

28 September 2012

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

Dear Sirs

Response to consultation on amendments to the Takeover Code – Pension Scheme Trustee Issues

Thank you for the opportunity to comment on the proposed amendments to the Takeover Code. This response has been prepared on behalf of Towers Watson, a global firm with a substantial presence in the UK pension consultancy market; the firm provides advice to around one-half of the top 100 pension funds in the UK.

In our response, offeree company is referred to as the “target” and the offeror as the “bidder”.

On balance we are in favour of the proposed changes both from the perspective of shareholders and pension scheme trustees. The Takeover Code’s primary purpose is to regulate takeovers and mergers involving listed companies to ensure shareholder interests are protected. A target’s pension promises and, in particular, the financial circumstances of its defined benefit pension scheme(s), can give rise to significant issues in relation to corporate transactions. In our view, the proposed amendments will increase transparency and will help ensure shareholders and pension scheme trustees are alert to the potential pensions implications of corporate transactions.

From a pension scheme trustees’ perspective, we note that the aim of the specific amendments is to create “... a framework within which the effects of an offer on the offeree company’s pension scheme(s) ... could become a debating point during the course of the offer and a point on which each of the offeror, the board of the offeree company and the trustees ... could have an opportunity to express their views.” In practice, the changes will have a varying impact depending on the nature and the financial circumstances of the target pension scheme(s). If a defined benefit pension scheme(s)’ immediate or short-term funding needs are a significant issue in relation to the target’s finances, in our experience, parties to a transaction will engage with the trustees at an early stage. The parties will want to reach agreement with the trustees about how the scheme(s) will be funded after the transaction is completed and to avoid circumstances which may result in the Pensions Regulator exercising its “moral hazard” powers either at the time of the transaction or at a later date. In this respect, the amendments will formalise current good commercial practice.

Where the bidder and target do not consider that the pension scheme(s) will raise any major issues, there is less reason to involve pension trustees during the offer process. In these circumstances, the proposed amendments will give trustees an opportunity to enter into discussions on a timely basis and to have their views at least heard if not always acted on. However, an important benefit of the proposed framework is that it will ensure greater consistency in terms of engaging with pension trustees. Also, pension trustees may be well placed to identify possible unforeseen issues, giving parties the opportunity to resolve any

problems before the offer becomes unconditional. It is for this reason that early engagement with trustees is strongly encouraged by the Pensions Regulator.

On specific issues discussed in PCP 2012/2, we have the following comments:

- We agree with the Code Committee's view that offers should not be made conditional on agreement between the bidder and pension trustees on the future funding arrangements for the target's pension scheme(s). Imposing such a condition is more likely to pose a hindrance to normal commercial transactions than a benefit to pension schemes. There is already extensive pension's legislation and guidance regulating the funding of pension schemes, which will continue to apply during and after the offer period. Furthermore, the Pensions Regulator has extensive legal powers to intervene if it considers the financial support underpinning the scheme has been materially compromised.
- We agree with the Code Committee's decision not to extend Note 3 on Rule 19.1 to cover a period beyond 12 months for statements relating to the target's pension scheme(s). As the Committee notes, any decisions about the future funding of the scheme is better evidenced in a separate legal agreement between the bidder and trustees. The terms of the agreement can be drafted as the parties see fit without being subject to the requirements relating to Code statements. Furthermore, a breach of this agreement could give rise to a claim for damages whereas a breach of a Code statement at best could lead to disciplinary action being taken by the Panel. As stated in the previous bullet, there is legislation already in place to regulate the funding of defined benefit pension schemes as well as protect members' accrued rights and entitlements.
- In our view there is no need to amend Rule 21.2(a) in order to facilitate agreement on future scheme funding between the bidder and the trustees during the offer period. In our experience, there would generally be no need for the target to be party to such an agreement. A trust scheme is a legal entity separate from its sponsoring employer(s).
- On the whole, we agree that it should not be necessary for the Code to require the trustee's costs of obtaining advice to verify their opinion of the effects of an offer on their scheme be met by the target. Pension scheme costs are met in various ways depending on scheme rules but generally fall into two categories i.e. they are either met through general funding by including an amount for scheme expenses in funding calculations or paid directly as a separate item by the sponsoring employer. In relation to multi-employer schemes, expenses may be shared equally by the sponsoring employers or met by a principal employer. In our view, costs incurred by trustees in formulating their opinion are best met under current scheme funding arrangements or in a separate agreement between the trustees and the target/principal company.

