the same rights to notice and disclosure of information as those proposed for employee representatives.



Mercer Limited is authorised and regulated by the Financial Services  
Authority  
Registered in England No. 984275 Registered Office: 1 Tower Place West,  
Tower Place, London EC3R 5BU

**Consulting. Outsourcing. Investments.**

# MERCER

Page 2  
27 May 2011  
The Secretary to the Code Committee  
The Takeover Panel

In addition, we note the Code Committee's conclusion in Statement 2010/22 that offeree companies should be required to publish the employee representatives' opinion. We suggest that the Code Committee consider whether this requirement should be extended to the opinion of trustees of DB schemes sponsored by the offeree company.

In order to explain the rationale for these proposals, we have set out in Appendix I an explanation of the role and resources of trustees of DB schemes.

We have made specific comments on Sections C and D of the consultation document, contained in Appendix II to this letter, reflecting our proposals above. The context for these comments is the trustees' position as explained in Appendix I.

Yours sincerely

Eleanor Dowling  
Principal

## APPENDIX I

### **Extending information rights to the trustees of DB schemes: context and rationale**

The main aim of our response is to suggest that the amendments in the Code should be extended to give trustees of defined benefit (DB) pension schemes that are sponsored by the offeree or offeror the same rights to notice and provision of information as those proposed for employee representatives.

In order to explain the rationale for our proposal, this appendix sets out the position of trustees of DB schemes, their relationship to the employer which sponsors the scheme, and their duties as trustees with regard to the security of scheme benefits and the strength and prospects of the sponsor.

#### *Trustees as “creditors” of the employer*

A large proportion of DB schemes in the UK are currently in deficit, that is, the scheme's assets are not sufficient to meet its liabilities<sup>1</sup>. When this occurs, the trustees of DB pension schemes (referred to hereafter in this document as “trustees”) often stand in relation to the sponsoring employer in a position akin to that of non-priority debt holders. The nature of the debt is such that it is payable over a period of time that is, in most cases, negotiable between the trustees and the company: the period of time could be decades, although it could become immediately repayable in certain circumstances. In some cases, the scheme's deficit exceeds the value of the sponsor company. Although often responsible for the largest part of a company's debt, trustees have few of the bargaining tools available to those with similar exposure (such as banking covenants, including change of control provisions), or those creditors ranking *pari passu* with them (such as ongoing trading commitments).

We understand that the Takeover Panels' prime function is to protect the interests of shareholders when there are takeover bids. Consequently, the Code largely relates to

---

<sup>1</sup> There are different ways of measuring pension scheme 'liabilities'. The position taken in company accounts is determined by accounting standards and is most relevant when considering the trustees as 'debt holders'. However, trustees often take a different view of the liabilities when deciding the pace of funding, and in some circumstances legislation requires the liabilities to be calculated using an insurance company approach. Where the distinction is relevant to our argument, we will make it clear which measure we are referring to.

requirements that must be fulfilled in relation to shareholders and employees, and does not consider the interests of a company's debt holders. This seems proportionate: debt holders do not own the company and, normally, when they enter into financing arrangements with their creditor they limit the extent of their exposure to individual firms and negotiate the terms under which they can call in their debt. Trustees do not have these comforts: in reality, it is only an accounting convenience to consider them 'lenders' to the firm since they have not deliberately engineered the situation; in addition, their ability to extricate themselves from debt is limited and they have no leverage (for example, future trading opportunities) with the employer.

- Most lenders, with the same degree of exposure to the firm that trustees sometimes have, will have as terms of their debt the requirement for the company to provide them with information about any change in the financial or economic position of the company (for example, a putative takeover, or change in borrowing schedules). Trustees can only get these agreements as a gesture of goodwill from the employer and may have no power to enforce them.
- On the other hand, the actions taken by trustees can have material financial impact on current *employees*, because they have the ability to make decisions that may increase the size of the scheme deficit, or even, in certain circumstances, require immediate payment of the debt, leading to the insolvency of the employer. So, in extremis, their decisions can also affect the shareholders.

We are conscious that DB pension schemes should not become greater obstacles to corporate activity than they are already. We wish to avoid situations where corporate restructuring can result in pension liabilities becoming detached from a 'viable' part of the commercial entity, leading to scheme closures that result in less than full benefits being paid, without due consideration by affected parties.

