Regulatory intervention report

Issued under s89 of the Pensions Act 2004 in relation to the:

- Coats Pension Plan
- ▶ Brunel Holdings Pension Scheme
- ▶ Staveley Industries Retirement Benefits Scheme

Background

Coats Group plc (Coats) – formerly known as Guinness Peat Group plc – is one of the world's leading industrial thread manufacturers. It is the ultimate parent company of Coats Ltd and is listed on the London Stock Exchange.

Historically, Coats has operated as an investment holding company and held a number of shareholdings in other businesses. In 2011, the group began selling off these investments with the exception of Coats Ltd, and finished the process in 2013.

There are three defined benefit (DB) schemes sponsored by employers within Coats group.

- ► The Coats Pension Plan (CPP) has approximately 24,000 members and, at 1 April 2015, had an estimated deficit of just over £400m on a scheme specific funding basis.
- ► The Staveley Industries Retirement Benefits Scheme (SIRBS) has approximately 3,700 members and at 5 April 2015 had an estimated deficit of just over £97m on a scheme specific funding basis.
- ► The Brunel Holdings Pension Scheme (BHPS) has approximately 3,000 members and at 1 April 2015 had an estimated deficit of approximately £80m on a scheme specific funding basis.

SIRBS and BHPS are schemes that Coats had inherited from businesses it had previously acquired. Before TPR became involved with this case, the sponsoring employers of both of these schemes were non-trading subsidiaries of Coats, whereas CPP was sponsored by three trading subsidiaries of Coats Ltd. All of the schemes' employers were and continue to be solvent companies.

Illustrated summary









now supporting all 3 schemes

Events leading to regulatory action

During our discussions with CPP's trustees and employer about the scheme's 2012 valuation we became aware that Coats was selling off its investment shareholdings and intended to make significant returns to its shareholders. Around that time we were approached by the BHPS trustees about their concerns over future support for their scheme. We began to investigate the potential impact that the Coats' disposal programme would have on CPP, SIRBS and BHPS, in particular the impact on the covenant¹ supporting the schemes in the context of their underfunded positions.

The accounts for Coats (at the time called Guinness Peat Group plc) as at 31 December 2012 reported consolidated shareholders' funds of £434m. At that time we understood that the intention was to give the majority of these funds to shareholders, with around £124m being retained within Coats for the ongoing funding of SIRBS and BHPS. There was, however, no intention for it to be paid immediately as cash into the schemes and in any event it would have been insufficient to fund the deficits.

When we told them we were investigating, Coats committed not to distribute these funds to shareholders while our case was ongoing.

1 The employer covenant is the extent of the employer's legal obligation and financial ability to support the scheme now and in the future.

Regulatory action

All three schemes had substantial deficits on a buy-out basis and our initial investigations indicated that the statutory employers for all three schemes were 'insufficiently resourced'². Starting in July 2013 we wrote to a number of companies within the Coats group asking for valuations in accordance with our Financial Support Direction (FSD) regulations. The respective statutory employers of BHPS and SIRBS did not dispute that they were insufficiently resourced. However, the valuations that were provided relating to CPP (at all three stages of the regulations³) claimed that the schemes' employers were not insufficiently resourced.

The case team obtained expert evidence which supported our view that the CPP employers' valuations did not accurately reflect the fair value of the businesses on the basis that they had overvalued some of the employers' assets when completing their calculations for the 'insufficiently resourced' test. Based on that evidence, we concluded that the 'insufficiently resourced' test was met in respect of all of the employers based on our estimate of the buy-out debts for each scheme, and the value of the relevant employers' resources.

After a thorough investigation, which involved reviewing a substantial volume of documentation, we issued warning notices for SIRBS and BHPS in December 2013, and for CPP in December 2014. These documented our intention to issue financial support directions (FSDs) against a number of Coats group entities, including Coats.

We argued that it would be reasonable to issue FSDs because as a result of Coats' control and influence, all three schemes had been left with a weak employer covenant and were running inappropriately high levels of risk relative to the strength of the employer covenants.

We received representations from the Coats group companies, who disputed our cases in respect of all three schemes and, for CPP, continued to claim that the scheme's employers were not insufficiently resourced. The trustees for all three schemes submitted representations supporting our position.

Following the issuing of the SIRBS and BHPS warning notices, we received further evidence that required analysis and review. We then responded⁵ to the representations in September 2015 for SIRBS and BHPS, and in February 2016 for CPP.

After receiving replies from the Coats group entities and trustees, the case team began to take steps to prepare the case for referral to the Determinations Panel.

- The insufficiently resourced test is defined in s44(3) of the Pensions Act 2004. It is one of a number of requirements which have to be satisfied for TPR to issue an FSD.
- Under Regulation 9 (4),(6) and (7) of the FSD Regulations there are 3 methods by which the valuations can be calculated.
- 4 Section 43(2) specifies that TPR's opinion determines whether an employer is "insufficiently resourced"
- 5 In accordance with the Case Team Procedure www.tpr.gov.uk/ caseteam

Outcome

During the investigation process Coats made a number of proposals for financial support that were not accepted. After submitting their reply to our response for CPP, Coats began discussions with our case team and the trustees of the three schemes. They made a number of offers which included upfront payments for all schemes and improved the ongoing covenant supporting the schemes. These offers reflected Coats' change of position, from intending to use the proceeds of the sale of its former investments for shareholder returns, to instead using those proceeds to support the three schemes and improve their funding positions.

