Regulatory intervention report

issued under s89 of the Pensions Act 2004 in relation to
Monarch Airlines Limited Retirement Benefits Plan

December 2016

The Pensions Regulator

Background

Monarch Airlines forms part of the Monarch Group. Based at Luton airport, Monarch is a British low-cost carrier operating scheduled flights to holiday destinations in the Mediterranean, Canary Islands, Cyprus, Greece and Turkey. It is one of the oldest UK airlines and the Monarch Group as a whole has around 3,000 employees.

Before its restructure in 2014, the Monarch Group ('the group') included Monarch Airlines Limited (the statutory employer of Monarch Airlines Limited Retirement Benefits Plan), First Aviation Limited, and Monarch Aircraft Engineering Limited (both participating employers in the pension scheme). Its ultimate parent and shareholders were the Mantegazza family and Mr Mario Albek.

The scheme had 2,441 members and, as at 30 June 2013, assets of around £287 million and a deficit on a buy-out basis of approximately £594 million.

Monarch operates in a very competitive industry, in which operating costs are very high and profit margins relatively low. From our previous engagement with the scheme's trustees it was clear that the business was subject to many factors which could affect its profitability and, therefore, how much it could afford to contribute to the scheme. The business experienced several difficult trading periods leading up to the 2013 valuation. During these periods the shareholders were asked to make significant investments (£45 million and £75 million) to ensure the business could continue to trade and provide support to the scheme.

In light of these concerns we decided to work with the trustees ahead of the scheme's 2013 valuation.

We choose a number of schemes each year to engage with in this way, meeting with the trustees and the employer from the beginning of the valuation process until it is submitted. This is known as 'proactive engagement' and helps us better understand the issues faced by the scheme and the employer.

In July 2014, we were informed that Monarch was facing insolvency. This was unexpected as the group had recently published its 2013 Annual Report which showed that there had been improvements in the profitability of the business in the previous two years. It had also recently publically announced its intention to order 30 new aircraft from a major manufacturer.

KPMG, advising the employer, informed us that the group required additional funding of between £125-160 million over the next 12 months to prevent insolvency. The employer initially sought support from the shareholders, but after many years of providing financial support to the business, they decided that they were not prepared to provide the level of additional funding that was needed.

As a key stakeholder, we worked with the trustees, their advisers and the group to find the best solution for the scheme and the business. It was noted that recoveries for the scheme would be minimal in the event of an insolvency. Several options were considered, including a solvent sale of the business.

Illustrated summary

2,441
scheme members

£30m
from shareholders

£7.5m
in loan notes from Greybull for PPF

Sale to Greybull completed
24 Oct 2014

The proposal

Several companies put themselves forward for the tendering process. Among potential bidders were the scheme's trustees. Although their proposal would have meant that the scheme would remain attached to the employer, it would have required the trustees selling a very significant proportion of the scheme's assets to fund the purchase of the business. Our key concerns with this proposal were the costs and risks associated with running an airline and legal issues including restrictions on employer-related investments.

We were also concerned that, while the trustees may have been able to fund the initial cashflow requirement (approx £125 million) by selling a proportion of the scheme's assets, there were likely to be further substantial cash demands from the business in the future. This meant that the scheme was unlikely to have the long-term financial capacity to take over the business without an increased risk to members' benefits.

Because of these concerns, we were unable to support the trustees' proposal and ultimately the shareholder decided not to accept their bid.

Under the circumstances it was clear that without a buyer who could provide the necessary funding for the group, insolvency was inevitable.

Greybull Capital Limited was identified as the preferred bidder, but confirmed they would only proceed with the purchase basis without the scheme. This is both legal and common in transactions of this kind, particularly when the employer is in financial trouble.

Their offer to buy the business and fund the cash flow requirement was conditional on the scheme being separated from the group and there being no ongoing liabilities in respect of the scheme. Accordingly, the employer proposed using a Regulated Apportionment Arrangement (RAA), which would separate the scheme from the employer.[1] This would result in the scheme eventually transferring into the Pension Protection Fund (PPF).

Regulatory action

We have powers under the Pensions Act 2004 to issue either a Contribution Notice (CN) or a Financial Support Direction (FSD), which requires the recipient of the Notice to provide support for a pension scheme.

The transaction proposed would effectively remove all covenant support from the scheme and would trigger PPF assessment. As a result this raised the prospect that our CN or FSD powers could potentially be used. The parties sought clearance to confirm that we would not use these powers in relation to the deal.