Looking at each question separately, we have the following response:

Q1. Do you have any comments on the proposed amendments to Rules 24.2(a) and (b) relating to the requirement for an offeror to disclose, among other matters, its intentions with regard to the offeree company's pension scheme(s)?

We support the proposed amendments to Rule 24.2(a) and (b).

Q2. Do you have any comments on the proposed amendments to Rule 25.2(a) relating to the requirement for the offeree board to include in the offeree board circular its views on, among other matters, the effects of implementation of the offer on the offeree company's pension scheme(s)?

We support the proposed amendments to Rule 25.2(a).

Q3. Do you have any comments on the proposed amendments to Rules 2.12(a), 2.12(b), 24.1, 25.1, 32.1, 32.6(a) and 27.1(b), and to Note 6 on Rule 20.1, in each case relating to the information to be disclosed to the trustees of an offeree company's pensions scheme(s)?

We support the proposed amendments to Rules 2.12(a), 2.12(b), 24.1, 25.1, 32.1, 32.6(a) and 27.1(b), and to Note 6 on Rule 20.1.

Q4. Do you have any comments on the proposed amendments to Rule 25.9 (and Note 1 on that Rule) and to Rule 32.6 regarding the rights of the trustees of an offeree company's pension scheme(s) to make known their views on the effects of the offer on the scheme(s)?

We support the proposed amendments to Rule 25.9 (and Note 1 on that Rule) and to Rule 32.6.

It is our understanding that trustees can decline to give an opinion – the requirement is not mandatory. Where the offeree company has a number of schemes, either defined benefit and/or defined contributions, it may not be practical to obtain opinions from all the schemes' trustees within the regulatory timeframe. In these cases, we assume that it will be acceptable to provide trustees opinion for some but not all the schemes. In these circumstances, we envisage that trustees' opinion will be given only where the deal may have a material impact on the pension scheme and/or where the pension scheme may have a material impact on the deal.

Q5. Do you have any comments on the proposed amendments to Rule 2.12(d) and to Rule 32.1 regarding the requirement for the trustees of the offeree company's pension scheme(s) to be informed of their rights under the Code to make known the effects of the offer on the scheme(s)? Do you have any comments on the proposed amendment to Rule 19.2 relating to directors' responsibility statements?

We support the proposed amendments to Rule 2.12(d) and to Rule 32.1. We also agree that the offeree company should not be required to take responsibility for the information contained in the trustees' opinion. Trustees are not legally required to make available to the target any actuarial and valuation analysis or legal advice on which their opinion is based. As such, targets should not be required to accept responsibility for information that they cannot verify.

Q6. Do you have any comments on the proposed new Rule 24.3(d)(xvi) and new Rule 26.2(i) relating to the requirement for the offer document to include a summary of any agreement between the offeror and the offeree company's employee representatives or the trustees of the offeree company's pension scheme(s) in relation to any of the matters described in Rule 24.2 and to the requirement for any such agreement(s) to be put on display?

We note that the Panel has proposed this change in order that any agreement can be reviewed by the beneficiaries of the pension scheme and other interested parties. However, in the normal course of events, it is a responsibility of pension scheme trustees to communicate with scheme beneficiaries any agreements on funding and related matters as and when they consider appropriate, subject to specific reporting requirements already set out in regulation. Therefore, we do not consider this change to be necessary from the perspective of pension scheme beneficiaries.

Yours faithfully



Stephen Postill