After months of negotiations, in September 2016 Coats made the following settlement offer:

- Upfront payments of £329.5m in total into the three schemes (which represented all the cash remaining within the Coats group from the investment disposals). The split of these payments was intended to ensure that all three schemes were left in similar funding positions after the settlement.
- A change to the statutory employer for all three schemes to Coats Limited the immediate holding company for Coats group's main trading business. This represented an improvement in the strength of the employer standing behind CPP and a significant improvement in the covenant position for SIRBS and BHPS.
- A full guarantee from Coats of the liabilities of the three schemes up to the amount of the relevant scheme's buy-out deficit.

In December 2016, Coats and the trustees for CPP and BHPS reached an agreement based on this offer. The main features of the agreement were:

- ▶ Upfront payments totalling £255.5m into the two schemes (including certain contributions already paid to BHPS since 1 January 2016).
- A change in the statutory employer for the two schemes to Coats Limited.
- A guarantee from Coats of the full buy-out liabilities of the two schemes.

In June 2017, Coats and the trustees for SIRBS also reached agreement based on the September 2016 settlement offer. The main features of the agreement included:

- ► An upfront payment of £74m into the scheme (inclusive of certain contributions already paid to SIRBS since 1 January 2016).
- ▶ A change in the statutory employer to Coats Limited.
- ▶ A guarantee from Coats of the full buy-out liabilities of the scheme.

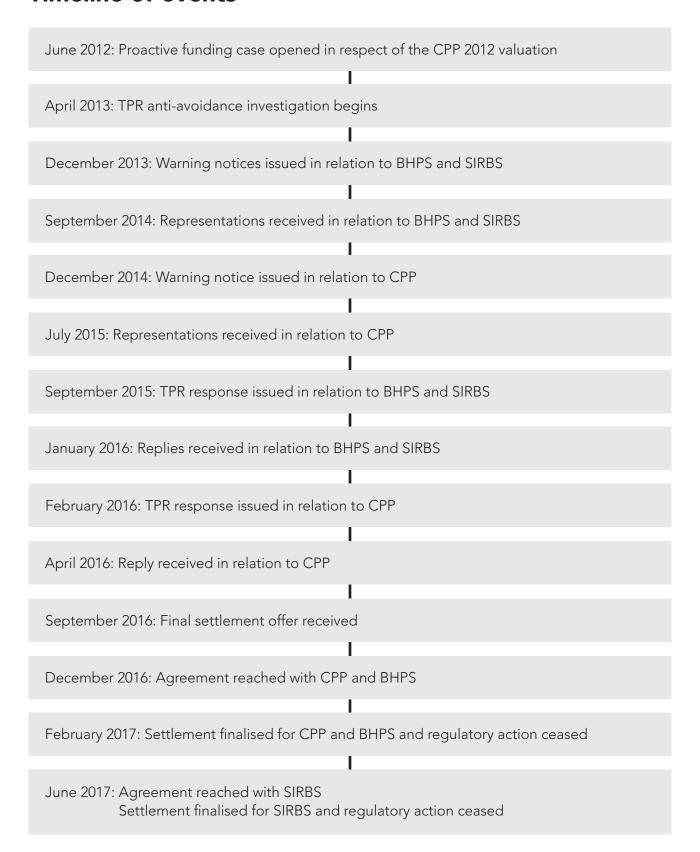
In light of these agreements, which represent a significant settlement and a very good outcome for the members of all three schemes, we agreed to cease regulatory action as we believe that the ongoing trading operations of Coats are sufficient to support the schemes.

Our approach

We are determined to help protect members of UK DB pension schemes by using our anti-avoidance powers where appropriate. This case shows that we can and will use our powers against a solvent employer where we consider it is reasonable for the wider group to provide financial support to underfunded schemes. This settlement shows our willingness to work with all parties to reach a positive, fair, negotiated outcome for pension scheme members.

We will continue to take a commercial and pragmatic view when using our powers, and remain committed to achieving a positive outcome for members. This includes being prepared to pursue a case to the Determinations Panel where the subjects of our investigations do not make a satisfactory settlement offer. In this case, the settlements have substantially improved the current funding position and covenant support of the three schemes and, as a result, increased the likelihood of members' benefits being met in full.

Timeline of events



The regulator's consideration and approach to individual cases is informed by the specific circumstances presented by a case, not all of which are referred to or set out in this summary report.

This summary report must be read in conjunction with the relevant legislation. It does not provide a definitive interpretation of the law. The exercise of the regulator's powers in any particular case will depend upon the relevant facts and the outcome set out in this report may not be appropriate in other cases. This statement should not be read as limiting the regulator's discretion in any particular case to take such action as is appropriate. Employers and other parties should, where appropriate, seek legal advice on the facts of their particular case.

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Coats

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