The trustees' advisers, Ernst and Young, undertook comprehensive analysis into the potential use of our powers, both in relation to the deal and the business activities of the parties involved, to establish whether there was any avoidance activity. This included analysis of the shareholders' support for the company, along with analysis to establish whether the shareholders might have used their trading relationships with the employer to extract value. We accepted the advisers' conclusion that there were no reasonable grounds for us to use our powers.

The initial clearance application featured an RAA, and offered a £20 million mitigation payment by the shareholders to the scheme. Given that a third-party purchaser was involved, and in keeping with PPF guidelines, a 10% equity stake for the PPF in the ongoing business was also offered.

When reviewing the application, it appeared to us that the scheme was not being treated fairly in comparison to the group's other unsecured creditors. We therefore concluded that the offer was not acceptable and we refused to grant clearance in respect of the transaction and did not approve the RAA.

With input from the PPF, we entered into a series of robust negotiations with the shareholder, Greybull and the employer. They provided evidence of compromises by all of the group's existing creditors, and submitted a revised application detailing an improved offer. Based on this new proposal, and with the support of the PPF, we gave clearance and granted approval for the RAA.

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Further information about RAAs can be found in our regulatory guidance on multi-employer schemes and employer departures on our website at **www.tpr.gov.uk/multi-employer**.

The employer and the shareholders jointly applied for clearance from TPR for the transaction and for approval for the RAA.

How we assess RAAs

RAA test	How it was met
Whether insolvency of the employer would be inevitable or whether other solutions would prevent this	The trustees sought independent financial advice which confirmed that insolvency was inevitable
Whether the scheme might receive more from an insolvency	The trustees sought independent financial advice on the scheme's estimated outcome on insolvency
Whether a better outcome might be arrived at by using a CN or FSD	We concluded that the RAA delivered the best outcome in the circumstances and that there was no evidence of avoidance activity
The circumstances of the rest of the employer group	The shareholder relinquished control of the entire group and we were comfortable that no one was benefiting disproportionately from the RAA
The outcome of the proposal for other creditors	Evidence provided demonstrated that other creditors of the group were making significant compromises

Why did we accept the revised offer?

Under the revised offer the shareholders confirmed they would sell their entire shareholding in the Monarch Group, write off £61 million of debt and £20 million of preference shares for a nominal sum and would settle a further £27.5 million of guarantees in respect of the company's debts. They would also pay an additional £30 million to the scheme immediately on completion of the sale.

In addition to the £30 million payment, Greybull provided a 10% equity stake in the new restructured business to the PPF and a £7.5 million secured loan note from Monarch to the PPF, payable in instalments over the next three years.[2]

Monarch also provided evidence of other stakeholder concessions, which included leases being terminated or renegotiated, staff pay cuts, and other creditors taking a reduction in their entitlement.

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While we and the PPF will give consideration to offers of payments to be made after the transaction (such as loan notes), we assess the acceptability of any RAA proposal primarily based on the amount of cash offered upfront.

Outcome

We provided clearance for Greybull's acquisition of Monarch, approved the RAA, and the PPF confirmed it did not object. The sale to Greybull completed on 24 October 2014 and the scheme entered the PPF assessment period.

The Monarch deal led to a better outcome for the scheme than would otherwise have resulted from uncontrolled insolvency. A small number of highly-paid scheme members' benefits were affected by PPF's compensation cap. However, the proportion of scheme members affected by this cap was relatively low with the majority receiving 90% or more of their benefits. It also facilitated Greybull's acquisition of the group, which has enabled the business to continue trading.

Our approach

This is an example of where, in critical situations like this, we will work with employers, trustees and other stakeholders to try to achieve the best possible deal for members and the PPF within the legislative framework. We will carry out our due diligence to determine the risk to the parties and give consideration to the specific circumstances facing the employer and we will reject proposals that are not credible or which require further development.

Thanks to the hard work of all parties involved, a long-established business was able to continue trading, and the scheme received a greater amount from the shareholder and Greybull to offset the detriment to the fund.

Timeline of events

May 2013 – Case team begins proactive engagement with the trustees and the employer in relation to the 2013 valuation

Jul 2013 – Preferred bidder announced for re-fleeting programme for the airline

Dec 2013 – Annual report 2012-2013 published

Jul/Aug 2014 – Discussions with group regarding insolvency and possible solutions/options

23 Sep 2014 – We refuse clearance for an RAA

25 Sep 2014 – We provide clearance for a revised proposal and approves RAA

24 Oct 2014 – After expiry of the 28 day period, the sale to Greybull completes and scheme enters PPF assessment

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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