### *Trustee duties*

The scheme funding regime introduced by the Pensions Act 2004 implies that the trustees of any DB pension scheme must have an understanding of the sponsor's financial strength, prospects, ability and willingness to fund its commitments to the scheme (known as the "employer covenant") in order to set the scheme's funding target. The Pensions Regulator expects trustees to assess, monitor and take action on the employer covenant and any changes to it, specifically including those caused by corporate restructuring – see the

Page 5  
27 May 2011  
The Secretary to the Code Committee  
The Takeover Panel

Pensions Regulator's guidance for trustees regarding this matter at <http://www.thepensionsregulator.gov.uk/guidance/monitoring-employer-support.aspx>.

In addition, the trustees must manage interests that are not necessarily aligned, since they cannot ignore the interests of the company (as a potential beneficiary of the scheme), whilst having the responsibility for ensuring that members' best interests are met. In some cases, the latter responsibility could lead to them taking any action they think appropriate to ensure the scheme remains open, whereas in others their duties might lead them to wind the scheme up, thereby triggering a large employer debt which could in turn force insolvency.

Ideally, trustees would work in close partnership with their sponsoring employer, and should be made aware of any proposed sale or purchase in relation to the employer or an associated company immediately. However, this is not always the case and the trustees might not be given access to all the information included in the offer document or offeree board's opinion.

It will not be sufficient to assume that employees' representatives will be able to take the interests of scheme members into account: often, the concerns that will be most important to them will be different to those that will be important to trustees (as pension scheme members and employees are different groups). Scheme trustees also have access to expert advice that employees and their representatives would not naturally access, or could find difficult to access themselves.

Consequently, we believe the Takeover Code should give the trustees at least the same rights to provision information as employee representatives. In particular, trustees should be provided with notice of the offer, information regarding the offeror's intentions regarding the offeree company and its employees, the offeree board's opinion of the offer, details of how the offer is to be financed and its implications for the merged business.

### Requirement to circulate the trustees' opinion of the offer

Given that the Code Committee has taken a bold and admirable step in concluding that offeree boards should be required to publish the employee representatives' opinion of the offer, we suggest that the Code Committee consider whether the offeror board should be required to circulate the opinion of trustees.

Page 6  
27 May 2011  
The Secretary to the Code Committee  
The Takeover Panel

We are making this suggestion for a number of reasons:

- Trustees have continuous access to a range of professional advisers because of their legal obligations. Generally, trustees should be used to commissioning advice regarding the financial position of the company and its future, and have some familiarity with considering such advice and the impact upon the scheme. Employee representatives may have access to legal advice, but it is likely to focus specifically upon employment matters.
- The trustees are likely to have a different perspective upon the offer and its implications than other interested parties such as employee representatives. Although acting on behalf of members, trustees are not employee representatives, in particular since many of the people they represent will no longer be employed by the company.
- Shareholders may wish to understand the trustees' view of the offer and its impact upon the DB pension scheme, particularly where the companies or the scheme involved are large. For example, in a recent offer involving J Sainsbury plc, the trustees' opinion of the offer had a significant impact. However, we appreciate that there may be issues regarding price sensitivity and circulation of the trustees' view.

Page 7  
27 May 2011  
The Secretary to the Code Committee  
The Takeover Panel

## APPENDIX II

This appendix contains our specific comments on Sections C and D of the consultation document,

### **C: Increasing transparency and importing the quality of disclosure**

#### **6. Requiring disclosure of the same financial information in relation to an offeror and the financing of an offer irrespective of the nature of the offer**

**6.1(a)** We strongly agree with the statement at 6.1(a) that constituencies other than offeree company shareholders have an interest in information regarding the financial position of the offeror and its group. We would add the trustees to the list of those who have an interest in this information.

**6.2** We agree that the information regarding financing of the offer and its implications for the merged business should be disclosed. Given the trustees' obligations in relation to employer covenant (outlined in Appendix I), and their need to understand the financial prospects and gearing of the sponsor going forward, we would argue strongly that the offeror should be required to share this information with the trustees.

**6.27** and **6.28** – We agree that the readers of an offer document should be provided with information on how the offer is financed. Because of trustees' obligations to monitor employer strength and prospects (as outlined in Appendix I), it is appropriate that trustees are among those who must be provided with this information.

**Q24** Our comments on proposed new Rule 24.3(f):

It is not entirely clear from the appendix showing proposed amendments to the current Code that proposed new rule 24.3(f) will apply to all offerors, whether UK listed or not. It should be clarified that it will apply to all offerors.

## **D: Providing greater recognition of the interests of offeree company employees**

### **7. Improving the quality of disclosure by offeror and offeree companies in relation to the offeror's intentions regarding the offeree company and its employees**

#### **Q26** Our comments on the proposed new **Rule 24.2** (formerly 24.1)

We agree that the proposals mean that the new rule is likely to have more effect than the previous Rule 24.1. However, further clarity regarding the offeror's intended treatment of any DB scheme sponsored by the offeree would be helpful. This could be done via a specific sub-clause requiring the offeror to state its intentions regarding the future status and funding of the scheme. This is required because the members of the pension scheme may not all be current employees of the offeree – some will be pensioners or former employees.

In addition, we believe that the Rule should clearly require the offeror to confirm its intentions for the pension arrangements of employees. This could be done using Notes to the Rule, in the following ways:

- 24.1(i) – Clarification that a 'material<sup>2</sup> change in the conditions of employment' would include an alteration in any pension scheme terms and conditions, including the mode of benefit provision, could help protect member's accrued entitlements;
- 24.1(ii) – although we expect that younger employees would prioritise their employment over the security of the pension savings, older employees are likely to have different priorities, particularly those with long service.

#### **Q27** Our comments on the proposed new Note 3 on Rule 19.1

We support the proposed new Note. If it achieves its objectives it should give trustees, members and employees time to consider how any change in ownership will affect their position and the steps they should take as a consequence.

---

<sup>2</sup> The words 'significant' and 'material' are used throughout the Takeover Panel Code but neither is defined, nor is the context of their use – for example, in this case we have assumed the context is a change in employment conditions that would be 'material' to the employees, rather than material to the employer, offeror or offeree.



Page 9  
27 May 2011  
The Secretary to the Code Committee  
The Takeover Panel

**Q28** Our comments on the proposed new structure for the obligations in relation to the publication, content and display of documents.

*Ensuring that trustees receive the offer document and related information*

**New Rule 24.1, Rule 25.1, Rule 32.1, Rule 32.6** – we suggest that part c) extends the right to receive the offer document and offeree board’s opinion to trustees, for the reasons outlined in Appendix I.

**New Rule 25.2, Rule 32.6** – it would be very powerful if the offeree board was required to form a view of the likely effect of the offer on wider aspects of employee benefits (for example, more than just employment, and specifically including any DB pension arrangements sponsored by the offeree).

## **8. Improving the ability of employees’ representatives to make their views known**

**Q29** Do you have any comments on the proposed new definition of “employee representative”?

We believe that trustees of occupational pension schemes should be given similar information (at least) to that made available to employee representatives. However, although acting on behalf of members, they are not employee representatives, in particular since many of the people they represent will no longer be employed by the company. It might be possible to extend the definition of employee representative to include trustees, if that was felt necessary. It may be more appropriate to address the interests of occupational pension scheme members by including scheme trustees in the definition of “persons with information rights” throughout the Code.

As outlined in our letter and Appendix I, we suggest that the Committee considers whether it may also be useful to give trustees the right to have their opinion of the effects of the offer on pension arrangements, and in particular the security of any DB scheme, circulated.

**Q 30** Our comments on the proposed new Note 6 to Rule 20.1

Our only comment is that Note 6 should make it clear that there is nothing to prevent information from being passed in confidence to trustees also.

Page 10  
27 May 2011  
The Secretary to the Code Committee  
The Takeover Panel

**Q31** Our comments on the proposed new Rules 2.12(a) and (d) and second sentence of Rule 32.1(b)

Again, we believe that the Code should contain a requirement that copies of the relevant announcement and any revised offer document should be sent to the trustees also. If the Committee decides that trustees' should have the right to have their opinion of the offer circulated, the offeree company should be obliged to make the trustees aware of this right.

**Q32** Our comments on the proposed new Rule 25.9 and amendments to Rule 32.6

If the Committee decides that trustees' should have the right to have their opinion of the offer circulated, we are content that the same rules relating to timescale should apply to the trustees' opinion. It is not necessary that the offeree company is obliged to pay for the advice relating to the trustees' opinion.

**Q33** Our comments on the proposed new Rule 19.2(a)(iii)

If the Committee decides that trustees' should have the right to have their opinion of the offer circulated, Rule 19.2 should be further amended to make it clear that the trustees' opinion is excluded from the scope of the offeree board's responsibility statement.